CHAIRPERSON JAMES: With that, I'd like to turn the microphone over to Dr. Kelly and Doug Seay, our research staff from the Commission for an overview on the history and the economic impact of the lottery in the United States. Where's Doug?

Thank you, Doug.

MR. SEAY: Thank you. I would thank you for being here, but I was drafted, this is not volunteer.

My job today is to give you an overview of the subject of lotteries. You have in your packets a paper, a short paper, that was prepared by me, and ripped out of my clenched hands after two days. I had thought of reading it to you, but I thought the day would be long enough already, so I will try to summarize some of it.

Many of you know a great deal about lotteries, some of you may know nothing at all. I'll

try to aim for the broad middle. Any of you who live in a lottery state, cannot help but be bombarded by the advertisement and have somewhat of a general knowledge of it, which is most of the country.

I'd like to give a context in which to place the speakers and the issues that are going to be presented today and also help to frame questions regarding public policy. It's not my job to tell you as a Commission what your responsibilities are, but in my own mind, in addition to generating some very needed original and objective research there is the possibility of making recommendations at the end. We're often looked upon by critics as trying to federalize the industry, but as I see it the real opportunity here exists not just for possible recommendation for the federal government, but also to state and local governments, which I know for a fact would welcome some independent source, some independent judgement on some of these issues, which they

themselves have a great deal of difficulty grappling with.

However fascinating the aspects of this subject may be in its individual parts, or even in the general whole, for me every aspect of my investigation of it ultimately comes down to what does this mean for government policy. Because this is, as I said, to me one of the major focuses of the Commission is what do these problems that we are presented with, for all of their inherent interest, what does that actually mean for public policy. Is there anything the government can do about it? Is there anything the government should do about it, or should stop doing? All of those possibilities are there.

So my recommendation would be, my colleagues and certainly Chairman James are well aware that I'm often able to give my own opinion even when not asked for. My recommendation is to hear every statement, every criticism, every counter statement, every recommendation, in the framework and what does

this mean for government policy. Because that ultimately is the purpose of these hearings and our work.

I think one caveat at the beginning that many of the criticisms and charges and statements that I will make are not mine, they're simply those that are made in the community. Some are alleged, some have no substantive background that I can find.

I'm personally an agnostic on this issue. I know a whole lot more about it than I used to know, but I don't think my fundamental views on it have changed. And even if I had strong views of it, hopefully they will not come through in this presentation. I simply don't want anyone to assume that simply because I'm making an allegation that that necessarily indicates there are any substantive facts behind it. I'm simply representing the debate as it exists out there over several issues relating to lotteries.

I'll begin by saying that I'm reminded of the statement in Animal Farm that all animals are equal, but some animals are more equal than others. Lotteries are a unique form of gambling. Of course every form of gambling is unique, but lotteries are more unique than the other forms. It is the most widespread form of gambling in the United States, by far. It is the only form of gambling in which a majority of adults regularly report having participated in it in the past year. It exists in 37 states and the District of Columbia presently, plus a couple of territories.

One of our speakers is a consultant in the Virgin Islands Lottery, and I asked him why he goes down, and I don't think it's for the profits he's making from his consulting fees, I think it's simply to hang out in the Virgin Islands. But it is a very widespread form of gambling and it is in all corners of the United States.

It is the only form of gambling that is a virtual government monopoly. One may look at Indian gaming or Native American gaming or tribal gaming, however you wish to characterize it, as a form of government gaming, but this is the only one that is actually owned outright by the government and operated by the government.

State lotteries, as Chairman James pointed out, have some of the worst odds, if not the worst odds of any form of gambling. One estimate is that most lottos which is a prominent part of the lottery, the regular odds are one in 12 or 14 million. And they also have the greatest payoff in terms of absolute amounts of money at risk, and they regularly pay in sums of tens of millions of dollars.

Lotteries rank first, among the various forms of gambling, in terms of its gross revenues. Total lottery sales in 1996 amounted to about $43 billion dollars. Just for comparison, in 1982 that figure was $4 billion which represents a thousand

percent increase, not adjusted for inflation, obviously over the preceding fifteen years. Lotteries have the highest profit rates of gambling in the United States. Amounting to about 40 percent in 1996. And they're also the largest source of government revenue, from gambling, amounting to almost $14 billion dollars in 1996 for governments at all levels.

Now, two things that I think are important in looking at the lottery business and to keep in mind is that one, it is a business. Simply because it is an arm of the states, it does not mean that it is not a business. And the second is, that it is a dynamic and evolving business. Evolving quite rapidly as a matter of fact. As I said, it is not only a business, it is a very big business, amounting to tens of billions of dollars every year. And like every business it is driven by the source, by the search for revenues.

But even though it is a business, it is unlike other businesses because it is owned by the government. Now this is very unusual, not just in the

world of gambling but just in the world of business in general. In fact, it is hard to find a parallel in any other aspect. A lot of people would call this socialism, but this is socialism in a very benign form, I would think.

There aren't many industries in the United States that are run by the states. The closest comparison perhaps to gambling is that many states continue to control the sale of alcohol through their alcohol beverage stores or ABC stores. I know in Virginia, which is near where I live in the District of Columbia, that's certainly the case.

But the motivation of the state in regulating alcohol and the motivation of the state in running a lottery are completely opposite. In the former, theoretically at least, it's to prevent the abuses that may occur in the sale of alcohol by restricting it, you see very little advertising for alcohol in these states. Whereas, in lottery it is the exact opposite, it is to maximize revenues and to

ensure to cut out the middle man as much as possible and allow the state to profit from what many see as a vice.

It is also not like a business, a normal business, because the state is regulating itself. It is the owner of the business at the same time that it regulates the operations of that business. Normally businesses are allowed to concentrate on maximizing a profit and the state is supposed to look after the public good. At least that is the theory. I'm no fan of government regulation myself, but if there is to be a protection of the public good, it is generally assumed to come from the government.

But when the state itself is the one profiting from the business, it calls into question how effective can its protection of the public welfare, how effectively can it be reconciled with its desire for profits. I think we would all like to be responsible for the regulation of our own search for profits.

Also, no single person profits, the state does, and certainly public officials do, in the sense that they have more money to spend on their constituents, which is one of the few benefits of being in politics. And thus, the decision making, even though it is a business, is dominated by politics. The responsibility is fragmented, not only between the legislative branch and the executive branch but often within those branches with competing interests that often have very little to do with the operation of the lottery itself, or even of its impact on the public good.

The ultimate question I guess is, does the public benefit and perhaps more specifically, how does one weigh the benefits against the possible costs?

The second aspect of this is that it is a dynamic and evolving industry. When I first began looking at this subject, and I have -- my background in lotteries was limited to purchasing a single lottery ticket years ago -- was that it was a very stodgy

industry that had been the same for a very long time. In fact, it is a rapidly evolving industry, and continues to evolve as we speak.

There are many ancient antecedents of lotteries, depending on how you define them. And as the literature says, there are many instances in the Bible of decisions being made by the casting of lots and what have you. But I think that how we all normally look at lotteries in terms of buying a chance to win a very large prize, it's a fairly recent innovation within the past few centuries.

And there is a long history of involvement in American history with lotteries, again for the public good, both public and private, where the general public would be allowed to buy a chance at winning a large prize with the money going to some public good, be it helping to found the Virginia Colony or to build college buildings or even churches in early New England. And you may see in the materials that were prepared that even the attempt to defend Philadelphia

from the British, unsuccessful that it was, tried to be enhanced through a lottery run by Benjamin Franklin, it was unsuccessful.

But anyway, there has been a long history, at least in the United States, of lotteries up until the end of the 19th century, at which time, both the scale of abuses of lotteries reached a level such that states began clamping down on some of these abuses, as well as the rise of a general tenor of public improvement. And this was to culminate ultimately in the outlawing of virtually all forms of gambling and even into the era of prohibition, it's all part of the same movement where the state continued to try to eliminate what its social abuse is.

But again, it is a dynamic and evolving industry. And what drives the evolution of the industry is the unrelenting pressure for revenues. That phrase unrelenting currently, consistently, crops up in the statements of lottery directors. In terms of the pressures they're getting from state officials that

that pressure never stops, and that is what drives their own search for greater and greater revenues. And in fact it is evolving more quickly than the government itself is perhaps aware of and certainly greater than public policy can grasp. A very good analogy is the evolution of the Internet, which is happening so quickly and is leaving policy makers behind so quickly that even the attempts to catch up are woefully inadequate from the stand point of being something the government can control.

Now you can debate whether it's a good thing for the government to control it or not. But the fact is that the evolution has rapidly exceeded the ability of the government itself to capture within public policy. And you see a resulting scramble in many of the states to try to adjust to some of the problems that have cropped up, even as the industry continues to outrace them in terms of its evolution.

Also public perceptions have been left behind in this evolution of the industry. The

politicians themselves, public office holders also being part of that public perception. The idea of it simply being a tame stable industry that generatesrevenues for the public good may, by and large, still be true, if it ever was. But it has changed so much over the past couple of decades that the idea of how the lottery operates in the public mind is significantly different from how it actually does operate. And that is one of the things I wanted to address.

Now when lotteries were finally outlawed at the end of the 19th century, due largely to the abuses of a lottery in Louisiana that was operating nationally and involved large scale bribery of officials, it was essentially outlawed in the United States up until the early 1960's. One of the fears being that if you reintroduced lotteries you're going to bring criminal elements back into the equation.

The first state really to break throughthis wall of prohibition, although several states had

attempted to do something, and were beaten down, was New Hampshire. And I think the reasons New Hampshire was the first state to adopt the lottery was instructive. New Hampshire has historically been a very low tax state, it has no income tax, it has no sales tax, and people were looking for a way to increase revenues for the state with the least cost to the public good, on the public tax base.

And the idea was that people would voluntarily buy lottery tickets, by this voluntary tax, it could go to a charitable cause and be used for the public good. That is the argument that has been used in virtually every state and where the lottery has been successfully proposed. And that's what worked in New Hampshire. That was in 1964 when the lottery was put into operation. It had been approved in a public referendum.

Virtually every state that has passed a lottery has had a public referendum on it, and the public has virtually always supported it, largely for

the reason that I just outlined: at least that's the public reason. The only state that I'm aware of in which the public has consistently voted against the lottery is North Dakota, but it is one out of almost 40 states in which that has happened. And no lottery has ever been repealed. Lotteries continue, regardless of their performance, to hold the majority support among the population in every state in which they exist.

Soon after New Hampshire, the next big state to adopt lotteries was New York. And again, for very much the same reasons, but for one additional reason that New Hampshire paved the way for, and that was that our money is going to fund that state's lottery. Eighty percent of the New Hampshire's lottery, the money from the lottery came from out of state, which meant the surrounding states, and even though New York isn't a surrounding state, that argument did hit home in Albany. If we don't have a lottery, our tax money is going to pay somebody else's, the public good in some other state.

And because of that argument and other arguments, you can see a clear pattern of where one state has adopted a lottery that the surrounding states very quickly adopt lotteries. Not only for the reason of trying to capture that money that is leaving the state, in some people's eyes, in that sense it is a defensive expansion of the lottery, but also because lotteries are successful. I am not aware of any state that has lost money on a lottery. And that idea of being able to capture money to revenues "painlessly", is a very strong selling point both in the legislature and among the general population.

Now the original lottery in New Hampshire, and the first lotteries were traditional lotteries, where you would buy essentially a raffle ticket and weeks or months later there would be a drawing and you would see whether you won the prize or not. It was very much like a glorified church raffle. Very small scale, the prizes were not all that large, and it was also thought that it would sort of soak up whatever

residual gambling interests existed out there; as a way for people to simply to exercise this inclination and for the state and for the public good to profit from it. That's very much how it operated in the past, and assumed how it would very much operate in the future. What happened however as the industry began evolving, both because as I said earlier, this pressure for revenues and the developments of new technology.

Now the first real innovation was the introduction of scratch tickets, or instant games. And I think we've all done it, where you take a coin or something, some sharp object and scratch off a coating which does not allow you to see what is behind it, to see immediately whether you've won a prize or not. This is used in other places, obviously, than the lottery. And Massachusetts, I must point out, was one of the first states to introduce it and has done it very successfully.

No wonder this was an enormous success that very quickly and very rapidly spread. The reason,

or some of the reasons why it was such an enormous and immediate success was the impact it had on the player. It was a tangible thing, something the player could hold it his hand, something that had his involvement with, I mean it was not simply a passive participation on his part. The results were immediately known, so there was no delay of gratification, if you will, assuming you win. And the odds were much better. This was not a one in a million chance, there were much, much, much better odds depending on the type of game played.

Now this sub-industry of the lottery industry has its own dynamics. And there have been experience, and studies have shown, that the interest in this type of a game very quickly tails off, so there is a constant introduction of new types of games and there is always a new angle being looked for. There is a very limited duration of the life of these games. And so very quickly it moved from perhaps one or two scratch tickets to a wide range of things on the market

all the time. I believe in Massachusetts the number now is between thirty and forty scratch tickets you can go into a store and simply buy. There's just a wide variety of trying to appeal to all different types of tastes, different types of games developed for different people, different sub-categories of gambling interests.

That was an immediate success. A far bigger change, and a far bigger success was the introduction of online computerized gaming in the late `70's and early `80's. This allowed the entire state to be computerized, in the sense that you could walk into any of the vendors, typically in a food store or even in a bar or whatever, and start playing a numbers game.

Now in American cities there has always been a tradition of an illegal numbers game, where you simply try to pick a number and at the end of the day then whether you had matched it or not, depending on the type of game you were playing, you could determine

whether you won or not. Which allowed the state for the first time to get into this business of running a numbers game, only legally this time. And again, the same type, the same factors were very important in success.

And again it was dramatically successful very quickly. The idea of an immediate response to that night, rather than waiting weeks, days, sometimes even months for a response. That night you could see whether you won or not. You could play every day if you wished to. You could play several different types of games if you wished to. The odds were much better. And this game was deliberately modeled on the illegal numbers game.

If you're going to run a numbers game, obviously you want to do it with those people who are the most successful at it. And that pattern itself has proven to be remarkable successful and the odds are not so bad. They track fairly closely, they're usually better than the illegal numbers game, oddly enough, but

they track closely to the residual illegal numbers games that exist, which is understandable, that acts as a control. I mean whenever the state begins to become too greedy the illegal numbers games then picks up in activity.

Talking to one of the lottery directors, Jeff Perlee of the New York -- he runs the New York Lottery, who we invited to be here today, but was unable to be -- he confirmed that yes, they had deliberately targeted the illegal numbers game: to profit from it, because that is where the money was, but also to run it out of business. And he claims, and I have no reason to dispute his claim, that they have done that. But essentially it has ceased to exist in New York City except in isolated pockets.

The third game that came out of this on-line computerized network was what most people I think in the general public look upon as the lottery and that is the lotto. That is the big bucks, ten million dollar prize, you buy a one dollar ticket and you see

if you can win it. Because of the enormous publicity that has surrounded the winners and, as often the prizes build and build and build over weeks and they reach incredible amounts, the publicity of that alone, without the state advertising at all, has made the lottery an enormous business and made it part of the public culture in a way that none of the other activities had done before.

And it's not as though these happen to people you know nothing about. My parents live in Kentucky. I know their neighbors down the road won the lottery two years ago, I think they won $25 million dollars. And that has an immediate impact on people, it's not simply something you read in the papers or it's an activity that other people don't participate in. It's people that you go to church with or people you work with who know people who have won the lottery. So because of the introduction of the lotto, there's been this enormous increase in public perception, the presence of the lottery in American public life.

Now as the industry has evolved, the debate has evolved with it. The first argument that is for or against during the introduction is, is this morale: is this a good thing for the state to be doing. Almost always, as I've indicated, the proponents of the lottery who argue that this is a limited intrusion, it's a voluntary tax for the public good, so on and so forth, almost always wins out. But once the lottery is established, and this argument continues, the morality of the lottery obviously never goes away, but it is settled politically because of the populace's support for the lottery. But after the establishment, the debate evolves into more specific aspects of the lottery, as the lottery itself evolves.

I should point out, as Charles Clotfelter and Phil Cook do in their book, that around the world there are lotteries taking many, many, many forms for a number of reasons, not all fully understood, perhaps it's simply imitation. But the lotteries in the United States have been almost cookie cutter formula. There

have been very few innovations on the actual form lottery takes. It is a public monopoly. It often is administered by an arm of the state. Whether it be called an administrative agency or a public corporation, it is subject to the control of political authorities in the state, as it should be. And all competition to it is banned. And the evolution of both the lottery in every state and the debate itself follow very similar forms.

So, as I said before, the number one driver of lotteries in the states is this relentless pressure for revenues. So one has to ask the questions, where is the money going and what is the public good. That is the argument, is there a measurable benefit? As I said, on the face of it there are enormous numbers involved, and there is no question that a lot of this money is going to good places.

I know in Massachusetts, I think in 1996, if I remember the figures, $520 million dollars were going to state and local governments. The lottery

money in Massachusetts almost entirely goes to state and local government aid. And that accounts for three quarters of all the aid the state provides to local governments. It's an enormous chunk of money. And that's one of the reasons for its continued popularity in Massachusetts. Massachusetts is easily one of the most successful lotteries in the country by however you wish to define it, be it just in terms of revenues generated, public support or the efficiency with which it is run. If you look at the numbers, it comes out at the top or very close to the top in all of those.

But the critics say the impact, regardless of the individual instances you can come up with of public benefit, that the impact is actually quite different than the perception. This criticism generally focuses on what is known as earmarking. And I'm sure I don't have to explain it to you, that is where the funds are set aside for some purpose such as education, which is the most popular one. And the state says, we'll use this money for education and

therefore the public thinks: well, all right, the state education system is getting $500 million dollars from the lottery and it is all going to a good purpose.

But the problem with earmarking is, if anybody has worked in state government or who has worked with a budget, that it really is meaningless unless it is backed up with other types of restrictions. Simply to say that we're going to spend $500 million dollars of the lottery's revenue on education means that you don't have to spend $500 million dollars out of the general fund, which is the big pot that legislators generally fund things out of. It allows money to be moved around without necessarily adding additional money to the designated use. That is not to say that it does not add that money, there is just no guarantee here. And there is a lot of evidence that in states that use earmarking, there is no additional funding going to the areas for which the lottery funds are earmarked.

Why this is the case is difficult to say. Some people have alleged a vast conspiracy of the state legislators to cover up what is actually going on. One thing that I've learned from living in Washington is that you should never rule out incompetence as a motivation. But at this point, the debate has been: that probably was true that many aspects at the beginning of determining where the lotteries would go, it should go to this fund. But as it is worked out, it would be difficult now to say that legislators do not know that those earmarked funds are in essence fungible funds.

The tying of the lottery revenues to a public purpose such as education is an incidental. Generally the proponents of lotteries try to find some public good that the lottery can fund. I think for entirely good reasons, there's nothing alleged here about their own motivations.

And research by individuals such as John Morgan -- he's an economist at Princeton -- has shown

that, as you might expect, to the extent that the public perceives that giving to, that the money going to a cause is a good one. They are more willing not only to approve of lottery but to participate in it. The empirical evidence and the anecdotal evidence are both there, that people will buy a lottery ticket because they know they have no real chance of winning a lottery, but they know the funds are probably going to a good cause. But the fact is that it is unclear whether that money is actually going to the place it was intended. As I indicated, the money is often quite fungible.

One of the cases that's often pointed out is Florida. Florida's Lottery, and not to pick on Florida, there are many states you could use as an example; Florida’s funds are earmarked for education funding. But several studies have shown that in fact over the past years since the lottery has been in practice, or in effect, that the educational system has not at all benefitted from additional funding. If

anything it has actually decreased in relative terms to the rest of the state budget. And this has happened in state after state after state.

One of the notorious examples, and I hate to bring it up, because the person won't be here necessary to counter the claim, but I remember this just happened in the past couple of years, was in Virginia. Where the state officials and the lottery officials would say that our money is going to fund state education. Well, as it turned out the funds weren't even earmarked for that in Virginia. They never, not even from the inception, went anywhere except right into the general fund.

And yet everybody, and I think to a large extent just out of ignorance, continued to say the same things that they had been saying year after year after year, until someone actually investigated and said not a dime of this has ever been earmarked for education, why are you saying this. And the lottery officials had to go through the agonizing process of actually making

a public apology. The interesting thing is that it didn't change what Virginia did, they just stopped making these claims. The money still goes into the general fund.

It is one of the problems, I think, with lottery revenues, that once the state becomes used to them, it becomes very difficult then to correct abuses. The only way really to do that is if you're starting from scratch. And Georgia has done that, it's one of the few states that I know of that has addressed this issue head on.

In Georgia, it was determined that the lottery funds should be used for brand new projects, projects that had never been funded before so that there could be no question of this fungibility of funds moving back and forth between the general fund and the earmarked fund. And in Georgia I believe it is kindergarten education or pre school, college scholarships for state students and I've forgotten the third use. But by law the money can be used for

nothing else. And so there is a clear perception there then both real and in the public's mind that the lottery money is going for some tangible public good.

But as I said before, in those states which already had existing lotteries, where the funds have all ready either been earmarked and essentially dumped into the general fund, or they've always gone into the general fund, for the legislature to appropriate essentially as it sees fit, it is very difficult then to change that system even if the problems are recognized, because it means either cutting programs or raising taxes.

Another aspect of that is that even though this may be a big problem and in some critics eyes a violation of the original promise, the public pressure to do this is actually quite small. This is not a big issue in the public's mind. Again, the public perception of what is happening, and you ask most people in the street where the money for the lottery is going, you'll have a variety of different answers. But

the public perception and the actual reality have changed, or have not kept up with the change of the industry.

The second set of issues, as the lottery has continued to evolve, is that of marketing. Now if the lottery is a business, you want to run it as a business. And marketing a lottery is no different than marketing any other form of business. Again the problem comes back to state ownership. Is this something critics will say the state should be doing, is this a product that should be marketed, pushed? There's no getting around it. If you want greater revenues you either have to induce people who are already playing the lottery to play the lottery more, or to get people who are not playing the lottery to play the lottery. And there is no reward in the state at any level for getting people to play the lottery less. For getting less revenues from the lottery, nobody wants to do that.

So what often happens is that criticisms that may be made by critics or troubles that state officials may have are combined in a package and sent as directives to the lottery directors.

And I will state right here, I have a lot of sympathy for lottery directors, because they're getting a lot of conflicting pressures and are told to resolve them. Such as, decrease advertising but increase revenues or you will lose your job. And it's a political problem that is passed on bureaucratically to them.

Of that marketing, obviously the most prominent part of it, and that which has drawn the greatest criticism, has been advertising. And those who live in lottery states, lottery advertising is either nightly for the nightly drawing, or constant throughout the night.

Again the question here is, if the state is benefiting from this activity and is marketing it, who is looking out for the public good? Now it is a very

aggressive form of marketing in some states. In some states the lottery directors are told just worry about increasing revenues and don't worry about the other stuff, in so many words. They're not told that way, but essentially that's how the structure is set up.

There's a lot of criticism of marketing methods. And clearly every state does a great deal of research. Some of it fairly bizarre. There was one study in Colorado where the state had done this brain scan study of whether the left brain or right brain, which ever one was turned on during when they were playing the lottery, and trying to find ways of turning one of those centers on. I mean you just have to ask yourself at what point does propriety prevail from the state promoting this type of research?

But there is the other type of research that goes on, and as I said, in any business the product's innovation, the market testing, the advertising all that type of stuff, again, to push this product out in to the public, and again, the response

being an increased type of criticism on very specific types of issues.

Apart from the general issue, should the state even be doing this, there have been criticisms about the advertising the state is using. Is it deceptive? Is it misleading? Does it misstate the odds? Does it tell you your odds of winning are much greater than they are? Does it misstate the size of the prizes? Often the prize is given out as X millions of dollars, and not that I have all that much sympathy for the winners, but if it is paid out over twenty years then taxes and inflation are cutting into that. The prize level is not quite the same as what it is advertised to be, and that's simply one of the criticisms that's made.

Does it play upon false hopes? Clotfelter and Cook, in their book, talk about the need to emphasize magical thinking on the part of players. Of giving them some sense that they have some control over the odds of this, when in fact they have none at all,

as in by playing more. And is that something, is that a type of an activity the state should be pushing through its marketing methods.

One interesting rule of fact is that the state lotteries are not subject to the Federal Trade Commission truth in advertising standards that others are. That's one of the advantages of being a state run business. You can advertise, not that anybody is doing it consciously or deliberately or deceptively, but again, the federal government has a hands off policy towards the state bodies, and that's what lotteries are.

One thing is clear is that advertising is essential to the growth or even the maintenance of lottery revenues. I know in Massachusetts when, I'll get to it in seconds, when the advertising went down, state lottery revenues went down too. And the criticism, there was no reward for that, by the way for the lottery director, but there was a great deal of

criticism about the revenues going down and the scrambling to try to keep them up.

Clearly there have been abuses. Again, I wish Jeff Perlee could have been here because he was one of the more outspoken lottery directors that I had spoken to. And I quoted him here in his own public testimony to his own fellow lottery directors about advertising, which he warns them, he says that some state lottery advertisements are so far, I'm quoting him now: "...are so far fetched and so fanciful that they would not stand up to the same truth in advertising standards to which our advertising, to which advertising conducted by private industry is held."

The reason is, as I'd mentioned, because they're not bound by those standards.

"Add to that the fact that our advertising is often relentless in its

frequency and lottery critics and even supporters are left wondering what public purpose is served when a state's primary message to its constituents is a frequent and enticing appeal to the gambling instinct. The answer is none. No legitimate public purpose justifies the excesses to which some lottery advertising has resorted."

That's not a blanket condemnation, that's obviously some. There have been abuses that have occurred, and he went on to talk about things that need to be done to correct the industry. It was a friendly critique not an angry critique. But there have been abuses.

In Massachusetts, not that it was abuse, but just to indicate what might happen, the lottery advertising budget was cut from $12 million dollars over a couple of years to $400,000. Now it wasn't done necessarily out of concern for the public welfare, it would shock you to know that Massachusetts, that state

house politics actually plays a part in some of the decisions made there, and the advertising budget was essentially wiped out.

And as I said before, nevertheless, the lottery directors were told to keep revenues coming in and there would be a penalty if there were not revenues coming in, and yet you may not use the old advertising techniques that you were using before, or really any advertising at all.

So the two issues here are, is this proper for the state to be giving this message? And the second part of it is, is this advertising being aimed at vulnerable elements of society?

Now, there is a big debate over whether the state is targeting the poor and the compulsive gamblers, these types of people, in order to profit. In fact it's a very troubling image, if you had that image, of the state using its own devices to go after its poorest and most vulnerable citizens in order to profit from them. And that's often the image that

critics point out. I don't necessarily think it's true.

In terms of whether the lottery is regressive or not depends on your definition of regressive. By definition, any product that is the same price to anybody that's at the different income levels is going to be a regressive, have a regressive impact. But the greater question is, does the state encourage the poor, or those least able to control their gambling or those least able with the least disposable income to actually gamble more than they should? And here again, I said the evidence is mixed. It depends on the type of game you're talking about.

The numbers game, certainly the poor, the lower income levels do dominate that, and it is one of the big money makers for the lottery. The lotto however, the game with the worst chances, the worst odds, the most unrealistic hopes; that is the game of choice of the middle and the upper classes. In fact, even the lottery play declines with formal education.

It's odd that the lotto, the one with the worst odds, declines with education. So I'm not sure what that says about Americans' math skills.

And if you look at the numbers on where the money actually comes from for certain lottery games, there's some real evidence that for certain types of games, such as the numbers and scratch tickets, it very much does come from communities that are of lower income status. I think in Massachusetts just the evidence here that was uncovered by one of the series in the *Boston Globe* written by Dan Golden and his colleagues that the average per capita expenditure on the lottery in Massachusetts, I believe in 1996, was $547, if you can imagine that. But in some of the poorest communities it was up to $900 per capita spent on the lottery.

Actually, those figures can be quite misleading because it does not include the pay back, and given the types of games that those of the lower income groups play, there's a greater pay back then it

would be in say with the lottery. But nevertheless, those are extraordinary figures. They do tend to support the allegation that the lottery does disproportionately benefit from the participation by the poor.

CHAIRPERSON JAMES: Doug, I'm going to step in at this point and ask you to see if you can move toward a summary. I think the Commission is very grateful for the amount of research that you've done, and for the level of expertise that you've gained on an issue that you admittedly came into this knowing relatively little about. And it is very much appreciated. But I do want to make sure that we have the opportunity for questions before we move in to our expert panel.

MR. SEAY: Oh, see I was hoping there would be no questions. Because the experts are the ones usually asking questions of me. Okay. There are a couple of other issues that I won't go into.

The impact on compulsive gambling which is an important one especially given the latest iteration of the evolution of the industry and to video lottery devices, Keno, video poker and what have you, which the evidence appears to be that they're much more addictive, and have a much greater impact on compulsive gamblers.

Underage gambling, for example: there are vending machines where you can get lottery tickets in many states, including Massachusetts, and many other issues such as that. But I want to end up with the emphasis on, again, on the public policy aspect.

The public does support lotteries, there's no question about that. Every opinion poll shows that that is the case. You can argue they really don't know what they're supporting, but the fact is they do support it. And in this democracy the public rules.

I guess the question is, would people be as comfortable with the industry if it were a private industry and it wasn’t the state operating it. I think

that has got to be one of the things one has to look at. Trading off the public welfare vs. the harm that it may cause, how is that balance being made?

My point is, that I have talked to governors and governors aides and lottery directors, and legislative officials, and all of them, all of them who are intelligent, decent individuals and who understand some of these problems, and all of whom say the same thing. Some of these problems we cannot grapple with. We've inherited these policies. The state, and they said it over and over again, the state is addicted to the lottery revenues, they can't change them. We understand these are problems, we don't know what to do because no one has the responsibility to address these.

And I'm hoping that's something the Commission will keep in mind, the recommendations to state and local officials, not just potential federal recommendations, of looking at these issues, looking at how certain other states have addressed them,

possibilities for addressing them, and doing to a certain extent some of the thinking and comparing that these officials simply do not have the luxury to do for themselves.

Sorry for going over my time.

CHAIRPERSON JAMES: No, not at all. Thank you very much.

I'd like to open it up for commissioners and I'm going to recognize Commissioner Dobson, and then that I see your hand.

COMMISSIONER DOBSON: Thank you for your report, I found it very interesting. It's my understanding that the state lotteries are exempt from the Federal Trade Commission's truth in advertising standards. If that is true, why is that true?

MR. SEAY: Just because there is a blanket exemption in the federal standards for state entities. And lotteries are considered to be a state entity.

COMMISSIONER DOBSON: In your opinion, would that be an important item for us to address?

MR. SEAY: Definitely. I didn't mean to allege that there was anything improper going on. But it is a loophole, if you will, I'm not sure that it is exploited, but it exists. And to the extent that those standards exist to protect the public one would have to ask why they should not be applied to lotteries, if the lotteries are to be run as a business.

COMMISSIONER DOBSON: Thank you.

CHAIRPERSON JAMES: Commissioner Loescher.

COMMISSIONER LOESCHER: Yes, Madam Chairman, thank you very much.

You are a representative from the State Attorney General's Office?

MR. SEAY: No, sir. I am unfortunately representing only myself here, at least to my knowledge, I am a member of the staff of the Commission. And I apologize, I did not have a chance to meet you before.

CHAIRPERSON JAMES: Yes. He just joined the staff.

COMMISSIONER LOESCHER: Oh I see. I had a misperception.

Well, let me ask you a question. I have the perception as a Commissioner, that states, particularly in this area, are highly competitive with one another over this lottery, you know, Massachusetts is close to Connecticut and all this and it looks like there is a lot of competition in this lottery business who are consumers. I'm wondering, from your point of view, do you think that all of this commerce is subject to interstate commerce provisions of federal law?

MR. SEAY: You ask me, I have to warn you my expertise is as thin as it appears. That would be a--

COMMISSIONER LOESCHER: Well, don't go any further then. I have another question.

We don't have the proper representative here as was billed. I thought I had a chance at one of the states Attorney Generals, and I don't.

MR. SEAY: They will be coming.

CHAIRPERSON JAMES: Not quite yet, you will.

Let me frame this, just to make sure everyone is clear. Doug Seay is on the research staff of the Gambling Commission. And is presenting an overview before we go into our expert panels, so all of those individuals will be here a little later.

COMMISSIONER LOESCHER: Well, I'm anxious to have a chance at them.

CHAIRPERSON JAMES: Okay.

MR. SEAY: Let me just say, my attempts to answer questions may lead only to greater confusion. And I would advise that we save that for people who actually have involvement.

CHAIRPERSON JAMES: Those types of questions are best left for the expert panel. These are of a general nature to frame the issue, to put in to some type of perspective, historical in nature or broad in scope.

Commissioner Wilhelm.

COMMISSIONER WILHELM: Doug, I appreciate your work on this. I thought your introduction was quite helpful. I have three questions, and if we should direct these to somebody else, just say so.

The first one is, do you know, impressionistically it would appear to me that lotteries have probably created some, a relative handful of administrative jobs and may arguably have created a lot of low wage, no benefit convenient store jobs. But other than that, I can't see how lotteries contribute to quality jobs anywhere. Do you know if anybody has ever studied that question?

MR. SEAY: I'm sure every state's lottery has done some research in that area, if only for public relations purposes. Most of the spending is done through the government and I guess you would have to look at the employees who are hired by the government as a result of the lottery revenues to actually measure employment, or through contractors, things that have

been contracted out by the state. But I myself have not come across any particular study on that area.

COMMISSIONER WILHELM: Second, you mentioned a study in Florida on the question of what did or didn't happen to education funding in terms of this earmarking issue. I know that in my, or I've been told that in my home state of Virginia that, although when the voters approved the lottery it was on the supposition that the lottery income was going to go into capital expenditures for schools and parks and things like that.

I am told that under both Democratic and more recently Republican administrations that the money has gone into the general fund for ostensible purpose of balancing the budget. Whatever that means. And I just wonder if beyond Florida, you mentioned the study in Florida, has anybody actually systematically studied that question anywhere else that you know of?

MR. SEAY: There have been a number of studies state by state. Most states regardless of what they say, some states put it directly into the general fund, which means to be spent however the legislators feel, for good purposes. I'm not alleging anything here. Others, most other states earmark it, and yet for most states without other guarantees that means essentially putting it into the general fund. I don't know of a global study that's been done. But certainly state by state that has been looked at. And there are very few states which have adopted practices which would guarantee that could not happen.

COMMISSIONER WILHELM: Okay. And my third question, if you know, and I can direct this to the Massachusetts people when the time comes. You know, one of my hobbies is the observation of irony and public discourse, and I'm intrigued by those who on many fronts say that state governments as well as the federal government ought to be run like a business and everything ought to be privatized and so on. Except

that on this issue, people apparently think somehow state government shouldn't be run like a business. I agree with that, but it is interesting to observe who takes that position on different issues.

You made reference to a, I believe a legislated reduction in the advertising budget for the Massachusetts Lottery down to the level of nearly nothing. Do you know if as a matter of practical reality that reduction actually resulted in the near elimination of lottery advertising in Massachusetts?

MR. SEAY: Oh yes, it wiped it out. There is none, virtually none. There's a television show, and there is what is known as point of purchase advertising at the place where you buy the ticket itself. But just in terms of the flood of advertisements they used to have, from $12 million dollars to $400,000.

It's interesting, as one part of the industry evolves and it becomes a problem and there is a reaction to it, but often generates other problems.

Which is, if you're a student of irony that's obviously one of the constants in human nature.

In Massachusetts after the lottery budget, advertising budget, was virtually eliminated, and yet the pressure for revenues was still there. Again, the state giving conflicting instructions. What they did, or one of the things they did, or had been alleged to do, was to use the free play coupons that are mailed out, or used to be mailed out to virtually every household in the state, and started using those as money in paying for advertisements with those. Which led to investigations by the Massachusetts Attorney General's Office and the IRS, which said: you're using money, you're creating money and using money and not reporting the income.

The point being, that the legislature wasn't upset about the advertising, they cut the advertising budget for other reasons, the pressures to advertise were still there. But without that, other than that exception of creating money and going out and

buying advertising, once they wiped out the budget, yes, advertising virtually ceased, and the lottery revenues took a plunge.

COMMISSIONER WILHELM: They did?

MR. SEAY: Oh yes. There is a very direct connection between advertising and lottery revenues. There aren't many other instances to compare to that, because not many states have done that. But that was clearly a direct result and other economizing measures had to be taken by the lottery to make up the loss.

COMMISSIONER WILHELM: Thank you. You've done a very thorough job, Doug.

CHAIRPERSON JAMES: Commissioner Bible.

COMMISSIONER BIBLE: Doug, can we, do we have your supplementary report with the detailing of the, how the $13 or $14 million dollars gets expensed into state government, or whether it's earmarked or whether it goes into the general fund?

CHAIRPERSON JAMES: A state by state analysis, Bill?

COMMISSIONER BIBLE: A state by state analysis where lotteries operate. Because I assume from your figures, you say it is a $43 billion dollar industry and about a third of that would become revenue to the government.

MR. SEAY: That's correct.

COMMISSIONER BIBLE: If you could provide a detailing as to how those money get expended?

MR. SEAY: I'll be happy to do that.

CHAIRPERSON JAMES: Commissioner Lanni.

COMMISSIONER LANNI: Doug, could we also ask you to supplement that supplement by including the levels the lottery revenues in each individual state represented as a total portion of the budget, or the revenues for the entire state? I've read in this report over the weekend that it's minimal on a percentage basis, but I would like to see the percentages in each of those states, if you would?

MR. SEAY: Actually, it varies up to 13 percent. So, it's not often minimal.

I want to say, one of the things that I'm sure would be no surprise to anybody here, that was a surprise to me, that repeatedly I came across information that was put forward, I think, in very good conscience by people and when you look at it suddenly evaporates, like a river in the desert. And I found that about gambling in general, a lot of things everybody knows to be true, simply turn out not to be true when you look at them on both sides of the issue, I might point out.

But there is a crying need, obviously, for some original empirical verifiable research which often isn't done there, and anecdotes somehow become facts when they're repeated enough. In this case that's definitely true, and I've heard that allegation and really does vary by state. And yes, I'd be happy to provide that supplement.

CHAIRPERSON JAMES: Thank you. I would remind the Commissioners that the report that exists within your briefing books was in fact prepared by

Doug. And again, I think it was very thorough and very helpful to prepare for this meeting by having that kind of background briefing. And again, we'd like to thank you for that.

Thank you, Doug. And you survived. We had to twist his arm a little bit to get him to do this. But we're grateful.

MR. SEAY: And everybody is awake.