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## 13 Ways of Looking at a State Lottery:

by Gregory Gunter, Ran Coble and Mike McLaughlin

### Issue

**1.** For what programs do states earmark lottery revenues, and what are examples of program accomplishments funded by lotteries?

**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?

**3.** What is the cost of marketing a lottery, and does the cost increase, remain stable, or decrease over time?

**4.** Do lottery revenues *supplement* state funding for specific program areas such as education or *supplant* it?

**5.** Who plays the lottery?

### The Positives

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.

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.

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.

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.

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.

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

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## The Positives, the Negatives, and the Bottom Line

### The Negatives

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).

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.

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.

(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.

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.

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### Bottom Line

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.

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.

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.

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.

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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## 13 Ways of Looking at a State Lottery:

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**6.** Who is most likely to benefit from lottery revenues?

### The Positives

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).

**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).

**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.

**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.

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## The Positives, the Negatives, and the Bottom Line

### The Negatives

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.

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.

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.

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.

### Bottom Line

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.

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.

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.

Contemporary lotteries appear to operate relatively scandal free.

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## 13 Ways of Looking at a State Lottery:

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**10.** Are there additional social consequences to the operation of state lotteries?

### The Positives

Having a legal form of gambling may discourage citizens from seeking out illegal forms in which to participate. Carefully crafted programs also can result in desirable social outcomes, such as encouraging more young people to attend college (e.g., the Georgia HOPE Scholarship Program).

**11.** Political Influence: To what extent do firms associated with the administration or operation of lotteries become heavy contributors to political campaigns?

Given the popularity of most state lotteries once implemented, large political contributions may be unnecessary to keep the games in place.

**12.** Are most state lotteries publicly or privately operated, and does either type of game generate more revenue than the other?

All lotteries operated in the United States are entities of the state, though private concerns play a large role in their operations. By having lotteries run by an agency of state government, the state has substantial control over all aspects of the lottery's operation.

**13.** Could the North Carolina General Assembly put the question of whether to institute a lottery to the voters in the form of a public referendum, or would that be a violation of the state constitution?

Gerry Cohen, the director of bill drafting for the N.C. General Assembly, says such a referendum would be constitutional. Of the 38 jurisdictions in the United States that have lotteries, 23 were authorized by referendum.

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## The Positives, the Negatives, and the Bottom Line

### The Negatives

(1) State lotteries may induce people to engage in other forms of gambling. (2) State lotteries provide an avenue for minors to gamble, even though every state lottery prohibits sales to minors. (3) Lotteries may sap the work ethic of state citizens by promoting the idea that the way to get ahead in life is through luck rather than hard work. (4) Government may be viewed as hypocritical and diminished in the eyes of its citizens by promoting an activity that is otherwise illegal—a state-sanctioned numbers game. (5) Some people spend more than they can afford on the lottery in hopes of striking it rich. The government is cast in the role of encouraging this type of speculative behavior.

Gambling interests in general contributed \$8.6 million to national political committees from 1988-1996. Gambling interests also increased their soft-money donations at the state level to counter opposition to legalized gambling. And, video poker interests gave \$133,680 to four North Carolina gubernatorial candidates in the May 2000 primary. Lottery firms do involve themselves in the process of trying to get new lotteries approved. This can involve contributions to candidates, lobbying expenses, and campaigns for a favorable vote if a public referendum on a lottery is scheduled. However, such activity is not exclusive to lottery firms.

By running the lottery itself, the state may be viewed by some citizens as engaging in an immoral activity.

John Sanders, the former director of the Institute of Government at the University of North Carolina at Chapel Hill and a specialist in constitutional law, says a lottery referendum would be an unconstitutional delegation of the legislative power of the N.C. General Assembly. Referenda in other states were needed to amend state constitutional provisions that banned gambling.

### Bottom Line

Research indicates that lotteries do have negative social consequences. These include a modest increase in compulsive gambling and lottery play by minors. Citizens also may become more cynical about the role of government as a moral agent in people's lives.

Lottery firms will work to get a lottery on the ballot by hiring lobbyists and by contributing to candidates. If a public referendum is scheduled, proponents will organize a campaign to win a favorable vote. Pro-lottery interests will help to finance this campaign. Once lotteries are in place, however, research suggests that lottery firms take a lower profile in the political process.

All of the lotteries operating in the United States are run by the states, though private firms handle the technical aspects of the games. This helps to assure a cleanly run enterprise and to avoid scandal. Thus, it is not possible to determine whether a privately operated lottery would generate more revenue.

The majority of states (23 by referendum and five by ballot initiative) have conducted a public vote on whether to go into the lottery business, so a referendum would not be unusual. One distinction is that many states had to amend a constitutional ban on gambling in order to put a lottery in place, which required a public vote. North Carolina's constitution does not ban gambling. Experts disagree on whether a referendum would be constitutional. This issue likely would be settled by state appellate courts in North Carolina.