Fiscal Facts

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Federal Reserve Bank of Boston

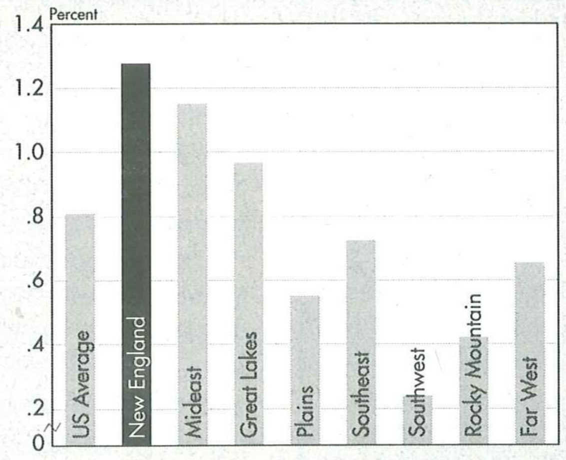
State Gambling Revenues:
Are Legislators Becoming Addicted?

New Englanders enjoy playing the odds. They spend a larger fraction of their income on games of chance than residents of most other regions (Chart 1). Proceeds from these games have provided New England's state governments with a small but generally expanding source of state revenue during difficult fiscal times. The odds that this source will continue to be lucrative, however, are far from certain. States have sustained interest in their gambling enterprises through extensive advertising and continuous innovation. If, at some point, the public's appetite for gambling becomes satiated, states may be forced to rely more heavily on budget cuts or other revenue sources to balance their budgets.

The majority of states obtain revenue from two major types of gambling: lotteries and parimutuel betting. Both forms date back to colonial times. From 1894 through 1963, however, no states permitted the operation of lotteries. New Hampshire inaugurated the modern era of state lotteries in 1964. The other five New England states also started modern-day lotteries relatively early; Vermont, the last state in the region to do so, began selling lottery tickets in 1978. Today, 35 states obtain revenues from lotteries. The only regions where they are the exception rather than the rule are the Southwest and Southeast, where the majority of states do not have lotteries, although Florida runs the second highest grossing lottery in the nation.

Chart 1

Percentage of Personal Income Spent on Lotteries and Parimutuels, by Region
Fiscal Year 1991



Source: Christiansen, Eugene M., "The Gross Annual Wager of the United States–Part 1: Handle." *Gaming and Wagering Business*, BMT Publications, Inc., New York, July 15 - August 14, 1992. Table 6, p. 35. U.S. Bureau of Economic Analysis, *Survey of Current Business*, vol. 73, no. 4, August 1992, p. 48.

Lotteries are, by far, the more important source of state gambling revenue, both in New England and in the nation as a whole (Table 1). In New England, the percentage of general own-source revenues from lotteries and race track betting ranged, in fiscal year 1993 (FY93), from approximately 2 percent in Maine and Vermont to over 8 percent in Massachusetts (Chart 2). The most salient current gambling issue, whether to authorize casinos, is being debated in several states. (Connecticut opened the first Indian reservation casino in the region in early 1992, but has fought hard to stop urban casino development.) Rhode Island and Maine are considering casino petitions from Native Americans.

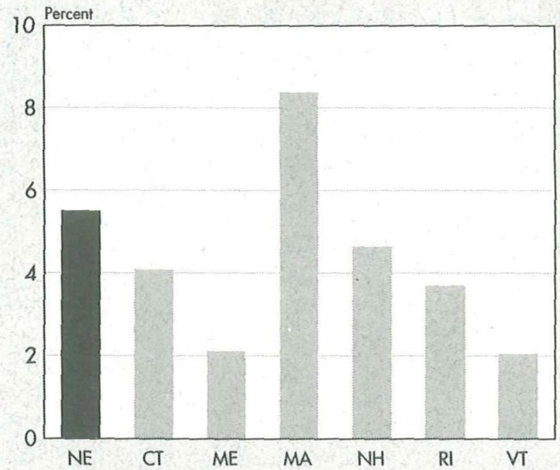
Like all state-sponsored gambling, casinos raise the moral issue of whether government should encourage participation in games of chance. Some policymakers are also reluctant to increase governmental revenues from state-sanctioned gambling operations because they view them as taxes whose burden falls disproportionately on low-income households. Permitting casinos to operate on Native American lands also raises some thorny legal issues. Yet, casino operations are widely seen as relatively painless sources of new jobs and increasing revenues. Experience in some states has reinforced that view.

In the long run, however, casinos may not be as lucrative as some state officials think. They may partially substitute for other forms of state-run gambling. Furthermore, their allure may weaken over time without continued, vigorous promotional campaigns.

Chart 2

State Gambling Revenues as a Percentage of Total Own-Source General Revenue

Fiscal Year 1993



Source: Official budget documents and conversations with state budget, lottery and parimutuel officials.

Table 1

State Revenues from Gambling Operations[a]

Fiscal Years 1991 to 1993

Millions of Dollars

		FY91	FY92	FY93
CT	Lottery	225.3	222.2	226.2
	Parimutuel	32.0	30.0	23.0
	Casino	0.0	0.0	30.0
	Total	257.3	252.2	279.2
ME	Lottery	29.4	35.4	36.5
	Parimutuel[b]	0.7	.7	0.5
	Total	30.1	36.1	37.0
MA	Lottery	543.0	552.0	609.0
	Parimutuel	27.0	26.0	26.0
	Total	570.0	578.0	635.0
NH	Lottery	35.0	36.7	37.0
	Parimutuel	10.0	9.0	7.0
	Total	45.0	45.7	44.0
RI	Lottery	26.0	23.6	43.0
	Parimutuel	9.0	12.0	14.0
	Total	35.0	35.6	57.0
VT	Lottery	15.2	16.9	15.9
	Parimutuel[c]	.2	0.2	0.1
	Total	15.4	17.1	16.0
US	Lottery	7702.5		
	Parimutuel[d]	897.4		

[a] Includes only lotteries, parimutuels (horse racing, dog racing, and jai alai), and the one existing casino in Connecticut. Lottery revenue reflects contribution to the state (that is, gross sales less prizes awarded and administrative costs).
[b] Maine parimutuel FY93 figures represent budgeted, not actual amounts.
[c] Operation closed down in mid-FY93.
[d] State revenues for parimutuels represent figures for FY90 (latest available data).
Source: Official budget documents and conversations with Association of Racing Commissioners officials, and state budget, lottery, and parimutuel officials. *Gaming and Wagering Business*, June 15-July 14, 1993, Table 6, p. 12.

New England's experience with lotteries and parimutuel betting provides some evidence of these potential problems. While revenues from the region's lotteries grew substantially between FY85 and FY91, the rate of growth has been lower each year (Chart 3). Revenues from taxes on parimutuel betting dwindled over the same period. The decline in patronage at racetracks and jai alai centers has been so steep that Vermont has shut them down and Connecticut has "privatized" them. Although other factors may contribute, apparently lotteries have partially supplanted racetrack betting in the public's consumption of state-sponsored gambling, as well. Would casinos, therefore, prosper partially at the expense of lotteries?

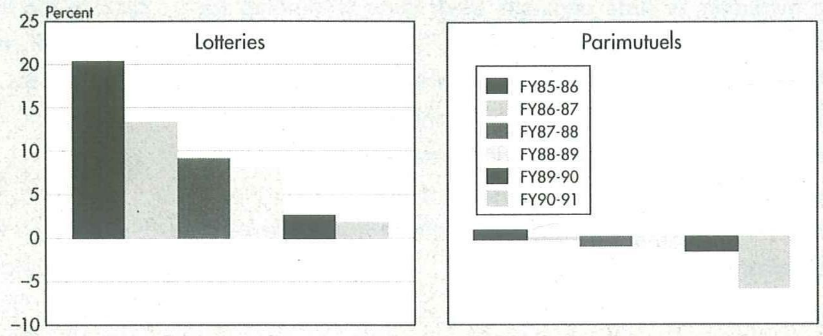
Furthermore, lottery revenues grew by more than 4 percent between FY92 and FY93 in only two New England states—Rhode Island and Massachusetts—even though personal income in five of the states in the region grew by at least 4 percent over the same period. Rhode Island successfully bucked this trend by introducing new games such as keno and powerball, a multi-state lottery that recently awarded a jackpot of $110 million, the largest in history. (Rhode Island was also the only state in the region to experience an increase in its revenues from parimutuel betting, by becoming one of five states in the nation to install video lottery terminals at several race tracks.) Will such innovations be necessary to sustain interest in casino gambling once its novelty wears off? If most states in the region sanction casinos, will they compete intensely with each other, diminishing their lucrativeness?

Whatever the merits and drawbacks, expanding the array of state-sponsored games of chance will be near the top of New England's public policy agenda for many months to come. This newsletter will monitor developments in this emerging policy issue. ■

Chart 3

Rate of Change in New England's Gross Lottery Sales and Parimutuel Revenues

Fiscal Years 85-86 to 90-91



Source: Christiansen (1992), see Chart 1. Christiansen/Cummings Associates, Inc., "U.S. Lotteries' Ticket Sales History: FY 1981-90." U.S. Department of Commerce, State *Government Tax Collections: 1985-1991*, Table 4.

Around New England

Reflecting cautious optimism concerning their short-term economic future, four New England states have enacted FY94 budgets that increase state spending between 3 and 6 percent above last year's levels. Maine and Vermont, the pessimistic exceptions, have provided for no increase in spending. Vermont has enacted deep spending cuts, in response to a grim revenue outlook and a cumulative deficit equal to 7 percent of general fund spending.

Legislators are struggling to control growing costs in welfare and aid to education. The majority of the region's states have trimmed welfare budgets; several are scheduled to consider new welfare reform packages during the upcoming legislative session. While funding public schools remains a priority, only Connecticut and Massachusetts substantially increased their local school aid.

Most of the region's states have recently enacted tax incentives designed to stimulate business investment. Rhode Island doubled its 2 percent investment tax credit for manufacturers. Massachusetts raised its corporate tax credit from 1 to 3 percent for all investments.

Connecticut

Connecticut's budget for the FY94-95 biennium calls for an increase in spending of about 6 percent per year. Underpinning these spending plans are the following key revenue assumptions: 1) combined revenues from the sales tax and personal income tax will increase by an average of 7 percent per year; 2) increases in the tax rate on cigarettes and motor fuels and a new environmental tax on tires together will generate additional revenues of about $462 million per year; and 3) the casinos operated by the Mashantucket Pequot Native Americans will generate average general fund revenues of $85 million per year beginning in FY94. A $52 million surplus from FY93 (0.8 percent of general fund spending), earmarked for debt service payments in FY94, will also help the state fulfill its spending plans.

While an annual growth rate in spending of 6 percent might appear ambitious, the budget strives merely to maintain current service levels in most spending categories. The cost of providing certain services, such as health care and corrections, is expected to rise. Some programs, however, will be expanded beyond current levels. School aid for cities and towns will increase by 14 percent in FY94 and almost 5 percent in FY95, continuing an expansion of aid that began a few years ago. The budget of the University of Connecticut will increase by about $14 million next year. Eligibility standards for Medicaid will be relaxed. On the other hand, raises for state employees have been suspended for two years, except those mandated by contract, and automatic increases in state pensions have been terminated for employees who retire after June 30, 1994.

The Legislature has continued to debate the rate structure of both the corporate and the personal income tax, in particular whether the statutory rate on high-income households should be increased. The Legislature enacted a motion calling for a reduction of the corporate tax rate from its current level of 11.5 percent to 10 percent by 1998.

Massachusetts

Late in July, Governor William Weld signed into law a $15.5 billion spending plan for FY94. Up 3.8 percent from last year, the budget continues a three-year trend of fiscal austerity, holding the average annual state spending increase for years 1991 to 1994 to about 4 percent. The budget is so precariously balanced, however, that a minor increase in state spending or shortfall in revenue might throw it off. The budget contains no new taxes, but relies instead on strong projected revenues from two sources of revenue created last year: a 25-cent per pack increase in the cigarette tax, and keno gambling (a new variant of the state lottery). The Commonwealth is also assuming that revenues from the bank tax, depressed for several years, will rebound sharply.

Several large items were added to the budget this year. The Legislature passed an education reform bill that includes an FY94 increase of $175 million in state aid for local education. The Legislature also set aside $30 million to reduce some homeowners' escalating water and sewer rates, among the highest in the country.

Cuts in spending included a large portion of the Lottery Commission's advertising budget, despite the recent introduction of keno gambling. Governor Weld also vetoed about $12 million in welfare spending by eliminating certain people from the emergency aid rolls, charging that the program is riddled with fraud and abuse. In addition, the Governor vetoed a modified trial "workfare" program included in the proposed budget.

Two other controversial measures were vetoed as well. One would in effect allow cities and towns to increase their property taxes by 2 percent, or $140 million, above the 2.5 percent allowed by Proposition 2 1/2. This would be achieved by permitting city councils or selectmen to shift "overlay" reserves collected for tax abatements to a fund outside the Proposition 2 1/2 cap. Another measure would permit municipalities to tax businesses located on state authority land, such as the hotels and restaurants at Logan Airport. It is unclear at this time whether the Legislature will override any of these vetoes.

State Budget Timetable

ANNUAL BUDGETS

FY93: July 1, 1992 to June 30, 1993
FY94: July 1, 1993 to June 30, 1994
Massachusetts, Rhode Island, Vermont

BIENNIAL BUDGETS

FY94 - 95: July 1, 1993 to June 30, 1995
Connecticut, Maine, New Hampshire

Maine

Maine's FY94-95 biennial budget calls for $3.2 billion in general fund spending, the same amount that it spent in FY92-93. Despite the planned lack of growth in outlays, the state found it necessary to enact new taxes, postpone scheduled tax reductions, refinance retirement system debt, and defer some spending until the next biennium in order to balance the new budget. The Governor is hoping a stronger state economy and long-term fiscal reforms will avoid the need for such measures to balance the budget for FY96-97.

The state postponed the scheduled reduction in the sales tax from 6 percent to 5 percent, enacted new taxes on the gross receipts of nursing homes and on meals sold in restaurants that serve liquor, postponed a scheduled reduction in the gasoline tax of 2 cents per gallon, and reduced state-financed property tax relief. An estimated $28 million in expenses normally paid for out of general revenues will instead be financed by loans from other sources. An estimated $11 million will be saved by delaying the state payroll one month.

The new budget introduces a number of reforms designed to slow long-term growth in spending on education, pensions, and entitlements. The maximum annual rate of growth in spending for aid to local schools, state universities, and state technical colleges was capped at 5 percent, starting in FY96. The percentage of employees' salaries that must be contributed to the state retirement system was increased from 6.5 percent to 7.65 percent. The budget also caps annual growth in non-optional Medicaid services at 6 percent, imposes new restrictions on the uses of local general assistance, reduces general assistance benefits by 4 percent, reduces AFDC benefits by 8 percent, and reduces the state's special housing allowance from $75 to $50 per month. The Legislature defeated Governor John McKernan's proposals to reduce supplementary welfare benefits to recipients who have additional children.

New Hampshire

The state ended FY92-93 with a surplus of nearly $72 million, a record for recent years. The rooms and meals tax, the tobacco tax, and the estate and legacy tax generated all-time-high revenues, and FY93 revenues from the business profits tax, the state's largest source of revenue, came in more than 30 percent over FY92 figures.

In July, the Legislature passed a $4.9 billion biennial budget that provides for a rate of increase in general fund spending of 4 to 5 percent per year. The principal beneficiaries of the FY94-95 budget are state employees, the state university system, and welfare recipients. In addition, according to Governor Steve Merrill's projections, the state will enjoy a $39 million surplus, $10 million of which will be earmarked in FY94 for local property tax relief and $20 million of which will be deposited in the state's "rainy day" fund.

The Governor and the Legislature agree on the need for an enlarged "rainy day" fund because of the high degree of uncertainty surrounding the future rate of growth in state revenues. During the past several years, New Hampshire has relied heavily on a loophole in federal Medicaid regulations that has enabled the state, as well as other states throughout the country, to channel federal Medicaid grant money into its general fund. (See *Fiscal Facts,* Spring 1992.) Most states are anticipating future cuts in Medicaid because of the Clinton Administration's proposed deficit reduction plan.

In July, New Hampshire enacted its first major business tax reform in 20 years. To provide tax relief for large businesses, the business profits tax will be reduced from 8 to 7 percent by July of 1995. To provide tax relief for small businesses, firms with gross income of $100,000 or less will be exempt from filing a tax return. The previous threshold was $12,000. The loss in revenue from these two tax reductions will be offset by the imposition of a new tax, the "business enterprise" tax (BET), of 0.25 percent on wages, interest, and dividends paid. Businesses will be able to take their liability under the BET as a credit against their business profits tax liability. The BET is designed to minimize tax avoidance by mid-sized, closely held firms, which now can reduce their profits tax liability by increasing the proportion of gross profits paid out to owners and owner/managers in the form of salaries and dividends.

Other tax changes include a reduction in the real estate transfer tax from $5.25 to $.50 per $1,000 of value; a drop in the telecommunications tax from 6 percent to 5.5 percent; the elimination of the savings bank tax and corporate franchise fees; and the enactment of several new tax credits, including a three-year "business transition" credit for firms that have experienced losses in the last two years.

In April 1993, New Hampshire reached an out-of-court settlement with the out-of-state owners of Seabrook nuclear power plant who challenged the constitutionality of the property tax on Seabrook in the U.S. Supreme Court. The settlement requires New Hampshire to refund one-half of the money previously collected from these utility owners, all of whom are located in Massachusetts, Connecticut, and Rhode Island. The refund, totaling $17.6 million, will be paid in the form of credits against future tax liability, half to be awarded in 1994 and half in 1995. The state, however, will collect nearly as much revenue as previously by restructuring a few existing taxes and tax credit provisions.

Rhode Island

The Rhode Island Legislature approved a $1.4 billion budget for FY94 in mid July. The new budget, similar to that proposed by Governor Bruce Sundlun, includes at least $20 million in new taxes and fees, deep cuts in welfare programs, pay raises for state employees, and tax breaks for business. The budget increases the gasoline tax by 2 cents per gallon and the cigarette tax by 7 cents per pack, and it introduces dozens of fee increases and new fees, such as a new $15 car inspection fee.

Spending cuts include a reduction in the maximum duration of general public assistance (GPA) from six to three months and tighter eligibility standards that will eliminate 4,000 single adults from GPA rolls. These measures are expected to save the state $16 million. In addition, the budget calls for a $14 million cut in Medicaid payments to nursing homes, a freeze on family welfare benefits for the third consecutive year, and a reduction in outlays for child day care. On the other hand, a 4.5 percent pay increase was approved for all state employees.

Improving Rhode Island's business tax climate is a high priority in the FY94 budget. It includes a package that accelerates the repeal of the 11 percent surcharge on the corporate income tax, doubles the investment tax credit for manufacturers (from 2 percent to 4 percent), and affirms the Legislature's intention to lower the marginal income tax rate on high-income Rhode Islanders by the end of the calendar year. A separate measure, enacted in July, eliminates the taxation of capital gains earned on the sale of stocks for executives and employees of selected publicly traded companies. These companies must already be located in Rhode Island and employ over 100 people. In addition they must have increased their work force by at least 10 percent over the last five years and must pledge to increase it by an additional 15 percent over the next five years.

Vermont

Governor Howard Dean had hoped to end FY93 with a $39 million surplus, enabling him to pay off much of the $65 million cumulative deficit carried over from the previous fiscal year. However, disappointing tax revenues, especially from consumption taxes and the personal income tax, frustrated his plans. The state's FY93 General Fund surplus was only an estimated $19 million, leaving the cumulative deficit at $46 million, or 7 percent of estimated FY93 state spending.

Given Vermont's uncertain economic forecast, the Governor sees no shrinkage in the cumulative deficit in FY94, absent further spending cuts and tax increases. Specifically, he has urged the Legislature to cut FY94 spending by $20 million and to generate an additional $25 million in revenues by increasing the sales tax rate from 4 percent to 5 percent. He estimates that, with these two measures in place, the state would end FY94 with an operating General Fund surplus of $21 million. Furthermore, the Governor intends to transfer a $24 million surplus expected to be accumulated by the end of FY94 from the Transportation Fund to the General Fund. Dean hopes that these funds, which were originally intended for two reserve accounts, will virtually eliminate the state's cumulative deficit, a goal that has eluded him for the past two fiscal years. In FY95, he envisions a balanced state budget that would include a stabilization fund of almost $10 million. To prevent a deficit from reemerging, he has advocated the imposition of a spending cap and a balanced budget requirement.

Widespread skepticism exists about whether the state can continue to make 2 percent expenditure cuts across the board without disabling certain government functions. This January, the Governor says, he may have to target entire programs and may be forced to cut state aid to education, welfare, and Medicaid. The Legislature, however, has claimed it will not make cuts, including cuts to regular and special education, which could lead to higher property taxes. ■

Table 2

Total State Spending[a]
for FY93 and Appropriations for FY94

	Millions of Dollars		Percent Change
	FY93	FY94	93-94
CT	6,682	6,925	3.6
ME	1,811	1,787	-1.3
MA	12,121	12,579	3.8
NH[b]	926	987	6.6
RI[c]	1,549	1,464	-5.5
VT	765	772	0.9

[a]Unless otherwise noted, includes spending out of general fund and transportation fund only. Excludes expenditure of federal grants and reimbursements.
[b]FY94 figure has been adjusted for changes in accounting practices.
[c]Includes spending out of all funds, less federal grants and reimbursements. Rhode Island does not have a separate transportation fund. Preliminary and unofficial estimates, supplied by Rhode Island Public Expenditure Council (RIPEC), have been adjusted by RIPEC for retroactive Medicaid reimbursement arrangements and changes in accounting rules.
Source: Official budget documents, state financial statements, and conversations with state budget officials.

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