Don't Bet on It

by Ronald C. Fisher and Robert W. Wassmer

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In this installment of State Fiscal Affairs, Fisher and Wassmer argue that even if the U.S. Supreme Court's recent *Murphy* decision results in an increase in legalized sports betting, it's unlikely to lead to the tax revenue windfall that some have predicted.

For a number of years the NCAA offered its "Don't Bet on It" program to inform student athletes about NCAA regulations regarding sports gambling and to discourage the activity altogether. With the U.S. Supreme Court's decision in *Murphy v. National Collegiate Athletic Association* finding the federal Professional and Amateur Sports Protection Act (PASPA) unconstitutional, a number of states are eyeing sports gambling as a potential source of substantial revenue.

The PASPA of 1992 prohibited sports gambling except in forms that existed before its adoption — including sports books in Nevada, a sports-based lottery in Oregon, and minor gambling games in two other states. New Jersey sought in the federal courts to have PASPA and its prohibition overturned. Since the Supreme Court decision in May, Delaware, Mississippi, New Jersey, and West Virginia joined Nevada in offering active, full-scale legalized sports betting, and other states are moving toward it. Professional sports leagues, which once strongly supported PASPA, now are exploring how they also might generate revenue from legalized sports gambling.

But perhaps the NCAA admonition is relevant: Don't bet on it. There are several reasons to suspect that the sports gambling revenue potential for states may be less than some expect or hope for.

First, we have the history of state lotteries, now operated in 43 states and the District of Columbia. After more than 50 years and increasing ticket sales, state lotteries still provide only about 1 cent for every dollar of state government revenue. From 2002 to 2016, real state lottery sales increased from $52 billion to about $73 billion, but declined from providing 1.2 percent of state revenue to only 1.07 percent, as shown in the figure. And state lottery organizations have had to continually add new games to achieve this. The share of total lottery sales that the state receives in the form of net revenue has fallen from more than 40 percent in the 1980s to only about 30 percent today.

Second, there is substantial research showing that the expansion of one type of gambling can reduce spending on and revenue from other types. Not surprisingly, it turns out that different forms of gambling are substitutes. This competition for the gambling dollar takes many forms. One study found that as lotteries expanded in neighboring states, lottery sales in West Virginia declined.

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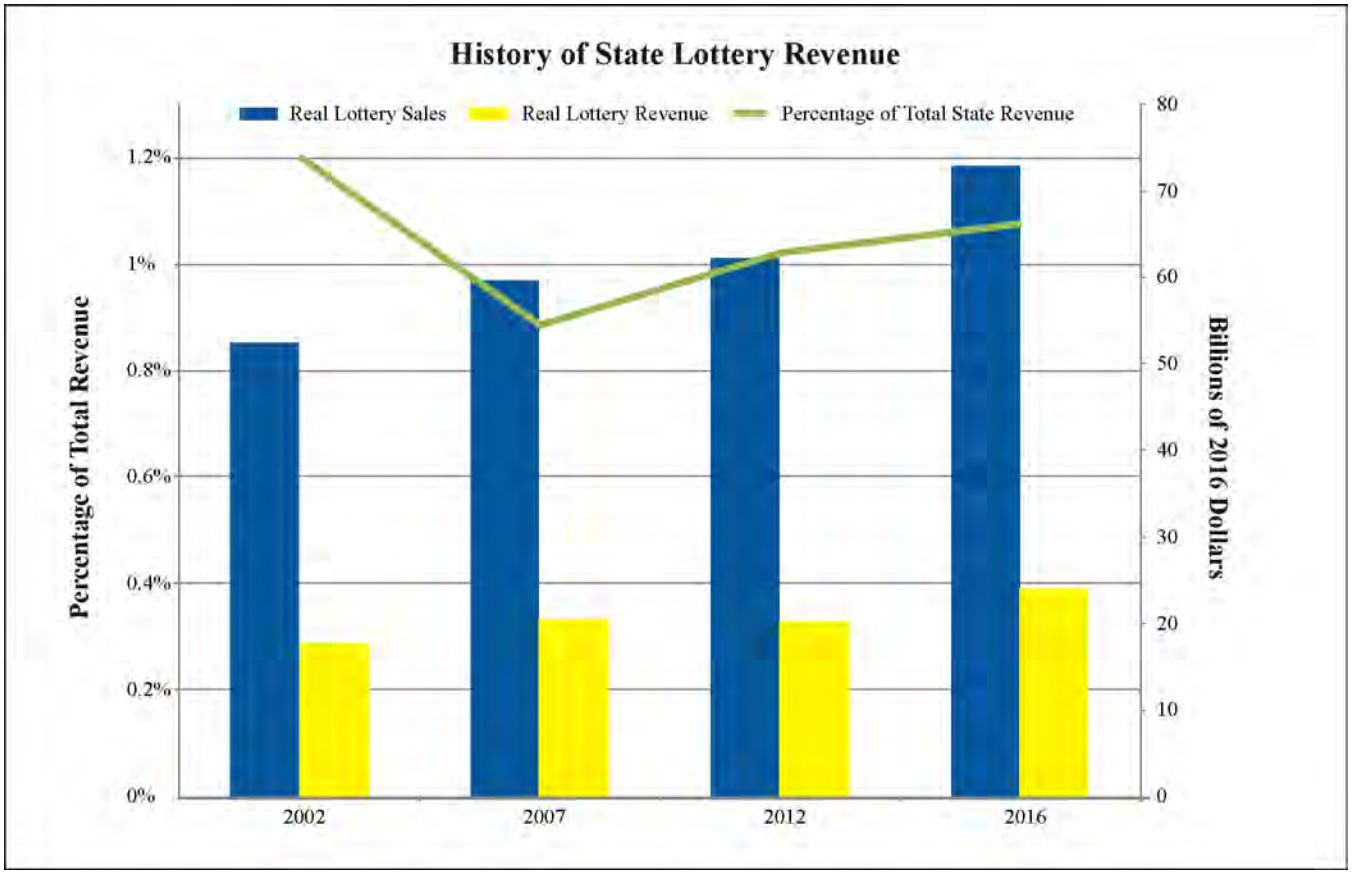

Others find that expansion of casinos (as well as parimutuel betting) in many new locations (beyond Nevada), from which state and local governments derived revenue, *reduced* state lottery sales and revenue. Thus it seems likely that introduction of legal sports betting in a state might very well reduce spending on the state lottery or in casinos. One can imagine a person thinking: "Should I buy a lottery ticket this week, go to the casino and play the slots, or place a bet on Sunday's NFL game?"

Indeed, there is even evidence that spending on consumer goods and gambling may be substitutes. Several studies suggest that expansion of gambling affects general consumer spending. If increased expenditure on gambling is offset by reduced expenditure on the sales of other taxable commodities, then the revenue increase from gambling may be at least partly offset by a decrease in sales or income tax revenue. Again, one might imagine someone placing a bet on a college football game and deciding to stay home Saturday evening to watch the game on TV rather than going to a movie or the shopping mall.

Third, there is evidence that states did not generate as much revenue from casinos as might have been expected or possible. For Indian casinos, some states entered into agreements with the tribes for annual payments for the rights to operate with limited competition. But after the fact, it appears as if states sold those rights for less than might have been possible. Effective state tax rates on both Indian casinos and commercial casinos are much lower than the effective rates for state lotteries.[1]

Lastly, a commonly cited estimate of the annual amount of illegal sports betting in the U.S. is $150 billion (although published estimates vary from $80 billion to $400 billion). The hope for those promoting sports gambling as an important new revenue source for states is that this amount would be transferred to legal state-sponsored or

[1] All of this research is reviewed in Ronald C. Fisher, *State and Local Public Finance* (2016).

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state-authorized betting. Of course, because this type of gambling is illegal, no one knows for sure the correct amount. But there are substantial reasons to think this amount is inflated.

Total 2015 expenditures on state and local police protection — state police, county sheriffs, and local police departments — were about $105 billion. Add fire departments and the total is about $150 billion, while the total expenditure for highways was about $168 billion. Does it seem reasonable that how much individuals spend on illegal sports betting in a year is the same as the total amount spent nationally on police and fire protection by all states and localities? Or about the same as total state-local spending on highways? Doubtful.

In data that are known, total legal sports betting in Nevada in 2017 was a bit less than $5 billion. For the $150 billion amount to be accurate, the amount of illegal sports betting would have to be double the amount spent for all state lottery games in a year. Making an adjustment for population difference and exchange rates, one economist used the amount of legal sports betting in the U.K. to estimate that sports betting in the U.S. (if people behaved similarly) would be about $67 billion.[2]

Of course, whatever the magnitude of illegal sports betting in the United States, it is not reasonable to expect that all of that would switch to legal sports betting if it is permitted. State lotteries exist, but illegal numbers games persist. Betting on racing at tracks is legal and available, but bookies also continue to operate.

For lotteries to provide 1 percent of state revenue, states retain about 30 percent of the total handle (amount bet). So far only Pennsylvania has adopted a planned tax rate on sports gambling at that level, with others varying from 6.75 percent in Nevada to 14.25 percent for sports gambling at racetracks in New Jersey. Thus, even if the total amount of legal sports betting is twice the amount spent on state lotteries, which is unlikely, net revenue would be less than that from lotteries given these tax rates.

In 1977, after working as a consultant with a federal commission on gambling that conducted a national survey of gambling behavior, our former Michigan State University colleague Daniel Suits argued that "gambling is not a fiscal panacea, and we would be foolish, indeed, to expect it to provide much in the way of budgetary relief."[3] Suits's perception seems just as appropriate today as 40 years ago. ■

[2] Jay L. Zagorsky, "Market for Illegal Sports Betting in US Is Not Really a $150 Billion Business," *The Conversation*, May 14, 2018.

[3] Daniel Suits, "Gambling Taxes: Regressivity and Revenue Potential," *National Tax Journal* (March 1977).

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