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Quantifying the Impact of Federalization of Internet Gaming on Lotteries

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Introduction: The introduction of Internet gaming into the marketplace will have a major impact on U.S. state lotteries, and therefore the regulation and taxation of Internet gaming should be controlled by the state, just as all forms of gaming and gambling are regulated, licensed, and taxed by the state.

Following is an analysis of the economic impact that proposed federal legislation to regulate, license, and tax Internet gaming would have on U.S. lotteries. This analysis is broken down by individual states in a way that enables state legislators to understand the specific economic impact to their state and the beneficiaries of their own state lottery. While predicting the future is not an exact science, this research report does yield a fact-based, data-driven picture of the loss in revenues and funding to Lottery stakeholders that would result from the federalization of the i-gaming taxation, licensing, and regulatory structure.

Regulation and taxation of the gambling industry has always been the province of state governments, not the federal government. Our purpose is to highlight the urgency for states to take action now to stop the federal take-over of the Internet gaming industry; preserve control over taxing, licensing, and regulating of all forms of gaming and gambling; and channel the economic benefits of gaming, gambling, and lottery industries to their in-state constituents.

Background: In 2010, U.S. lottery sales generated nearly $15 billion (excluding video lottery revenue) for state governments in 44 jurisdictions around the country [Source: NASPL; National Association of State and Provincial Lotteries]. Those funds went to buy books for school children; allowed high school graduates to go on to college; funded new infrastructure projects which help create jobs, and otherwise contribute to causes that serve the general public. That funding will be severely and negatively impacted by legislation which federalizes the regulation and taxing of Internet gaming. The timing could not be worse, with states making drastic budget cuts across the board:

> Of the 47 states with newly enacted budgets, 38 or more states are making deep, identifiable cuts in K-12 education, higher education, health care, or other key areas in their budgets for fiscal year 2012. Even as states face rising numbers of children enrolled in public schools, students enrolled in universities, and seniors eligible for services, the vast majority of states (37 of 44 states for which data are available) plan to spend less on services in 2012 than they spent in 2008 – in some cases, much less. [Source: *State Budget Cuts in the New Fiscal Year, Are Unnecessarily Harmful Cuts, Are Hitting Hard at Education, Health Care, and State Economies;* July 28, 2011; Center on Budget and Policy Priorities]

Objective: To quantify the impact that federalization of Internet gaming will have on state lottery revenues and funds transferred to lottery beneficiaries.

Hypothesis: If the introduction of a new lottery game into the market results in some measure of cannibalization, then the introduction of i-gaming into the market would result in at least some migration of lottery spend over to i-gaming.

Methods: We relied on survey data collected by The Nielsen Claritas Company and Mediamark Research & Intelligence (MRI), a tool widely used by marketing professionals to help them forecast consumer behavior. The Nielsen MRI Profiles enable you to analyze consumer behavior based on lifestyle, media exposure, product usage, consumption, purchasing and psychographic dimensions. This consumer data was integrated with lottery-specific data for the purpose of measuring the impact of i-gaming on lottery revenues and bottom-line funds transfers to beneficiaries.

The Lottery Player and Internet Gaming

The introduction of a successful new product into any marketplace changes the competitive landscape and the revenues of the existing products. Likewise, the introduction of a new lottery game with mass appeal results in at least some measure of cannibalization of existing games. For example, prior to January of 2010, U.S. state lotteries sold Mega Millions or Powerball but no state sold both games. When the states began to sell both games in 2010, total sales increased in most states, but sales of the original game declined by an average of 30% as a result of players migrating a portion of their lottery spend over to the new game. The federalization of i-gaming would not likely result in a 30% decline in lottery sales. Measuring the propensity of the lottery player to play Internet games is key to understanding the impact of i-gaming on lottery spend.

The argument that the lottery player and the poker player are two different people is a popular misconception. Examination of the Nielsen Claritas data segmentation shows that on average, the lottery player who would migrate a portion of spend over to i-gaming comprises approximately 28 percent of the total population of lottery players. Further, Nielsen Claritas shows households who used the Internet for online gaming in the last month and their likelihood to play the lottery 1-5 times per month over the course of a year. According to the Nielsen Claritas cross segmentation, there is a strong correlation between people who have a propensity to play games on the Internet and play lottery games multiple times a month (67 percent). Most importantly, a state lottery could manage the implementation of Internet gaming in ways that would minimize cannibalization, maximize synergy between games and across market segments, and optimize the overall outcome of the major change in the marketplace that Internet gaming represents. The federal government and Big Casino interests would not have that as their objective and the outcome would be predictably negative for state interests and the beneficiaries of lottery funding.

Conclusion: The regulation, licensing, and taxation of Internet-gaming must be controlled by the state. If implemented by the federal government, the introduction of i-gaming into the marketplace would have an immediate, measurable, and negative impact on lottery revenues and funds transferred to lottery beneficiaries. State legislators need to manage the introduction of i-gaming for the overall outcomes to be positive for the state. Specifically, it is projected that the aggregate loss to U.S. state lotteries resulting from the federalization of Internet gaming would be ***$1.4 billion***. That is $1.4 billion in bottom-line funding (not lottery sales revenue). The three largest states stand to lose over $100 million each, most states lose between $10 million and $100 million, and the lotteries of even small states lose millions of dollars that they cannot afford to lose.

Lotteries in the United States will be severely and negatively impacted by any proposal that calls for Congress to license, regulate and/or tax online poker. The evidence of this report just confirms the common-sense concern that the current revenue stream for lottery beneficiaries would be threatened significantly by the introduction of online poker. With states facing more revenue shortfalls, a federal online poker initiative would exacerbate revenue shortfalls being faced by governors and legislatures in lottery states. In fiscal year 2013, some two dozen states are projecting budget deficits totaling $46 billion [Source: *States Continue to Feel Recession's Impact;* June 17, 2011; Center on Budget and Policy Priorities]. With very few, if any, revenue generating options available to lottery states other than raising taxes, these states need to be able to protect the revenues generated by their lotteries, and to preserve the brand-value of one of its most valuable assets.

See Tables below

The impact on the return to the state can be seen in the following table entitled "Predicted Lottery Sales with Launch of Online Gaming." This table shows that ***on average, lottery states would see a decrease in the return to state government of 8.65 percent.*** In some cases, it would be almost 10 percent (i.e. Maryland at 9.89 percent). Those percentages translate into nearly a $1.4 billion loss of funding to Good Causes for U.S. lottery states. It is estimated that the impacted population currently accounts for approximately $16 billion in lottery sales.

The player profile and propensity to migrate spend to i-gaming does vary somewhat by state. The chart shows, for example, that West Virginia has an index of 117, which means that WV indexes 17 percent above the average in terms of their total population's propensity to play both the lottery multiple times per month and also play games online. Therefore, West Virginia would have a better chance of seeing lottery game cannibalization with the introduction of online poker, than a state that indexed only at 105.

Propensity by Lottery Player to Play Games on the Internet	
State	Play Lottery 1-5 Times per Month over 1 Year
AZ	107
AR	114
CA	105
CO	105
CT	104
DE	106
DC	104
FL	109
GA	107
ID	108
IL	106
IN	108
IA	110
KS	108
KY	111
LA	110
ME	110
MD	105
MA	104
MI	108
MN	107
MO	110
MT	112
NE	110
NH	104
NJ	105
NM	110
NY	107
NC	109
ND	112
OH	109
OK	111
OR	108
PA	109
RI	106
SC	110
SD	112
TN	111
TX	108
VT	107
VA	107
WA	106
WV	117
WI	107

								Predicted Lottery Sales with Launch of On-Line Gaming					
State	Population	Estimated 2011 Per Capita Sales	Return to State	Current Annual Return to State based on 2011 Avg. Wkly Sales Estimates	% of Total Pop with Potential to Decrease Lottery Spend when Online Gaming is Launched*	Population Impacted with Launch of Online Gaming	Discounted Per Capita Lottery Sales of Impacted Population	Annual Sales from Impacted Population	Annual Sales from all Other Population	Total Annual Sales	Total Annual Return to State	$ Change in Return to State	% Change in Return to State
AZ	6,747,261	$ 1.74	25.72%	$ 157,340,104	28%	1,905,368	$ 1.22	$ 120,911,227	$ 438,939,590	$ 559,850,817	$ 144,010,656	$ (13,329,448)	-8.47%
AR	2,891,999	$ 2.97	21.63%	$ 96,661,546	23%	650,843	$ 2.08	$ 70,395,308	$ 346,291,122	$ 416,686,429	$ 90,135,454	$ (6,526,092)	-6.75%
CA	37,853,430	$ 1.83	35.27%	$ 1,273,301,752	32%	12,167,291	$ 1.28	$ 812,328,034	$ 2,449,843,452	$ 3,262,171,485	$ 1,150,517,902	$ (122,783,851)	-9.64%
CO	5,087,819	$ 1.91	22.53%	$ 113,881,490	31%	1,559,865	$ 1.34	$ 108,460,048	$ 350,435,176	$ 458,895,223	$ 103,407,076	$ (10,474,414)	-9.20%
CT	3,512,033	$ 5.48	28.90%	$ 289,255,716	32%	1,127,841	$ 3.84	$ 224,970,541	$ 679,392,913	$ 904,363,454	$ 261,388,572	$ (27,867,144)	-9.63%
DE	889,560	$ 2.59	27.75%	$ 33,269,274	29%	258,127	$ 1.81	$ 24,352,096	$ 85,100,566	$ 109,452,662	$ 30,373,114	$ (2,896,160)	-8.71%
DC	595,933	$ 7.42	29.00%	$ 66,686,102	30%	176,768	$ 5.19	$ 47,743,942	$ 161,734,041	$ 209,477,983	$ 60,751,892	$ (5,934,210)	-8.90%
FL	18,901,197	$ 4.31	31.96%	$ 1,353,353,259	26%	4,931,194	$ 3.02	$ 773,212,675	$ 3,129,286,568	$ 3,902,499,243	$ 1,247,429,055	$ (105,924,204)	-7.83%
GA	9,951,992	$ 6.59	26.09%	$ 889,902,257	29%	2,907,785	$ 4.61	$ 697,538,804	$ 2,414,015,954	$ 3,111,554,758	$ 811,898,442	$ (78,003,816)	-8.77%
ID	1,568,377	$ 1.72	24.89%	$ 34,926,349	28%	438,582	$ 1.20	$ 27,472,128	$ 101,098,163	$ 128,570,291	$ 31,996,301	$ (2,930,048)	-8.39%
IL	12,989,744	$ 3.48	29.74%	$ 698,313,021	30%	3,895,216	$ 2.43	$ 492,875,310	$ 1,643,946,241	$ 2,136,821,551	$ 635,492,379	$ (62,820,642)	-9.00%
IN	6,432,254	$ 2.22	25.62%	$ 190,428,545	28%	1,774,332	$ 1.56	$ 143,534,808	$ 538,290,300	$ 681,825,108	$ 174,669,679	$ (15,758,867)	-8.28%
IA	3,023,197	$ 1.55	22.60%	$ 54,995,540	27%	801,681	$ 1.08	$ 45,173,957	$ 178,828,876	$ 224,002,833	$ 50,620,479	$ (4,375,061)	-7.96%
KS	2,829,338	$ 1.54	28.85%	$ 65,170,816	27%	765,826	$ 1.07	$ 42,804,317	$ 164,765,594	$ 207,569,911	$ 59,878,818	$ (5,291,997)	-8.12%
KY	4,314,623	$ 3.50	29.62%	$ 232,716,077	24%	1,027,811	$ 2.45	$ 131,029,989	$ 598,596,292	$ 729,626,281	$ 216,085,082	$ (16,630,995)	-7.15%
LA	4,490,874	$ 1.60	35.90%	$ 133,980,982	26%	1,157,898	$ 1.12	$ 67,351,500	$ 276,956,180	$ 344,307,680	$ 123,617,543	$ (10,363,439)	-7.74%
ME	1,319,356	$ 3.18	24.36%	$ 53,091,955	25%	335,497	$ 2.22	$ 38,793,971	$ 162,521,162	$ 201,315,133	$ 49,041,750	$ (4,050,205)	-7.63%
MD	5,665,977	$ 5.77	29.92%	$ 508,254,102	33%	1,868,538	$ 4.04	$ 392,139,684	$ 1,138,496,527	$ 1,530,636,211	$ 457,970,172	$ (50,283,931)	-9.89%
MA	6,535,679	$ 12.88	20.48%	$ 896,176,662	32%	2,068,415	$ 9.01	$ 969,537,088	$ 2,991,371,607	$ 3,960,908,694	$ 811,089,934	$ (85,086,728)	-9.49%
MI	9,961,386	$ 4.49	30.25%	$ 704,229,395	27%	2,708,560	$ 3.15	$ 443,114,351	$ 1,695,066,257	$ 2,138,180,608	$ 646,784,159	$ (57,445,236)	-8.16%
MN	5,271,819	$ 1.79	24.50%	$ 120,258,361	30%	1,565,509	$ 1.25	$ 102,029,352	$ 345,074,963	$ 447,104,315	$ 109,544,858	$ (10,713,503)	-8.91%
MO	5,965,573	$ 3.20	26.72%	$ 264,830,390	26%	1,562,369	$ 2.24	$ 181,710,120	$ 731,587,770	$ 913,297,890	$ 244,022,866	$ (20,807,524)	-7.86%
MT	981,970	$ 0.87	22.48%	$ 10,011,350	23%	230,606	$ 0.61	$ 7,322,242	$ 34,082,083	$ 41,404,324	$ 9,306,031	$ (705,320)	-7.05%
NE	1,798,882	$ 1.53	24.51%	$ 35,045,754	26%	476,175	$ 1.07	$ 26,498,661	$ 105,153,350	$ 131,652,012	$ 32,262,708	$ (2,783,047)	-7.94%
NH	1,323,558	$ 3.30	28.33%	$ 64,289,058	32%	419,675	$ 2.31	$ 50,373,785	$ 154,990,835	$ 205,364,620	$ 58,173,611	$ (6,115,447)	-9.51%
NJ	8,711,870	$ 5.87	35.47%	$ 943,137,961	33%	2,854,599	$ 4.11	$ 609,894,441	$ 1,787,750,488	$ 2,397,644,929	$ 850,427,197	$ (92,710,764)	-9.83%
NM	2,016,306	$ 1.35	30.37%	$ 42,962,969	25%	509,002	$ 0.94	$ 24,996,647	$ 105,746,153	$ 130,742,800	$ 39,709,258	$ (3,253,711)	-7.57%
NY	19,562,561	$ 6.75	27.75%	$ 1,906,438,092	29%	5,714,262	$ 4.73	$ 1,404,727,764	$ 4,863,293,229	$ 6,268,020,994	$ 1,739,375,826	$ (167,062,266)	-8.76%
NC	9,471,519	$ 3.16	30.48%	$ 474,702,743	26%	2,457,923	$ 2.21	$ 282,920,759	$ 1,153,292,110	$ 1,436,212,868	$ 437,746,179	$ (36,956,563)	-7.79%
ND	643,941	$ 0.69	23.42%	$ 5,413,393	25%	158,394	$ 0.48	$ 3,979,332	$ 17,426,266	$ 21,405,598	$ 5,013,924	$ (399,470)	-7.38%
OH	11,496,025	$ 4.22	29.26%	$ 737,593,901	27%	3,049,702	$ 2.95	$ 468,112,834	$ 1,852,092,705	$ 2,320,205,539	$ 678,892,519	$ (58,701,382)	-7.96%
OK	3,687,452	$ 1.04	35.28%	$ 70,469,464	25%	918,356	$ 0.73	$ 34,823,015	$ 150,001,318	$ 184,824,333	$ 65,204,359	$ (5,265,105)	-7.47%
OR	3,864,064	$ 1.60	27.75%	$ 88,967,372	27%	1,038,858	$ 1.12	$ 60,336,148	$ 234,408,645	$ 294,744,793	$ 81,791,680	$ (7,175,692)	-8.07%
PA	12,533,694	$ 4.78	29.87%	$ 930,837,457	27%	3,337,597	$ 3.35	$ 580,880,748	$ 2,286,433,719	$ 2,867,314,467	$ 856,475,657	$ (74,361,800)	-7.99%
RI	1,045,591	$ 4.24	27.75%	$ 63,929,927	29%	302,660	$ 2.97	$ 46,680,234	$ 163,692,067	$ 210,372,301	$ 58,378,314	$ (5,551,614)	-8.68%
SC	4,581,525	$ 4.19	27.06%	$ 270,379,821	25%	1,144,372	$ 2.94	$ 174,734,045	$ 749,740,430	$ 924,474,474	$ 250,119,196	$ (20,260,625)	-7.49%
SD	815,166	$ 0.99	27.75%	$ 11,632,784	24%	197,766	$ 0.69	$ 7,119,078	$ 31,749,832	$ 38,868,910	$ 10,786,123	$ (846,662)	-7.28%
TN	6,316,245	$ 3.45	27.25%	$ 308,906,120	25%	1,576,892	$ 2.42	$ 198,114,372	$ 850,619,053	$ 1,048,733,426	$ 285,769,991	$ (23,136,130)	-7.49%
TX	25,006,778	$ 2.98	28.44%	$ 1,102,392,477	29%	7,264,099	$ 2.09	$ 788,261,964	$ 2,750,489,160	$ 3,538,751,124	$ 1,006,323,861	$ (96,068,616)	-8.71%
VT	622,079	$ 2.99	22.14%	$ 21,417,114	27%	166,694	$ 2.09	$ 18,146,665	$ 70,820,411	$ 88,967,076	$ 19,695,420	$ (1,721,694)	-8.04%
VA	7,884,742	$ 3.68	29.98%	$ 451,707,456	31%	2,418,548	$ 2.57	$ 323,551,500	$ 1,044,661,587	$ 1,368,213,086	$ 410,140,733	$ (41,566,724)	-9.20%
WA	6,680,982	$ 1.50	29.02%	$ 151,499,989	31%	2,062,198	$ 1.05	$ 112,801,637	$ 360,923,194	$ 473,724,831	$ 137,471,083	$ (14,028,907)	-9.26%
WV	1,817,907	$ 2.16	27.75%	$ 56,745,634	19%	352,188	$ 1.51	$ 27,731,296	$ 164,872,636	$ 192,603,932	$ 53,447,591	$ (3,298,043)	-5.81%
WI	5,669,380	$ 1.77	26.62%	$ 138,874,867	28%	1,603,702	$ 1.24	$ 103,291,347	$ 374,089,108	$ 477,380,455	$ 127,089,771	$ (11,785,096)	-8.49%
	293,331,658	$ 3.68	27.75%	$ 16,118,379,402	28%	83,909,584	$ 2.59	$ 11,312,777,761	$ 39,927,967,692	$ 51,240,745,453	$ 14,724,327,213	$ (1,394,052,188)	-8.65%

VLT states - traditional Lottery % return estimated based on average of other states; *Based on Nielsen Claritas cross segmentation of households that Play Lottery, 1yr (A) and households that have a Propensity to Use the Internet to Play On-line Games; Expected loss of Sales due to Online Gaming Launch: 30.00%