

CITIZENS LEAGUE REPORT

"IT'S ONLY A GAME"

A Lottery in Minnesota

Prepared by
Citizens League Lottery Committee
Virginia Greenman, Chair

Approved by
Citizens League Board of Directors
February 11, 1986

CITIZENS LEAGUE
84 South 6th Street
Minneapolis, MN 55402
338-0791

TABLE OF CONTENTS

Executive Summary.....	i - iii
Minnesota and a Lottery.....	page 1
What is a Lottery?.....	page 3
Is a Lottery Acceptable in Minnesota?.....	page 5
What Should the Legislature Do?.....	page 13
Appendix 1 - History of the Lottery.....	page 17
Appendix 2 - Minnesota Poll.....	page 17
Appendix 3 - Charitable Gambling in Minnesota.....	page 18
Appendix 4 - Commissions Governing Gaming in Minnesota.....	page 19
Appendix 5 - Lottery and the Minnesota Constitution.....	page 20
Appendix 6 - Inefficient Revenue Source.....	page 20
Appendix 7 - Unstable Revenue Source.....	page 22
Appendix 8 - Regressivity as Revenue Source.....	page 23
Appendix 9 - Revenue to the State of Minnesota.....	page 24
Appendix 10 - Lottery Operations in Other States.....	page 26
Appendix 11 - Title 18, U.S. Code.....	page 28
Appendix 12 - Tax Rates of Selected Minnesota Revenue Sources.	page 29
Work of the Committee.....	page 30

EXECUTIVE SUMMARY

In the fall of 1985 a committee of citizens committed themselves to study the lottery issue for the Citizens League. A majority of them began the study strongly skeptical about having a lottery in Minnesota. For the next four months they listened to testimony about existing lotteries, read relevant literature, and debated the issues among themselves. At the end they concluded that a lottery in Minnesota would be an acceptable addition to gambling opportunities in Minnesota, but only if it is introduced as recreation, not as new revenue policy.

The Citizens League will support a constitutional amendment repealing the lottery prohibition, provided that the enabling statute that would establish a lottery is adopted at the same time and commits the state to organize it as a publicly regulated, privately operated game; with state taxes on it set at levels comparable to other consumption taxes which carry comparatively higher rates; and with the state's tax revenues committed only to the general fund.

Lotteries in America go back to the seventeenth century when they contributed financially to such wide-ranging causes as the Revolutionary War and the founding of Harvard College. They disappeared in the late nineteenth century when the federal government cracked down on the corrupt practices of the Louisiana Lottery (a private enterprise), which had become something of a national monopoly. Most existing federal and state prohibitions are rooted in the excesses that developed in the Louisiana Lottery.

The advent of modern lotteries in this country came in 1964 when New Hampshire introduced one as a revenue-generating alternative to implementing any state taxes. Several eastern states followed suit. In 1981 Arizona adopted a lottery, and by the mid-eighties, lotteries were operating in 22 states, the District of Columbia, Puerto Rico, the Virgin Islands, and five Canadian provinces.

Among the remaining states, Minnesota still carries a constitutional prohibition against lotteries, although it has approved a variety of similar gaming activities. Starting with bingo in 1945, legal gambling in Minnesota has grown to include such games as tipboards, raffles, pulltabs, paddlewheels, and most recently, parimutuel betting on horse racing. Most of them are built on the same elements that characterize the lottery -- chance, consideration (money paid to participate), and a prize.

The results of two Minnesota Polls show that Minnesota adults generally support a lottery. These polls, conducted in 1984 and 1985, found 70 percent and then 73 percent in favor of a lottery. We say "generally," however, because there is no basis for knowing conclusively the nature of the public's interest. Most discussion on the subject through the media has focused on using a lottery as a new state revenue source; and some legislators seem eager to link apparent public support to this purpose. We found no evidence, though, that providing more revenue for the state is the primary explanation for public support of a lottery. It seems at least as likely that the public favors a lottery simply as a game people want to play, for recreation and a chance to win money for themselves. And that is the only basis on which it can really be justified.

Approving a lottery as a means of raising revenue for the state amounts to little more than an acknowledgement that there is no consensus for raising taxes. It makes the lottery into a tax-surrogate and a rather devious revenue solution. Raising revenue directly, though politically difficult, helps hold government accountable for its spending. Raising revenue "painlessly," as the lottery supposedly does, makes government less accountable.

Minnesota's public revenues are already too susceptible to business cycle shifts; adding a lottery for its public revenues, given the pattern of instability they show in other states, renders the state's fiscal prospects even more vulnerable. The worst application we can imagine is depending upon a lottery for revenues, and dedicating those revenues to some specific needy program.

And a lottery is an inefficient means of raising revenue. The cost to the state per dollar received in taxes is much higher than the costs of collecting taxes traditionally.

We do support, however, putting a constitutional amendment on the ballot to repeal the prohibition on lotteries. But our support depends on whether a lottery is proposed as revenue policy or recreation. If its primary purpose is revenue, we consider it fundamentally bad policy. If it's presented as recreation, to be added to similar games already approved and taxed at levels comparable to other special consumption taxes, then we support it. We have considered carefully the criticisms most frequently made about lotteries -- regressivity, compulsive gambling, organized crime, displacement of spending, and counter-productivity -- and find that there is too little evidence to justify resisting what appears to be a strong popular preference for a lottery.

What matters most is why it is introduced and how it is organized.

The best way of knowing whether its purpose is revenue or recreation is the level of state tax set. There is no justification for setting this state tax higher than other special consumption tax rates. To use cigarettes as an example, the state tax rate is about half what is typically proposed for a lottery. And cigarette taxes are higher than those imposed on any form of gambling so far. To have a lower tax would mean better payouts and odds to the players.

Taxes collected on a lottery should be dedicated to the general fund, not to any special purpose. If the proposition cannot develop legislative support without attachment to some special purpose, then let's not have a lottery. If some special purpose cannot survive the legislative process to get funding, then we have questions about how high a priority it really is. We don't need this presumably painless revenue mechanism to prop up special purpose funding that cannot pass the usual test of legislative priorities. And we also don't need the beneficiaries of the lottery revenues encouraging people to play because it's a "patriotic" gesture.

So we recommend that the Legislature set a reasonable tax level and reserve the proceeds to the general fund. We further recommend that the lottery be organized so that it can be operated privately. All the other state lotteries are publicly operated, though some utilize private vendors for certain services. We suggest that maximum use be made of the private sector to run the lottery. It should be structured so that incentives for efficiency and responsiveness to the market are built in. Private operation will minimize, properly in our judgment, the role of government in promoting lottery sales, and will put the state in a stronger position to conduct its regulatory responsibilities effectively. It is absolutely essential that the responsibility to regulate and the opportunity to operate the lottery be separated structurally; we think the best way to do that is through private operation. And to strengthen further the integrity of the regulatory approach, we recommend consolidating oversight of all gaming into a single commission, so that regulation is more easily distinguished from concerns about the success of any one game or vendor of games.

Finally, we should build in a review of policy in five years, requiring the Legislature to act affirmatively to perpetuate the lottery policy.

If the Legislature establishes a lottery as we have proposed, it will have responded to the public interest in expanding opportunities for recreational gambling. After all, it's only a game.

MINNESOTA AND A LOTTERY

The Minnesota Constitution states explicitly that "the Legislature shall not authorize any lottery or the sale of lottery tickets." (1) However, a movement to remove that ban and implement a lottery in Minnesota has grown in recent years.

In 1982, the Minnesota Senate passed a bill to send an amendment to the voters repealing the constitutional prohibition. In the same year the House of Representatives proposed an amendment to the voters for legislative authorization of on-track betting at horse races. The conference committee agreed on the parimutuel betting measure, but not the lottery amendment. The voters approved the parimutuel amendment, and Minnesota's first horse racing track and parimutuel betting opened in 1985.

Other attempts have been made since the 1982 legislative session to get an amendment to the voters on the lottery, but none has been successful. All bills introduced in the 1985 session remain active in 1986. The many lottery bills vary; some propose amendments to authorize lotteries without dedication of the net revenues, while others dedicate the net revenues to various state programs, such as education, tax relief, hunting, fishing, tourism, arts, economic development, and environmental purposes.

The pressure to move positively on the lottery issue in the 1986 session is stronger than ever. Recent polls of citizens suggest strong public approval of a lottery. Moreover, the state is experiencing an unexpected budget deficit following a previously strong fiscal year and the biggest tax cuts granted in the state's history. The governor has chosen the lottery as one of his main issues of the 1986 session, stating that it is the only way to help struggling farmers in the state. He has pledged to take the amendment to the voters and to push legislation which would, upon removal of the prohibition, authorize a lottery immediately. As more and more farmers of Minnesota face foreclosure and uncertainty, the tie between them and the lottery seems to strengthen.

In addition, growing acceptance of the lottery throughout the country has encouraged the debate in Minnesota at this time. Regardless of the origins of the debate here, Minnesotans displayed support for the lottery most recently in a poll conducted December 13 - 19, 1985 by the Minneapolis Star and Tribune: 73 percent of the 612 Minnesotans polled favored the establishment of a lottery; 54 percent strongly favored it, six percent mildly opposed it, and 16 percent showed strong opposition (2).

(1) Minnesota Constitution, Article XIII, Section 5

(2) Minneapolis Star and Tribune, January 27, 1986, Robert Whereatt, staff writer (see Appendix 2)

It seems that Minnesotans like to gamble, and that they are liking it more and more in recent years. Their sentiment favoring a lottery increased recently, as suggested in an earlier and similar poll conducted by the Minneapolis Star and Tribune in 1984. At that time, 70 percent of those polled said they favored the lottery. Notably, 43 percent of the voters polled then strongly favored it (compared to 56 percent in December 1985) and 18 percent strongly opposed (16 percent in 1985). (3)

The first contemporary horse racing track in Minnesota, Canterbury Downs, which is located near Shakopee, reported total wagers in its initial season of 83 days (1985) of over \$84 million. The average per-capita wager was \$77, although in the final 17 days of racing it reached \$100. While it certainly is not a per-capita wagering record, this level of gambling activity at the horse tracks is not inconsequential.

Prior to the establishment of the Charitable Gambling Control Board, there was no reliable indication of the level of charitable gambling activity in the state (see Appendix 3). But the number of licenses authorized by the Board since its inception, as well as the total taxes it has collected in its first partial year, provide solid evidence that the activity is significant. The tax on charitable gambling is ten percent of net revenues (an average of two percent of total wagers). In its first month of collection (April, 1985), total state taxes paid were \$78,000. As the Board located and licensed existing and new operators, that figure grew to \$488,000 in September, 1985. The Board is projecting total taxes of \$6.1 million in fiscal year 1986 and \$7.3 million in fiscal 1987. Total wagers, then, for 1986 would be approximately \$305 million, based upon the tax rate of two percent of gross wagers.

In all gambling arrangements to date, the state of Minnesota acts as regulator, licensor, and taxpayer. In no case does the state play an active part in the promotion or development of these operations (see Appendix 4 for a discussion of the responsibilities of the Charitable Gambling Control Board and the Racing Commission).

(3) Minneapolis Star and Tribune, December 31, 1984, Robert Whereatt, staff writer

WHAT IS A LOTTERY?

Minnesota Statutes 1984, Section 609.75, subdivision 1(a), recognize a lottery to be as follows:

"A lottery is a plan which provides for the distribution of money, property or other reward or benefit to persons selected by chance from among participants some or all of whom have given a consideration for the chance of being selected."

In the narrowest sense of this definition, the games prohibited by the Minnesota constitution are those offered by what is explicitly called a "lottery." These include the Instant Games, in which a player buys a ticket with fixed odds and uncovers a combination of numbers which may or may not be winners; the Numbers Games, another fixed odds game in which a player picks a three or four digit number; and Lotto, a parimutuel game in which a player chooses five or six numbers out of a potential 40 or 42.

Notably, the lotteries in operation today in other states look and operate much like the forms of gambling that Minnesotans already enjoy. For example, like pulltabs offered by charitable organizations, the lottery Instant Games require only that the player purchase a ticket and uncover the numbers printed on the ticket to learn immediately whether a prize has been won. And like parimutuel betting at horse races, the popular game of Lotto involves the player in picking numbers from a group of potential winners (like picking the winning horse out of all horses entered in the race), waiting through the event (the race or the drawing of the winning numbers), and verifying if the winning numbers were chosen. (See Appendix 5 for a discussion of the how the definition of a lottery may be interpreted broadly, and what that would mean for the constitutional prohibition.)

IS A LOTTERY ACCEPTABLE IN MINNESOTA?

I. The lottery as "revenue policy" is bad policy.

Nearly all observable governmental interest in a lottery seems rooted in the perceived need to raise more revenue, without resorting to tax increases. If this is the reason the Legislature is being asked to act on this question, it's the wrong reason. We do not believe it is the reason the public largely supports a lottery. It makes the lottery into a tax-surrogate.

We do not argue that the state should not tax a lottery, if one is introduced in Minnesota. But the level of taxation should not be so high as to be exploitative toward the people who play it. The prevailing rate around the country is about 40 percent. To authorize a game which the public supports and then tax it at 40 percent is a devious way to collect revenue. It would make more sense to index the rate to, say, the highest rate imposed on any other approved gaming enterprise, or to set the rate comparable to commodities such as liquor or cigarettes.

The lottery as a revenue source departs from the state's traditionally accepted means of raising money. For revenue collection purposes, a lottery is comparatively inefficient. Particularly if it is operated as a governmental service, the amount of money spent compared to the yield to the state is usually much higher than the expenses of regular tax collection. It is typical for states operating public lotteries to spend 15 percent of total sales to operate the lottery in order to get its revenue of 40 percent (see Appendix 6).

Further, as a revenue source, a lottery is unstable. While some states operating lotteries have experienced fairly stable revenues, others have been subject to wide swings in revenue (see Appendix 7); lottery revenues seem even less predictable than income and sales tax revenues. Minnesota already is burdened with a revenue structure that is susceptible to fluctuations in the business cycle. There is no discernible pattern of flowing with business cycles or going against them in the experiences of current lottery states. Any dependency on lottery revenues only extends the state's vulnerability to fiscal crises.

Creating a new product and persuading the public to spend money on it just because the state might need revenue is simply bad policy. And depending upon something which has the likelihood of being unstable and inefficient for up to two percent of the general fund is unwise policy. If the state needs more money to balance the budget, it ought to get it the traditionally accepted way -- tax for it -- so that the burden falls proportionately according to an ability-to-pay and other generally accepted criteria for a good tax system.

II. A lottery, given the available evidence of strong public support and as an addition to the variety of already approved gambling opportunities in Minnesota, is acceptable.

We come to this conclusion with due respect for the many concerns about lotteries. In fact, if the question before the Legislature were simply "Should Minnesota have a lottery?", we might well have answered "No." The majority of the committee that studied this issue for the Citizens League started with a negative orientation to the lottery proposal. We found, however, too little evidence to suggest that the apparent popular preference of the public as found in recent polls should be resisted.

Minnesota already permits gambling -- parimutuel and charitable -- in forms similar to the lottery. While some gambling clearly creates revenue for certain organizations, the public's interest in gambling is recreational. And opinion polls consistently demonstrate that most people want to add the lottery to those gambling opportunities. While we find enough substance in the concerns to stop short of endorsement of a lottery, we also find the answers to the concerns credible enough for us to conclude a lottery is acceptable as a form of recreation.

We have been concerned about "regressivity," since a lottery ticket purchase places a greater relative burden on a person of lower income than on one with a higher income (Appendix 8). But this observation theoretically applies to every purchase that low-income people make. If the state insists on considering the lottery as "revenue policy" and taking 40 percent of the gross revenue, then we will continue to be concerned about this issue. The burden of that 40 percent would rest most heavily on the lower income. But as "social policy", this concern is not significant. When people play the lottery as a gaming opportunity in the market, they will pay the tax on the ticket. But because it is an entirely voluntary transaction, it is no more regressive than any other discretionary purchases subject to tax. Furthermore, to say that lower income people need to be protected from this use of their discretionary money -- however they may define that -- seems inexcusably patronizing.

Other claims we studied are that a lottery breeds compulsive gambling and leads to an increase in organized crime. There is no contemporary evidence for either concern. Dr. Robert L. Custer of the Veterans Administration in Washington, D.C. is widely recognized as an expert on compulsive gambling. Of the compulsive gamblers he has treated at the V.A. hospital, he estimates that the lottery may be responsible for perhaps two percent of the cases. The lottery just does not seem to provide the needed "excitement" to cause compulsive behavior in a gambler (3). The advent of computerization and rigorous auditing procedures have reduced substantially the likelihood of organized crime becoming an issue in modern lotteries. Whatever threat remains is the same one -- computer fraud -- that challenges every institution and business engaged in large-scale financial transactions.

(3) The Lottery Journal, January 1985, page 22.

Another argument is that money spent on the lottery is taken away from other forms of entertainment. This is probably true, although it also seems likely that some people would spend more on entertainment if the lottery were added to what is now available. The important question, though, is not whether displacement would occur, but who is encouraging it. This is a primary reason why we have concluded that government itself should not be in a central role operating or promoting a lottery. Using Video Cassette Recorders (VCRs) as an example, it was widely believed that VCRs would displace spending on theater movies. But that possibility was not judged to be a sufficient reason to ban their sale. The question would be very different, however, if government were selling VCRs in order to satisfy its revenue needs. We nearly always reject putting government in the role of picking winners and losers when we consider the issue carefully.

Finally, another argument -- in many ways the most thought-provoking -- is that a lottery encourages the type of thinking that damages the cultivation of a productive spirit in society; that it holds out the alluring prospect of getting something for nothing, or for very little, when building a productive society depends upon a pervasive commitment to investing to get results, working hard to achieve success. Again, with due respect for the concern, we conclude that people are not generally naive; if the odds of winning are displayed, they can arrive at their own assessments of acceptable risk. Government may publish a list of healthy and unhealthy foods, but it does not dictate menus to restaurants; it licenses them according to basic consumer protection standards. It permits the sale and consumption of cigarettes, warns consumers about the health risks, and taxes the sale at a comparatively high rate. And it protects non-smokers from the smoke of others. But it does not protect people from the decision to smoke. These examples may not correspond perfectly to the lottery question, but we have concluded that, as entertainment, a lottery is not sufficiently different from other risks in society to warrant its illegal status.

We recognize that this acceptance could be interpreted to include other unapproved forms of gambling; it should not be. We examined only the lottery, not any other forms, as there is no discernible public interest or precedent emerging either in Minnesota or in other states for other gambling.

III. The acceptability of the lottery depends upon the commitment to the general fund of any revenues the state may derive from taxing it.

Central to the lottery issue is the question of how the state will spend its tax revenues from the game. Not only is it central, but the lottery debate currently swings around it. Much of the lottery's support exists because it is proposed to fund some project that could otherwise go unfunded.

We believe that lottery revenue should not be dedicated to a specific project, but belongs more appropriately in the general fund.

Any project that deserves state funding should not be wedded to a source of revenue that has proven itself unstable. What appears to be a windfall one year can easily turn into shortfall in the next. Such revenues are better added to the general fund, which, in its already unstable state, would feel only moderate impacts from this relatively small contribution (see Appendix 9).

Moreover, any project that seeks state funding should prove itself deserving through the appropriation process set up for that review purpose. Surviving that review is the traditional test of merit.

One can imagine the beneficiaries of lottery revenues promoting lottery purchases as a "patriotic" gesture. The state should have no incentive to encourage individuals to spend their discretionary money on this product as opposed to others because of its dedicated tax proceeds.

IV. The acceptability of the lottery depends upon its being privately operated and publicly regulated.

The lottery should be organized around the goals of ensuring economic viability, maximizing return to the players, and maintaining financial and operational integrity. Theoretically, either the public or private sector could capably fulfill these requirements; indeed, the lotteries in the 22 states operating them are all variations on a public model. A private-operator approach, however, has some important advantages. To give the public the best lottery possible, we conclude that the form of operation should be private, with regulation by the public sector.

The private operation

The criteria we suggest to create the best possible lottery operation are operational efficiency, market sensitivity, avoidance of governmental promotion and involvement, and effective regulation. In every case, we determined that a public commission should perform regulatory functions. We considered various operational forms:

- (1) A purely public operation in which a state agency conducts the lottery and all operations are internalized (no contracting for services).
- (2) A public operation in which a state agency conducts the lottery and selected services are contracted with private suppliers (such as ticket printing and advertising).
- (3) A public operation that uses neither state's personnel nor purchasing structures. Operations could be performed internally or selectively contracted with private suppliers.
- (4) A private operation in which the management of the operation is contracted for a fee or percentage of gross sales; the public commission regulates all policy and operational aspects.
- (5) A private operation in which an exclusive license is let to a private, for-profit operator; the public commission regulates policy aspects and leaves the operational aspects to the operator.
- (6) A purely private operation in which a number of licenses are granted; the public commission regulates policy aspects only.

We strongly prefer options four and five above. Putting the lottery's operation into the private sector avoids potential role conflicts for the government. The government should not be involved in a system that regularly picks winners and losers. It should maintain an appropriate distance from a role of encouraging individuals to spend money on one product rather than another. It is this kind of industrial policy that the government should resist.

Moreover, the private sector could operate the lottery at least as well as could the public. The incentives for operational efficiency usually inherent in a private business are not prominent in the public sector. The public sector does not have the motive of profit pushing it to efficiency in operation. And the bidding process which would be utilized in this situation serves as an additional check for efficiency and fairness in the operation. Because these incentives are missing in the public sector, equivalent operational efficiency is unlikely.

The private sector is not as constrained as the public by such operational structures as civil service and uniform purchasing systems. The comparative inflexibility of public bureaucratic systems presents special problems in sustaining efficiency and market-responsiveness. What has been reported recently about the inefficiencies and inflexibilities of the Minnesota Zoo's operations only reinforces these points.

The commission that studied the Minnesota Zoo to uncover what inhibits its success has concluded that the zoo's status as a state agency with a politically appointed board, state employees, and state financing has left it unable to adopt the best strategies to increase its annual visitor rates. According to the commission, the zoo should be reorganized to operate independently as a non-profit organization.

While the operation of the lottery by the private sector is desirable in and of itself, it is equally necessary that only one franchise be contracted in Minnesota. An operation like a lottery requires an economic critical mass to be successful. To ensure that it is both economically viable throughout the state as well as economically equitable across regions of the state, there should be only one lottery in Minnesota.

We are aware of provisions in the federal criminal codes that prohibit the use of the mails or media advertising by a private lottery operator. We urge that a legal relationship be constructed that complies with federal law but accomplishes the private provision we recommend. We anticipate no serious problem doing this. Most states currently operating lotteries make extensive use of private vendors to provide a variety of services. Contracting for the operation of the lottery itself is not substantially different. (Appendix 11 for description of federal criminal codes)

The public regulation

Whatever organization operates the lottery, public or private, regulation will be necessary. We point to fair selection and licensing of the vendor (the operator) and agents (businesses which sell tickets), ensuring basic security and financial integrity, regulation of advertising standards, delineation and enforcement of participation eligibility based upon age, and general oversight of compliance with statutes.

The single operator approach we recommend requires that a regulatory body be established. What automatic regulation the competitive market enforces may not exist in this exclusive structure, except through the bidding process.

Regulating the lottery is clearly a public responsibility, and to be effective, needs to be organized separately from the responsibility for operations. The record of organizations trying to do both is not encouraging. We point as a useful example to the slowness with which some public school boards respond to consumer interests (the students and families they represent) because they also operate the educational system.

Another example, which the Legislature acted on in 1984, is a structure entirely within the public sector but one which required achieving the same organizational separation. The Metropolitan Transit Commission (MTC) could not effectively make plans on how to meet the transit needs of the metropolitan area while it was also operating the metropolitan bus company. The MTC was planning everything around the continuation of the bus system and therefore was not meeting the broader transit needs. When this was recognized, the Legislature created the Regional Transit Board (RTB) to do the policy planning for metropolitan transit, leaving the MTC free to concentrate on running the bus system. The RTB, with a general regulatory role toward the MTC, looks to it for many transit services, while also contracting with other providers (mostly but not necessarily private) to deliver other services.

WHAT SHOULD THE LEGISLATURE DO?

I. The Legislature should respond to the demand for putting a constitutional amendment on the ballot on the question of removing the lottery prohibition.

The issue of whether a lottery would be acceptable public policy in Minnesota does not belong in the Constitution, but instead should be determined by the Minnesota Legislature. The arguments for leaving the prohibition in the Constitution are no longer compelling.

In light of significant legislative and public interest in the lottery issue, the voters should vote on whether the lottery prohibition should remain in the Constitution.

Even though the vote will be on the constitutional prohibition explicitly, it is realistic to assume that the Legislature will interpret a positive vote as a mandate to authorize a lottery.

II. The same Legislature should adopt a statute which will authorize a lottery. It should make clear what kind of lottery will be authorized if the constitutional ban is removed. We support the introduction of a lottery in Minnesota provided that it is established with the following characteristics:

A. The tax revenue collected by the state is committed to the general fund.

B. The lottery is organized as a private operation with public regulation.

C. The state tax on the lottery is not set at an exploitative level.

We do not oppose taxing the lottery, but the tax should be set at a level comparable to the rates on other commodities with special consumption tax rates (see Appendix 12). The reason to approve a lottery is not to create a new tax as a substitute for traditional taxation. Rather, it is to respond to the strong public interest in adding another form of gambling to those that Minnesota already allows. A reasonable tax level in turn should mean greater payouts to players than the typical 45 percent. Where the tax level is set offers the best test of the Legislature's purpose in establishing a lottery.

D. A Gaming Commission to regulate the lottery and all other gambling activity in the state of Minnesota is created.

The commission in Minnesota should not be a new entity whose sole purpose is to regulate the lottery. Rather, we recommend a Gaming Commission which would regulate all gambling forms in the state of Minnesota, charitable and parimutuel, as well as the lottery.

A commission with only one body to oversee often is co-opted by the activity it is intended to regulate. The commission becomes so closely involved in maintaining the organization's economic livelihood, that it steps beyond regulatory oversight to ensure sustenance of that livelihood.

Because such a close relationship should be avoided between the industry and its regulator, we recommend that the body that regulates this lottery have other regulatory responsibilities. The fact that the Gaming Commission would be regulating several forms of gambling in nearly direct competition for the gambling public's dollar would make it less likely that the commission could be compromised in its regulation of any one of the games. (See Appendix 4 for current regulatory agencies for charitable and parimutuel gambling.)

The regulatory responsibilities

The Gaming Commission should have the authority to design boundaries of operation, perform ongoing oversight of operations, and provide financial auditing. Some of the elements described below should be set by statute: the prohibition of governmental authorities as lottery agents; the prohibition of public officials in lottery advertising; truth-in-advertising; and the age of player eligibility. The remainder of the elements should be enacted within the rule-making authority of the commission.

(a) Prohibit governmental authorities from agent status

Authorities of the public sector not be allowed to sell lottery tickets. The government should not promote the sale of lottery tickets in any way, nor should it pre-empt businesses in the private sector from earning the commissions on ticket sales.

(b) Prohibit public officials in lottery advertisements

Because the state's role with the lottery should be consumer protection and not operation and promotion, we strongly recommend that the lottery be forbidden from using public officials in its advertising. We reject the idea that individuals should be persuaded to spend money on lottery tickets because the state needs their support. The appearance of public figures on advertising for the lottery, like operating the lottery, brings the state into the role of promoting gambling. Some politicians may wish to make the lottery a campaign issue, but none should be involved in promoting lottery sales.

(c) Require truth-in-advertising

Just as financial organizations are required to post interest rates on their savings accounts and loans, the operator of the lottery should disclose to the public the odds of winning with a lottery ticket when such odds are known. Odds should be posted prominently on all advertising, at the point of sale, and on the lottery tickets.

(d) Set 18 as minimum age to purchase lottery tickets

Imperfect as it always is, we have a responsibility to determine, for some activities, minimum ages for legal participation. In Minnesota, we allow people to begin driving at age 16, to vote at age 18, to register to be drafted into active military service at age 18, and to drink alcoholic beverages at age 19. With each of these, a judgment has been applied about the individual's ability to make rational decisions and accept responsibility. We presume that persons under these ages may not recognize the full potential of harm to themselves or others. They are, therefore, protected from this potential by society until that designated age is reached.

Following this same rationale, no person under the age of 18 should be allowed to purchase a lottery ticket. This is the age at which it is assumed a person can make rational choices on the election ballot. He can do likewise in purchasing a lottery ticket.

We do not find any need to set a minimum age to redeem a lottery ticket for a prize, as no rationale is involved. We recognize that such a non-policy could enable some individuals to escape paying income taxes on lottery winnings by having their children accept the money, but we leave such concerns to the Department of Revenue.

(e) Require audits

The regulator should conduct financial audits of the operation, as well as require additional outside audits.

(f) Use a bidding process to select operator

The regulator must set objective guidelines by which to select the successful bidder to operate a lottery, and to conduct the bidding process. The process should include attention to the background of the businesses, particularly a requirement for full disclosure of ownership, and should feature (1) the amount of revenue expected, (2) the types and frequency of games to be conducted, (3) the plan to maximize access to the lottery throughout the state, and (4) the approach to advertising. Actual bid comparisons should be based on the promised percentage return to players of total lottery receipts.

(g) Open the bidding periodically

In an effort to introduce some competition into the lottery's operation, we recommend that this exclusive franchise be opened to rebidding every five years. The frequency of this rebidding should be determined carefully. If it is opened too frequently, the capital costs to operate the lottery could dissuade businesses from entering the process; if it is not opened often enough, the point that the opportunity to operate the lottery does not necessarily "belong" to the successful bidder could be weakened.

(h) Set criteria for license removal

The regulating body should design criteria by which it could terminate the license should the lottery be conducted in a poor manner. If, for example, the advertising style is consistently objectionable, the regulator should have the right to review the contract, and determine if the operator must forfeit its license.

(i) Require agent selection guidelines

Lottery tickets usually are sold by agents, such as small businesses. The commission on ticket sales to every business licensed is new revenue.

The selection of lottery agents could become a political issue. Consequently, the regulator should require that the operator set objective guidelines for selection of agents. The regulator should have the authority to approve such guidelines.

The primary goal of the guidelines should be to select those businesses that can be the best sellers of the lottery, but which also will not threaten the integrity of the operation. To satisfy this latter point, the regulator should require that all agents be bonded. The other criteria we recommend include disclosures such as statements of business traffic and sales, and willingness to display point-of-sale advertising. The regulator need not be concerned with the total number of agents the operator determines should be licensed, or with their locations, except to ensure that some minimal accessibility is maintained.

(j) Provide access to the lottery

Accessibility to the lottery and placement of agents in areas where sales potential is not high are concerns that must be addressed by the regulatory body as well. While a minimum level of accessibility is desirable, Minnesotans do not have an absolute entitlement to the lottery. The regulatory body could request that the operator set different business sales levels in the agent selection criteria for those businesses which may be located in such sparse areas as compared to those in populated areas.

(k) Conduct ongoing oversight

The regulatory body should provide continuing oversight of the lottery operations in the context of both the statute and rules it sets.

III. The legislation which authorizes a lottery in Minnesota should be reviewed every five years.

To assure a systematic legislative review of the lottery, we recommend the Legislature establish an expiration date of five years from initial enactment. The Legislature would then be requiring itself to act affirmatively to keep the lottery operating. It would have enough information and experience in five years to judge whether the state should make any change in its policies toward the lottery.

Appendix 1

HISTORY OF THE LOTTERY

Although the lotteries currently in operation are all of recent origin (the first modern state lottery was implemented in 1964 by New Hampshire), they are not a new concept to this nation. Records of lotteries go back as far as the Roman Empire and include many European operations in the 16th century. In North America, lotteries have been conducted to finance such things as the Jamestown settlement in 1612, the Revolutionary War, and many Ivy League schools. In addition to lotteries offered by governments, private lotteries grew in the 17th century. The Louisiana Lottery, a private enterprise, became a national monopoly in the late 1880s. But fraud and corruption forced the federal government to ban ticket distribution through the mails in 1890 (effectively forcing the lottery within Louisiana's borders), and the Louisiana Legislature followed suit to outlaw it completely. State after state then rejected lotteries, until they were abolished.

The lottery was revived in 1964 (the state law passed in 1963) by New Hampshire in an effort to raise revenue without implementing a state sales or income tax. Other East Coast states quickly followed with lotteries in an effort to keep all the money that was drifting to New Hampshire within their own borders. It remained an East Coast phenomenon until Arizona adopted a lottery in 1981. Currently, all regions of the country have lotteries, with the exception of the Southeast. This includes 22 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Five Canadian provinces also have lotteries.

Appendix 2

MINNESOTA POLL

The Minnesota Poll, conducted by the Minneapolis Star and Tribune December 13-19, 1985 surveyed 612 adults. The question asked was:

"The Legislature is considering a constitutional amendment that, if approved by the voters, would permit the state to operate a lottery. Do you favor or oppose a state lottery? Do you feel strongly about that or not so strongly?"

"If a bill for a constitutional amendment permitting a state lottery were before you today, would you vote for or against it?"

The margin of error on this poll was plus or minus four points. Phone numbers for the poll were picked randomly by a computer and included unlisted numbers. One adult in each household was picked statistically. If there was no answer at the number called, or if the adult called refused to be interviewed, the computer selected a random replacement phone number.

Limitations on the polling procedure are that persons both must have a telephone and agree to be interviewed.

Appendix 3

CHARITABLE GAMBLING IN MINNESOTA

The first authorization of gambling in Minnesota since statehood came in 1945 when the Legislature made bingo lawful for charitable purposes, as long as it was not conducted to the benefit of individuals. Local units of government were granted the authority to prohibit bingo within their borders. A 1976 law expanded that to require that charitable organizations obtain a license from the local governmental unit before conducting bingo. Another law in 1978 expanded the authorization of gambling even further to include the conduct of raffles, tipboards (numbers are uncovered from a hidden seal), and paddlewheels (wheels of fortune) for charitable purposes. Pulltabs (tabs are pulled off of cards to reveal winning combinations of numbers) were brought into this pool of games by the 1981 Legislature. And the 1984 legislative session transferred all regulation of gambling from the local units of government to a new state Charitable Gambling Control Board; the effort was to make the enforcement of gambling uniform throughout the state and to improve tax collections.

Appendix 4

COMMISSIONS CURRENTLY GOVERNING GAMING IN MINNESOTA

Racing Commission

Horse racing and parimutuel betting were authorized by the vote of the public in November, 1982. Subsequently, enabling legislation was passed in March-April of 1983 and codified as Chapter 240.

The Racing Commission holds regulatory functions over the horse racing and parimutuel industry in Minnesota. The commission's nine members are all appointed by the governor. Its functions include the following:

- granting of licenses for horse tracks in Minnesota
- placement of two veterinarians at the race track
- diagnostic testing of the blood and urine of horses at a University of Minnesota laboratory
- oversight of parimutuel finance
- oversight of racing security
- licensing of 'anything' at the race track
- drafting of any rules of racing
- implementation of the Breeders Fund established by the legislation to promote horse breeding in the state

Charitable Gambling Control Board

Various forms of gambling conducted by charitable organizations (veterans, fraternal, religious, and any non-profit organizations) have been authorized since a 1945 law first enabled bingo. Currently, such organizations can conduct bingo, raffles, tipboards, paddlewheels, and pulltabs. The requirements for conduct are organizational existence for at least three years, membership of at least fifteen people, and conduct of the games only on premises owned or leased by the organization. The revenue may be used only for "allowable expenses," such as rent and machinery repair, and for "lawful/charitable purposes," which include purposes to the benefit of a person in need, with respect for the nation, for a governmental purpose, or for the maintenance, erection, or expansion of the organization's premises.

The Charitable Gambling Control Board was created by a 1984 law to put the duties of regulator and tax collector under one body. Prior to this law, charitable gambling activities were regulated by the local units of government. Tax collection was slight and sporadic. The board has 13 members, eleven of which are appointed by the governor to serve staggered three year terms. The remaining two members are the attorney general (or a representative) and the commissioner of public safety (or a representative).

The Control Board's main functions are to screen both existing charitable gambling operators and applicants for licensure according to the criteria listed above and to collect the state taxes on charitable gambling. It can revoke licenses when abuse is reported, but does not have authority over cases in violation of the state's gambling laws, such as conduct of gambling not allowed by law. In such a case, the county attorney or local law enforcement agency has legal authority.

Appendix 5

LOTTERY AND THE MINNESOTA CONSTITUTION

The Minnesota Constitution prohibits the operation of a lottery, stating "the Legislature shall not authorize any lottery or the sale of lottery tickets" in Article XIII, Section 5.

This ban has been assumed to cover only the particular games called "lottery", although a literal interpretation of what games contain all three elements suggested in the above definition (consideration, prize, and chance) could include others such as slot machines, roulette, craps, bingo, keno, and video games of chance. The charitable gambling which the Minnesota Legislature has authorized could, therefore, fall under this broad interpretation. None has been challenged, however.

It is impossible to know exactly what the framers of the Minnesota Constitution had in mind when they wrote the prohibition; therefore, any court decisions to date regarding gambling have dealt with statutory constructions rather than the constitutional restrictions. Moreover, the Minnesota Attorney General cannot challenge the constitutionality of any statutes regarding gambling. Minnesota statute 645.17 states that any decisions made by the Legislature and passed into law shall be assumed to be in agreement with the federal and state constitutions. All games authorized by the Minnesota Legislature, therefore, have been left unchallenged.

Appendix 6

INEFFICIENT REVENUE SOURCE

The percentage of sales which must be dedicated to operations is dependent largely upon how great the sales are in the state and how mature the lottery is. While some states are able to keep that percentage relatively low, others can hardly keep costs below net revenue.

INEFFICIENT (continued)

Typical state lottery operations return 45 percent of gross revenue to the players in payouts. Operations require approximately 15 percent of gross revenue, leaving 40 percent to the state. The 15 percent figure, however, does not adequately explain how high operational costs are because it is the percentage of gross revenue, not net revenue to the state. If 55 percent of gross revenue is the state's revenue after payouts, we need to know what percentage of that total net revenue is used for operational costs. This will make the figure equivalent to the computations of how much it costs the state of Minnesota to collect all other revenues.

If the players take 45 percent of gross, this leaves 55 percent for the state in total net revenue. Operational costs (15 percent of gross revenue) are actually 27.3 percent of the total net revenue (15 percent of 100 percent is equal to 27.3 percent of 55 percent).

Using typical lottery breakdowns, if Minnesota grossed \$200 million, \$90 million would be player payouts, and \$110 million the state's total net revenue. Operational costs could be expected to take \$30 million of that \$110 million (15 percent of gross revenues), which calculates as 27.3 percent of total net revenue.

The Minnesota Department of Revenue spent less than one percent (.74 percent) of total revenue for collection of all taxes in its jurisdiction in 1984. Fiscal 1984 total taxes were approximately \$4.6 billion, and costs of collection were approximately \$34.1 million. The comparison of 27.3 percent of revenue against .74 percent shows that a lottery would be a highly inefficient revenue source in Minnesota.

Administrative Costs as Percent of Net Lottery Revenue
By State, FY 1978-83

	1978	1979	1980	1981	1982	1983
Arizona	-	-	-	-	36.5	66.9
Colorado	-	-	-	-	-	23.8
Connecticut	13.8	15.8	6.4	14.8	14.9	14.1
Delaware	44.2	28.8	23.8	17.9	20.5	20.3
Illinois	19.5	28.0	26.5	11.5	7.7	7.1
Maine	109.7	159.7	351.4	136.9	105.5	76.9
Maryland	15.5	15.3	6.8	7.2	7.1	9.3
Massachusetts	10.7	10.9	10.1	24.3	28.0	26.7
Michigan	5.7	5.0	4.6	6.9	7.4	13.3
New Hampshire	58.1	65.6	52.1	46.6	39.3	38.4
New Jersey	15.8	16.1	11.1	3.7	3.5	6.3
New York	30.9	35.8	32.0	21.6	9.4	9.4
Ohio	30.9	27.7	31.4	15.9	14.1	18.6
Pennsylvania	17.8	13.8	13.3	11.4	10.2	8.5
Rhode Island	18.4	12.5	125.0	19.9	18.1	14.4
Vermont	-	-	864.3	127.9	71.1	68.2
Washington	-	-	-	-	-	31.6
District of Columbia	-	-	-	-	22.6	24.5

Source: U.S. Department of Commerce, Bureau of the Census, State Government Finances, assorted years

Appendix 7

UNSTABLE REVENUE SOURCE

In some states, the lottery is a relatively stable revenue source. But such stability is not the norm among lottery states. While revenue generated by lotteries over the years has grown on the whole, on a state-by-state basis revenues are neither stable nor predictable. Ohio, for example, saw a drop in net revenues of 43.7 percent between fiscal years 1978 and 1980. In fiscal 1981, though, the state experienced a 214.3 percent increase in net revenues, followed by an increase of 33.3 percent fiscal 1982, and a drop by 2.1 percent fiscal 1983. Even when a state is on a dramatic upswing, it can rarely predict whether that upswing will continue (at what angle if it does), level off, or drop again. Increases in revenue cannot be frowned upon, but such unpredictability breeds only instability.

Growth of Net Revenue for State Lotteries By State, 1977-1983 (Percent Change)

	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83
Arizona	-	-	-	-	-	-49.7 %
Colorado	-	-	-	-	-	-
Connecticut	50.4 %	2.2 %	47.6 %	- 8.7 %	12.6 %	18.1 %
Delaware	72.7	152.6	31.3	22.2	10.4	17.7
Illinois	-28.9	-24.8	28.3	143.0	62.6	51.9
Maine	12.5	-22.2	-50.0	57.1	118.2	58.3
Maryland	64.7	16.2	42.5	- 7.6	21.5	- 4.9
Massachusetts	15.3	- 0.8	21.4	-29.9	7.1	21.5
Michigan	48.3	23.4	17.0	-16.6	0.8	8.3
New Hampshire	20.0	- 6.7	32.1	5.4	35.9	7.6
New Jersey	18.4	26.8	21.8	27.4	18.5	37.5
New York	-	- 9.5	- 2.5	16.5	84.5	50.2
Ohio	-37.4	0.0	- 6.3	214.3	33.3	- 2.1
Pennsylvania	97.8	32.1	11.9	6.9	34.3	56.5
Rhode Island	33.7	33.3	12.2	-28.9	8.5	12.5
Vermont	-	-	-	150.0	100.0	10.0
Washington	-	-	-	-	-	-
TOTAL	46.9	13.3	19.8	9.7	31.6	32.8
District of Columbia	-	-	-	-	-	215.8

Source: U.S. Department of Commerce, Bureau of the Census, State Government Finances, assorted years.

Appendix 8

REGRESSIVITY OF THE LOTTERY AS A REVENUE SOURCE

Cumulative Percentage of Household Income and Lottery Sales in Maryland			
Income	Percent of Total Income Earned by Families w/ Less Than Indicated Income (1)	Cumulative Percent of Total Sales (2) From:	

		Daily Lottery	Weekly Lottery

\$ 8,000	3.2	13.9	8.5
10,000	11.0	34.6	21.8
12,000	18.8	45.2	34.4
14,000	31.6	60.2	48.5
16,000	45.4	75.7	62.8
18,000	62.4	85.6	76.4
20,000	72.2	90.9	83.7
22,000	89.7	98.0	95.5

(1) Incomes are based on estimates of median household income for zip code areas in 1974.

(2) Unpublished data, Maryland State Lottery Agency.

The above table was reproduced from National Tax Journal and used in testimony by Charles T. Clotfelter before the Senate Subcommittee on Intergovernmental Relations, Committee on Governmental Affairs, October 3, 1984 (see pages 321 - 329, subcommittee hearing summary).

The data obtained from the Maryland State Lottery Agency that went into this table represented ten-week averages of sales by zip code. The estimates of the numbers of households and the median household income were obtained for each zip code area as well. The table, then, presents the distribution of daily and weekly lottery sales by income.

What is evident in the table is that low income households account for a greater proportion of lottery sales than of income.

Other recommended studies to reference on this subject:

Brinner, Roger E. and Charles T. Clotfelter, "An Economic Appraisal of State Lotteries," National Tax Journal, December 1975, pp. 395-404.

Mikesell, John L. and C. Kurt Zorn, "A Survey of the Structure and Revenue Performance of State Lotteries," School of Public and Environmental Affairs, Indiana University, October 16, 1985.

Suits, Daniel B., "Gambling Taxes: Regressivity and Revenue Potential," National Tax Journal, March 1977, pp. 19-35.

Appendix 9

REVENUE TO STATE OF MINNESOTA

GROSS AND NET REVENUE

The following figures assume a return to the state of 40 percent of gross sales (with 45 percent to the players and 15 percent to operational costs).

Based on the average per capita expenditure

In 18 states operating lotteries in 1984, the average per capita expenditure was \$74.14. Using this average, a lottery in Minnesota would gross \$302 million (1980 population of 4,075,970) and produce net revenues of \$121 million in Minnesota. Player payouts would be \$136 million.

Based upon best and worst per capita states

Maryland (best) has an average per capita expenditure of \$127.30. If such a figure were applied to Minnesota, the lottery would gross \$519 million and net \$208 million. Player payouts would be \$236 million.

Vermont (worst) has an average per capita expenditures of \$10.00. If such a figure were applied to Minnesota, the lottery would gross \$41 million and net \$16 million. Player payouts would be \$18 million.

Based upon state of Washington (see next page; similar demographic characteristics to Minnesota)

Gross sales in 1984 were \$158 million and net to state was \$63.2 million. The industry has suggested that Minnesota could have better sales, as it already has gambling (charitable and parimutuel) and has gambling states on its borders (unlike Washington). Hypothetically, Minnesota could expect \$200 million gross sales and \$80 million in net revenue. Player payouts would be \$90 million.

REVENUE AS PERCENTAGE OF GENERAL FUND

If net revenue to Minnesota were \$120 million (average per capita), this would represent approximately 2.5 percent of a \$4.6 billion general fund. It would be the sixth largest revenue source for the state, falling between the motor vehicle excise tax and mining tax and royalties.

If revenue were \$80 million (Washington experience), this would represent 1.7 percent of total state revenue, and would be the eighth largest revenue source, falling between insurance taxes and cigarette and tobacco taxes.

1980 DEMOGRAPHICS OF MINNESOTA AND LOTTERY STATES

State	Gross Sales 1984	Net Revenue 1984	Population	% in Metropolitan Areas	% in Non-metro Areas	Percent Unemployed
MINNESOTA			4,076,000	64.0	36.0	5.9 8.2
Arizona	\$59.3	21.3	2,286,000	39.0	61.0	6.7 9.1
Calif.	N/A	N/A	23,668,000	95.0	5.0	6.8 9.7
Colorado	138.3*	41.7*	3,020,000	77.0	23.0	5.9 6.6
Connect.	188.0*	80.5*	3,107,000	93.0	7.3	5.9 6.0
Delaware	33.1	14.0	594,000	67.0	33.0	7.7 8.1
District Columbia	50.5*	13.1*	638,000	100.0	0.0	7.3 11.7
Illinois	912.0	379.8	11,427,000	82.0	18.0	8.3 11.4
Iowa	N/A	N/A	2,914,000	42.0	58.0	5.8 8.1
Maine	13.1*	3.7*	1,124,000	36.0	64.0	7.8 9.0
Maryland	536.8	216.9	4,217,000	93.0	7.0	6.5 6.9
Massach.	690.2	242.0	5,737,000	91.0	9.0	5.6 6.9
Michigan	548.9*	221.2*	9,263,000	81.0	19.0	12.4 14.2
Missouri	N/A	N/A	2,521,000	28.0	72.0	7.5 12.6
New Hampshire	13.8*	3.7*	921,000	55.0	45.0	4.7 5.4
New Jersey	693.1*	294.9*	7,365,000	100.0	0.0	7.2 7.8
New York	645.0*	275.2*	7,558,000	90.0	10.0	7.5 8.6
Ohio	604.3	245.8	10,798,000	79.0	21.0	8.4 12.2
Oregon	N/A	N/A	2,633,000	67.0	33.0	8.3 10.8
Pennsylv.	1,295.0	572.7	11,864,000	85.0	15.0	7.8 11.8
Rhode Island	52.9	18.3	947,000	93.0	7.0	7.2 8.3
Vermont	4.4*	1.1*	511,000	23.0	77.0	6.4 6.9
Washington	183.3	66.4	4,132,000	80.0	20.0	7.9 11.2
West Virginia	N/A	N/A	1,950,000	37.0	63.0	9.4 18.0

* Figures are 1983 fiscal year, first 6 months

* Figures are 1983 fiscal year

Appendix 10

CURRENT LOTTERY OPERATIONS IN OTHER STATES

Model laws shared from state to state (and offered by vendors as they lobby potential lottery states) create a state agency to operate the lottery, a director to head the operations, a commission to oversee the operations and policies, and guidelines regarding ticket agents, the proportion of revenues shared between state and players, and the like.

Director

Typically appointed by the governor to this fulltime position, the director has immediate supervision and direction over the lottery. His authority is subject to the rules and statute of the lottery and the guidance of the commission.

Authority includes promulgation of rules pertaining to the types of lottery games conducted, prices of the tickets, number and sizes of prizes, method of selecting winning tickets, manner of payment of prizes, and the frequency of drawings.

Commission

Composed of three to nine members, some or all of whom are appointed by the governor with consent of the Senate. Qualifications vary, from a minimum of state residency to specifics for some commission members (eg. one member must be certified public accountant, another in public safety, and so on). Terms are staggered.

Commission has power to advise on the director's administrative decisions, to review all contracts negotiated by the director, ensure that the regulations are properly administered, and identify any abuses in the operations.

As state agencies, all lotteries use the state civil service and purchasing systems in their operations.

The states' uses of the net revenues vary.

Some dedicate the revenue to the general fund, while others send it directly into education, senior citizen funds, environmental purposes, and funds designed for economic development.

Contractual arrangements

All states, with the exception of Massachusetts, contract various aspects of the operations with private vendors. This includes advertising, instant ticket printing, and computer management. The state sets the policies, makes the administrative decisions and selects the vendors which can best fulfill those decisions at least cost to the state.

Massachusetts has elected to internalize all operations of the lottery, including those suggested above. The philosophy is that the state may have greater expenses now, but will save money over time. The agency is its own vendor, hires its own computer technicians and advertising specialists, and owns all lottery equipment.

Games

Most states offer both instant games and on-line lottery games, such as lotto. Some, however, offer only instant games, while others offer only the other games. Factors determining what games and how many to conduct include state demographics (age of players and population spread), political climate, and maturity of the lottery.

While the instant games can most easily and least expensively be spread throughout the state, they do not provide the greatest "bang for the buck." The life of an instant game is eight to twelve weeks, thus requiring constant new product development and marketing. But they enable the fastest start-up.

On-line games (computerized networks), on the other hand, are more expensive and take longer to implement, hence making it difficult to cover a comparatively larger and less-populated state. But they are more cost-efficient in the long run. Player interest grows over time rather than dies as it does with the instant games. Start-up is slower than instant games given hardware installation and the greater player learning curve.

It is difficult to generalize on which games work most successfully for particular states. On the East Coast, experience suggests that the Numbers Games are the most successful, and Instant least successful, due to the illegal numbers games' presence. That experience easily could be just the opposite on the West Coast, but it is too early to tell. In Delaware, about 98 percent of total sales comes from the Numbers and Lotto games, and only two percent from Instant Games. The state of Washington's results thus far show that slightly more than 50 percent of sales are from Instant Games, but that state has just recently added on-line games. Most states do not allocate costs by game, therefore we can only assume that the experience lottery directors draw upon to state that the on-line games in the long run are more cost-effective is good.

Who plays which games

Although such data is difficult to collect, David Ellis of the Massachusetts Lottery offered these general guidelines:

- Megabucks (Lotto) -- this is the biggest game and sells more in the suburbs than in the cities. With the big \$22 million jackpot, "everybody bought."
- Daily Numbers Game -- appeals more to the low to low-middle income players, sells more in the cities.
- Weekly Numbers Game -- appeals more to the older population, through the annual subscription ticket (passive).
- Instant Game -- appeals to the younger population (instant gratification).

Agents

The number of agents to license varies based upon a state's demographics and marketing plan. Basic accessibility that is desired often requires placement and service of agents in sparsely populated regions that otherwise would not warrant one. Some lotteries prefer to saturate the state with agents so that the public sees it constantly. Other states adopt an almost exact opposite strategy, licensing relatively few businesses as agents to create an aura of specialism so they assume responsibility for the lottery, and are aggressive sellers.

Appendix 11

TITLE 18, U.S. CODE, CHAPTERS 61, SECTIONS 1301 - 1307

The codes recognize a lottery as follows:

Section 1301, Note 10: "The three necessary elements of a "lottery" are the furnishing of a consideration, the offering of a prize, and the distribution of the prize by chance, rather than entirely upon a basis of merit."

Section 1301. Importing or transporting lottery tickets

Prohibits the mailing of lottery tickets, the importation of lottery matter from abroad, the carrying of lottery tickets from one state to another, and the transfer of lottery tickets and advertisements by any means or method from one state to another.

Section 1302. Mailing lottery tickets or related matter

Prohibits mailing any letter, package, card or circular concerning any lottery; any lottery ticket or anything purporting to be or to represent a ticket; any check, draft, bill, money, postal note, or money order for the purchase of a lottery ticket; and any newspaper, circular, pamphlet, or publication advertising the lottery or containing a list of the prizes drawn or awarded by a lottery.

Section 1303. Postmaster or employee as lottery agent.

Excludes officers and employees of Postal Service from acting as agent of lottery of knowingly sending or delivering any materials related to a lottery.

Section 1304. Broadcasting lottery information

Prohibits the broadcasting by radio station, or the permitting of broadcasting, of any advertisement or information concerning any lottery, or any list of the prizes drawn or awarded by a lottery.

Section 1307. State-conducted lotteries

Exempts "a lottery conducted by a state acting under the authority of state law" from the above prohibitions. A state lottery may:

- 1) make an advertisement, list of prizes, or information concerning a lottery contained in a newspaper published in that state or in an adjacent state that conducts a lottery, or
- 2) broadcast an advertisement, list of prizes, or information concerning a lottery by radio or television station licensed by that state or an adjacent state that conducts a lottery.
- 3) transport or mail equipment, tickets or material concerning a lottery within a state conducting a lottery, or
- 4) transport or mail to an addressee within a foreign country equipment, tickets or materials to be used within that country in a lottery which is authorized by that country.

Appendix 12

TAX RATES OF SELECTED MINNESOTA REVENUE SOURCES

The following are special taxes on the product (do not include sales taxes):

Cigarettes -- taxed at a rate of 11 1/2 mills per cigarette, which equals 23 cents for a pack of 20 cigarettes.

Liquor -- varies by liquor content

Distilled Spirits:

-- \$1.16 per liter plus 1 cent per bottle

Wines:

- greater than 24 percent alcohol = 81 cents per liter plus 1 cent per bottle
- 21 to 24 percent alcohol = 42 cents per liter plus 1 cent
- sparkling = 40 cents per liter plus 1 cent
- 14 to 21 percent alcohol = 21 cents per liter plus 1 cent
- less than 14 percent alcohol = 7 cents per liter plus 1 cent

Charitable Gambling -- taxed at ten percent of net revenues. Since net revenues (as percentage of gross) varies with each game, the tax is an average of two percent of gross wagers.

Parimutuel -- taxed at 1 3/4 percent of gross wagers up to \$48 million, and six percent of gross after \$48 million (returns 83 percent in payouts to bettors).

WORK OF THE COMMITTEE

COMMITTEE ASSIGNMENT

The charge to the committee is as follows:

Recommend whether Minnesota should adopt a lottery. A constitutional amendment for a state lottery may be considered by the 1986 Legislature for placement on the ballot in November 1986.

The committee shall:

--Propose explicit criteria for evaluating the goals, structure and operations of a lottery.

--Design a specific lottery proposal.

--Recommend, based on the criteria, whether a lottery should be adopted.

The committee shall attempt to address the same issues the Legislature would need to face. For example, what kind of advertising would be permitted? Would the state be encouraging its citizens to buy lottery tickets or would it only be allowing its citizens to participate? What would the state's share be? How much money would likely be raised by the state? For what purpose would the revenue be used? At what locations would it be permissible to buy lottery tickets? Where would sales be prohibited? What state agency or board would oversee lottery operations? Would persons of all ages be allowed to buy lottery tickets? What effect would a lottery have on compulsive gamblers? What is the likelihood of the lottery bringing in organized crime? How would a lottery relate to maintaining integrity of government?

The committee should examine the experience with lotteries in other states and determine whether that experience would apply in Minnesota.

COMMITTEE MEMBERSHIP

The following people participated on the committee on a regular basis:

Virginia Greenman, chair	Craig DeBerg
Judith Betty	Patrick Farrell
Marsha Blumenthal	Leo Foley
Robert Bonine	Robert Hentges
Ellen Temple Brown	Cecily Hines
Carl Carlson	David Koehser
Earl Colborn	John Nystul
Pat Cragoe	James Storm
	Blaine Thrasher

Kenneth Andersen, board of directors liason

COMMITTEE WORK

The committee began work on October 15, 1985, and met 18 times. Its final meeting was held on February 6, 1986.

COMMITTEE RESOURCE GUESTS

The following people appeared before the committee. The Citizens League thanks them for their assistance on this study.

Robert Ebel, former director, Tax Study Commission; current director of Competitive Strategies, Northwestern Bell

Roger Franke, executive secretary, Charitable Gambling Control Board

Representative Gil Gutknecht, Minnesota Legislature

Representative Lowell Norland, majority leader, House of Representatives, Iowa Legislature

Representative Thomas Osthoff, Minnesota Legislature

Martin Puncke, director, Maryland Lottery; president, North American Association of State Lotteries

Doug Wallace, director, Center For Ethics, Responsibility and Values, Saint Catherine College

John Williams, legislative analyst, Minnesota House of Representatives

The following people provided assistance to the committee's work. Their time, as well as those mistakenly omitted, is appreciated.

Jerry Anderson, Minnesota Attorney General's office

Liz Anderson and Stanley Bowker, Canterbury Downs Racetrack

Norman Coleman, assistant attorney general, Minnesota

David Ellis, Massachusetts Lottery

Jennifer Engh, former committee administrator, House of Representatives Veterans and General Legislation Committee

Mary Faulk, director, Washington Lottery

John Haynes, Minnesota Department of Revenue

Paul Murphy, U.S. Department of Justice

Deborah Phillips, government affairs, General Instrument Corporation

Erin Roth, committee administrator, Senate Veterans and General Legislation Committee

CITIZENS LEAGUE STAFF

Deborah Loon, Curtis Johnson, Paul Gilje, Marina Lyon, Alison Crane, Joann Latulippe.