A LOTTERY THAT HELPS STUDENTS
How Lottery Proceeds Should Be Spent for Education

SUMMARY: As the law is currently written, the education lottery will do little to fund the most critical needs of North Carolina's students. Too much of the revenue will be used for unproven class-size reduction efforts and pre-kindergarten programs. Too little of the lottery revenue will be given to school districts and charter schools that have critical school facilities needs. The General Assembly can maximize the educational benefit of the lottery revenue by distributing more funds for capital expenditures to high-growth school districts and to charter schools.

under the lottery law, the North Carolina Lottery Commission will allocate at least 35 percent of the total lottery revenue for educational purposes, and 65 percent will be used for lottery prizes and administration. The state will set aside five percent of the revenue earmarked for education into the Education Lottery Reserve Fund to be used when lottery proceeds fall short of a predetermined amount.[1] Of the total remainder, fifty percent will be distributed for pre-kindergarten programs for at-risk students and class-size reductions in low income and low performing elementary schools. Forty percent of the remainder will be allocated to all of the state's school districts for school construction. The remaining ten percent will be used for college scholarships for low-income students. The General Assembly estimates that $425 million will be produced by the lottery for education purposes in the 2006-07 fiscal year.[2] This Spotlight provides a revised distribution of lottery funds that better meets the needs of North Carolina's students.

Eliminate Funding for Class-Size Reductions

To best meet the needs of North Carolina's students, the General Assembly must begin by revising plans to distribute lottery revenue for class-size reduction and pre-kindergarten programs. The state's own assessment of class-size reductions in low-income and low-performing elementary schools showed that such reductions did not improve the students' academic performance.[3]

In addition, class-size reductions lead to two serious problems, neither of which is addressed by the lottery law.[4] First, school districts will not be able to recruit enough teachers to implement the desired class-size reductions. They

are barely able to keep up with current demand. Second, schools do not have enough classroom space to accommodate additional classes created by across-the-board reductions in class size. Ironically, by heavily funding class-size reductions, the state deprives school districts of the funds that they would need to build the classrooms required for smaller classes. In the end, class-size reductions are an unproven reform and would be an underfunded mandate. The dollars can be better spent elsewhere (see Table 1).

Limit Funding of Unproven Programs

There is evidence that pre-kindergarten programs may benefit impoverished children and children that have unstable home environments, but that does not mean that all expenditures for pre-kindergarten programs are worthwhile. For example, we do not know if North Carolina's oldest pre-kindergarten program, *Smart Start*, is producing lasting educational outcomes. The last evaluation of *Smart Start*, in 2003, concluded, "The study does not establish causality between *Smart Start* participation, child care quality, and child outcomes."[7] In addition, evaluations of *More at Four* show that students made only equivalent or slightly greater gains in literacy, math, and social skills compared to children attending other types of programs.[8] The distribution of lottery revenue for pre-kindergarten programs should be limited until yearly evaluations of *Smart Start* and *More At Four* show definitively that investments in pre-kindergarten programs are educationally effective and fiscally efficient.

Increase Funding for School Construction

There is little doubt that school districts across North Carolina are facing a school facilities crisis. Since 1995, voters across the state passed 69 bond issues for school construction totaling nearly $6 billion to accommodate an additional 155,000 students statewide.[9] In 2006 alone, bond referendums for school construction will likely exceed $1.5 billion.

The state's two largest school districts, Wake and Charlotte-Mecklenburg, maintain that they will need over $7 billion over the next ten years to accommodate their rapid enrollment growth,

Table 1. Current and Revised Distribution of Education Lottery Funds[5]

Current Lottery Distribution	Purpose	Revised Lottery Distribution
$201,875,000	Pre-K and Class-Size Reduction Programs	$40,000,000 (Pre-K only)
$161,500,000	School Construction	$253,375,000
$0	School Construction Cost-Saving Incentives	$20,000,000
$0	Charter Schools	$50,000,000
$40,375,000	College Scholarships	$40,375,000
$21,250,000	Reserve	$21,250,000
$425,000,000	ESTIMATED TOTAL	$425,000,000

Table 2. Enrollment Growth Estimates for High-Need School Districts[6]

School District	Percentage Growth 2005-15	Projected Growth (ADM) 2005-15	Average Yearly Growth (ADM)	Percentage of Yearly Growth Within Group
Alamance-Burlington	8.56%	1,855	186	1.01%
Brunswick	15.93%	1,749	175	0.95%
Buncombe	7.54%	1,895	190	1.03%
Cabarrus	36.82%	8,525	853	4.63%
Catawba	10.93%	1,876	188	1.02%
Chapel Hill	19.11%	2,079	208	1.13%
Charlotte-Mecklenburg	36.45%	44,419	4,442	24.13%
Currituck	49.62%	2,031	203	1.10%
Dare	37.26%	1,827	183	0.99%
Davidson	8.52%	1,682	168	0.91%
Durham	12.50%	3,806	381	2.07%
Forsyth	11.13%	5,417	542	2.94%
Guilford	9.38%	6,337	634	3.44%
Henderson	26.72%	3,351	335	1.82%
Hoke	30.02%	2,076	208	1.13%
Iredell-Statesville	15.52%	3,071	307	1.67%
Johnston	44.13%	12,085	1,209	6.57%
Kannapolis	37.12%	1,750	175	0.95%
New Hanover	18.80%	4,453	445	2.42%
Pitt	17.44%	3,806	381	2.07%
Union	57.70%	17,493	1,749	9.50%
Wake	44.30%	52,494	5,249	28.52%

Note: ADM (Average Daily Membership) = total days in membership for all students over the school year divided by the number of days school was in session

Table 3. Revised Distribution for School Construction[10]

School District	Revised Distribution Based on Yearly Growth	Current Estimated Distribution to All School Districts	"High Tax Bonus"	Estimated Distribution – Total
Alamance-Burlington	$925,852	$1,663,971	$0	$2,589,823
Brunswick	$872,947	$853,525	$0	$1,726,472
Buncombe	$945,817	$1,949,579	$0	$2,895,396
Cabarrus	$4,254,928	$1,789,528	$0	$6,044,456
Catawba	$936,334	$1,319,035	$0	$2,255,369
Chapel Hill	$1,037,653	$829,686	$775,521	$2,335,254
Charlotte-Mecklenburg	$22,170,046	$9,426,412	$8,811,023	$40,407,481
Currituck	$1,013,696	$316,805	$0	$1,330,501
Dare	$911,877	$381,269	$0	$1,293,146
Davidson	$839,506	$1,515,649	$0	$2,355,155
Durham	$1,899,619	$2,360,129	$2,206,051	$6,465,799
Forsyth	$2,703,689	$3,758,653	$3,513,275	$9,975,617
Guilford	$3,162,871	$5,226,471	$4,885,268	$13,274,610
Henderson	$1,672,524	$973,563	$0	$2,646,087
Hoke	$1,036,156	$534,804	$499,890	$2,070,850
Iredell-Statesville	$1,532,772	$1,523,697	$0	$3,056,469
Johnston	$6,031,766	$2,106,256	$1,968,752	$10,106,774
Kannapolis	$873,446	$357,047	$83,040	$1,313,533
New Hanover	$2,222,545	$1,836,440	$1,716,550	$5,775,535
Pitt	$1,899,619	$1,685,587	$1,575,546	$5,160,752
Union	$8,730,962	$2,330,924	$0	$11,061,886
Wake	$26,200,374	$9,151,996	$0	$35,352,370
SUBTOTAL	$91,875,000	$51,891,026	$26,034,916	$169,800,942
All other school districts (93)	$0	$53,083,968	$30,490,079	$83,574,047
Reconciliation for rounding	$0	$6	$5	$11
TOTAL	$91,875,000	$104,975,000	$56,525,000	$253,375,000

estimated to add around 100,000 students between the two districts. Counties from across the state will also experience growth that may necessitate hundreds of millions of additional dollars for capital expenditures. Supporters of the state lottery touted it as the way to solve the state's school facilities crisis, but school districts with high enrollment growth were unequivocally disappointed by the lack of resources allocated for school construction.

Likewise, charter schools were justifiably displeased that they would receive none of the lottery revenue under the current distribution scheme. Charter-school enrollment has nearly doubled in the last five years, and every school year there is an unmet demand for charter school seats.[11] For example, Franklin Academy, a K-12 public charter school in Wake Forest, had 1,164 applications for 118 seats available for the 2006-07 school year. Given that charter schools receive no state money for capital expenditures, they have had to turn away thousands of students because their facilities limit the number of new students that they are able to accommodate. If distributed wisely, proceeds from the lottery can provide both charter and county schools a reliable funding stream for capital expenditures.

Because of the state's school construction needs, this revised distribution directs funding to school districts with high growth. For this revised distribution plan, high growth is defined as those districts that will add over 1,500 students in the next ten years (see Table 2, Column 3). According to current DPI projections, 22 school districts meet this criterion for high growth. It is recommended that the state issue new projections every year. Revised projections may necessitate adding school districts to the list or distributing additional capital funds to a district that is growing faster than expected.

Table 3 provides the revised distribution of funds for school construction. In this revised distribution, the calculation for the distribution of funds to high-growth school districts will begin by establishing a pool of funds ($91,875,000), which is the balance remaining once funds are distributed to all other areas. These funds should be allocated to each of the 22 districts according to their percentage of total growth within this group (see Table 2, Column 5 and Table 3, Column 2). For example, Wake County would receive 28.5 percent of the total or $26.2 million because it represents approximately 28.5 percent of the growth within the group of 22 high-growth school districts. Similarly, Charlotte-Mecklenburg Schools would receive 24.1 percent or $22.1 million because it represents approximately 24.1 percent of the growth.[12] This system of distribution assures that those school districts that have the most growth receive the greatest percentage of the available pool of funds.

This revised distribution amount has been added to the funds allocated by the existing lottery law for school construction. In the lottery law, an estimated $161.5 million will be distributed to school districts. Sixty-five percent of this total is distributed to all school districts based on their Average Daily Attendance (ADM) (see Table 3, Column 3). Districts with effective county tax rates greater than the effective state average tax rate receive the remaining 35 percent, what should be called the "high tax bonus" (see Table 3, Column 4). Under the revised distribution plan, these funds remain intact for all 115 school districts.

Although retained here, the General Assembly should phase out the "high tax bonus." It rewards counties that have high taxes and encourages counties to keep their taxes above the state average. Furthermore, the counties that have high taxes are not necessarily those that have critical capital needs. For example, Scotland County has the highest tax rate in North Carolina and will receive the high tax bonus for school construction. Yet the county's student enrollment will decrease by nearly 16 percent in the next ten years. Thus, the lottery law's current formula for distributing school construction money does not target funding to the counties that need it the most.

It should be noted that the purpose of increasing the distribution of funds to high-growth counties is to pay the debt service on bonds for school construction, not to pay for schools outright as is commonly believed. It is unlikely that the fastest growing school districts can finance their debt service by using the lottery revenue alone. Thus, in order to substantially reduce the burden on taxpayers in North Carolina, increased lottery revenue for school construction must be coupled with efforts to cut capital expenditures.

Fund School Construction Cost-Saving Incentives

One more addition to the revised lottery distribution offered here is funding for cost-saving incentives related to capital expenditures. Currently, there are no incentives for school districts to implement cost-saving measures for school construction and renovation. This is particularly troublesome considering that the rising cost of steel, concrete, and petroleum has produced dramatic increases in school construction costs. Furthermore, Hurricane Katrina and worldwide demand for construction materials has led to additional cost increases.[13] Even as the cost of school construction rises, school districts appear to be unresponsive to the need to cut costs. Instead, they pass the cost on to the taxpayers in the form of larger bond issues and higher taxes.

Financial incentives would encourage school districts to employ innovative solutions to their facilities needs. One cost-saving incentive would include merit pay for senior administrators and facilities managers who satisfy all district needs but keep capital expenditures low and minimize dependence on large bond issues and tax increases. School districts would also receive funds to engage in public/private partnerships, facility sharing, adaptive reuse of vacant buildings, prototype designs, and similar school-construction and financing techniques.

Provide Funding for All of Our Public Schools: Lottery Proceeds for Charter Schools

Currently, charter schools receive no money from the state for capital expenditures. To correct this, each charter school should receive capital funds based on their enrollment or average daily membership (ADM) and the per-pupil capital outlay (five-year average) of the county school district where they reside. For example, a charter school in Wake County with an average daily membership of 100 students would receive $1,400.73 per student or a total of $140,073 each year from the lottery revenue for capital needs. This would ensure that charter schools receive capital funds that

are comparable to the county schools.

Lottery revenue should also be set aside for a charter school startup fund and a facility expansion fund. Assuming the legislature will lift the cap of 100 charter schools, the startup fund will assist new charter schools in financing their initial facilities needs, including down payment on a new building, leasing classroom space, or renovating an existing building. An expansion fund for charter schools would allow existing schools to expand their facilities to meet their increasing enrollment demands or programming needs (see Table 4).

Moving Forward

Dislike for the lottery should not breed indifference to it. Opponents of the lottery should try to make the best of bad situation by making sure that the lottery revenue yields a maximum return on its investment in public education. This means that the effort to redesign the way that General Assembly distributes lottery revenue must enlist the support of those who did not agree with the lottery law in the first place.

Likewise, supporters of the lottery should not be content to allow the law to remain in its current form. The refrain from school districts across the state is that the lottery does not sufficiently meet their needs. If the lottery is to have the kind of positive effect on public education that supporters expect, then there is no choice but to change the distribution scheme that is currently in place.

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Table 4. Revised Distribution of Lottery Revenue for Charter Schools[14]

Purpose	Description	Distribution
Capital Expenditures	Funds capital expenditures for all current charter schools. Allocation is based on the ADM of the charter school and the per-pupil capital outlay (five-year average) of the county school district.	$22,615,000
Startup Fund	Funds capital expenditures for all new charter schools. Assumes that the General Assembly will lift the cap on new charter schools.	$10,000,000
Facility Expansion Fund	Funds expansion of current charter school facilities. Allocation would be based on enrollment growth and demand for seats.	$17,385,000
TOTAL		$50,000,000

Notes

1. The Reserve Fund may not exceed $50 million.
2. North Carolina Education Lottery Commission, "Education Lottery Proceeds," http://lottery.nc.gov/index.htm
3. Metis Associates, "Third Annual Evaluation Report, High Priority Schools Initiative: 2004 – 2005," October 17, 2005. See also Terry Stoops, "Honey, I Shrunk The Class!" *Spotlight* 276, The John Locke Foundation, January 10, 2006, http://www.johnlocke.org/spotlights/display_story.html?id=123; Eric A. Hanushek, "The Evidence on Class Size," *Occasional Paper* Number 98-1, W. Allen Wallis Institute of Political Economy, University of Rochester, February 1998.
4. General Assembly of North Carolina, "North Carolina State Lottery Act, House Bill 1023 (S.L. 2005-344), as amended by Section 31.1 of Senate Bill 622 (S.L. 2005-276)," 2005, http://www.ncga.state.nc.us/gascripts/BillLookUp/BillLookUp.pl?Session=2005&BillID=H1023
5. *Op.cit.* at note 2. "Lottery Distribution," North Carolina Department of Public Instruction, Financial and Business Services, October 4, 2005.
6. "Average Daily Membership Projections, 2005-2015," North Carolina Department of Public Instruction, School Planning Division, September 23, 2005.
7. Frank Porter Graham Child Development Institute *Smart Start* Evaluation Team, "Smart Start and Preschool Childcare Quality in NC: Change Over Time and Relation to Child Readiness," Frank Porter Graham Child Development Institute, March 2003.
8. Frank Porter Graham Child Development Institute *More At Four* Evaluation Team, "More at Four External Evaluation Report for Year 3 (2003-04)," Office of the Governor, Education Office, 2005, http://www.governor.state.nc.us/Office/Education/PublicationsAndReports.asp
9. "Local Bond Issues Since 1995," North Carolina Department of Public Instruction, School Planning Division, November 16, 2005.
10. *Op.cit.* at note 5.
11. "Statistical Profile 2005" North Carolina Department of Public Instruction, p. 4.
12. These percentages are not included here.
13. Ken Simonson, "AGC's Construction Inflation Alert," The Associated General Contractors of America, 2005, http://www.agc.org/page.ww?name=Construction+Inflation+Alert&section=Construction+Economics
14. *Op.cit.* at note 5, pp. 59 – 61. "Charter School List," North Carolina Department of Public Instruction, Office of Charter Schools, January 19, 2006. "2004-2005 Selected Financial Data," North Carolina Department of Public Instruction, Division of School Business, Financial and Business Services, December, 2005, pp. 19-21. The actual distribution of funds to each charter school for capital expenditures is not included here. To simplify the calculation for the reader, the amount shown for capital expenditures in Table 4 has been rounded up from $22,611,842.