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NORTH CAROLINA CENTER FOR PUBLIC POLICY RESEARCH INC.

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N.C. CENTER'S RESEARCH ANSWERS 13 QUESTIONS ABOUT STATE LOTTERIES

With a state lottery having passed the N.C. House and under consideration by the state Senate, the North Carolina Center for Public Policy Research today re-released a major study addressing 13 key questions about the experiences with lotteries already operating in 42 states. The Center also cautioned lawmakers about trying to enact a lottery by including it as a special provision in the budget bill. The Center's study presents research findings on questions such as whether lotteries are large and reliable sources of revenue, whether lotteries prey on the poor, and whether lotteries provide new revenue for government programs such as education or merely supplant existing revenues. The Center says it is providing this research now to help ensure that lawmakers and both advocates and opponents of the lottery have accurate information on which to base their views on this important issue

"North Carolina is closer to passing a state lottery than it has been in contemporary times," says Mike McLaughlin, editor of *North Carolina Insight*, the Center's magazine in which the lottery study was originally published. "The time is now for the citizens of this state to educate themselves on this issue and make their voices heard. Our study shows about four pluses for lotteries, five minuses, and four questions where the research findings are inconclusive. We hope this raises the level of debate about lotteries in the public, the press, and the pulpits."

Proponents of a lottery in North Carolina estimate it would generate as much as $400 million in revenue in its first full year of operation, or 2.2 percent of the state's $15.9 billion operating budget. Governor Mike Easley made a lottery a centerpiece of his 2000 election campaign and has since pushed hard for one to support public education and relieve chronic budget shortfalls. Lottery bills have been introduced during every legislative session in North Carolina since 1983. While the Senate has passed lottery bills several times, this session the House passed one after Speaker of the House Jim Black (D-Mecklenburg) backed it. The House version sets aside funding for school construction, college and university scholarships, and other education programs to be chosen by the legislature. Unlike legislation from prior years, the House bill does not ask for a citizen referendum and thus avoids the question of whether submitting the issue to a vote of the people would be constitutional.

The Center said it would oppose any effort to enact a state lottery by adding it as a special provision to the state budget bill. In four separate reports since 1986, the Center has detailed the legislature's past inappropriate use of special provisions and said that process is unfair to the public, the press, and rank-and-file legislators. The Center's director, Ran Coble, says, "The lottery is an important public policy decision that needs to stand or fall on its own merits and not used as a poker chip in trades for votes in gaining passage of a state budget."

Special provisions are defined in previous Center reports as portions of budget bills which are used in any of the following inappropriate ways:

(1) to amend, repeal, or otherwise change any existing law other than the Executive Budget Act;

(2) to establish new government programs (such as a lottery) or to alter the powers and duties of existing programs;

(3) to establish new boards, commissions (such as a commission to run the lottery), or councils or to alter the powers of existing boards;

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(4) to grant special tax breaks or otherwise change the tax laws; or
(5) to authorize new interim studies by the General Assembly, executive agencies, or other groups within the budget bill rather than in the normal omnibus bill authorizing interim studies.

"Lottery bills have come before the legislature every session since 1983, but this year is the first time a lottery bill has passed the House," says the Center's McLaughlin. "That's why it's critical that the citizens educate themselves on the pluses and minuses of lotteries and make their feelings known to their elected representatives."

IS A LOTTERY A LARGE OR RELIABLE SOURCE OF REVENUE FOR THE STATE?

The current wave of lotteries started with a 1964 decision by the New Hampshire legislature and has since swept to 41 states and the District of Columbia. When the Center first published its research in 2000, 31 states earmarked at least a portion of the lottery proceeds for a particular government program. Of those that earmarked, the majority (20 states) channeled at least a portion of the proceeds to public education.

Other states use lottery funds to support programs ranging from parks and recreation to police and firefighters' pensions. Georgia uses lottery funds for its HOPE college scholarship fund, while Pennsylvania supports a broad range of programs for the elderly. The Center found that as a percentage of total state budgets, the revenue from lotteries is small, ranging from 0.33 percent ($6.3 million in revenue) in Montana to 4.07 percent ($558.5 million) in Georgia.

While lotteries provide a relatively reliable revenue source compared to some sources of revenue such as the sales tax, lottery revenues are on the decline as a percentage of total state revenues. For the 29 states operating lotteries in 1989, lottery revenues constituted 3.5 percent of the total budget at that time but dropped to 1.9 percent by 1997 for those same 29 states. Experts blamed "jackpot fatigue" and competition from other forms of gambling for the decline. To keep interest strong, states must continually introduce new games and maintain or even increase their commitment to advertising and marketing.

"The bottom line is that state lotteries are a very small source of revenue but a fairly reliable source, because if lottery play drops, the states just adopt more aggressive games or step up their marketing," says the Center's McLaughlin. However, McLaughlin pointed out that the legislation that passed the House outlaws marketing except where tickets are sold, which could handicap the lottery in reaching its revenue goals.

WHO PLAYS THE LOTTERY AND WHAT ARE ITS SOCIAL CONSEQUENCES?

Critics contend that the lottery preys on the poor and uneducated, though lottery advocates dispute this contention vigorously. The Center found that the weight of the evidence shows that lottery play is spread fairly evenly across almost all income groups and that the poor do not participate in lotteries out of proportion to their percentage of the population. However, the poor do spend a higher proportion of their incomes on lottery tickets than do players who earn more.

The Center says proponents and opponents mix up these measures of lottery participation when debating this issue. One measure is the *participation rate*, or the percentage in a group such as the poor who buy lottery tickets in a given period of time. A second measure is the *average expenditure* by members of the group, and a third is the *prevalence of heavy players* in the group.

Education levels, however, do affect how much lottery participants spend. The 1999 Report to the National Gambling Impact Study Commission states that *participation rates* do not vary much by education, but that the *amount of money spent* by players drops sharply as education levels increase. High school dropouts who play the lottery are by far the biggest spenders. African Americans who play lotteries spend more than other racial groups. Other socioeconomic groups that play heavily include males, Catholics, Hispanics, laborers, and the middle-aged.

Commenting on the high level of lottery expenditure versus the poor odds of winning, mathematician Roger Jones says, "I guess I think of lotteries as a tax on the mathematically challenged."

But despite heavy play by some socioeconomic groups, the Center found that the evidence suggests that a lottery does not contribute to compulsive gambling as much as certain other games of chance. Lottery officials say compulsive gamblers tend to gravitate instead toward types of gambling that involve a skill element and provide an immediate reward, such as casino games and games played at video terminals. In addition, states have not found a way to prevent minors from playing the lottery, even though play by minors is illegal in every state.

The Center says other social consequences of lotteries are difficult to prove or disprove through research. One such question is whether state government is diminished in the eyes of its citizens for promoting an activity that otherwise would be illegal. Indeed, lottery states find themselves in the hypocritical position of aggressively promoting one form of gambling (lotteries) while criminalizing others (such as video poker or betting on college athletics). Many citizens simply think that lotteries are a form of gambling and are morally wrong. Another possible social consequence is the impact of frequent lottery play on the work ethic of citizens and their susceptibility to get-rich-quick schemes.

DO LOTTERY REVENUES *SUPPLEMENT* STATE FUNDING FOR SPECIFIC PROGRAM AREAS SUCH AS EDUCATION OR *SUPPLANT* IT?

In promoting lotteries, proponents typically argue that lottery revenues will enhance funding in certain program areas such as education. However, there is no guarantee that state legislatures will not merely substitute lottery revenues for normal appropriations. The Center found that research results on this question are inconclusive.

Research in California, Florida, and Michigan shows that lottery funds have merely substituted for normal levels of appropriations, despite the fact that lotteries had been promoted as boosting spending for education. And, a separate study by *Money* magazine found that states with lotteries devote a lower percentage of their total operating budgets to education than do states without a lottery. The *Money* magazine study also found that lotteries do not necessarily protect taxpayers from tax increases. It found that tax revenue grew by 21.7 percent over a five-year period in lottery states compared to 7.2 percent tax revenue growth in states without a lottery. However, an analysis by *State Policy Reports* yielded a different result – that lottery states spend more on education per student, on average, than non-lottery states.

Since the Center conducted its original research on state lotteries, South Carolina and Tennessee have joined Georgia and Virginia in adopting lotteries, meaning every state bordering North Carolina operates this game of chance. Of the nine states that do not have a lottery, North Carolina is by far the most populous. According to estimates from Virginia lottery officials, North Carolinians spend in excess of $100 million annually on Virginia lottery tickets alone. North Carolinians also play in South Carolina, which adjoins the state's most heavily populated county, Mecklenburg.

The N.C. Center for Public Policy Research is an independent, nonpartisan, nonprofit research corporation created in 1977 to evaluate state government programs and to study public policy issues facing North Carolina. The Center is supported in part by a grant from the Z. Smith Reynolds Foundation in Winston-Salem, with additional support from 10 other foundations, 160 corporate contributors, and nearly 700 individual and organizational members across the state. In addition to publishing *North Carolina Insight*, the Center recently has conducted in-depth studies on the teacher shortage in North Carolina, ways to improve voter turnout, and how all 50 states govern their public universities. The Center also publishes *Article II*, a citizens' guide to the legislature.

Copies of the issue of *North Carolina Insight* containing the Center's research on state lotteries are available from the Center for $20.00 each, and the latest study of special provisions in budget bills is available for $15. Both prices include tax, postage, and handling. To order, write the N.C. Center at P.O. Box 430, Raleigh, NC 27602, call (919) 832-2839, fax (919) 832-2847, or email *tbromley@nccppr.org*.

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For more information, contact Mike McLaughlin, editor of *North Carolina Insight*, at (919) 832-2839.

13 Ways of Looking at a State Lottery: The Positives, the Negatives, and the Bottom Line

by Gregory Gunter, Ran Coble and Mike McLaughlin

Issue	The Positives	The Negatives	Bottom Line
1. For what programs do states earmark lottery revenues, and what are examples of program accomplishments funded by lotteries?	Of the 31 states that earmark funds, 20 states earmark at least some lottery proceeds for education. Seven other states put lottery proceeds into the general fund. The other states use lottery funds to support programs ranging from parks and recreation to police and firefighters' pensions. Georgia uses lottery funds for its HOPE college scholarship program. Pennsylvania funds a broad range of programs for the elderly with lottery proceeds.	When funds are earmarked, programs no longer have to compete against other priorities in the budget-making process. As a result, funds may not be put to their most pressing use. On the other hand, lottery funds make only a small contribution to states' general funds and may not be large enough to result in significant accomplishments or may simply supplant existing revenue (see number 4 below).	Earmarking funds for broad purposes such as public education will not protect against lottery funds merely supplanting existing state funds. However, earmarking for education is the most politically popular use of lottery funds. Polls show support for a state lottery in N.C. increases by 5 to 10 percent when the poll question mentions using the proceeds for education.
2. What is the track record of lotteries as revenue sources, and does the reliability or size of the revenue stream depend upon the programs for which the revenue is earmarked?	In 1997, total revenues from the 37 lottery states and the District of Columbia amounted to 2.2 percent of the general revenue collected by those jurisdictions. A lottery in North Carolina would generate an estimated $300 million in revenue in the first full year of operation, or 2.3 percent of the total state budget.	When taken as a percentage of state revenues, lottery revenues appear to be on the decline. The Center's research indicates that lottery revenues as a mean percentage of state operating budgets for the 38 lottery jurisdictions dropped from 3.5 percent in 1989 to 2.2 percent in 1997. Just looking at the 29 jurisdictions operating lotteries in 1989, the mean percentage of operating budgets these lotteries produced dropped to 1.9 percent by 1997. *State Policy Reports*, in its July 2000 edition, notes that the average annual increase in lottery sales per capita declined from 9 percent between 1973 and 1987 to 1.6 percent from 1987 to 1997.	Although lottery revenues are declining as a percentage of state revenue, research indicates that they are a comparatively reliable revenue source relative to other state government revenue sources such as the sales tax.
3. What is the cost of marketing a lottery, and does the cost increase, remain stable, or decrease over time?	On average, marketing costs (including media advertising) account for approximately 1 percent of lottery sales. Over time, marketing expenses will vary based on how badly a state needs revenue and wants to promote its games.	Research suggests that in order to maintain the public's interest, states may be forced to increase advertising costs. However, other factors can influence the public's interest in the lottery, such as the size of the jackpot or introduction of new games.	States must market heavily and continue to introduce new games in order to maintain a reliable revenue stream from the lottery. When sales stagnate, states also may be forced to consider more aggressive forms of gaming, such as video terminal gambling or riverboat casinos.
4. Do lottery revenues *supplement* state funding for specific program areas such as education or *supplant* it?	Some states, such as Georgia, have made use of their lottery to fund new programs that supplement their efforts in public education. The Georgia effort includes a pre-kindergarten program, technology for the public schools, and college scholarships based on grades. An analysis by *State Policy Reports* indicates that *per student spending* on education is slightly higher in lottery states than in non-lottery states.	(1) In California, Florida, Illinois, and Michigan, research shows that lottery funds have substituted for normal levels of appropriations, despite the fact that lotteries had been promoted as boosting spending for education. (2) A separate study indicates that states *without* lotteries devote *a higher percentage of their general funds to education* than do states with lotteries. (3) States with lotteries have seen per capita tax revenues increase an average of 21.7 percent over the past five years versus 7.2 percent for states without a lottery.	Lottery revenues may supplant rather than supplement normal levels of funding for state government programs, but this is difficult to prove or disprove through research. Rising costs in other program areas such as Medicaid and corrections also may account for a lottery-funded program receiving a smaller proportion of the state budget over time. Such costs may hit harder in lottery states, which generally are more populous.
5. Who plays the lottery?	Though the research findings conflict, the evidence seems to indicate that there is little variation between racial and ethnic groups in terms of who plays the lottery. Also, the percentage of players who participate does not vary much by education levels, though the amount of money spent by these players does vary.	Low-income players spend a higher proportion of their income on lottery tickets than do players who earn more. The amount of money spent by players drops sharply as education levels increase. High school dropouts who play the lottery are by far the biggest spenders. African Americans who play tend to *spend* more, on average, than other racial groups. Other socioeconomic groups that play heavily include males, Hispanics, Catholics, laborers, and the middle-aged generally.	There is a difference between comparing *participation rates* at various income levels versus *proportion of income spent* by the poor on lotteries. Lotteries are regressive in that lower-income players spend a higher percentage of their incomes on tickets than do higher income players. However, the poor do not seem to participate in lotteries in numbers greater than their proportion in the population.

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summary prepared by Center Intern Gregory Gunter, Center Executive Director Ran Coble, and Insight *Editor Mike McLaughlin*

13 Ways of Looking at a State Lottery: The Positives, the Negatives, and the Bottom Line

Issue	The Positives	The Negatives	Bottom Line
6. Who is most likely to benefit from lottery revenues?	States tend to earmark lottery proceeds for education, so students are the most frequent beneficiaries. Nationwide, lottery revenues also benefit senior citizens (Pennsylvania), police and fire departments (Indiana), Vietnam veterans (Kentucky), juvenile delinquents (Montana), compulsive gamblers (Iowa), and even baseball fans (Washington State).	The lottery may shift resources from frequent players—including high school dropouts—to more affluent beneficiaries, such as those most likely to earn a merit-based college scholarship.	If a lottery is designed in a way to supplement rather than supplant existing revenue, students benefit from lottery revenues. The HOPE Scholarship Program, though skewed toward the more affluent, has also boosted the college-going rate in Georgia and enhanced available financial aid for college students.
7. Do lottery ticket sales displace other retail spending, or do they stimulate more sales?	Retailers who sell lottery tickets typically receive a 5 percent commission from sales, and having tickets available for sale can bring in customers. One study indicates that lottery players significantly reduced their spending in only one category (alcohol).	Sales of other goods may decline if the consumer's discretionary income is limited or if lines become so long for the lottery that they discourage other customers. The benefits of selling lottery tickets may not offset the increased hassle that could be created by long lines for lottery ticket sales in retail outlets. Also, states without a state income tax (North Carolina has a state income tax) and with high rates associated with sales and excise taxes lose non-lottery revenue as a result of instituting a lottery.	Lottery sales may displace some discretionary retail purchases, though the research does not give a clear answer on this question. State sales tax revenue may also suffer with the institution of a lottery.
8. Do lotteries contribute to problems with compulsive gambling?	Most compulsive gamblers tend to gravitate toward types of gambling that involve a skill element or provide an immediate reward, such as casino games and video poker.	Legalization of gambling can encourage people to gamble more frequently and spend more on gambling. The lottery may be a gateway to other forms of gambling, particularly for minors.	Lotteries may contribute to compulsive gambling, though not as much as other games of chance that require at least some skill level and that provide quick results and rewards to the player. The research findings are in conflict here. There have been numerous studies on links between legalization and compulsive gambling, several of which showed increases and others not. One study found that participation in a state lottery was associated with a greater involvement in general gambling, which was in turn linked with problem gambling. But another study found that the Minnesota lottery switched adolescents from illegal to legal gambling and did not increase overall gambling in the state.
9. Are present-day lotteries plagued by scandal, or are they relatively scandal-free?	States place a high priority on operating scandal-free lotteries in order to safeguard the public trust and protect the integrity of the games. Corruption has not been a major problem in the operation of modern-day lotteries.	Scandals have and still can occur even with state governments running the games. Pennsylvania suffered a scandal in the 1980s when an operator tried to rig a daily numbers drawing. In 1996, an executive with GTECH, the largest private lottery operator in the U.S., was convicted for defrauding his employer through a kickback scheme involving state government lobbyists in New Jersey. And in 1999, Massachusetts suspended three employees at a local lottery office after an investigation turned up missing scratch tickets.	Contemporary lotteries appear to operate relatively scandal free.

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