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BILL ANALYSIS

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Senate Bill 1208 (as introduced 4-19-06)
Sponsor: Senators Michael Switalski
Committee: Appropriations

Date Completed: 9-13-06

CONTENT

The bill would amend the McCauley-Traxler-Law-Bowman-McNeely Lottery Act to postpone the scheduled change on January 1, 2007, in the distribution of lottery revenue and continue until January 1, 2012, the current formula that requires not less than 45.0% of total annual ticket sales to be used for prize money. After the designated date, 45.0% (rather than not less than 45.0%) must be used for prizes.

MCL 432.12

BACKGROUND

Almost all of the revenue received by the Bureau of State Lottery comes from ticket sales. Small amounts of revenue may result from charitable gaming and investments. After the payment of prizes and reasonable operating expenses for the Bureau, the net revenue in the State Lottery Fund is deposited in the State School Aid Fund.

When the Act initially was enacted in 1972, the Lottery Bureau was required to distribute 45.0% of total annual sales for prizes. Public Act 53 of 1995 amended this provision to require not less than 45.0% of ticket sales to be used for prize money, and set a sunset of January 1, 1999, on which the ratio would return to 45.0% of sales used for prizes. Public Act 167 of 1996 added a subsection excluding games involving joint enterprise agreements (multistate games such as the Big Game) from the calculations of ticket sales or prizes. Additional revisions to this section in Public Act 393 of 1998 and Public Act 471 of 2002 pushed the date of the sunset back to January 1, 2003, and then January 1, 2007, continuing the ratio of not less than 45.0% of sales used for prize money for another four years.

Based on the May 2006 consensus estimate that \$712.0 million in lottery revenue would be deposited into the School Aid Fund during FY 2006-07, the lottery deposit to the School Aid Fund will decrease between \$147.7 million and \$200.9 million on an annualized basis following the sunset on January 1, 2007, assuming a 40.0% to 45.0% reduction in annual lottery ticket sales. Compared with the FY 2006-07 consensus revenue estimate, because the change would affect only a portion of the fiscal year, the lottery deposit to the School Aid Fund during FY 2006-07 would decrease only between \$110.8 million and \$150.7 million under such a reduction in annual lottery ticket sales. The May 2006 consensus revenue forecast, upon which the FY 2006-07 School Aid budget was built, did not incorporate the statutory lottery revenue distribution change expected on January 1, 2007.

Between FY 1996-97 and FY 2002-03, approximately 54.0% of ticket sale revenue was distributed for prizes. The introduction of new games with higher prize payout rates and the increase in the payout rates on existing games have increased the average to almost 59.0% for the first 50 weeks of FY 2005-06. Under the Big Game, 50.0% of sales are allocated to

prizes, leaving prizes from other games to average approximately 60% of sales for year-to-date FY 2005-06, compared with approximately 55.0% during the FY 1996-97 to FY 2002-03 period. Under the current statute, on January 1, 2007, the change in revenue distribution will result in a 24.6% reduction in the share of lottery sales allocated to prize money for games other than the Big Game. The sunset in statute, which the bill would postpone, does not affect prizes under the Big Game.

The degree to which sales will respond to the change in the amount of prizes awarded is unknown. Factors such as the opening of the Detroit casinos, the introduction of new games, and general economic conditions make it difficult to predict the response to less prize money using historical data. As gaming activities that compete with the lottery have proliferated, the responsiveness of sales to changes in prize money appears to have increased. Reducing prize distributions will likely cause ticket sales to decline. Other states that reduced prize payout rates by smaller proportions (than what will occur if the bill is not adopted) experienced significant reductions in sales that remained even after payout rates were later restored. Recent experience suggests that the change in sales due to the sunset could easily be 50.0% to 80.0%, although these figures are probably too large because they reflect the initial effects of introducing new gaming opportunities such as the Detroit casinos, internet gambling, and the Big Game, as well as a substantial increase in Indian gaming. While the initial impact of these new gaming opportunities on sales is likely greater than the ongoing effect, the availability of substitutes for the lottery virtually ensures that declines in prize money will reduce lottery ticket sales. However, the effect of changes also has increased as the prize payout rates have increased. Furthermore, the impact of the sunset varies significantly from even small changes in the assumption of how responsive sales are to the share of revenue devoted to prize money. For example, changing the estimated decline in sales from 40.0% to 45.0% increases the revenue impact of the sunset by approximately \$53.2 million.

Overall, lottery revenue declined at an average rate of 3.4% a year between the time the casinos opened in the City of Detroit and FY 2001-02. Should the purchase of lottery tickets become less attractive relative to the Detroit casinos (particularly as the casinos open the "permanent" facilities) due to less lottery prize money, the rate of decline in lottery participation could increase. However, because Big Game prizes are not affected by the sunset, the decline in the share of sales allocated to prizes also might increase Big Game sales.

FISCAL IMPACT

The changes proposed by Senate Bill 1208 would continue the current distribution formula of not less than 45.0% of total annual revenue from ticket sales being used for prizes for another five years. The bill would maintain lottery revenue and the lottery deposit to the School Aid Fund at levels consistent with the May 2006 consensus revenue estimate. The anticipated reduction in prize money and the deposit to the School Aid Fund would not occur. The estimate assumes that prize money would follow the pattern of the past few fiscal years and continue to be awarded at a share of approximately 60.0% of annual ticket sales for games other than the Big Game.

Under the latest estimate for FY 2006-07 lottery revenue, the bill would increase School Aid Fund revenue by \$110.8 million to \$150.7 million over the nine months of FY 2006-07 affected by the bill. This estimate is included in the current consensus estimate of lottery revenue to the School Aid Fund.

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