

Uncertain Benefits, Hidden Costs: The Perils of State-Sponsored Gambling

The state fiscal crisis of the past three years has forced cash-strapped, tax-averse state lawmakers to seek unconventional revenue-raising alternatives. In the past year alone, lawmakers in dozens of states have proposed legalized gambling as a substitute for the income, sales and property taxes that form the backbone of most state tax systems. This policy brief looks at the advantages and disadvantages of using these revenues to fund public services.

Approaches to Legalized Gambling

Like tax policy, gambling policy is made in a decentralized way: each state's lawmakers choose which (if any) forms of legalized gambling to allow. As a result, the states now have very different approaches to allowing gambling activities. Some form of government-sanctioned gambling is now allowed in all but two states (Utah and Hawaii). By far the most popular forms of legalized gambling are lotteries and casinos: 37 states and the District of Columbia have state lotteries, and more than half of the states have some form of casino gambling. Many states also allow "pari-mutuel" gaming, wagering on live events such as horse racing and greyhound racing.

Advantages and Disadvantages of State-Sponsored Gambling

In 2004 alone, more than 20 state legislatures considered proposals to use new gambling revenues to fund public services—or to reduce other taxes. For example, Pennsylvania Governor Ed Rendell signed a law allowing the creation of 61,000 new slot machines estimated to eventually bring in up to \$1 billion a year. These revenues will be partially used to reduce Pennsylvania property taxes. Advocates of state-sponsored gambling typically see it as a painless, voluntary tax—and one that is at least partially paid by residents of other states. At a time when lawmakers' willingness to increase politically unpopular taxes is especially low, a tax paid by non-residents may seem especially palatable. It is also argued that in the absence of legal gambling, many state residents will either gamble illegally or travel to other gambling-friendly states—with no benefit to the state. But opponents raise a host of troubling objections to states' use of legalized gambling.

- Even if gambling boosts state revenues in the short run, **competition from other states** will eventually make state-sponsored gambling less profitable—and will ultimately put the burden of this tax primarily on in-state residents rather than tourists from other states. When a state introducing a lottery is surrounded by non-gambling states, lawmakers can initially count on residents of these other states visiting to play the lottery. But as more neighboring states enact lotteries and open casinos of their own, the attraction of gambling in other states will fade. As more states seek a piece of the gambling pie, every other state's share of the pie will decline—and more of each state's gambling revenues will come from the pockets of its own citizens.
- Instead of increasing the total amount of state revenue available to fund public services, **gambling may simply shift money from one tax to another** with no net gain to the state. When consumers spend more money on gambling activities, they will spend less money on other items, such as travel, recreation and basic needs. Since these other

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types of purchases are usually subject to state sales taxes, any increase in state gambling revenue usually means a decrease in state sales tax revenue.

- Rather than simply capitalizing on existing illegal gambling activities, legalized gambling **encourages consumers to spend more on gambling activities** than they otherwise would. When states use gambling as a revenue source, they depend on the continued flow of this revenue to help fund important public services. This often leads to the unwholesome sight of state-sponsored advertising that actively encourages its citizens to gamble more. In this respect, gambling is very different from “sin taxes” on alcohol and cigarettes, which are often enacted not to raise money but to discourage socially harmful behavior. A state using gambling revenues face constant pressure to actually encourage its residents to gamble more.
- **Promises of additional spending for specific public services may be illusory.** Advocates of state-sponsored gambling often seek to earmark gambling revenues for specific purposes, usually to help fund education. These advocates often promise that total state spending on education will increase as a result of the new gambling revenues. But it is just as likely that lawmakers will use gambling revenues to replace other revenues that have been shifted from education to other areas—leaving the total amount of spending on education unchanged. States facing budget shortfalls will find this “shell game” especially tempting.
- Low-income and poorly-educated taxpayers are far more likely to participate in lotteries and other forms of gambling than are wealthier, better-educated taxpayers. As a result, state-sponsored gambling can be considered a **regressive tax**.
- Like other “sin taxes,” gambling is **not always a truly voluntary tax**. Compulsive gambling has been recognized as an addictive disease. Relying on compulsive gamblers to fund public services amounts to taking advantage of these gamblers’ addictions. And because state gambling administrators tend to downplay the poor odds of winning, gamblers are usually given incomplete information about these odds—which means, in a sense, that gamblers are being tricked into these “voluntary” spending decisions. Those with a poor understanding of basic probability may simply not understand their low likelihood of winning.
- Gambling may introduce a **variety of social costs** associated with compulsive gambling, including increased crime rates, decreased private savings, increased debt and bankruptcies, and job losses. These added financial difficulties associated with compulsive gambling can reduce the quality of life for children living in families headed by gamblers. These social costs can result in increased social welfare spending by state governments in the long run.

Conclusion: Uncertain Benefits, Hidden Costs

The slow economic growth of the past several years has forced policymakers across the nation to make difficult and often painful fiscal policy decisions. Lawmakers have sought every opportunity to avoid general tax increases while continuing to provide public services. But there is growing evidence that state-sponsored gambling is both inequitable and inadequate as a long-term revenue source—and that the associated social costs of encouraging destructive gambling behavior may offset much of the revenue gains enjoyed by states in the short run. States that use gambling revenues as a “quick fix” to avoid politically difficult structural tax reforms in the short run will likely be forced to confront the same difficult tax policy decisions in the future.

To find out more about this issue, contact ITEP at (202) 626-3780