

# spotlight

No. 405 – February 2, 2011

## JUST NOT WORTH THE GAMBLE

*The NC Education Lottery's many problems have a common solution*

**KEY FACTS:** • The North Carolina Education Lottery was sold as a way to boost education spending in this state, but research shows that has historically been a false promise of lotteries. States without education lotteries maintained and increased education spending more than states with lotteries.

• N.C. has the same problem found in other lottery states: a declining rate of spending for education, especially in comparison with the rest of the budget.

• Lottery funds replacing rather than supplementing education spending has been a problem in North Carolina since before the first lottery ticket was even sold.

• Poverty, unemployment, and property tax rates remain the best predictors of a county's lottery sales.

• Eight of the top ten counties in lottery sales per adult were among the most economically distressed counties in the state.

• The lottery is a state funding source that many North Carolinians find immoral out of either religious belief or concern for social justice or both.

• In the lottery, the state has erected a very costly system of capturing money from citizens that converts just a small portion of it into education funding.

• The best possible reform to address all those concerns would be to end the state lottery and return to a more honest, direct form of education funding. The state's dire financial picture is a clarion call for root-and-branch reform, and there are several education reforms that could be featured.

• Another reform, deregulated gambling, would allow industries to develop and compete in the state, creating jobs, buttressing the economy, and contributing through responsible taxation to education spending and the General Fund.

• At the very least, state policymakers should reform the lottery so as to use education proceeds more effectively.

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The North Carolina Education Lottery was created in August 2005 and began selling Scratch-Off tickets in 2006. Over the next few months and years, the lottery quickly added games, including the multi-state Powerball and Mega Millions.

### Who benefits from the North Carolina Education Lottery?

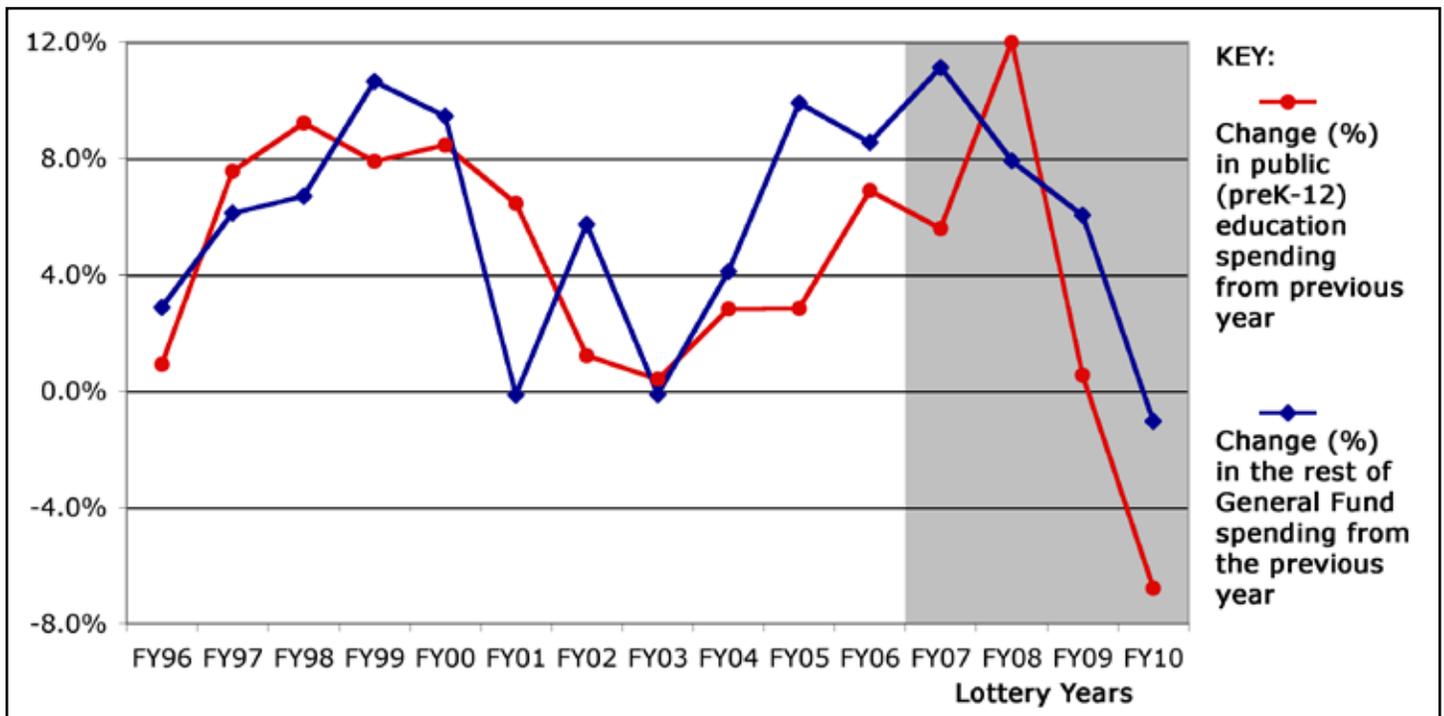
The nominal purpose of the lottery is to raise money for public education. Fifty percent of lottery proceeds goes toward class-size reduction and the More at Four program, 40 percent goes toward school construction, and the remaining 10 percent goes toward college scholarships.<sup>1</sup>

The lottery was sold as a way to boost education spending in North Carolina,<sup>2</sup> but that has historically been a “false promise” of education lotteries to their states. In their study of 11 state education lotteries in the 1980s and ‘90s, associate professor of mathematics Donald E. Miller and associate professor of political science Patrick A. Pierce of St. Mary’s College found that

The popularity of lotteries and legalized gambling is based in part on their claim to painlessly provide additional revenue to needed state functions. The most popular purpose to which these revenues have been devoted is education. However, we have demonstrated that these are false promises for education. States are likely to *decrease* their growth of spending for education upon operating a lottery designated for that purpose. Furthermore, the decrease in the rate of growth is a long-term function of lottery adoption that occurs regardless of revenue generated by the lottery.<sup>3</sup> (Emphasis in original.)

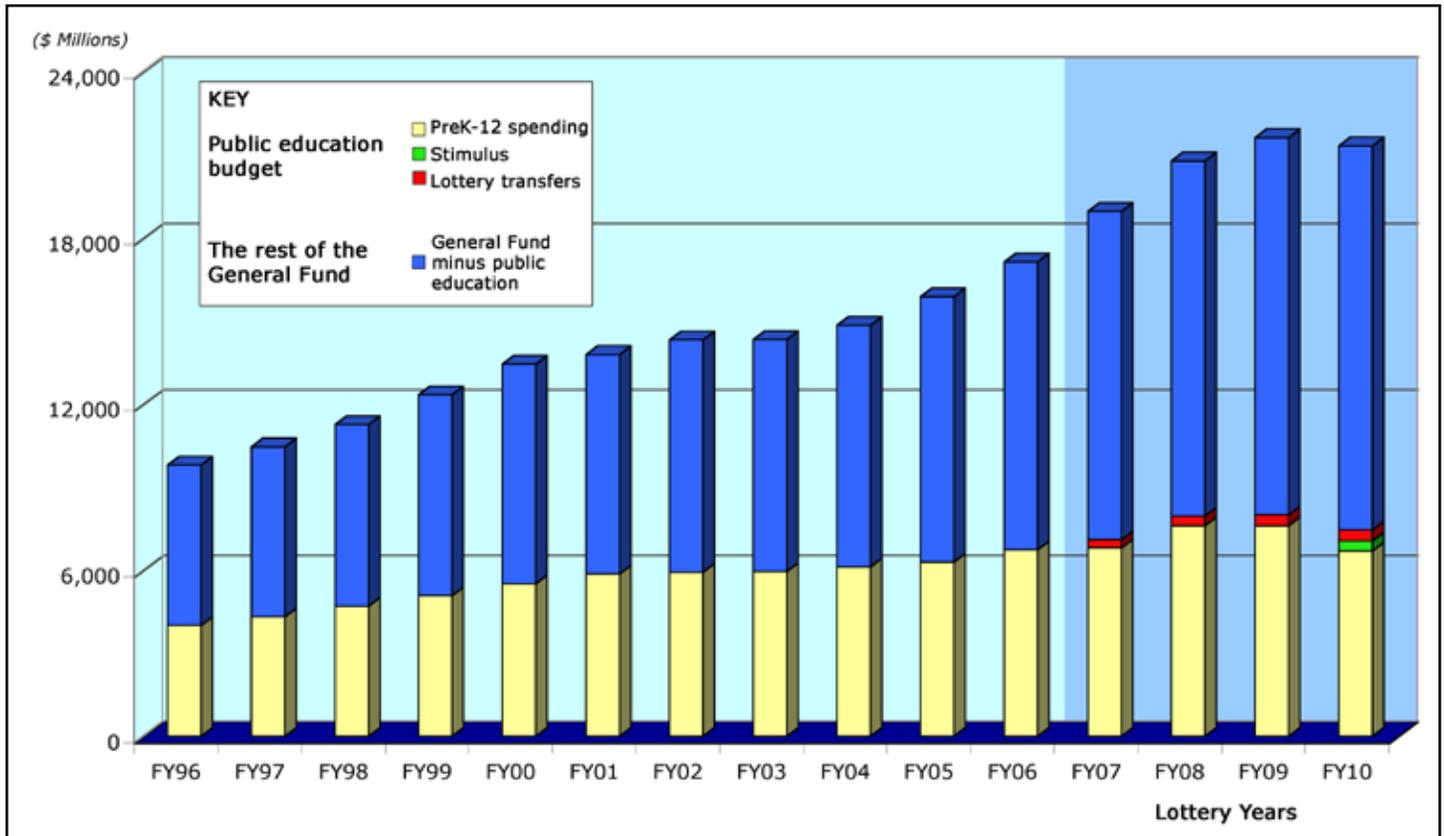
On closer examination of the lotteries’ impact on education spending, Miller and Pierce found what they called “an even more perverse portrait”: this long-term decline in education spending followed an immediate initial spike in spending growth. Education spending spikes initially, citizens and policymakers infer the lottery is delivering as promised, and education spending overall declines in the following years.<sup>4</sup>

**Figure 1. Annual Growth in Funding, Public Schools vs. the Rest of the General Fund, FY 1996-2010**



**Figure 2. Components of the General Fund, FY 1996-2010<sup>5</sup>**

*Public education, lottery transfers, stimulus funds, and the rest*



Most revealing, Miller and Pierce find that

Regardless of the state or the time at which its lottery operated, educational spending declined once a state put a lottery into operation. Hence, the pattern of a declining rate of spending is not simply an artifact of state fiscal problems in the 1980s. The present analysis indicates that states *without* lotteries maintained and increased their educational spending more than states *with* lotteries.<sup>6</sup> (Emphasis in original.)

Miller and Pierce conclude that lottery revenue is not used to increase education spending, and as to where those revenues go, they note that “lottery revenue constitutes a very small percentage of total revenue” and posit that the funds replace general revenue. In short, they find that

To conclude, lottery revenue is unlikely to materially increase funding for education--and perhaps any other purpose. However, such revenue has political returns for governors that are significant.<sup>7</sup>

Lottery funds going to replace general revenue (also called supplanting) rather than supplement education spending is a problem that has overtly dogged the NC Education Lottery from its onset, just as critics predicted.<sup>8</sup> In early 2006, before the first lottery ticket was even sold, Gov. Mike Easley announced that half of the expected \$400 million revenues would go to replace current education spending.<sup>9</sup> In 2009 Gov. Bev Perdue transferred \$50 million from the Lottery Reserve into the General Fund, as well as \$37.6 million intended for school construction (later returned).<sup>10</sup>

By 2009 the problem had gotten so bad that some state legislators sponsored legislation to remove “Education” from the name of the North Carolina Education Lottery, out of concern for truth in advertising.<sup>11</sup> In 2010, WRAL pub-

**Table 1. Lottery sales, poverty, unemployment, and property taxes in North Carolina, by county economic distress level, FY 2009<sup>12</sup>**

	<b>Top 10 lottery counties</b>	<b>NC average</b>	<b>Tier One counties (most economically distressed)</b>	<b>Tier Two counties</b>	<b>Tier Three counties (least economically distressed)</b>
<b>Lottery sales per adult</b>	\$389	\$180	\$211	\$197	\$159
<b>Poverty rate</b>	22.8 %	14.6 %	20.3 %	15.6 %	12.4 %
<b>Median household income</b>	\$35,109	\$46,574	\$36,188	\$42,776	\$51,550
<b>Unemployment rate</b>	11.8 %	10.6 %	12.2 %	10.7 %	9.6 %
<b>Property tax rate (cents per \$100 valuation)</b>	71.72	61.67	68.09	56.79	58.69

lished a report entitled “Lottery is replacement, no addition in school budgets,” which found that “since the lottery was established ... [education] spending slowly increased, but the actual percentage of the general fund allotted to education has dropped.”<sup>13</sup>

This report looked at how state spending on public (preK-12) education and the rest of the General Fund grew over the 15-year period from Fiscal Year (FY) 1996 to FY 2010, with the lottery years highlighted. The results in Figure 1 show that, per Miller and Pierce, the rate of growth in education spending spiked early in the lottery’s existence, but since then education spending — despite being supplemented by not only the lottery but also, in FY 2010, federal stimulus funds — has declined at a markedly faster rate than has the rest of the General Fund.<sup>14</sup>

Figure 2 offers a year-by-year look at the General Fund, with preK-12 education spending highlighted. It also illustrates that North Carolina as an education lottery state boasts the very problems that Miller and Pierce observed in the 11 education lottery states they studied — a declining rate of spending for education, especially in comparison with the rest of the state budget. (Note: This finding is *not* to argue that increasing the rate of spending is itself the goal of improving preK-12 education in North Carolina. It is instead to contrast with the promises of lottery proponents; i.e., to test the lottery according to its own standards first. For ways to improve preK-12 education through more efficient use of scarce resources, see the discussion and notes listed under Item 1 under “Conclusion and Possible Reforms” at the end of this report.)

### **Who plays the lottery?**

A 2007 *Spotlight* report on N.C. lottery sales found that “property tax rates, unemployment rates and poverty rates were the best predictors of a county’s lottery sales to adults.”<sup>15</sup> With the counties suffering under the varying effects of the deep recession, the predictive factors of especially unemployment and poverty are graver now, but with the lottery more entrenched, they remain the best predictors of a county’s lottery sales.

This report analyzed N.C. lottery sales per adult in each county in conjunction with county poverty rates, median household incomes, unemployment rates, and property tax rates. It also examined counties according to the Depart-

**Table 2. Lottery sales, poverty, unemployment, and property taxes in Tier One (most economically distressed) counties, FY 2009<sup>16</sup>**

KEY: Top 10 lottery counties named in ALL CAPS BOLD Ranks among the bottom half of counties Ranks among the bottom 25 counties Ranks among the bottom 10 counties

Tier One County	Sales per adult, FY09	Statewide rank (1=highest)	Poverty rate 2008	Statewide rank (1=highest)	Est. median household income, 2008	Statewide rank (1=lowest)	Unemployment rate, 2009 avg.	Statewide rank (1=highest)	County property tax rates, 2009-10	Statewide rank (1=highest)
Alexander	\$98.63	86	12.7%	81	\$44,460	68	14.3%	12	\$0.6050	54
Alleghany	\$106.47	82	18.5	30	\$33,824	15	11.4	39	\$0.4300	86
Anson	\$204.45	33	23.4	11	\$34,012	16	14.8	6	\$0.8940	3
Beaufort	\$285.22	11	19.1	27	\$38,641	40	10.9	53	\$0.6000	57
Bertie	\$272.68	13	23.3	13	\$31,375	4	10.5	56	\$0.7800	18
Bladen	\$270.62	14	24.0	7	\$29,043	1	11.7	33	\$0.7400	24
Burke	\$169.55	53	15.5	54	\$37,225	31	14.5	10	\$0.5200	74
Caldwell	\$145.51	67	15.4	56	\$40,966	52	15.4	5	\$0.6599	45
Camden	\$117.31	78	8.7	99	\$56,424	95	8.0	95	\$0.5900	61
Caswell	\$146.00	66	18.9	29	\$39,693	48	12.6	21	\$0.6290	50
Chowan	\$153.86	62	18.5	31	\$38,330	38	11.1	48	\$0.6850	36
Clay	\$45.52	99	15.2	57	\$38,049	34	11.2	45	\$0.4300	87
Cleveland	\$155.97	61	17.5	40	\$39,049	44	14.6	9	\$0.7200	29
Columbus	\$202.74	35	21.9	20	\$33,329	10	12.4	25	\$0.8150	11
<b>EDGECOMBE</b>	\$379.15	4	22.6	16	\$33,346	11	16.1	2	\$0.8600	4
Gates	\$85.19	91	15.7	52	\$44,737	72	7.4	98	\$0.6400	48
Graham	\$69.30	96	17.7	38	\$32,835	9	16.1	1	\$0.5800	64
Greene	\$175.92	50	21.7	21	\$38,530	39	10.6	55	\$0.7560	22
<b>HALIFAX</b>	\$401.02	3	23.7	9	\$31,495	5	13.1	17	\$0.6800	37
Hertford	\$239.26	23	22.7	15	\$34,131	19	9.3	78	\$0.9100	2
<b>HYDE</b>	\$376.33	5	22.4	17	\$34,868	21	8.3	92	\$0.5200	77
Jones	\$242.57	21	18.0	35	\$38,672	41	10.2	66	\$0.7000	33
<b>LENOIR</b>	\$363.54	6	23.5	10	\$32,457	8	11.4	38	\$0.8000	14
<b>MARTIN</b>	\$325.79	9	23.4	12	\$35,072	22	10.3	61	\$0.6700	42
McDowell	\$152.23	64	14.6	65	\$37,394	33	14.8	7	\$0.5500	68
Mitchell	\$85.29	90	17.2	42	\$35,195	23	11.8	32	\$0.4400	85
Montgomery	\$243.46	20	19.6	26	\$37,180	30	13.0	19	\$0.6200	51
Northampton	\$224.25	26	26.6	4	\$31,054	3	10.9	52	\$0.7800	17
Richmond	\$203.53	34	23.7	8	\$30,743	2	13.3	16	\$0.8100	12
Robeson	\$220.85	27	30.4	1	\$31,499	6	11.4	37	\$0.8000	13
Rockingham	\$187.16	41	16.2	46	\$38,267	37	12.9	20	\$0.7150	30
Rutherford	\$133.30	69	16.8	44	\$36,866	29	15.6	4	\$0.5300	72
Scotland	\$204.47	32	27.6	2	\$33,364	12	16.1	3	\$1.0200	1
Surry	\$98.47	87	15.9	48	\$37,282	32	12.1	29	\$0.5820	63
<b>TYRRELL</b>	\$305.99	10	26.9	3	\$31,732	7	10.3	60	\$0.6700	41
<b>VANCE</b>	\$425.72	2	25.7	5	\$34,093	18	13.1	18	\$0.7820	16
Warren	\$173.70	52	24.4	6	\$33,632	13	12.5	23	\$0.6000	56
<b>WASHINGTON</b>	\$342.09	8	23.2	14	\$34,027	17	11.2	44	\$0.7900	15
Wayne	\$250.28	18	18.3	33	\$39,934	49	9.0	82	\$0.7640	21
Wilkes	\$130.45	71	20.9	23	\$34,692	20	12.2	26	\$0.5700	66
<i>Tier averages</i>	<i>\$211.09</i>		<i>20.3%</i>		<i>\$36,188</i>		<i>12.2%</i>		<i>\$0.6809 (per \$100 valuation)</i>	

**Table 3. Lottery sales, poverty, unemployment, and property taxes in Tier Two counties, FY 2009<sup>16</sup>**

KEY: Top 10 lottery counties named in ALL CAPS BOLD Ranks among the bottom half of counties Ranks among the bottom 25 counties Ranks among the bottom 10 counties

Tier Two County	Sales per adult, FY09	Statewide rank (1=highest)	Poverty rate 2008	Statewide rank (1=highest)	Est. median household income, 2008	Statewide rank (1=lowest)	Unemployment rate, 2009 avg.	Statewide rank (1=highest)	County property tax rates, 2009-10	Statewide rank (1=highest)
Alamance	\$228.99	25	15.8%	50	\$43,769	64	12.0%	31	\$0.5200	75
Ashe	\$102.00	84	15.8	49	\$35,689	24	11.4	40	\$0.4250	88
Avery	\$95.18	88	17.6	39	\$36,844	28	8.8	84	\$0.3900	91
Catawba	\$205.55	31	13.8	77	\$43,737	63	14.4	11	\$0.5350	70
Cherokee	\$78.46	92	17.9	36	\$33,645	14	14.6	8	\$0.3850	92
Craven	\$247.39	19	14.9	62	\$45,747	75	9.8	70	\$0.6100	53
Cumberland	\$254.67	17	15.8	51	\$44,658	70	9.2	79	\$0.7660	20
Currituck	\$153.10	63	9.7	96	\$55,745	94	7.0	99	\$0.3200	94
Dare	\$132.11	70	9.3	97	\$55,122	92	9.6	75	\$0.2600	99
Davidson	\$158.71	60	14.5	67	\$44,136	66	12.6	22	\$0.5400	69
Davie	\$121.06	76	10.8	93	\$52,408	90	11.4	42	\$0.6200	52
Duplin	\$282.44	12	20.5	24	\$36,682	27	9.1	80	\$0.6900	35
Franklin	\$241.43	22	14.1	69	\$46,189	78	10.4	59	\$0.8225	10
Gaston	\$177.70	46	15.1	59	\$46,265	79	14.0	13	\$0.8350	8
Granville	\$269.61	15	13.7	79	\$48,468	84	10.3	64	\$0.8250	9
Harnett	\$166.86	55	15.2	58	\$43,626	62	11.1	49	\$0.7250	28
Haywood	\$142.93	68	14.5	66	\$39,042	43	9.8	69	\$0.5140	78
Hoke	\$192.46	37	19.6	25	\$40,351	50	8.4	89	\$0.7000	34
Jackson	\$109.34	80	16.9	43	\$41,506	53	8.5	87	\$0.2800	97
Lee	\$264.44	16	13.9	73	\$45,297	73	13.7	14	\$0.7500	23
Lincoln	\$147.00	65	12.4	86	\$49,743	86	13.6	15	\$0.5700	65
Macon	\$72.50	94	13.8	74	\$38,989	42	10.4	58	\$0.2640	98
Madison	\$38.96	100	17.7	37	\$38,077	36	9.7	71	\$0.5100	79
<b>NASH</b>	\$437.49	1	15.5	55	\$44,719	71	12.5	24	\$0.6700	39
Pamlico	\$201.03	36	16.3	45	\$42,479	54	9.4	76	\$0.6525	46
Pasquotank	\$184.90	43	17.3	41	\$43,135	61	9.6	73	\$0.5850	62
Perquimans	\$86.28	89	18.1	34	\$39,477	46	10.1	67	\$0.4100	89
Person	\$206.39	30	13.7	78	\$44,630	69	11.4	41	\$0.7000	32
Pitt	\$237.88	24	22.0	19	\$40,742	51	10.3	62	\$0.6650	43
Polk	\$70.54	95	12.3	87	\$44,362	67	8.8	85	\$0.5200	76
Randolph	\$122.40	75	14.1	68	\$42,480	55	11.5	36	\$0.5550	67
Rowan	\$177.30	49	15.6	53	\$43,096	60	12.2	27	\$0.5950	59
Sampson	\$214.74	28	22.1	18	\$38,065	35	8.4	88	\$0.8450	6
Stanly	\$160.58	59	12.7	83	\$45,673	74	11.7	35	\$0.6700	40
Stokes	\$129.20	72	14.9	60	\$42,958	59	10.5	57	\$0.6000	58
Swain	\$66.77	97	16.1	47	\$36,382	26	11.3	43	\$0.3300	93
Transylvania	\$104.11	83	12.4	85	\$42,608	56	9.0	83	\$0.3949	90
Watauga	\$78.06	93	18.9	28	\$39,490	47	7.5	97	\$0.3130	95
<b>WILSON</b>	\$359.04	7	21.0	22	\$39,285	45	12.1	30	\$0.7300	27
Yadkin	\$100.12	85	13.8	75	\$42,774	57	10.3	63	\$0.7400	25
Yancey	\$58.71	98	18.4	32	\$35,707	25	11.7	34	\$0.4500	83
<i>Tier averages</i>	<i>\$196.95</i>		<i>15.6%</i>		<i>\$42,776</i>		<i>10.7%</i>		<i>\$0.5679 (per \$100 valuation)</i>	

**Table 4. Lottery sales, poverty, unemployment, and property taxes in Tier Three (least economically distressed) counties, FY 2009<sup>16</sup>**

KEY: Top 10 lottery counties named in ALL CAPS BOLD Ranks among the bottom half of counties Ranks among the bottom 25 counties Ranks among the bottom 10 counties

Tier Three County	Sales per adult, FY09	Statewide rank (1=highest)	Poverty rate 2008	Statewide rank (1=highest)	Est. median household income, 2008	Statewide rank (1=lowest)	Unemployment rate, 2009 avg.	Statewide rank (1=highest)	County property tax rates, 2009-10	Statewide rank (1=highest)
Brunswick	\$165.31	56	11.9%	88	\$46,686	80	11.0%	50	\$0.3050	96
Buncombe	\$124.10	74	13.9	72	\$43,805	65	8.6	86	\$0.5250	73
Cabarrus	\$177.38	48	9.9	95	\$56,747	96	11.2	47	\$0.6300	49
Carteret	\$207.18	29	11.8	89	\$49,443	85	8.2	93	\$0.2300	100
Chatham	\$179.06	45	10.3	94	\$57,677	98	8.1	94	\$0.6022	55
Durham	\$191.59	39	13.8	76	\$51,292	89	7.9	96	\$0.7081	31
Forsyth	\$167.59	54	14.9	61	\$47,318	81	9.7	72	\$0.6740	38
Guilford	\$186.16	42	13.6	80	\$47,836	82	11.0	51	\$0.7374	26
Henderson	\$108.85	81	12.7	82	\$46,047	76	9.1	81	\$0.4620	81
Iredell	\$161.73	58	11.6	90	\$50,971	87	12.2	28	\$0.4450	84
Johnston	\$192.00	38	12.7	84	\$52,443	91	10.1	68	\$0.7800	19
Mecklenburg	\$127.88	73	10.9	92	\$57,293	97	10.8	54	\$0.8387	7
Moore	\$174.34	51	11.6	91	\$48,250	83	9.6	74	\$0.4650	80
New Hanover	\$187.59	40	14.0	70	\$51,098	88	9.4	77	\$0.4525	82
Onslow	\$177.50	47	14.8	63	\$46,186	77	8.4	90	\$0.5900	60
Orange	\$117.64	77	13.9	71	\$55,522	93	6.6	100	\$0.8580	5
Pender	\$181.60	44	14.8	64	\$42,872	58	11.2	46	\$0.6500	47
Union	\$114.20	79	8.6	100	\$62,478	99	10.3	65	\$0.6650	44
Wake	\$162.19	57	9.2	98	\$65,487	100	8.4	91	\$0.5340	71
<i>Tier averages</i>	\$158.60		12.4%		\$51,550		9.6%		\$0.5869 (per \$100 valuation)	

ment of Commerce’s economic development tier designations. Tier One counties are considered the most economically distressed; Tier Three, the least economically distressed.<sup>17</sup>

Table 1 provides an overview of tier lottery sales per adult in 2009. The statewide average of lottery sales per adult was \$180. The average of lottery sales per adult in the most economically distressed counties in the state (Tier One) was higher, at \$211 per adult, as was the average in Tier Two counties (\$197 per adult). The least economically distressed counties had lottery sales below the statewide average (\$159 per adult).

The top 10 counties in terms of lottery sales averaged \$389 per adult, over twice the statewide average. Eight of the ten counties (Edgecombe, Halifax, Hyde, Lenoir, Martin, Tyrrell, Vance, and Washington) were among the most economically distressed counties in the state. The other two (Nash and Wilson) were among Tier Two counties.

Compared with the state average, these counties had a far higher poverty rate (22.8 percent vs.14.6 percent), higher unemployment (11.8 percent vs. 10.6 percent), lower incomes, and much higher property taxes.

Tables 2 through 4 look at county-by-county lottery sales per adult, poverty rate, median household income, unemployment rate, and county property tax rate. A few highlights:

- The average poverty rate in Tier One counties, where lottery sales were highest, was a whopping 20.3 percent.
- Unemployment and property tax rates were highest in Tier One counties, and median income levels were lowest.
- Poverty and unemployment rates were successively lower in Tier Two and Tier Three counties, and lottery sales likewise stepped down. Median income levels successively increased in Tier Two and Tier Three counties.

## Analysis

In short order the North Carolina Education Lottery has become, by design, a very visible contributor to education funding in the state. By that fact, it would seem to be irreplaceable. Nevertheless, by virtue of observable spending trends and the recurrence of supplanting, the lottery contributes no *unique* flow to education funding.

However redundant, the lottery is also a state funding source that many North Carolinians find immoral, out of either religious belief or concern for social justice or both. Perceived immorality of the lottery is no small concern given that it is a state monopoly; i.e., something endorsed and promoted under the aegis of the State of North Carolina, whose name it bears.

Certainly a free society allows many private enterprises to flourish despite their being regarded by many people as wrong. Government is neutral towards those enterprises, as it should be. If goods, services, real property, etc. are involved, the government becomes involved insofar as they are taxable.<sup>18</sup>

Furthermore, in generating tax revenue — as opposed to “profit” revenue — from any private enterprise, the state avoids taking upon itself the high administrative costs of conducting the enterprise itself.<sup>19</sup> As it is, the lottery requires about three dollars to produce one dollar for education (that is without accounting for supplanting).<sup>20</sup> In other words, the state has erected a very costly system of capturing money from citizens that converts a rather small portion of it into education funding. But when accounting for supplanting, it is essentially an expensive machine to raise money for various public programs *outside* of education.

Many concerns arise any time a government engages in market activities. Of top importance is asking whether the activity is a proper role of government. Protecting the lives, rights, and property of its citizens are without question a government’s primary reason for being. Protecting markets, establishing the rule of law, having a well-educated citizenry, and having an efficient transportation system are among the other generally accepted governmental roles.

Some of those ancillary government roles involve providing things that could be achieved in the private markets — including such things as education, roads, public parks, water, sewage, etc. Usually doing so involves no profit revenues but rather providing the good to the public at or (usually) below cost, with taxpayers bearing the rest. The generally held assumption is that the public benefit of having those goods widely available outweighs the cost to taxpayers in providing them.

Then there is the curious case of government monopolies on goods not generally held to be beneficial to the public nor provided at or below cost. In North Carolina, those would include, for example, the Alcohol Beverage Control (ABC) system and the lottery.

Since 2010, deregulating the ABC system has become a viable option for N.C.<sup>21</sup> Many ABC proponents argue against it on the basis of maximizing state revenues, but research and results in other states have shown that deregulation would not necessarily affect revenue from liquor sales negatively.<sup>22</sup> Of course, the ABC system wasn’t set up to grow state revenues, but to restrict citizens’ access to “demon rum” in the aftermath of the 21st Amendment to the U.S. Constitution, which repealed Prohibition.

The lottery, on the other hand, was set up specifically to raise revenue for a specific purpose (regardless of how often that purpose is thwarted).<sup>23</sup> Nevertheless, it has led to calls to restrict citizens’ access to other forms of gambling, especially the fast-growing sweepstakes cafes. (As of this writing, the state’s recent ban on sweepstakes games<sup>24</sup> is still before the North Carolina Court of Appeals. Guilford County Superior Court Judge John Craig ruled that the part of the law banning video sweepstakes was overbroad and constituted a prior restriction on free expression. In January the appellate court denied the state’s request for a stay of that ruling and declined to fast-track the case.<sup>25</sup>)

The interests of maintaining the monopoly here thwarts the evolution of a market, leaving those citizens in North

Carolina who wish to gamble stuck not only with the form of gambling with the worst odds of winning, but also with one that tends to lose the public's interest over time regardless of prize amounts<sup>26</sup> and is increasingly subject to what researchers call "lottery fatigue."<sup>27</sup>

State lotteries' tendency to lose the public's interest over time also likely exacerbates their negative effects on education spending.

## Conclusion and Possible Reforms

The issues surrounding the North Carolina Education Lottery may seem intractable, but if anything, they promise to get thornier over time.

1. The clearest and best solution is to eliminate it now. **End the state lottery and return to a more honest, direct form of education funding.** The state lottery has not become an irreplaceable funding source in the few short years of its existence.

Furthermore, the state budgeting process is itself in dire need of overhaul, with the state facing a structural deficit of 17 percent of the General Fund<sup>28</sup> and an inability to pay \$43.4 billion in promised health and pension benefits to state employees.<sup>29</sup> Spending reform as it pertains to education would center on lifting the cap on charter schools, making better use of technology, expanding the North Carolina Virtual Public School,<sup>30</sup> widening school-choice options, including virtual schools as well as virtual charter schools (which should be exempted from enrollment restrictions),<sup>31</sup> decreasing the administrative overhead of public school systems while aligning personnel changes more closely to enrollment changes,<sup>32</sup> paying teachers for meritorious performance in the classroom,<sup>33</sup> removing barriers to state certification to expand the pool of qualified teachers,<sup>34</sup> and rethinking the ineffective Dropout Prevention Grants program,<sup>35</sup> among other ideas.

Ending the lottery would address concerns about its taking advantage of the poor and unemployed, its moral questions (including as a state monopoly), as well as its ineffectiveness at supplementing education funding.

2. Another route would be to **deregulate gambling in North Carolina**, which would allow gambling industries to develop and compete in the state,<sup>36</sup> including not just the sweepstakes cafes but also Internet poker,<sup>37</sup> private casinos,<sup>38</sup> horseracing, etc. Those industries would contribute to job creation<sup>39</sup> and also, through responsible taxation, to education and the General Fund. It would remove the state from being a seller (the only seller) of gambling-related materials,<sup>40</sup> which is no worthwhile role for any government to have.

Having gambling deregulated in North Carolina would countermand the keeping-up-with-the-Joneses appeal for a state lottery (the silly idea that a North Carolinian buying a lottery ticket in another state had effectively withheld money from North Carolina's public schools, which was a staple<sup>41</sup> of Gov. Mike Easley's speeches), as the wider market would no doubt attract gambling enthusiasts from other states.

Deregulating gambling would address the concerns over the lottery's ineffectiveness at supplementing education funding and whether the state should be a monopoly provider of gambling goods. Still, deregulated gambling in North Carolina would continue to draw opposition on moral grounds, but that could not possibly be interpreted as a vote of confidence in the state lottery. There are reasons to oppose a state lottery without being an opponent of legalized gambling — but it would require some twisted logic to oppose legalized gambling while supporting a state lottery.

3. Short of repealing the lottery, state leaders could at least address the issue of lottery funds not being used effectively by choosing to **reform the lottery so as to use education proceeds more effectively.**

Toward that end, John Locke Foundation Director of Education Studies Dr. Terry Stoops has argued for the following reforms:

- Eliminate funding for class-size reductions, which the state’s own assessment has shown has not improved students’ academic performance
- Eliminate funding of other unproven programs, such as Smart Start and More at Four
- Increase funding for school construction
- Fund school construction cost-saving incentives
- Provide funding for all public schools, including charter schools<sup>42</sup>

In short, doing absolutely nothing about the lottery would be the worst of all possible outcomes.

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## End Notes

1. For the transfer of net revenues of the North Carolina Education Lottery, see §18C-164, North Carolina General Statutes, [www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByChapter/Chapter\\_18C.html](http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/ByChapter/Chapter_18C.html).
2. E.g., “This goes a long way toward solving our problems,” said House Speaker Jim Black, the Matthews Democrat who largely engineered the passage [of the lottery in the House] in hopes of recouping more money for the state’s schools” (Mark Johnson and Sharif Durhams, “N.C. places bet on lottery,” *Charlotte Observer*, April 7, 2005); “supporters of a Tar Heel lottery [said that] North Carolina’s numbers game would supplement current education spending” and “The lottery law passed last summer included a promise that proceeds wouldn’t replace other education revenue” (“Lottery’s promise,” *The News & Observer*, Feb. 15, 2006).
3. Donald E. Miller and Patrick A. Pierce, “Lotteries for Education: Windfall or Hoax?,” *State and Local Government Review*, (1997) Vol. 29, pp.34-42, [www.saintmarys.edu/~ppierce/pierce51.html](http://www.saintmarys.edu/~ppierce/pierce51.html); see also discussion in Peter Schmidt, “Experts Question States’ Reliance on Gambling Revenue to Support Education; the Social Costs Are High, They Say: They charge lawmakers engage in a shell game, providing little new money for schools and colleges,” *The Chronicle of Higher Education*, Sept. 13, 1996, p. A40.
4. *Ibid.*
5. Under “Public education budget,” the amounts for “Lottery transfers” do *not* include scholarship funds, which go to college-bound students and therefore are included instead in “The rest of the General Fund;” also, the FY 2010 budget for North Carolina includes \$373,281,648 in federal American Recovery and Reinvestment Act stimulus funds for K-12 education (out of over \$1.6 Billion in federal stimulus funds in the budget); see Joseph Coletti, “Budget Crisis Is Opportunity: Bigger budget for FY’11 shows need for policy reform,” John Locke Foundation *Spotlight* No. 395, July 20, 2010, [johnlocke.org/research/show/spotlights/246](http://johnlocke.org/research/show/spotlights/246).
6. Miller and Pierce, *op. cit.*, note 3.
7. *Ibid.*
8. Among them it is worth quoting from a staff editorial from the *Fayetteville Observer* on April 6, 2005, which was prescient. Entitled “Dismiss This Class” and subtitled “Our View: From any perspective, the state’s commitment to education is taking a sharp turn for the worse,” the editorial states,  
  
*If we do get a lottery, it won’t be used as the governor and top legislators have promised — as additional funding, a supplement that will help us achieve even greater educational improvements. If the lottery means to fill the budget shortfall and avert a disastrous demolition of educational progress, then we will gain nothing. It’s just one more dedicated fund that betrays its own name — a new revenue stream that the governor and legislature will use as they please.*
9. “Easley Officials: Lottery Money Will Replace Some School Spending,” WRAL, Feb. 14, 2006, [www.wral.com/news/local/story/1091447](http://www.wral.com/news/local/story/1091447). Note also that the Easley administration’s projections of lottery sales were highly optimistic, as the total lottery proceeds for education were just over \$283,000 (with only about \$75,000 going to More at Four), North Carolina Education Lottery, FY ‘07 Beneficiary Brochure, [www.nc-educationlottery.org/about\\_where-the-money-goes.aspx](http://www.nc-educationlottery.org/about_where-the-money-goes.aspx).
10. “Editorial: Perdue’s lottery grab violates state’s promise,” *News & Record*, March 4, 2009, [www.news-record.com/content/2009/03/03/article/editorial\\_perdues\\_lottery\\_grab\\_violates\\_states\\_promise](http://www.news-record.com/content/2009/03/03/article/editorial_perdues_lottery_grab_violates_states_promise); Amanda Vuke, “Lottery Funds Continue to Be Diverted for Unauthorized Purposes: Few safeguards to prevent raids by General Assembly, governor,” *Carolina Journal Online*, Aug. 25, 2010, [www.carolinajournal.com/articles/display\\_story.html?id=6778](http://www.carolinajournal.com/articles/display_story.html?id=6778); “Perdue Fully Restores School Lottery Funds,” press release, Office of Gov. Bev Perdue, Aug. 28, 2009, [www.governor.state.nc.us/NewsItems/PressReleaseDetail.aspx?newsItemID=594](http://www.governor.state.nc.us/NewsItems/PressReleaseDetail.aspx?newsItemID=594) (note that the funds were withheld in February 2009 and restored in August 2009 without interest).

11. Mike Charbonneau, "Raid on lottery funds prompt call for name change," WRAL, March 10, 2009, [www.wral.com/news/local/politics/story/4708703](http://www.wral.com/news/local/politics/story/4708703).
12. County lottery sales figures: the North Carolina Education Lottery Commission; adult population: the North Carolina State Demographics office, [www.osbm.state.nc.us/demog/countytotals\\_agegroup\\_2009.html](http://www.osbm.state.nc.us/demog/countytotals_agegroup_2009.html); poverty rates and estimated median household income by county: U.S. Census Bureau, Small Area Income and Poverty Estimates, [www.census.gov/did/www/saipa/county.html](http://www.census.gov/did/www/saipa/county.html); average unemployment rate, 2009, by county: North Carolina Employment Security Commission, [eslmi40.esc.state.nc.us/ThematicLAUS/clfasp/CLFAASY.asp](http://eslmi40.esc.state.nc.us/ThematicLAUS/clfasp/CLFAASY.asp); county property tax rates, 2009-10: N.C. Department of Revenue, [dorn.com/publications/propertyrates.html](http://dorn.com/publications/propertyrates.html).
13. Cullen Browder, "Lottery is replacement, no addition in school budgets," WRAL, May 10, 2010, [www.wral.com/news/local/wral\\_investigates/story/7561544](http://www.wral.com/news/local/wral_investigates/story/7561544).
14. See note 5.
15. Joseph Coletti, "Eastern NC's Lottery Bug: Counties with higher taxes and unemployment play more," John Locke Foundation *Spotlight* No. 316, March 21, 2007, [johnlocke.org/research/show/spotlights/165](http://johnlocke.org/research/show/spotlights/165).
16. See note 12.
17. The N.C. Department of Commerce annually ranks the state's 100 counties based on economic well-being and assigns each a Tier designation. The 40 most distressed counties are designated as Tier One, the next 41 as Tier Two, and the 19 least distressed as Tier Three ([www.nccommerce.com/en/BusinessServices/SupportYourBusiness/Incentives/CountyTierDesignations2010.htm](http://www.nccommerce.com/en/BusinessServices/SupportYourBusiness/Incentives/CountyTierDesignations2010.htm)).
18. Those taxes would, in a free society, be based on sound principles of taxation. See Dr. Roy Cordato, "Reforming the Sales Tax: Keep in mind liberty, prosperity, and sound principles of taxation," John Locke Foundation *Spotlight* No. 394, July 12, 2010, [johnlocke.org/research/show/spotlights/245](http://johnlocke.org/research/show/spotlights/245).
19. See Dr. Roy Cordato's explanation for measuring the administrative costs of a state lottery against its usable revenue, contained in "A Costly Tax: State Lottery Is Inefficient Way to Collect Revenue," John Locke Foundation *Spotlight*, Feb. 27, 2001, [johnlocke.org/research/show/spotlights/38](http://johnlocke.org/research/show/spotlights/38).
20. In FY 2010, the requirements for the base budget for the NC Education Lottery proceeds was \$1,220,574,690 (North Carolina State Budget, Recommended Operating Budget 2009-11, General Fund, Department of Commerce, p. 294), while the lottery distributed \$400,929,982 to education (North Carolina Education Lottery, FY '10 Beneficiary Brochure, [www.nc-educationlottery.org/about\\_where-the-money-goes.aspx](http://www.nc-educationlottery.org/about_where-the-money-goes.aspx)).
21. Gov. Bev Perdue recently came out against deregulating liquor sales in North Carolina (see Cullen Browder and Renee Chou, "Perdue opposes privatizing liquor sales," WRAL, Jan. 20, 2011, [www.wral.com/news/local/politics/story/8971783](http://www.wral.com/news/local/politics/story/8971783)), but the issue itself is still before the legislature (see Lynn Bonner and Rob Christensen, "Privatizing ABC system will be a legislative issue," *The News & Observer*, Jan. 21, 2011, [www.newsobserver.com/2011/01/21/934181/privatizing-abc-system-will-be.html](http://www.newsobserver.com/2011/01/21/934181/privatizing-abc-system-will-be.html)).
22. Geoffrey Segal and Geoffrey Underwood, "Divesting the Pennsylvania Liquor Control Board," Testimony to Pennsylvania Senate Majority Policy Committee, April 18, 2007, [reason.org/files/7f7554148c4ea620727a4243e7d49020.pdf](http://reason.org/files/7f7554148c4ea620727a4243e7d49020.pdf).
23. In terms of sound principles of taxation, note that the purpose — education — is far removed from the funding tool (except, of course, in the wags' remarks about lotteries being a tax on the undereducated).
24. House Bill 80, "Ban Electronic Sweepstakes," [www.ncga.state.nc.us/gascripts/billlookup/billlookup.pl?Session=2009&BillID=H80](http://www.ncga.state.nc.us/gascripts/billlookup/billlookup.pl?Session=2009&BillID=H80), passed July 10, 2010, and signed into law by Gov. Bev Perdue on July 20.
25. See *Hest Industries, Inc. v. State of North Carolina*, [www.wral.com/asset/news/state/2010/11/29/8696624/Sweepstakes\\_cafe\\_ruling.pdf](http://www.wral.com/asset/news/state/2010/11/29/8696624/Sweepstakes_cafe_ruling.pdf); also see "Appeals court won't delay sweepstakes ruling," WRAL, Jan. 7, 2011, [www.wral.com/news/state/story/8900823](http://www.wral.com/news/state/story/8900823).
26. Dr. Michael L. Walden, "How 'Elastic' Are Lottery Sales," *Carolina Journal Online*, Aug. 20, 2007, [www.carolinajournal.com/opinions/display\\_story.html?id=4259](http://www.carolinajournal.com/opinions/display_story.html?id=4259).
27. Lottery fatigue is well discussed in the research literature; a brief explanation is given in, e.g., Sarah David Spears, "Ad agencies roll dice on lottery," *Atlanta Business Chronicle*, Feb. 27, 2006, [www.bizjournals.com/atlanta/stories/2006/02/27/story3.html](http://www.bizjournals.com/atlanta/stories/2006/02/27/story3.html):  
*David Forrest, an economist with the Centre for Study of Gambling at the University of Salford in the United Kingdom, studies lotteries all over the world. He said most lotteries start out strong due to the novelty of the product, but lag after 10 years or so as the public gets 'lottery fatigue.' The general picture in the U.S. seems to be that lotteries are always threatened with this boredom,' Forrest said.*
28. "North Carolina's FY 2011-12 Budget Gap," Fiscal Brief, Fiscal Research Division of the North Carolina General Assembly, Dec. 7, 2010, [www.ncleg.net/fiscalresearch/frd\\_reports/frd\\_reports\\_pdfs/Fiscal\\_Briefs/Fiscal%20Brief\\_%20FY%202011-12%20Budget%20Gap.pdf](http://www.ncleg.net/fiscalresearch/frd_reports/frd_reports_pdfs/Fiscal_Briefs/Fiscal%20Brief_%20FY%202011-12%20Budget%20Gap.pdf); also see Joseph Coletti, "Budget Crisis Is Opportunity: Bigger budget for FY'11 shows need for policy reform," John Locke Foundation *Spotlight* No. 395, July 20, 2010, [johnlocke.org/research/show/spotlights/246](http://johnlocke.org/research/show/spotlights/246).
29. "Financial State of North Carolina As of June 30, 2010," Institute for Truth in Accounting, Jan. 10, 2011, [northcarolina.statebudgetwatch.org/files/2011/01/NC-2010-Trifold-2.pdf](http://northcarolina.statebudgetwatch.org/files/2011/01/NC-2010-Trifold-2.pdf).
30. See Dr. Terry Stoops, "Good Classroom 'Disruption': Use the Internet to expand educational options in rural school districts," John Locke Foundation *Spotlight* No. 396, Aug. 16, 2010, [johnlocke.org/research/show/spotlights/247](http://johnlocke.org/research/show/spotlights/247).
31. *Ibid.*
32. Dr. Terry Stoops, "No Bureaucrat Left Behind: N.C. Public Schools Add Staff at a Much Faster Rate Than Enrollment," John Locke Foundation *Spotlight* No. 373, May 28, 2009, [johnlocke.org/research/show/spotlights/224](http://johnlocke.org/research/show/spotlights/224).
33. Dr. Terry Stoops, "Performance Pay for Teachers: Increasing Student Achievement in Schools with Critical Needs," John Locke Foundation *Policy Report*, September 2008, [johnlocke.org/research/show/policy\\_reports/175](http://johnlocke.org/research/show/policy_reports/175).
34. "School Standards and Testing," John Locke Foundation *Agenda 2010*, [johnlocke.org/agenda2010/schoolstandardsandtesting.html](http://johnlocke.org/agenda2010/schoolstandardsandtesting.html); "The First 100 Days: Eleven Action Items for the 2011 Legislative Session," John Locke Foundation, [johnlocke.org/research/show/policy\\_reports/224](http://johnlocke.org/research/show/policy_reports/224).
35. Dr. Terry Stoops, "Dropout Prevention Grants: Legislators Need to Rethink Their Approach to the Dropout Problem," John Locke Foundation *Spotlight* No. 371, May 24, 2009, [johnlocke.org/research/show/spotlights/222](http://johnlocke.org/research/show/spotlights/222).

36. See, e.g., Cullen Browder, "Gambling becoming a safer bet in N.C.," WRAL, Jan. 27, 2010, [www.wral.com/news/local/wral\\_investigates/story/6899807](http://www.wral.com/news/local/wral_investigates/story/6899807):

*Once taboo in North Carolina, gambling appears to be a growth industry.*

*The casino on the Cherokee reservation in the North Carolina mountains, which already draws 2 million people a year, is expanding, as is the North Carolina Education Lottery, which will join the Mega Millions multi-state lottery game next week.*

*As law enforcement waits for legal guidance – a challenge to the state ban on video poker will likely go before the Supreme Court this year – the gaming industry continues building its market share in the state. The newest frontier is in so-called sweepstakes cafes, which are opening across North Carolina. ...*

37. Pending legislation in California would legalize Internet poker in that state; a casinos group commissioned a study of the issue that would, they claim, in short order raise over \$100 million per year in state revenues. See Sajid Farooq, "Forget Cellphones; Casinos Say Poker Is Answer to State's Budget Woes," NBC Bay Area, Jan. 14, 2011, [www.nbcbayarea.com/news/politics/Forget-Cellphones-Casinos-Say-Poker-Is-Answer-to-States-Budget-Woes-113497784.html](http://www.nbcbayarea.com/news/politics/Forget-Cellphones-Casinos-Say-Poker-Is-Answer-to-States-Budget-Woes-113497784.html).
38. *Op. cit.*, note 35, second quoted paragraph.
39. In the sweepstakes cafes industry alone, estimates range from 5,800 to 10,000 people employed. In 2010 alone, approximately 1,000 sweepstakes cafes opened in strip shopping centers statewide. See Cullen Browder, "Sweepstakes cafes look for way around state ban," WRAL, Nov. 29, 2010, [www.wral.com/news/state/story/8696624](http://www.wral.com/news/state/story/8696624), and Bryan Mims, "Luck runs out for employees of sweepstakes cafes," WRAL, Nov. 26, 2010, [www.wral.com/news/state/story/8688369](http://www.wral.com/news/state/story/8688369). Furthermore, opportunities for expanded horse breeding and training industries could potentially benefit rural communities in North Carolina.
40. With the exception, of course, of the casino on the Cherokee reservation, which is another issue entirely.
41. A few examples:
- *The truth is, North Carolina is already funding smaller classes and education improvements. Unfortunately, we're funding them in other states ... in Virginia, in Georgia, and soon in South Carolina and Tennessee. We are spending hundreds of millions of dollars — North Carolina's dollars — to build new schools in other states, while we're packing our kids in trailers at home. We are the only state that plays the lottery and gives away the proceeds.*  
*I want to keep North Carolina's money in North Carolina's schools for North Carolina's children. Those resources could, and should, stay home. Now I am not saying a lottery for education is the only solution, it's just one solution. If anyone has a better idea ... if anyone has another way to find the \$400 million to \$500 million for education, I am open to it.*  
— Gov. Mike Easley, State of the State Address 2001, [www.stateline.org/live/details/speech?contentId=16092](http://www.stateline.org/live/details/speech?contentId=16092).
  - *Tonight, I tell you that we are also paying for schools in South Carolina and soon in Tennessee.*  
*When you are sitting here this year, struggling with the budget, just remember that your colleagues in 39 other states have a revenue source that you do not have. That makes it more difficult for you to improve education and keep taxes down.*  
*Now I heard you loud and clear last year that you do not want a lottery in the budget. But now you hear me — and a strong majority of our people — loud and clear. We want to keep North Carolina education money in North Carolina.*  
— Gov. Mike Easley, State of the State Address 2003, [www.stateline.org/live/details/speech?contentId=16176](http://www.stateline.org/live/details/speech?contentId=16176).
  - *Since I delivered my first state of the state address, hundreds of millions of North Carolina dollars have gone to education in South Carolina, Georgia, Virginia and Tennessee. Our people are playing the lottery. We just need to decide which schools we should fund, other states or ours.*  
*I am for funding our schools.*  
— Gov. Mike Easley, State of the State Address 2005, [www.stateline.org/live/details/speech?contentId=16618](http://www.stateline.org/live/details/speech?contentId=16618).
42. Dr. Terry Stoops, "A Lottery That Helps Students: How Lottery Proceeds Should Be Spent for Education," John Locke Foundation *Spotlight* No. 280, Feb. 15, 2006, [johnlocke.org/research/show/spotlights/127](http://johnlocke.org/research/show/spotlights/127).