

Background Paper 83-8

STATE LOTTERIES

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I

INTRODUCTION

One form of legalized gambling that is receiving considerable attention throughout the United States is the state-operated lottery. Seventeen states and the District of Columbia have authorized such a lottery, and several other states are considering similar action.

A lottery can be simply described as a game of chance in which players buy chances to share in a distribution of prizes based on a drawing of lots. A wide variety of games can be played under a lottery, and there are numerous ways to structure lotteries. Large cash prizes are most common in lotteries, but sometimes goods or services are awarded to the winners.

The state lottery has emerged as a popular method for increasing state revenue. The budgetary shortfalls of the 1970's resulted in 12 states turning to lotteries, and the even more profound economic situation of the current decade has already brought another three states into the lottery business. States are considering alternative sources of revenue, and the state lottery is becoming one of the more attractive alternatives to raising taxes.

This paper examines state lotteries and the issues surrounding them. Particular emphasis is placed on discussing the state lottery as a possible revenue source for Nevada.

II

HISTORY AND DEVELOPMENT

The history of the lottery in America can be traced to 1612 when the Virginia Company received an English public license to finance the Jamestown settlement (Weinstein and Deitch, p. 7). Lotteries were common in this country from the colonial period through the early 19th century.

Although many of the early lotteries helped finance public projects, they were usually conducted by private groups or individuals under government license. Lottery funds were used to build public institutions such as hospitals, orphanages and colleges.

During the 1830's, fraud and corruption surfaced in lottery operations throughout the country. Most states reacted to lottery abuses by prohibiting lotteries. In fact, by 1860, almost every state had enacted constitutional or statutory prohibitions against lotteries (United States Commission on the Review of the National Policy Toward Gambling, Gambling in America, p. 145).

By 1878, Louisiana was the only state to allow lotteries. The Louisiana Lottery Company was chartered by the state in 1868, and it used the mails to expand operations nationwide. Bribery was used by the lottery company to guarantee its support by public officials in Louisiana, but national opposition grew as the other states came to resent the lottery profiting at the expense of their residents.

The Federal Government was called upon to stop the interstate business of the Louisiana Lottery, but the first federal anti-lottery statutes proved to be weak and unenforceable. It was not until 1890 that a law which effectively prohibited mailing lottery materials passed Congress. Finally, an 1895 federal law made it illegal for lotteries to use interstate commerce. The federal prohibitions and Louisiana state legislation (1893) combined to put an end to the lottery.

In recent years, the economic problems of state and local governments focused attention on the financial benefits of lotteries. Faced with the need to increase revenues at a time when state taxpayers were already overburdened, New Hampshire lawmakers authorized the first state lottery in 1963. The New York State Lottery followed in 1967 under similar revenue conditions.

Lottery revenues in New Hampshire and New York were far short of expectations, but New Jersey initiated a sound revenue producing lottery in 1971. New Jersey's lottery system (inexpensive tickets, easily accessible playing locations, and fast action game results) soon became the success model for other states.

After Congress repealed most of the federal restrictions on lotteries in the 1970's, state lottery operations improved and expanded. New types and varieties of games attracted increasing numbers of players, and ticket sales rose dramatically.

As more states confront fiscal crises, the lottery becomes an increasingly attractive revenue source. Fourteen states have now joined New Hampshire, New Jersey and New York with state lotteries; and several additional states are studying the lottery as a possible means of funding necessary government services.

III

STATE LOTTERY PROGRAMS

As noted above, 17 states have established lottery programs. (See listing of the state programs on pages 5 and 6.)

Organization

In all but three states, commissions or boards are responsible for regulating lottery operations. In the states of Delaware, Michigan and New York, the lotteries are regulated by administrators. Although a majority of the lottery states (Arizona, Maine, Maryland, Massachusetts, Michigan, New Hampshire, Ohio, Rhode Island, Vermont and Washington) created independent lottery agencies to administer their lottery programs, seven states (Colorado, Connecticut, Delaware, Illinois, New Jersey, New York and Pennsylvania) placed the responsibility for lottery regulation in their revenue departments.

Games

The lottery games introduced by New Jersey in 1971 set the pattern for modern state lotteries. New Jersey's computer-based "weekly game" has been picked up by all the lottery states. In recent years, the types and varieties of games have increased to include the "daily numbers game" (3-digit and 4-digit varieties), the "instant game" and "lotto." (See appendix A for a description of lottery games.)

Although the daily numbers game produces the greatest revenue for lotteries, the instant game is gaining in popularity and in earned revenues. The numbers game accounted for nearly half of the lottery sales in 1980 while the instant game contributed more than one-third of the total sales revenue nationwide.

Lotto is the newest lottery game, but it may soon lose this distinction to a video lottery game. Video lottery games,

using the same principle as existing video entertainment games, are under experiment in New Jersey. Many gaming industry experts view video games as having great potential in attracting young, professional consumers.

Ticket Sales

Lottery tickets are commonly sold for 50 cents to \$1. For more expensive games, tickets cost up to \$5. Tickets are sold through retail establishments such as groceries, liquor stores and pharmacies. In most games, sales agents use on-line computer terminals to make lottery transactions for the players. The agents and/or the retailers receive commissions for their ticket sales.

According to lottery industry research, state lotteries grossed \$2.4 billion in sales in 1980 and \$3 billion during 1981 ("The Economic Potential of State Lotteries," Public Gaming, p. 41). Duane Burke, president of the Public Gaming Research Institute, recently stated that the gross lottery revenues in the United States reached \$3.8 billion in calendar year 1982. Predicted estimates for 1983 put the sales total close to \$4.5 billion ("Lotteries Make Bucks," p. 11).

Costs (Revenue Allocations)

Most state lottery laws stipulate the percentage of gross revenues to be allocated for prizes. In a majority of the lottery states, the prize allocation is set at or near 45 percent of the gross. Some states restrict operating costs (ticket printing, gaming devices, advertising, sales commissions and administrative expenses) with a statutory limit based on a maximum percentage of sales revenue.

Computations, based on the most recent revenue data available from the 15 state lottery programs operating in fiscal year (FY) 1982, reveal that the average state program paid out an estimated 48 percent of sales revenue in prizes, while the average cost of operating a state lottery was approximately 15 percent of the gross sales revenue. (See table 1 on pages 5 and 6 for revenue data.)

Net Revenue

Revenue has grown sharply since 1980, and some of the lottery programs are surpassing even optimistic sales projections. For example, New York's record high sales of \$425 million in FY 1982 were 79 percent higher than the previous year's sales. Several other state programs are reporting annual gross sales increases over 20 percent.

TABLE 1

STATE LOTTERY PROGRAMS

State	First Drawing	Organizational Authority	Sales Revenues* [Millions]	Prize Allocation* [Millions]	Net Revenue* [Millions]	Revenue Use
ARIZONA ^a	1981	State Commission	\$118	\$ 53 (45%)	\$ 37 (38%)	Local Transportation Fund and General Revenue Fund
COLORADO ^b	1983	State Commission	----	50% Min.(Stat.)	----	Conservation Fund, Parks and Recreation, Capital Construction
CONNECTICUT	1972	State Board	\$169	\$ 88 (52%)	\$ 71 (42%)	General Fund
DELAWARE	1975	Lottery Director	\$ 26	\$ 13 (50%)	\$ 10 (38%)	General Fund
ILLINOIS	1974	State Board	\$335	\$158 (47%)	\$143 (43%)	General Revenue Fund/ Corporate Loan Fund
MAINE	1974	State Commission	\$ 10	\$ 5 (50%)	\$ 2 (20%)	General Fund
MARYLAND	1973	State Commission	\$457	\$211 (46%)	\$199 (44%)	General Fund
MASSACHUSETTS ^c	1972	State Commission	\$224	45% Min.(Stat.)	\$ 78 (35%)	Local Aid
MICHIGAN	1972	Commissioner (Administrator)	\$525	\$270 (51%)	\$218 (42%)	School Aid Fund
NEW HAMPSHIRE	1964	State Commission	\$ 13	\$ 6 (46%)	\$ 4 (31%)	Education
NEW JERSEY ^d	1971	State Commission	\$417	\$208 (50%)	\$176 (42%)	Aid to Education and State Institutions
NEW YORK	1967	Lottery Director	\$425	\$191 (45%)	\$179 (42%)	Aid to Education

State	First Drawing	Organizational Authority	Sales Revenues* [Millions]	Prize Allocation* [Millions]	Net Revenue* [Millions]	Revenue Use
OHIO ^c	1974	State Commission	\$297	45% Min.(Stat.)	\$110 (37%)	General Fund
PENNSYLVANIA	1972	State Commission	\$562	\$274 (49%)	\$227 (40%)	Senior Citizen Programs
RHODE ISLAND	1974	State Commission	\$ 38	\$ 19 (50%)	\$ 13 (34%)	General Revenue Fund
VERMONT	1978	State Commission	\$ 4	\$ 2 (50%)	\$ 1 (25%)	General Fund, Capital Expenditures/Debt Service
WASHINGTON ^b	1982	State Commission	----	45% Min.(Stat.)	----	General Fund

*All revenue figures were rounded to the nearest million.

^aSales revenue and prize allocation for July 1, 1981 to July 11, 1982 (first five games); net revenue for fiscal year 1982.

^bNo revenue figures available for new program.

^cRevenue figures for fiscal year 1981 (Public Gaming Research Institute, Rockville, Maryland).

^dRevenue figures for fiscal year 1981 (New Jersey State Lottery 1981 Annual Report).

NOTE: Percentage figures listed under "Prize Allocation" and "Net Revenue" each refer to a percentage of their state's sales revenue.

SOURCES OF REVENUE INFORMATION: Fiscal year 1982 annual lottery reports from the respective state lottery programs.

Increasing gross sales means increasing net revenue for the lottery states. Considering the revenue figures for FY 1982, the average lottery state netted an estimated 37 percent of its total lottery sales revenue. The Public Gaming Research Institute found that the 14 state lotteries operating in 1980 contributed a cumulative \$1.2 billion to their respective states--an average contribution of between 1.5 percent and 3 percent of the state's total budget (Public Gaming, p. 42).

Revenue Use

Eight states earmark their net revenue funds to the state general revenue fund. Arizona allocates part of its revenues to local transportation and the remainder to the general fund. In Illinois, the state's general revenue fund and the corporate loan fund both receive lottery revenue. Education is the sole recipient of state lottery funds in Michigan, New Hampshire and New York. New Jersey provides for both education and state institutions with its lottery resources. Lottery revenues are dedicated to aiding local government in Massachusetts and to assisting senior citizens in Pennsylvania. Colorado's new program targets funding for conservation, parks and recreation, and capital construction.

IV

PROS AND CONS

Pros

The strongest arguments in favor of state lotteries relate to revenue production.

1. Lotteries generate millions of dollars for state treasuries, and legislators can rely on the lottery as an income source for meeting the state budget.
2. Compared to the political struggles involved in imposing new taxes or increasing existing tax rates, a lottery is a relatively painless way to raise revenue. It has been argued for centuries that the lottery is the only "tax" which people appear happy to pay (Weinstein and Deitch, p. 75).

3. Lotteries benefit business. Lottery prizes and most of the operating expenses are absorbed by the private sector. Retail establishments that act as ticket agents and banks that handle lottery funds benefit. Of course, vendors and lottery service providers--ticket printers, computer companies, news media, consultants and advertising agencies--receive direct income from state lotteries.
4. State lottery games offer inexpensive forms of amusement. The public is entertained while helping to fund state government.

Cons

Critics argue that state lotteries are ineffective, inequitable and inefficient.

1. Lotteries contribute only a small percentage of total state revenues--from less than 1 percent of revenue in Vermont to no more than 3 percent in most states. Revenues from lottery programs are small in comparison with income from major taxes, and it would be simpler and more effective to raise the rate of a major tax than to operate a lottery.
2. Since the money spent on lottery tickets would most likely have been spent on other taxable items, the lottery results in the state losing revenue from consumption (sales) taxes.
3. As a substitute for taxation, the lottery acts as a regressive tax which results in lower income groups paying a larger proportion of their income than higher income classes.
4. Developing a lottery and stabilizing the revenue requires constant promotion through increased advertising and the introduction of new types of games. These promotional costs make a lottery an expensive source of public funds. The cost of raising \$1 by lottery--between 15 and 40 cents--is much higher than raising a dollar by other forms of taxation which is about 5 cents (Blakey, p. 80).

NEVADA OVERVIEWBackground

Article 4, section 24, of the Nevada constitution prohibits lotteries. Furthermore, chapter 462 of Nevada Revised Statutes defines "lottery" and provides penalties for lottery activities.

The constitutional prohibition was part of the original constitution adopted in 1864. Although the records of the constitutional proceedings and other historical documents do not reveal the reasoning behind the lottery prohibition, it is likely that the members of the convention subscribed to the strong anti-lottery sentiment prevailing in the United States at the time. The statutory penalties relating to lotteries were enacted in 1873.

Toward the end of the 19th century, various groups attempted to repeal the constitutional prohibition or to bypass it by other means. The goals of the lottery supporters ranged from individual profit and pleasure to providing needed funds for state projects and charitable institutions.

The 1887 legislature passed a bill authorizing a lottery corporation, but Governor Stevenson vetoed it based on constitutional grounds (Scrugham, p. 354).

In 1899, the legislature approved a proposed constitutional amendment to legalize lotteries, but it was defeated in the next session before the amendment could be submitted to the voters. Many of the members of the 1901 legislature had run for office on an anti-lottery platform, and newspaper editorials of the day opposed the immorality of a lottery law (Glass, pp. 195 to 196).

Lottery support in Nevada generally remained dormant until the midsixties. In 1965, a sweepstakes corporation was chartered in Nevada. This corporation sought to amend the constitution by initiative, but the voters defeated the private lottery proposal in 1968.

Recent Proposals

The following lottery proposals have been introduced in recent legislative sessions:

58th Session (1975)

- A.J.R. 33 - Proposing to repeal the constitutional prohibition of lotteries.
- A.J.R. 34 - Proposing to amend the constitution to allow lotteries conducted by charitable organizations.

59th Session (1977)

- A.J.R. 24 - Proposing a state lottery for the support of senior citizens' property tax relief.
- A.J.R. 33 - Proposing to amend the constitution to allow legislative authorization of lotteries conducted by charitable or religious organizations.

61st Session (1981)

- A.J.R. 24 - Proposing to amend the constitution to allow lotteries for charity and activities conducted by nonprofit organizations. (Passed the 61st legislature and presented to the 1983 session.)
- S.J.R. 23 - Proposing a state lottery to benefit older residents and education.
- S.B. 312 - Repealing the statutes relating to lotteries (penalties for lottery activities).

62nd Session (1983)

- A.J.R. 24 of the 61st Session - Returned for consideration by this legislature.
- S.J.R. 1 - Proposing to repeal the constitutional prohibition of lotteries (see appendix B).

Assembly Joint Resolution 24 of the 61st session, which, as noted above, does not pertain to a state lottery--just

charities, is the only lottery measure to pass the legislature. If the present S.J.R. 1 passes two sessions of the legislature and receives the necessary voter approval, the earliest that a lottery could be legally and practically established in Nevada would be in 1985 or 1986.

Revenue Projections

The fiscal analysis division of the legislative counsel bureau made a "minimum" revenue projection for a Nevada lottery operating in fiscal year 1982-1983 (Legislative Counsel Bureau, Fiscal Analysis Division, pp. 4 and 5). This projection was the result of the application of a formula used by the state lottery programs in Arizona, Colorado and Washington.

The fiscal analysis division's projection for net revenue to the state for the 1982-1983 fiscal year was \$7.3 million from gross revenues of \$18.4 million. Lottery expenses considered in the projections were prizes (45 percent of the gross revenues) and operating costs (15 percent of the gross). The division's net revenue projection represents approximately 1.7 percent of the state's \$423 million current fiscal year budget.

Concerns

The failure of lottery proposals in recent Nevada history can be attributed to vigorous opposition from leading public officials and various business groups. Before the Federal Government relaxed its anti-lottery laws, there was serious concern that a lottery operating in Nevada might invite federal intervention in the gaming industry. The more immediate opposition has come from a belief that a lottery would not generate any appreciable revenue but would antagonize neighboring states and have a negative impact on gambling in general (Bushnell and Driggs, pp. 131 to 132).

The overriding concern relates to the impact of a state lottery on Nevada's gaming industry. Nevada's gaming industry has gone on record in opposition to a state lottery. Both the Gaming Industry Association of Nevada and the Nevada Resort Association hold the position that a Nevada state lottery would have a detrimental impact on gambling. They believe that a lottery would compete with gaming and, consequently, reduce the industry's earnings.

VI

LEGISLATIVE CONSIDERATIONS

One advantage that Nevada has over other states considering lotteries is its pro-gambling attitude. While other states debate the moral and social issues regarding the lottery as a form of legalized gambling, Nevada is free to concentrate on concerns pertinent to its economy.

How Would a State Lottery Affect the Gaming Industry?

Revenue data and program information from the states with lotteries cannot be properly compared to Nevada. Although New Jersey now has legalized gambling, its state lottery was a successful operation well before the opening of the Atlantic City casinos. Nevada presents the only case where a state-operated gaming enterprise, a lottery, might compete with existing business.

A recently released report on the gaming industry (The Role of Gaming in the Nevada Economy: An Update, pp. II-1 and IV-4), reveals that gaming and casino taxes provide over 52 percent of the state's general fund revenue. Nearly 60 percent of Nevada jobs depend, directly or indirectly, on gaming.

Since the gaming industry is so vital to state government and the state's overall economy, any proposal to establish a Nevada state lottery must be studied in relation to its effect on gaming revenue. The Nevada gaming industry, as mentioned earlier, believes that a state lottery would have a negative impact on gaming and should not be considered by the legislature.

A comprehensive study on legalized gambling (Weinstein and Deitch, p. 5) found that various forms of gambling can substitute for one another and lead to a saturation of the gambling market. Thus, a state lottery might compete with private sector gambling activities and dilute gaming industry revenue.

Some believe the potential impact of a lottery on gaming needs to be determined through a marketing survey and a detailed financial analysis based on a definite lottery proposal.

What Would Be the Initial Costs of Starting a State Lottery?

Startup costs have averaged \$1 million for existing state lotteries. Arizona's legislature appropriated \$1.4 million for its lottery. Revenue from a Nevada lottery would be partly dependent upon the state's financial commitment to starting the program.

The organization of the lottery is the primary cost factor. Creating a new state agency could be costly. Ticket sales would generate prize money, but only after state funds pay for the tickets, advertising and general operating expenses.

Would a State Lottery Be Worth the Costs?

It is said that the current budgetary problems facing the state dictate that the legislature consider all additional sources of potential revenue. The possibility that over \$7 million a year could be earned by a state lottery is sufficient reason, some say, to seriously consider the creation of a Nevada lottery.

As discussed earlier, however, projected lottery revenue must be weighed against the costs associated with a state lottery. These costs include state appropriations for starting and operating the lottery and possible tax revenue and personal income lost from any negative impact on the gaming industry. Cost factors need to be estimated and compared with projected revenue to obtain an accurate cost-benefit analysis of a state lottery in Nevada.

VII

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APPENDIX A

LOTTERY GAMES

Daily Numbers Game

In this game, a 3-digit number (ranging from 000 to 999) is selected for play. The player tells the agent his number and then places his bet (amount of bet and type of bet).

Five common bet types:

Straight bet - winning number in exact order.

3-way combination bet - two of the same digits in winning number in any order or combination.

6-way combination bet - any three digits in winning number in any combination.

Back-up bet - split between a straight bet and a combination bet.

Front, back or split pair bet - any two digits in winning number as either the front pair of numbers, back pair or split pair (one front, one back).

The 3-digit number is then drawn, and the winning player collects his prize based on one of two prize schedules:

Fixed payment - a certain payout is guaranteed based on the amount and type of bet.

Pari-mutuel - no guaranteed prize but big payoffs on the least played winning numbers.

4-Digit Numbers Game

This game uses the same basic game procedure as the 3-digit number except a 4-digit number is selected. In addition, the game may be offered on a daily, semi-weekly or weekly basis. The bets are similar to those in the 3-digit daily game except more combinations are available with the extra digit.

Instant Game

The player purchases a ticket which usually contains a concealed symbol or number. After rubbing off a covering, the newly revealed symbols or numbers are matched against the winning symbol or number. The player is an "instant" winner or loser. Tickets are sold at various time schedules which may include games lasting over a period of several weeks or months.

Weekly Game

A prenumbered ticket is purchased and matched against the winning number drawn each week. The ticket usually contains a series of boxes and several numbers. Each box represents a certain prize.

Lotto

Six digits out of a possible 40 are selected in the traditional lotto game. A weekly drawing results in the selection of six balls out of 40. First prize goes to the player with the six winning digits in any order. The prize is shared when more than one player has the winning six digits. If no first prize is won, part of the prize money is placed in the pool for the next drawing. This practice continues until an accumulated prize jackpot is won in a first prize selection.

SOURCE: Adapted from "The Economic Potential of State Lotteries," Public Gaming, January 1982, pp. 42-43.

APPENDIX B

S. J. R. 1

SENATE JOINT RESOLUTION NO. 1—SENATORS BILBRAY, FAISS AND NEAL

JANUARY 17, 1983

Referred to Committee on Government Affairs

SUMMARY—Proposes to repeal constitutional prohibition of lotteries. (BDR C-312)

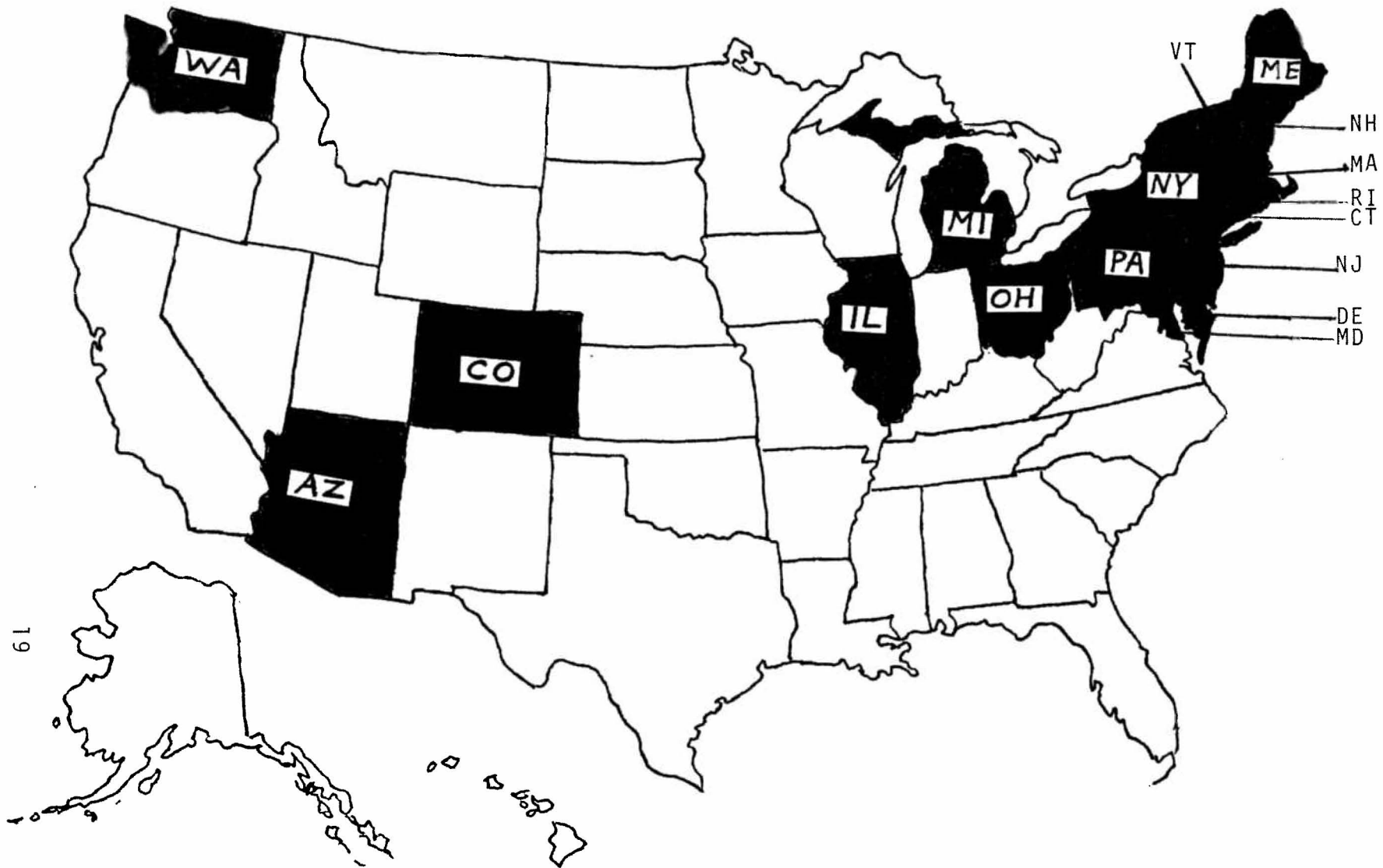
FISCAL NOTE: Effect on Local Government: No.
Effect on the State or on Industrial Insurance: No.



EXPLANATION—Matter in *italics* is new; matter in brackets [] is material to be omitted.

SENATE JOINT RESOLUTION—Proposing to repeal section 24 of article 4 of the constitution of the State of Nevada, prohibiting lotteries.

- 1 *Resolved by the Senate and Assembly of the State of Nevada,*
- 2 *jointly, That section 24 of article 4 of the constitution of the State of*
- 3 *Nevada be repealed.*



MAP 1

GEOGRAPHIC DISTRIBUTION OF LOTTERY STATES