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Lotteries, Online Lotteries and the Distribution of Lottery Revenues

Currently, 43 states have a state lottery while only two states allow for online lotteries and/or gambling: Delaware and Nevada. Delaware has legalized both online gambling and lotteries. Nevada has privatized online gambling and does not have a state lottery; therefore, it is excluded from this report. Other states are moving toward online lotteries, including Illinois, which has implemented a pilot program to determine if an online lottery will be beneficial to the state.¹ Some states, such as Minnesota² and New Hampshire,³ have created online subscriptions for lotto games. Vermont has a subscription service but it is not available for purchase online.⁴ This report examines states that have online gambling, lotteries, or subscriptions and how they dedicate the generated revenue to the state.

Online Gambling & Lotteries

All 43 states with a lottery have a percentage of total ticket sales dedicated to the state. In 2010, the total ticket sales revenue of all state lotteries was approximately \$53 billion. Of the \$53 billion, \$17.75 billion was returned to the states in profits. Each state's total revenue varies differently depending on the size of the state lottery.⁵ However, on average, the amount of revenue dedicated to the state was approximately 33.4%, ranging from 20.7% to 44.2%.⁶

Until 2011, states were not allowed to move their lotteries and gambling online due to the Wire Act of 1961. On September 20, 2011, the Department of Justice released their opinion that "interstate transmissions of wire communication that do not relate to a sporting bet or contest

¹ National Conference of State Legislatures (NCSL), "2012 Legislation Regarding Internet Gambling or Lotteries," September 20, 2012, accessed on November 5, 2012, <http://www.ncsl.org/issues-research/econ/2012-online-gambling-legislation.aspx>.

² Minnesota State Lottery, "Frequently Asked Questions," last modified in 2010, accessed on October 20, 2012, <https://www.mnlotterysubscription.com/Help.aspx>.

³ New Hampshire State Lottery Commission, "NH Lottery Commission Subscriptions," last modified in 2009, accessed on November 9, 2012, <http://www.nhlottery.com/Subscriptions.aspx>.

⁴ Vermont Lottery, "Untitled," accessed on December 3, 2012, <http://www.vtlottery.com/allgames/mbplus.aspx>.

⁵ NCSL, "Lotteries and Revenues by State, 2010," accessed on November 5, 2012, <http://www.ncsl.org/issues-research/econ/lotteries-and-revenue-by-state-2010.aspx>.

⁶ NCSL, "Lottery Payouts and State Revenue, 2010."

fall outside the Wire Act.”⁷ This opinion gave the green light for states to pursue the Internet lottery. Some states have been moving lottery systems online in order to generate more revenue for the state.⁸ No current information on the revenue between fiscal years is available at the time this report was created due to the recent passage of legislation.

Definitions

Numerous states refer to the same types of games with different terms. For simplicity, we refer to the following games as the following:

- Scratch games: “Consist of a paper ticket with a coating that when scratched off, reveals if a player has won.”⁹ Scratch games cannot be made available online.
- Lotto Games: “Requires players to match numbers on a computer-generated ticket with numbers selected in a random drawing.”¹⁰ Lotto games in this report include: Powerball, Mega Millions, Lotto, and all games listed under online subscriptions. Lotto games can be made available online.
- Video lottery: “Any machine in which coins, credits or tokens are deposited in order to play any game of chance in which the results, including options available to the player, are randomly and immediately determined by the machine.”¹¹ Video lottery can be made available online.
- Table games: “Any game played with cards, dice or any mechanical, electromechanical or electronic device or machine (excluding video lottery machines) for money, credit or any representative of value.”¹² Table games can be placed online.

Online Gambling and Lottery: Delaware

On June 28, 2012, Delaware’s governor signed into law the Delaware Gaming Competitiveness Act of 2012, which authorized the Delaware Lottery Office to offer lottery games online.¹³ The Lottery Office must verify that players in Delaware are of legal age, account security is maintained for their players, and that there are advertisements for services for compulsive

⁷ Virginia A. Seitz, “Memorandum Opinion for the Assistant Attorney General, Criminal Division,” Department of Justice, accessed on November 9, 2012, <http://www.justice.gov/olc/2011/state-lotteries-opinion.pdf>, p. 1.

⁸ National Conference of State Legislatures (NCSL), “2012 Legislation Regarding Internet Gambling or Lotteries.”

⁹ Minnesota State Lottery, “Gambling in Minnesota; An Overview,” last modified February 2012, accessed on December 3, 2012, http://www.mnlottery.com/_asset/23vhlx/Gambling_in_Minnesota_2012.pdf, p. 14.

¹⁰ Minnesota State Lottery, “Gambling in Minnesota; An Overview,” p. 14.

¹¹ Delaware Lottery Office, “Video Lottery and Table Game Regulations,” last modified February 23, 2010, accessed on November 30, 2012, http://www.delottery.com/pdf/Video_and_Table_Regulations.pdf, p. 12.

¹² Delaware Lottery Office, “Video Lottery and Table Game Regulations,” p. 11.

¹³ 146th General Assembly, “The Delaware Gaming Competitiveness Act of 2012,” H.B. # 333, accessed on November 9, 2012, <http://legis.delaware.gov/LIS/LIS146.NSF/vwlegislation/16D3B2FBA90AE777852579F90058959E>.

gamblers. The Delaware Lottery Law would place table games, online ticket games, and video lottery on the Internet.¹⁴

Delaware has many sources of lottery revenue because the state has legalized gambling, online gambling/lottery, and a traditional state lottery. As indicated in Table 1, scratch games generated the second smallest amount of revenue, whereas video lottery generated an overwhelmingly significant amount of revenue compared to all other forms. The figures in Table 1, below, represent Delaware’s lottery revenue before the games were introduced online.¹⁵

Table 1: Source of Delaware Lottery Revenue, 2011

| <i>Type of Game:</i> | <i>Revenue Generated:</i> |
|----------------------|---------------------------|
| Video lottery | \$499,457,285 |
| Lotto Games | \$83,082,308 |
| Table games | \$74,165,548 |
| Scratch Games | \$40,856,406 |
| Sports lottery | \$12,910,308 |

Source: Delaware State Lottery Office, “2011 Annual Report,” last modified June 30, 2011, accessed on November 6, 2012, <http://www.delottery.com/pdf/2011AnnualReport.pdf>.

Delaware’s distribution of lottery revenue is as follows: 45% are given as prizes, 30% are given to the State General fund, and the remaining 25% are given for the lottery’s operating expense with any excess being contributed to the General Fund. In 2011, the Delaware lottery contributed \$267 million to the Delaware General Fund out of the total revenue of \$3.5 billion. This made the lottery the fourth largest source of revenue, roughly eight percent, to its General Fund. The total expenditures of Delaware’s General Fund for 2011 were over \$3.2 billion. From the expenditures, Delaware gave \$220 million to higher education and over \$1.1 billion to the Department of Education.¹⁶ “Revenues from the internet lottery would be distributed in a manner similar to current lottery games... with the exception that the first \$3.75 million would be retained by the Lottery to ensure the proposal is at least revenue neutral to the State.”¹⁷

Illinois: A Pilot Program

On August 27, 2012, the State of Illinois launched a pilot program to gauge the benefits of creating an online lottery for the state and would last for “not less than 36 months, but not

¹⁴ 146th General Assembly, “The Delaware Gaming Competitiveness Act of 2012.”

¹⁵ Delaware State Lottery Office, “2011 Annual Report,” last modified June 30, 2011, accessed on November 6, 2012, <http://www.delottery.com/pdf/2011AnnualReport.pdf>, p. 5.

¹⁶ Division of Accounting, “State of Delaware Comprehensive Annual Financial Report for Fiscal Year Ended June 30, 2011,” Department of Finance, <http://accounting.delaware.gov/2011cafr.pdf>, p. 124.

¹⁷ 29 Del.C. 4805(a), “Delaware State Lottery Rules and Regulations,” accessed on November 9, 2012, <http://regulations.delaware.gov/register/july2000/proposed/4%20DE%20Reg%2078%2007-01-00.htm>.

more than 48 months from the date of its initial operation.”¹⁸ The pilot program introduced two games online: Lotto and Mega Millions. Current state legislation is underway to introduce a third online game, the Powerball. If the pilot program proves to be successful, then the state will consider introducing additional games online.¹⁹ Since the program is so new, there have not been any financial reports to indicate how much revenue was generated.

According to last year’s figures, the games that are now offered online through the pilot program generated approximately 21.6% of ticket sale revenue. However, scratch games, games that cannot be available online, generated more than half of the revenue stream for Fiscal Year (FY) 2011, roughly 56%.²⁰

The lottery law in Illinois states that “the entire net proceeds of the Lottery are to be used for the support of the State’s Common School fund...”²¹ The distribution of lottery revenue is as follows: 58% is returned as prize money, 12% is set aside for commissions, bonuses and operating expenses, and 30% is dedicated to the Common School Fund. In FY 2011, the Illinois state lottery generated \$2.3 billion in ticket sales, of which, \$632 million was dedicated to the Common School Fund.²² With the introduction of the pilot program, the net revenue of all Powerball tickets sold online shall be deposited into the State Financial Recovery Fund. Net proceeds from Lotto and Mega Millions sold online will go toward the State’s Common School Fund.²³

Online Subscriptions

A number of states, such as Minnesota and New Hampshire, offer online subscriptions to purchase lotto games. Online subscriptions “permits an eligible player to purchase plays for certain Lotto Games for a number of consecutive drawings over a stated period of time from the Lottery’s website...To make a Subscription Play the player must select the Lotto Game, the type of play (Group or individual), the desired Game Numbers...the amount wagered per draw, and the number of weeks of the Subscription...Once a purchase of a Subscription Play is completed, the numbers selected for the Subscription Play may not be changed.”²⁴

¹⁸ Illinois General Assembly, “Internet Pilot Program,” accessed November 9, 2012, <http://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=097-1121>.

¹⁹ Illinois General Assembly, “Internet Pilot Program,” accessed November 9, 2012

²⁰ Department of Revenue, “Financial Statements 2011,” Illinois Lottery, last modified June 30, 2011, accessed on November 12, 2012, http://www.illinoislottery.com/content/dam/ill/documents/subsections/accounting/Annual_Sales_FY-11.pdf, p. 3.

²¹ Illinois General Assembly, “Illinois Lottery Law,” accessed November 9, 2012

<http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=312&ChapterID=5> Ch, 120, par. 1152, Sec. 2.

²² Illinois Association of School Boards, “Where does the Lottery Money Go?” accessed November 9, 2012, <http://www.iasb.com/pdf/lottery.pdf>.

²³ Illinois General Assembly, “The State Financial Recovery Fund,” accessed on November 12, 2012, <http://www.ilga.gov/legislation/fulltext.asp?DocName=09700SB3497&GA=97&SessionId=84&DocType=SB&LegD=65170&DocNum=3497&GAID=11&Session>.

²⁴ Minnesota State Lottery, “Subscription Service: Terms of Service,” accessed on December 3, 2012, <https://www.mnlotterysubscription.com/TermsOfServiceAgreement.aspx>.

Minnesota

In 2010, Minnesota's state lottery started the sale of online lotto subscriptions. Originally, Minnesota only sold online subscriptions for Powerball and Mega Millions, but later expanded to include Gopher 5, Northstar cash, Daily 3, and Hot Lotto. Registered users can "manage their accounts, check their winnings, and create group/pool plays."²⁵ To open an account, the user must meet the following criteria: a current Minnesota address, be 18 years or older, be a U.S. citizen or resident of the United States, have a Minnesota bank account, and be in the state of Minnesota when making the purchase.²⁶

Funding for education stems from Minnesota's General Fund. According to the state lottery's website: "Education programs comprise the single largest beneficiary of General Fund dollars, accounting for 48 percent of state spending during Fiscal year 2011."²⁷ In FY 2011, the Minnesota state lottery contributed \$121.9 million back to the state. The General Fund receives around 57% of the total proceeds from the lottery, which amounted to more than 65 million.²⁸ Therefore, the state lottery has been a significant source of revenue.

For FY 2011, "the Minnesota state lottery achieved record operating revenue of \$504.5 million."²⁹ Scratch games sales amounted to \$354.8 million, or 70.3% of total state lottery revenue. Lotto games sales, which include online sales such as online subscriptions, amounted to \$149.6 million. While a substantial amount of money, it is important to note that lotto games sales decreased by \$11.2 million, whereas scratch games sales increased by more than \$16 million over the last fiscal year.³⁰

New Hampshire

In 2009, New Hampshire allowed lottery subscriptions to be purchased online. Online lottery subscriptions currently include: Powerball, Mega Millions, Mega Millions with Mega-plier, Hot Lotto, and Hot Lotto with Sizzler.³¹ To purchase an online lottery subscription, the purchaser and recipient must be over the age of 18 and have a New Hampshire mailing address. Purchasers are able to choose the number of lottery drawings they would like to buy, submit

²⁵ Minnesota State Lottery, "Frequently Asked Questions," last modified 2010, accessed on October 20, 2012, <https://www.mnlotterysubscription.com/Help.aspx>.

²⁶ Minnesota State Lottery, "Frequently Asked Questions."

²⁷ Minnesota State Lottery, "Revenue Distribution," last modified 2012, accessed on October 20, 2012, http://www.mnlottery.com/news_and_info/where_the_money_goes/revenue_distribution/.

²⁸ Jenny Canfield, "Fiscal Year 2011 Annual Report," Minnesota State Lottery, last modified October 25, 2011, accessed on November 12, 2012, http://www.mnlottery.com/asset/pbx617/2011_AR.pdf, p. 13.

²⁹ Jenny Canfield, "Fiscal Year 2011 Annual Report," p. 15.

³⁰ Jenny Canfield, "Fiscal Year 2011 Annual Report," p. 15.

³¹ New Hampshire Lottery Commission, "NH Lottery Commission Subscriptions," last modified 2009, accessed on November 9, 2012, <http://www.nhlottery.com/Subscriptions.aspx>.

their lottery ticket numbers, and renew their lottery subscriptions once their drawings are over.³²

New Hampshire's State Constitution explicitly states that all lottery revenue must be "appropriated and used exclusively for the school districts of the State."³³ The states "lottery game and revenues are made up of a variety of instant and online lottery products."³⁴ For FY 2011, the state lottery earned \$229 million in total operating revenues. Of this total, approximately \$62.2 million was contributed to the State's Education Trust Fund. However, in FY 2011, New Hampshire's operating lottery revenue decreased by 4.9 million. As a result, "distributions to the Education Trust Fund [have] decreased by \$4.0 million or 6.1%."³⁵

Scratch games continue to be the lottery's most profitable product. It comprised 70.4% of the state's fiscal year 2011 lottery sales. From 2010-2011, scratch ticket revenues increased their total sales by .5% whereas lotto games sales, which include online subscription sales, decreased by roughly eight percent.³⁶

Vermont

When first established in 1977, all profits of the Vermont state lottery, after distributing prizes and expenses, were dedicated to Vermont's General Fund. But in 1998, the Vermont Legislature mandated that these profits go to Vermont's Education Fund.³⁷ Public Act No. 60 amended the existing law so that all revenues from state lottery, multijurisdictional lottery, and Tri-state lottery games, were dedicated to Vermont's Education Fund.³⁸ Since 1999, the state lottery has generated over \$261 million for the Vermont Education Fund.³⁹ In 2012, the Vermont Education Fund had \$1.353 billion. Currently less than two percent of the Education Fund comes from the state lottery. The state lottery is the third smallest contributor to the Education Fund averaging around \$22 million a year of revenue.⁴⁰ As indicated in Figure 1, \$21.4 million of

³² New Hampshire Lottery Commission, "NH Lottery Subscriptions Home Page," last modified 2010, accessed on November 9, 2012, <https://www4.egov.nh.gov/LotterySubscriptions/HomePage.aspx>.

³³ State of New Hampshire, "Article 6B: Use of Lottery Revenues Restricted to Educational Purposes," last modified November 6, 1990, accessed on November 8, 2012, <http://www.nh.gov/constitution/formofgov.html>.

³⁴ Georges J. Roy, "Comprehensive Annual Financial Report," NH Lottery Commission, last modified June 30, 2011, accessed on November 8, 2012, p. 27.

³⁵ Georges J. Roy, "Comprehensive Annual Financial Report," p. 15.

³⁶ Georges J. Roy, "Comprehensive Annual Financial Report," p. 18.

³⁷ Vermont Lottery Commission, "Annual Report: Fiscal Year 2011," Vermont Lottery Commission, October 11, 2011, accessed on November 1, 2012, <http://www.leg.state.vt.us/reports/2012ExternalReports/274674.pdf>.

³⁸ Legislative Council of The General Assembly for the State of Vermont, *Title 31: Recreation and Sports, Chapter 14: State Lottery*, April 27, 1977, accessed on November 30, 2012, <http://www.leg.state.vt.us/statutes/fullchapter.cfm?Title=31&Chapter=014>.

³⁹ Vermont Lottery Commission, "Annual Report: Fiscal Year 2011."

⁴⁰ Vermont Department of Education, "Vermont's Education Funding System: June 2011," Vermont Department of Education, June 2011, accessed on November 1, 2012, http://education.vermont.gov/documents/EDU-Finance_Education_Funding_System_2011.pdf.

the total revenue was dedicated to Vermont’s Education Fund. This accounted for 22.5% of the total lottery revenue being dedicated to the Education Fund.⁴¹

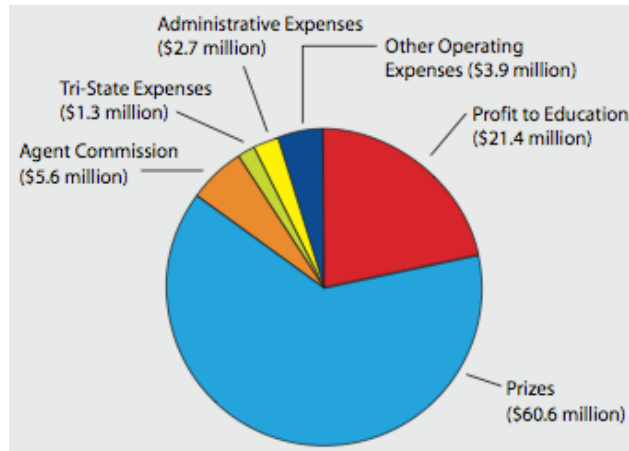


Figure 1: Distribution of Lottery Revenue

Source: Vermont Lottery Commission, “Annual Report: Fiscal Year 2011,” Vermont Lottery Commission, October 11, 2011, accessed on November 1, 2012, <http://www.leg.state.vt.us/reports/2012ExternalReports/274674.pdf>.

For FY 2011, the Vermont State Lottery’s revenue was \$95 million. As indicated in Figure 2, almost 75% of the revenue (\$71.3 million) came from scratch games, which cannot be sold online. The second biggest contributor to revenue was the Powerball, which can be sold online, grossing only \$8.1 million.⁴²

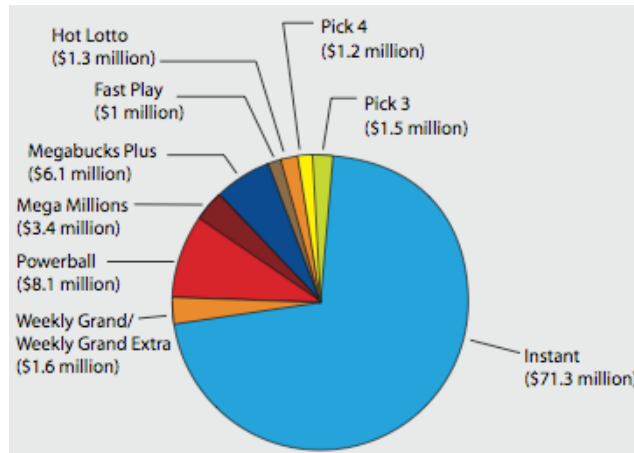


Figure 2: Source of Lottery Revenue

Source: Vermont Lottery Commission, “Annual Report: Fiscal Year 2011,” Vermont Lottery Commission, October 11, 2011, accessed on November 1, 2012, <http://www.leg.state.vt.us/reports/2012ExternalReports/274674.pdf>.

⁴¹ Vermont Lottery Commission, “Annual Report: Fiscal Year 2011.”

⁴² Vermont Lottery Commission, “Annual Report: Fiscal Year 2011.”

Do Lotteries Contribute to Education Spending?

Many states use lotteries to supplement other general fund revenue for education. Many researchers have found that lottery funds have a degree of fungibility. Lotteries revenues are considered fungible because they are easily shifted from their espoused purpose of funding education to other budget areas.⁴³ In order to combat fungibility, some states have instituted a policy of earmarking lottery profits for their education budget. Earmarking is when states set aside revenues from specific sources to specific expenditure programs.⁴⁴ There is conflicting research on the topic on whether earmarking effectively combats lottery revenue fungibility. Some scholars have found that earmarking does help fight fungibility. One researcher found that “\$1 of lottery profits earmarked for education increases current education spending by roughly \$0.79, whereas a nonearmarked dollar of lottery profits increases educational spending by only \$0.43.”⁴⁵ The fact that \$1 of lottery profits does not equal \$1 of education spending represents the fungible nature of lottery profits. Other scholars have found that nonearmarked lottery profits benefit education spending more. A group of researchers found that “lottery revenue rarely has a significant impact on K-12 spending in our sample of states that earmark the revenue for that purpose. Yet, in our sample of states that do not earmark, lottery revenue typically does increase the growth of K-12 spending.”⁴⁶ Whether earmarked or not, there is a general consensus that lottery revenue does not significantly increase education funding.^{47,48,49}

Conclusion

Since the clarification of the Supreme Court’s decision on the Wire Act, some states have been implementing online lottery programs as an additional way to generate state revenue. In most states, scratch games are the largest contributor of revenue for state lottery funds but cannot be sold online.

However in the case of Delaware, the only state that has legalized online lotteries and gambling, different sources of gambling and lottery games have allowed the state to generate more revenue from these games versus scratch games sales. Delaware offers the use of video

⁴³ O. Homer Erikson, Kimberly M. DeShano, Glenn Platt, and Andrea L. Ziegert, “Fungibility of Lottery Revenues and Support of Public Education,” *Journal of Education Finance* Vol. 28 (2002).

⁴⁴ Neva Navarro, “Earmarked Lottery Profits: A Good Bet for Education Finance?” *Journal of Education Finance* Vol. 31 (2005), p. 23.

⁴⁵ Neva Navarro, “Earmarked Lottery Profits: A Good Bet for Education Finance?”

⁴⁶ Louis Pantuosco, William Seyfried, and Robert Stonebraker, “The Impact of Lotteries on State Education Expenditures: Does Earmarking Matter?” *The Review of Regional Studies* 37 (2007), accessed March 13, 2013, <http://policy.rutgers.edu/cupr/rrs/files/vol37issue2/078.pdf>, p. 171.

⁴⁷ Louis Pantuosco, William Seyfried, and Robert Stonebraker, “The Impact of Lotteries on State Education Expenditures: Does Earmarking Matter?” p. 170.

⁴⁸ O. Homer Erikson, Kimberly M. DeShano, Glenn Platt, and Andrea L. Ziegert, “Fungibility of Lottery Revenues and Support of Public Education,” *Journal of Education Finance* 28 (2002), accessed March 13, 2013, p. 302.

⁴⁹ Donald E. Miller and Patrick A. Pierce, “Lotteries for Education: Windfall or Hoax?” *State and Local Government Review* (1997), accessed March 13, 2013, <http://slg.sagepub.com/content/29/1/34.refs>, p. 41.

lotteries, which is the largest revenue contributor to their state lottery. With the three largest revenue contributors being placed online, Delaware has the potential of generating more revenue for the state.

Illinois' pilot program currently has two games available online, and is in the process of introducing a third game. Prior to introduction of the pilot program, the three games generated approximately 21.6% of ticket sale revenue for FY 2011. By placing these games online, the state can expect a moderate increase in future lottery revenues, however, not to exceed scratch games sales.

Through the implementation of online lottery subscriptions, scratch games revenues have continued to increase. In the case of Minnesota and New Hampshire, Minnesota's lotto games sales have decreased whereas New Hampshire's entire lottery revenue has decreased. Therefore, the sales of online subscriptions in these two states have not been significant contributors to generating state lottery revenue.

Though many states seek to supplement education funding through lottery revenues, the general consensus of scholarly work has shown that lotteries do not benefit education spending.

States are currently looking toward expanding their lottery systems in response to changing market conditions. Due to how recently the laws were enacted, the long-term effects from states implementing online gambling and lottery products, as a form of additional revenue, are not known.

This report was completed on December 3, 2012 by Nick Ingersoll, Jon-Paul Scordio, and Ann Nguyen under the supervision of Program Specialist Kate Fournier and Professor Anthony Jack Gierzynski.

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