

Findings



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State Lottery Bill Analysis

How a Lottery Would Impact North Carolina

By John L. Rustin



Every legislative session since 1983, members of the North Carolina General Assembly have been inundated with bills to put the state in the gambling business through a state-run lottery. Over the years, these bills have taken different forms but all have attempted to overcome criticism of the lottery as a regressive tax by linking lottery revenues to a wide variety of public purposes. Despite this potential source of “new” revenue, however, state lawmakers have resisted the lure of the lottery and have opposed the idea of greatly expanded legalized gambling in North Carolina.

Binding Referendum

One common factor linking practically all of the lottery bills introduced over the last two decades in North Carolina is the idea developed by the gambling proponents that the citizens would have final approval of a lottery bill in a statewide referendum. This “binding” referendum idea has taken two primary forms. The first is a statewide vote that would take place after the General Assembly has passed a comprehensive lottery bill. The enactment of the lottery prescribed by the comprehensive bill would be final only after an affirmative vote of the citizens in a referendum. The second form, which was first developed in 2002 by the House Rules Committee, is a bill that asks the voters to approve the concept of a lottery in a referendum before details of the lottery plan are known. If such a referendum were approved, the theory is that the General Assembly would then reconvene and pass a lottery bill. The gambling industry would have full sway to manipulate the outcome of the referendum by pumping in massive amounts of money for advertising and promotion. This is a tried and true

method which has been used successfully by the gambling industry to leverage the introduction of state lotteries in at least 28 states so far.

While the question has yet to be decided ultimately by the courts, many constitutional experts agree that a binding statewide referendum on the lottery is an unconstitutional delegation of legislative authority to the people of the state.¹ According to the North Carolina Constitution, the power of the people to vote is limited to certain areas such as the approval of certain state or local government debts;² revising or

A lottery involves the state government, which is constitutionally charged to insure the welfare of the people, actively encouraging its citizens to gamble so that the state can gain more revenue from the people.

amending the state Constitution;³ and calling a constitutional convention;⁴ At its core, the concept of a referendum subverts a fundamental principle of our elected form of government: that state legislators are elected by the voters in their districts to study the issues and make informed decisions that are in the best interest of the constituents they represent and the state as a whole. It is not practical to expect every citizen of the state to be well informed on all of the issues that come before the General Assembly. This is why 170 members have been elected to represent the people by serving in the state legislature.

State lawmakers have become educated and informed on the lottery over the years, and the vast majority of members agree that

the lottery is bad public policy and bad for North Carolina. Thus, the lottery industry is seeking to remove the decision from the hands of a well-informed legislature and place it with a less-informed and sometimes wrongly-informed general public. This is not to say that the citizens of the state are unintelligent—that is not the case at all. It is simply reality that the vast majority of the public is unaware of the negative social, moral and economic impacts inherent with the lottery. Most of what they hear about are the multi-million dollar jackpots and the worthy causes that can be funded with lottery proceeds. But to make a truly informed decision, one cannot consider these things without weighing them against all of the other aspects involved in state-sponsored gambling. Since a majority of members of the General Assembly appear to agree that a binding referendum is unconstitutional, efforts to condition the enactment of a lottery on a vote of the people have somewhat subsided.

Non-Binding Referendum

As a result, another concept has surfaced—an “advisory” referendum, in which the people of the state would vote in an election for or against the concept of a lottery. Much like a statewide poll, this referendum would “test the waters,” so to speak, to determine the public’s support for the lottery, without technically binding the General Assembly to act in response to the outcome of the vote. The practical effect of a non-binding referendum, however, would be the same as a binding referendum. Lawmakers would undoubtedly feel bound to vote on a lottery in exactly the same way the majority of their constituents voted in an advisory referendum. An advisory referendum has never taken place in North Carolina, but would certainly set a precedent for referenda on a host of other issues in the future.

The Comprehensive Lottery Bill

While much of the lottery debate has been clouded by whether or not a lottery referendum is constitutional or a good idea, each lawmaker must not lose sight of the fact that he or she will ultimately decide if the state goes into the gambling business. Lawmakers will also determine what form the lottery would take. It has been said, “the devil is in the details,” and this is certainly the case with the lottery. While the concept of creating a new source of revenue through a lottery is attractive for some, many more are concerned about the specifics that go along with such a revenue-raising scheme.

In order to move the lottery debate back on course, this paper analyzes some of the details of proposed lottery legislation. Although lottery bills have been refined and modified over the last two decades in North Carolina, many components of recently proposed legislation have remained relatively unchanged. In order to provide a specific analysis of lottery legislation, this paper makes reference to House Bill 1, introduced in the 2001 session of the North Carolina General Assembly. This bill provides a fair representation of a typical lottery bill.

The Purpose and Intent

The purpose and intent clause of the lottery bill spells out what the lottery is supposed to do and how it is supposed to do it. It states the following:

The General Assembly declares that the purpose and intent of this Chapter is to provide additional monies to benefit the public purposes described in this Chapter through the implementation of a State-operated lottery without the imposition of additional or increased taxes. The lottery shall be initiated at the earliest practical time, and it shall be operated to maximize new revenue to the State. That new revenue shall be raised in a manner consistent with the dignity of the State and the general welfare of the people and in a manner consistent with effective business practices.⁵

Despite its claims, what the lottery legislation says it will do and what it actually does are two different things.

No Additional Taxes?

The stated purpose and intent of the lottery is to “provide additional monies to benefit the public purposes...without the

imposition of additional or increased taxes.” While the lottery would provide additional monies, it would also impose a new and hefty tax. Webster’s Dictionary defines the term tax as “a charge usually of money imposed by authority on persons or property for public purposes.”⁶ Just as taxes are attached to consumer goods such as clothing, liquor and cigarettes, the lottery is simply a tax of 50 cents that is levied on a one dollar lottery ticket. The state legalizes and operates a gambling business which is called “a lottery, numbers, or butter and egg lottery” and is currently illegal in North Carolina. A lottery is simply a way for the State to become the “bookie” for millions of potential gamblers. They operate the lottery as a business, developing a customer base and aggressively attracting more gamblers every day. The only difference between the currently illegal lottery, and a “legal” state-run lottery is that the state assumes a monopoly on gambling operations, access to gambling outlets is greatly increased, an illegal activity is made legal, the jackpots are larger, and the payout rate to the gambler is lower than in illegal games.

Of every dollar spent to purchase a lottery ticket, 34 cents would go to support government programs, 16 cents would be used for administrative and operational activities, and 50 cents would be returned to participants in the form of prizes. This means that half of every dollar spent on the lottery would go to fund public purposes or be used to raise that money.

Raise More State Revenues

The lottery’s stated purpose to “maximize new revenue to the State” means that its primary function is to generate as much revenue as possible. In order to meet this requirement, other states have gone to great lengths to maximize incoming revenue through the use of extensive advertising, promotional schemes, free ticket giveaways and increasing the accessibility of lottery outlets and the ease of participating in the lottery. In other words, the State would seek out as many ways as it can to sell more lottery tickets so that it can take in more and more money.

Types of Lottery Games Allowed

HB 1 would allow “any type of lottery game that has been conducted by any state government-operated lottery in the United States...” These games would include instant lotteries, lottery vending machines, on-line games, games played on electronic computer terminals, like keno, or other devices, etc. This gives a lottery commission broad powers to expand gambling

beyond a lottery without the need for approval by the General Assembly. They may also enter into agreements with other states for the operation and promotion of multistate lotteries.

As seen in other states, when lottery revenues drop off a few years after being enacted, more addictive lottery games are created to boost sales. These games prey on the gambling addicts that have been hooked by the lottery. A recent study conducted by two Duke University professors for the National Gambling Impact Study Commission confirms that five percent of lottery players account for 54 percent of total lottery sales.⁷

Effective Business Practices?

The legislation further specifies that lottery revenues shall be raised “in a manner consistent with the dignity of the State and the general welfare of the people and in a manner consistent with effective business practices.” Contrary to this stated purpose, the lottery is actually designed to maximize the amount of money taken from North Carolina citizens and given to the State.

Unfortunately, when state government actively pushes its citizens to spend revenue on a lottery that it has a monopoly on and that it also regulates and benefits financially from, it creates a clear conflict of interest. The National Gambling Impact Study Commission recognized this contradiction in their report to Congress when they asked “how can a state government ensure that its pursuit of revenues does not conflict with its responsibility to protect the public?”⁸

There is a further contradiction when the State is promoting a scheme which offers little chance for success. The chances of winning are based on staggeringly poor odds; 14-million-to-one in single state lotteries and 80-million-to-one in multistate games.⁹ Instead, the state should promote policies that encourage citizens to invest their money wisely and to be good stewards of what they have, not to throw money away on schemes that are practically guaranteed to make them losers. In fact, Duke Professors Charles Clodfelter and Philip Cook point out that 98 percent of lottery participants lose money on the lottery over time.¹⁰

A lottery would also hurt retail business. Retail merchants in southeastern Virginia lost \$430 million over three years to the lottery.¹¹ Lost sales mean fewer businesses and fewer jobs. Every dollar that goes to a lottery is a dollar that cannot be spent somewhere else—or saved.

Protect the General Welfare?

Despite the claims of lottery bills to promote the general welfare, the lottery would do just the opposite. One of the most disturbing aspects of a lottery is that it will cause at least five percent of adults and 13 percent of adolescents in the state to become compulsive gamblers.¹² Over time a lottery would create approximately 300,000 to 400,000 compulsive gamblers in North Carolina.¹³ Implementing gambling while knowing that it will ruin the lives of a percentage of the state's population is hardly consistent with raising revenue in a "manner consistent with... the general welfare of the people." Pushing citizens to gamble directly contradicts the state's responsibility to ensure the well-being of its citizens. Instead, it involves the state government, which is constitutionally charged to protect the people, actively encouraging its citizens to gamble so that the state can get more money.

A lottery will greatly increase the number of compulsive gamblers and will increase crime, theft, divorce, domestic violence, child abuse and other social ills. One study revealed that between one quarter and one half of spouses and at least one in 10 children of compulsive gamblers have been the victims of abuse.¹⁴ Among both pathological and problem gamblers, about a third have been detained or arrested by police (compared to about one in 20 of non-gamblers). About 21 percent of pathological gamblers and 10 percent of problem gamblers have been incarcerated.¹⁵

Lotteries also abuse the poor and less educated by enticing them to spend hard-earned dollars. Studies show that lottery players with household incomes under \$10,000 per year wagered nearly three times as much as those with household incomes over \$50,000.¹⁶ The highest per capita spending on the lottery is among those who have not completed high school with high school dropouts spending almost four times as much annually as college graduates.¹⁷

The State's Share—Net Revenue

Referred to as "net revenue," the state's take of the lottery is 34 percent. Throughout the years, the proposed uses of net revenues have differed greatly. Initially, most bills allocated lottery revenues to the state's General Fund. When these efforts failed, more targeted attempts were made to garner support for the lottery by earmarking lottery revenues to politically popular programs. Over the years, lottery bills have proposed to use lottery funds for benefitting poor and needy people; retiring state bond debt; increasing salaries for teachers and state

employees; public school technology, technology at universities and community colleges; local and state infrastructure; additional funding to local school administrative units; additional funding for cities and counties; early childhood education programs; university and community college scholarships; natural gas expansion; and water and sewer infrastructure.¹⁸ All of these programs may have merit, however, none have anything to do with a lottery other than being potential recipients of lottery money and a cover for a new revenue raising scheme.

Unreliable Revenue Source

Experience from other states with lotteries shows that programs earmarked to receive lottery funds, especially education, are often harmed in the long-run by the lottery. One reason for this is that lotteries are an unreliable source of revenue. During the first few years of a lottery, revenues may remain high, but when the novelty wears off and public interest wanes, lottery revenues fall. This has been evidenced even more in recent years as numerous state lotteries have seen their sales declining significantly.¹⁹ When these revenues fall, the programs funded by lottery dollars are hurt—forcing states to find ways to increase revenues by increasing jackpots, introducing new games and advertising more aggressively.

Many states have found that it is also more difficult to secure additional funds, such as school bonds, for lottery funded programs. This is primarily because the public is under the impression that the lottery is meeting all of the funding requirements of these programs and there is no need for additional revenue. However, states with education lotteries typically spend less of their overall budget for education and see a decrease in the rate of growth for education, while states without lotteries, such as North Carolina, spend more on education (North Carolina spends 60 percent of its budget on education.)²⁰ Additional revenues generated by the lottery are not enough to sway these percentages. In fact, projected net lottery revenues would amount to less than three percent of our existing \$14 billion plus budget.

Supplant vs. Supplement

It has been common practice in other states for the revenues that are generated by a lottery to simply replace or supplant, existing revenues earmarked to a program (often times education) instead of supplementing them.²¹ HB 1 states that lottery revenues "shall not supplant revenues already expended or projected to be

expended for those public purposes." While this is an interesting concept, it is not workable. One General Assembly cannot pass a law and bind a future General Assembly, and it is likely that lottery funds would eventually be used for all kinds of programs. Furthermore, there is no guarantee that the money will not be seized by a governor to cover other expenses during a revenue shortfall in the state budget. Recently, funds were taken from the highway trust fund and a sales tax fund for municipalities to fund other state government programs. The lottery would be no different.

Administrative Cost

Sixteen percent of gross lottery revenues would be used to cover administrative and operational expenses. Of this 16 percent, typically five to six percent would be used to compensate retailers for selling lottery tickets, four percent would be spent on advertising, four percent would likely go to the company with the contract to operate the lottery and the remaining two percent would go toward other administrative costs.²²

It is easy to see that a lottery is a very inefficient way to generate new money for the state. Because the lottery spends 16 cents to raise 34 cents, the effective administrative cost is 50 percent. This is significantly higher than what it costs the state to collect the sales tax. In fact, the \$160 million per year that it would cost to run a North Carolina lottery is almost three times the amount of so-called revenue that some lottery proponents claim that North Carolina loses to out-of-state lotteries.

Lottery Advertising

One matter that is directly tied to lottery revenues is lottery advertising. Current lottery legislation limits lottery advertising during the initial period of the lottery to 4 percent of all lottery proceeds. If the lottery grossed \$1 billion in revenues, \$40 million dollars could be spent on lottery advertising in a single year. After this initial period, the limit is removed and the Commission is directed to "consider the future rate of expenditures for these activities."

Although some lottery bills prohibit the use of false, misleading or deceptive information, state lotteries, being governmental entities, are exempt from the Federal Trade Commission truth-in-advertising standards.²³ As a result, they are able to say just about anything. For example, some states advertise the lottery as a way to financial freedom, as a ticket out of the ghetto, etc. despite the fact that the odds of winning the jackpot are astronomical. Such tactics put the state in the awkward position

of luring people by carefully crafted, ostentatious and persuasive advertising tactics to get them to spend money gambling. This role is at odds with the government's stated purpose to protect and promote the welfare of its citizens.

Typical advertising focuses on the multi-million dollar jackpot (with 14-million-to-one odds), but lists the odds of winning any prize such as another ticket (which may be 30-to-one). If HB 1 passes, all citizens of our state will be bombarded with all types of lottery advertising—each one sponsored by the state government.

Lottery legislation also directs the commission to conduct a special study of the demographic characteristics of the players of each lottery game, including income, age, sex, education, and frequency of participation, and similar studies are to be conducted on a continuing, periodic basis. This information will help the Commission to determine who is playing the lottery and enable them to further target their advertising approach.

New State Bureaucracy

An entirely new state bureaucracy would be created to oversee the operation of a lottery—The North Carolina State Lottery Commission. The nine member commission would be an independent, self-supporting, and revenue-raising agency of state government. It would have full rulemaking authority; would oversee the establishment of licensing and contracting requirements and procedures; and would be responsible for regulating and enforcing the laws. Such a commission, which is charged to maximize new revenue from a lottery, would also be responsible for regulating and overseeing its own activities.

Impact on Local Governments

HB 1 states: "All matters relating to the operation of the Commission and lottery games established by this Chapter shall be governed solely by the provisions of this Chapter and shall be free from regulation or legislation by local governments, including cities and counties." In other words, it preempts any local regulation of state gambling operations. Cities and counties will be powerless to regulate the location and operation of lottery game outlets, much

like they do with adult establishments and those with permits to sell alcohol. This means no zoning regulations or limits on the location of outlets in relation to schools, churches, residences or businesses. In most cities, more lottery outlets are located in poor areas of the city than in more affluent sections. Even if lottery outlets become centers of crime, local governments may be unable to shut them down.

Furthermore, because sales tax is not collected on the purchase of lottery tickets, local governments lose sales tax revenues.

Conclusion

North Carolina's state motto is "Esse Quam Videri" meaning "to be rather than to seem." Lottery legislation hardly conforms to this pledge. State-sponsored gambling is simply the government's attempt to get more revenue from its citizens by linking it to a politically popular issue such as education. When deciding on the lottery, lawmakers must weigh the high costs associated with generating relatively meager revenues. The negative impacts of gambling on society are well-documented, and the methods used to promote and operate the lottery undermine the state government's proper role to protect and promote the general welfare of its citizens. A majority of legislators already understand this. Legislators must also remember that the people of the state cannot enact a lottery. This authority ultimately rests with the General Assembly. Approval of a lottery referendum would only delay an up or down vote in the General Assembly, and would open the state to an entirely new form of government based on advisory referenda and undue influence from the gambling industry.

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