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

The recent fiscal downturn forced cash-strapped, tax-averse state lawmakers to seek unconventional revenue-raising alternatives, for additional revenue-raising opportunities outside of the income, sales and property taxes that form the backbone of most state tax systems. One of the most popular alternatives to those major revenue sources is state-sponsored gambling. As this policy brief points out, however, gambling revenues are rarely as lucrative, or as long-lasting, as supporters claim.

Approaches to Legalized Gambling

Like many areas of 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: 43 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.

The Perils of State-Sponsored Gambling

In recent years, state legislatures all across the country have considered proposals to use new gambling revenues to fund public services, or to reduce other taxes. Maryland, Ohio, and Pennsylvania have all enacted major gambling expansions in recent years, and numerous other states have taken more modest steps to boost their take from gambling. 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.

- **Lengthy implementation periods**, and frequent delays, mean that state coffers rarely receive the immediate boost that gambling's supporters promise. Legal challenges, facility construction, and the search for gambling operators are just a few of the most frequent speed bumps on the road to implementing legalized gambling. While these obstacles can usually be overcome with time, lawmakers should not expect to receive much if any immediate budgetary relief by legalizing gambling.

- Even if gambling boosts state revenues in the short- or medium-term, **competition from other states** will eventually make state-sponsored gambling less profitable—and will ultimately shift much of this tax primarily onto 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**, limiting the net gain to the state. When consumers spend more money on gambling activities, they will spend less money on other items, such as recreation and even basic needs. Since these other 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. States using gambling revenues face constant pressure to actually encourage their 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.

- 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

With anti-tax attitudes as prevalent as ever, lawmakers have found it increasingly difficult to continue providing the public services their residents demand without busting their states' budgets. As a result, gambling is quickly becoming more attractive to lawmakers as a means of supplementing inadequate revenue streams. But state sponsored gambling is both unsustainable and inadequate as a long-term revenue source. 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.