



Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

May 4, 2001

Joint Committee on Finance

Paper #810

Lottery Sales, Retailer Compensation, Vendor Fees Reestimates and Lottery and Gaming Tax Credit Reestimate (Revenue -- Lottery Administration and Shared Revenue and Tax Relief -- Property Tax Credits)

[LFB 2001-03 Budget Summary: Page 592, #1; Page 594, #2; Page 595, #3; and Page 608, #4]

GOVERNOR

Lottery Sales. Estimate lottery sales at \$412.4 million in 2001-02 and \$414.2 million in 2002-03. The following table shows the 2001-03 projections, as well as 2000-01 estimated lottery sales and 1999-00 actual sales. The 2000-01 estimate was established by DOA and the Joint Committee on Finance in October, 2000, for the purposes of certifying the amount available for the 2000(01) lottery and gaming tax credit.

Lottery Sales Projections (\$ in Millions)

<u>Game Type</u>	<u>Actual 1999-00</u>	<u>2000-01</u>	<u>2001-02</u>	<u>Percent Change from 2000-01</u>	<u>2002-03</u>	<u>Percent Change from 2001-02</u>
Scratch	\$235.6	\$237.6	\$238.5	0.4%	\$239.5	0.4%
Pull-tab	5.5	6.5	8.1	24.6	8.7	7.4
On-line	<u>165.6</u>	<u>165.0</u>	<u>165.8</u>	<u>0.5</u>	<u>166.0</u>	<u>0.1</u>
Total	\$406.7	\$409.1	\$412.4	0.8%	\$414.2	0.4%

The projected sales directly affect the sum sufficient appropriations for retailer compensation and lottery vendor fees.

Retailer Compensation. Delete \$1,205,000 SEG in 2001-02 and \$1,014,700 SEG in 2002-03 to adjust base level funding for retailer compensation, including payments to retailers under the retailer performance program, to reflect projected lottery sales in the 2001-03 biennium.

Vendor Fees. Provide \$166,000 SEG in 2001-02 and \$384,800 SEG in 2002-03 to adjust funding for vendor fees to reflect projected lottery sales in the 2001-03 biennium.

Lottery Fund Condition. The effects of the Governor's sales and expenditure estimates are shown in the following lottery fund condition statement. The total revenue available for tax relief, minus a statutory reserve (2% of gross revenue) and the amount appropriated for the farmland tax relief credit, determines the amount available for the lottery and gaming tax credit. The bill appropriates \$107,400,000 in 2001-02 and \$108,400,000 in 2002-03 for the lottery and gaming tax credit. However, the available revenue under the bill would support credits of only \$102,735,200 in 2001-02 and \$102,672,100 in 2002-03. These amounts are used in the fund condition statement, rather than the appropriated amounts.

**Lottery Fund Condition Statement
Governor**

	<u>2001-02</u>	<u>2002-03</u>
Fiscal Year Opening Balance	\$8,184,100	\$3,584,700
Operating Revenues		
Ticket Sales	\$412,392,100	\$414,244,300
Retailer Fees and Miscellaneous	<u>84,000</u>	<u>84,000</u>
Gross Revenues	\$412,476,100	\$414,328,300
Expenditures		
Prizes	\$235,854,400	\$236,834,100
Retailer Compensation	29,368,800	29,559,100
Vendor Payments	12,585,000	12,803,800
General Program Operations	21,758,500	22,017,500
Appropriation to DOJ	300,700	310,300
Appropriation to DOR	<u>209,000</u>	<u>214,700</u>
Total Expenditures	\$300,076,400	\$301,739,500
Net Proceeds	\$112,399,700	\$112,588,800
Interest Earnings	\$2,868,700	\$2,814,300
Gaming-Related Revenue	\$2,532,200	\$2,306,100
Total Available for Tax Relief *	\$125,984,700	\$121,293,900
Appropriations for Tax Relief		
Lottery and Gaming Tax Credit	\$102,735,200	\$102,672,100
Farmland Tax Relief Credit	<u>15,000,000</u>	<u>15,000,000</u>
Total Appropriations for Tax Relief	\$117,735,200	\$117,672,100
Gross Closing Balance	\$8,249,500	\$8,286,600
Reserve (2% of Gross Revenues)	\$8,249,500	\$8,286,600
Net Closing Balance	\$0	\$0

* Opening balance, net proceeds, interest earnings and gaming-related revenue.

DISCUSSION POINTS

1. Lottery sales have been declining by an average of 4.8% annually since 1994-95, as shown in the following table. Although sales increased in 1998-99, as compared to 1997-98, this increase was attributable to sales associated with large Powerball jackpots in 1998-99 and did not reflect any turn-around of the overall trend of declining sales.

Lottery Sales History (In Millions)

Fiscal Year	Game Type			Total Sales
	Scratch	Pull-Tab	On-Line	
1994-95	\$310.3	\$10.0	\$198.6	\$518.9
1995-96	302.2	8.2	171.7	482.1
1996-97	266.2	7.2	157.7	431.1
1997-98	246.6	6.3	165.7	418.6
1998-99	224.9	5.9	197.4	428.2
1999-00	235.6	5.4	165.6	406.7
Average Annual Percent Change -- 1994-95 to 1999-00	-5.4%	-11.5%	-3.6%	-4.8%

2. This decline in sales can be attributed to a number of factors. These would include, but are not limited to the following:

a. Lotteries often experience steady sales growth in the initial years of operation that reaches a peak and then drops back to a more modest level. This reflects the novelty nature of lottery play. Large numbers of players are initially attracted to lottery play, but many eventually reduce or end their play. For many years, large, on-line jackpots in Wisconsin received a great deal of publicity and attention with a corresponding dramatic increase in ticket sales. Recent experience is that less attention is paid to large jackpots and the sales increases associated with these drawings are becoming progressively smaller.

b. Other forms of gambling directly compete with the Wisconsin lottery, including: (1) pari-mutuel wagering relating to live greyhound racing and simulcast greyhound and horse racing at three racetracks; and (2) casino-style gambling at 17 tribal gaming facilities.

c. The Wisconsin lottery, unlike other state lotteries, is constitutionally prohibited from conducting promotional advertising. In addition, the lottery's advertising budget (\$4.6 million annually) has not been increased since 1990-91.

3. Another argument that might be made to explain declining sales is that the number of lottery retailers has also been decreasing through this period. In December, 1995, there were 4,442 lottery retailers. This number decreased to 3,721 in December, 2000, a decline of 16.2%. The significance of this decrease for lottery sales is unclear. It is possible that in the initial years of the state lottery the actual number of retailers exceeded the number needed to make lottery tickets widely available in the state. A decrease in the number of lottery retailers in recent years may be an adjustment to the decline in consumer interest in the lottery rather than a cause of declining sales. Given the general availability of lottery tickets throughout the state at this time, the number of lottery retailers may be adequate.

4. A number of lottery initiatives during this period have, however, been approved to provide retailer support. Retailer compensation was 5% of on-line and scratch ticket sales in the initial years of lottery operations. Under 1995 Act 27 (the 1995-97 biennial budget act), retailer compensation was increased to 5.5% of these sales. In 1997 Act 27 (the 1997-99 biennial budget act), the compensation rate was increased for scratch tickets to 6.25% of sales. Also, in 1997 Act 27, 18 additional lottery positions were provided for retailer field support services or customer telemarketing services. Finally, under 1999 Act 9 (the 1999-01 biennial budget act), DOR was provided the authority, effective January 1, 2000, to establish a program for additional compensation for retailers who meet certain performance goals identified by the Department. The additional compensation paid to retailers under the program may not exceed 1.0% of gross lottery sales revenue. Payments to retailers under this program totaled \$2,114,000 in the initial six months of the program in 1999-00 and is expected to total \$4.0 million in 2000-01.

5. All of these initiatives were approved after the peak sales year of 1994-95 and all were intended, directly or indirectly, to support retailers and improve lottery sales. However, sales have continued to decline. It could be argued that the decline in lottery sales is subject to market forces that cannot easily be affected by modifications to retailer compensation, field support or sales incentives. The lottery may be at a point where any additional resources that are provided for operational costs would have no effect on sales performance and, instead, would lower the amount available for the lottery and gaming credit. It should be noted that DOR, in its 2001-03 budget request, did not request funding or positions for any new lottery initiatives.

6. As noted above, the 2000-01 lottery sales estimate established by DOA and the Joint Committee on Finance in October, 2000, for the purposes of certifying the amount available for the 2000(01) lottery and gaming tax credit, was \$409.1 million. Under the bill, sales are projected at \$412.4 million in 2001-02 and \$414.2 million in 2002-03. These sales estimates are the same as the projections by DOR in the Department's 2001-03 biennial budget request submitted on October 6, 2000.

7. Following the introduction of the bill, DOR reestimated 2000-01 and 2001-02 sales in a sales and prize payout report that is required to be submitted to the Joint Committee on Finance no later than March 1st of each year. In its March 1, 2001, report, DOR reestimated 2000-01 sales at \$405.6 million and 2001-02 sales at \$405.5 million. The following table compares: (a) the 2000-01 sales estimate made under the October, 2000, lottery and gaming credit certification and the 2000-

01 estimate made in the March, 2001, prize payout report; and (b) the 2001-02 estimate under the Governor's bill and the 2001-02 estimate under the prize payout report.

**Comparisons of Lottery Sales Estimates
(In Millions)**

Game Type	2000-01			2001-02		
	October 2000	March, 2001 Report	Percent Change	Governor's Budget	March, 2001 Report	Percent Change
Scratch	\$237.6	\$237.2	-0.2%	\$238.5	\$237.2	-0.5%
Pull-Tab	6.5	4.2	-35.4	8.1	4.2	-48.1
On-Line	<u>165.0</u>	<u>164.2</u>	<u>-0.5</u>	<u>165.8</u>	<u>164.1</u>	<u>-1.0</u>
Total	\$409.1	\$405.6	-0.9%	\$412.4	\$405.5	-1.7%

8. According to lottery officials, the Department's modifications of the scratch and on-line estimates for 2000-01 are based primarily on year-to-date sales results. The report projects no growth in scratch ticket sales in 2001-02. Officials indicate that one reason for this is that attempts to recruit additional lottery retailers for scratch ticket sales have not yet been successful. On-line sales in 2000-01 and 2001-02 were reestimated primarily on the basis of a reassessment of sales relating to the Megabucks game.

9. The largest decrease in projected sales made in the report relates to pull-tab sales. In the Governor's 2001-03 biennial budget bill, pull-tab sales were estimated at \$8.1 million in 2001-02. This represented a significant increase from actual sales of \$5.4 million in 1999-00 and the \$6.5 million projection for 2000-01 made in October, 2000. The increase was predicated on planned improvements in pull-tab prize structure, recruitment and contracting procedures affecting nonprofit organizations that sell pull-tab tickets. However, lottery officials now indicate that these changes are not being implemented as quickly as originally expected and that it will take additional time to build the interest of nonprofit organizations in the new pull-tab prize structure. In addition, pull-tab sales by for-profit retailers, primarily taverns, have declined in the last year, according to lottery officials.

10. The Department's rationale for lowering sales estimates appears reasonable. Additional year-to-date data is now available and 2000-01 lottery sales can be reestimated, at this time, to \$404.5 million. Based on the generally declining sales patterns established over the last several years, 2001-02 and 2002-03 sales are reestimated at \$403.6 million and \$402.9 million respectively. The following table shows the 2001-02 and 2002-03 sales reestimates as compared to the bill:

**Governor and Reestimated Lottery Sales Estimates
(In Millions)**

Game Type	2001-02			2002-03		
	Governor's Budget	Reestimate	Percent Change	Governor's Budget	Reestimate	Percent Change
Scratch	\$238.5	\$232.7	-2.4%	\$239.5	\$233.9	-2.3%
Pull-Tab	8.1	4.2	-47.9	8.7	3.9	-55.0
On-Line	165.8	166.7	0.5	166.0	165.0	-0.6
Total	\$412.4	\$403.6	-2.1%	\$414.2	\$402.9	-2.7%

11. Sum sufficient appropriations for retailer compensation and vendor fees are estimated on the basis of projected sales. Basic retailer compensation rates under current law are 5.5% for online ticket sales and 6.25% for instant ticket sales. In addition, the retailer performance program provides an amount of up to 1% of for-profit sales (estimated at \$4.1 million annually, under the bill) as incentive payments to retailers. Base level funding of \$30,573,800, established under 1999 Act 9, was based on estimated lottery sales of \$427.3 million in 2000-01. Under the bill, lottery sales projections of \$412.4 million in 2001-02 and \$414.2 million in 2002-03, result in reductions to retailer compensation funding.

12. Base level funding for vendor fees is \$12,419,000. Vendor fees are paid on major procurement contracts for the provision of data processing services relating to on-line and scratch ticket lottery games. The fees are calculated on the basis of a formula containing both fixed costs and a percentage of on-line and scratch ticket sales. The fixed-cost component relating to on-line sales increases by 2% each year under the contract. The bill, therefore, assumes a 2% annual increase in the on-line fixed component of the contract in the 2001-03 biennium. Under the bill, vendor fees would total 3.1% of on-line and scratch ticket sales in the 2001-03 biennium.

13. Under the reestimated sales totals, retailer compensation would total \$28,519,700 in 2001-02, and \$28,352,000 in 2002-03, which represent decreases to the bill of \$849,100 in 2001-02 and \$1,207,100 in 2002-03. Vendor fees may be reestimated at \$12,575,400 in 2001-02 and \$12,790,500 in 2002-03. These amounts would reduce vendor fee funding under the bill by \$9,600 in 2001-02 and \$13,300 in 2002-03.

14. In addition to retailer compensation and vendor fees, reestimated sales also result in recalculations of prize payout, interest earnings and the amounts available for lottery and gaming tax relief. Under these reestimates, the lottery and gaming credit amounts would total \$101,159,900 in 2001-02 and \$98,857,400 in 2002-03. These amounts are less than the amounts appropriated under the bill by \$6,240,100 in 2001-02 and \$9,542,600 in 2002-03. [As noted above, the bill appropriates \$107,400,000 in 2001-02 and \$108,400,000 in 2002-03 for the lottery and gaming tax credit, but the available revenue under the bill would not support credits in these amounts.] The reestimated amounts would provide average lottery and gaming credits of \$75 in 2001-02 and \$73

in 2002-03, based on the number of claimants in 2000-01.

15. The following fund condition statement reflects these reestimates:

Reestimated Lottery Fund Condition Statement

	<u>2001-02</u>	<u>2002-03</u>
Fiscal Year Opening Balance	\$9,324,400	\$8,074,400
Operating Revenues		
Ticket Sales	\$403,647,100	\$402,871,000
Retailer Fees and Miscellaneous	<u>72,000</u>	<u>72,000</u>
Gross Revenues	\$403,719,100	\$402,943,000
Expenditures		
Prizes	\$230,258,200	\$229,867,000
Retailer Compensation	28,519,700	28,352,000
Vendor Payments	12,575,400	12,790,500
General Program Operations	21,758,500	22,017,500
Appropriation to DOJ	300,700	310,300
Appropriation to DOR	<u>209,000</u>	<u>214,700</u>
Total Expenditures	\$293,621,500	\$293,552,000
Net Proceeds	\$110,097,600	\$109,391,000
Interest Earnings	\$2,335,000	\$2,455,000
Gaming-Related Revenue	\$2,477,300	\$1,995,900
Total Available for Tax Relief *	\$124,234,300	\$121,916,300
Appropriations for Tax Relief		
Lottery and Gaming Tax Credit	\$101,159,900	\$98,857,400
Farmland Tax Relief Credit	<u>15,000,000</u>	<u>15,000,000</u>
Total Appropriations for Tax Relief	\$116,159,900	\$113,857,400
Gross Closing Balance	\$8,074,400	\$8,058,900
Reserve (2% of Gross Revenues)	\$8,074,400	\$8,058,900
Net Closing Balance	\$0	\$0

*Opening balance, net proceeds, interest earnings and gaming-related revenue

MODIFICATION

Delete the following: (a) \$849,100 in 2001-02 and \$1,207,100 in 2002-03 from the retailer compensation appropriation; (b) \$9,600 in 2001-02 and \$13,300 in 2002-03 from the vendor fees appropriation; and (c) \$6,240,100 in 2001-02 and \$9,542,600 in 2002-03 from the lottery and gaming credit appropriation.

Explanation: The lottery sum sufficient appropriations for retailer compensation, vendor fees and the lottery and gaming credit are estimated, in part, based on lottery sales estimates. Based on reestimated sales, the bill provisions relating to lottery sum sufficient appropriations should be modified to reflect: (a) reestimated retailer compensation of \$28,519,700 in 2001-02 and \$28,352,000 in 2002-03; (b) reestimated vendor fees of \$12,575,400 in 2001-02 and \$12,790,500 in 2002-03; and (c) reestimated lottery and gaming credits of \$101,159,900 in 2001-02 and \$98,857,400 in 2002-03.

Modification	SEG
2001-03 FUNDING (Change to Bill)	- \$17,861,800

Prepared by: Art Zimmerman