North Carolina Cooperative Extension Service

NC STATE UNIVERSITY

COLLEGE OF AGRICULTURE & LIFE SCIENCES

NC STATE COOPERATIVE EXTENSION

NC State Economist

Agricultural and Resource Economics • November/December1999

Should North Carolina Take A Chance on the Lottery?

Dale Hoover
Professor Emeritus

Introduction

Bills to institute a state lottery in North Carolina have been introduced in the last two legislative sessions. An informal proposal was made recently to use a lottery to support university capital improvement bonds in the state (Triangle Business Journal 1999). The question of a state lottery is almost certain to be debated in the next session of the general assembly.

To evaluate alternative policy proposals, North Carolinians need as much information as possible. This issue of the NC State Economist supplies some of that information. The rest of this introduction outlines the history of state lotteries. Following sections lay out the major arguments for and against state lotteries and outline alternative approaches North Carolina can take toward gambling.

Legal gambling has had its ups and downs in the United States. Lotteries to raise money for public functions were widespread before and during the Revolution but then gradually declined. After the Civil War, a number of state lotteries were started, only to be outlawed amid charges of fraud and deception in the 1890's. New Hampshire launched the first modern state lottery in 1964. Currently there are public lotteries in thirty-seven states and the District of Columbia.

States sponsor lotteries to increase their revenues, sometimes to make up for a tax shortfall, and sometimes to fund a new program without new taxes (Clotfelter and Cook 1989). State lotteries generate millions of dollars; however, in no state do they account for more than two percent of the general fund (Trussell 1998). At this rate, North Carolina would generate $260 million per year or less. Either a sales tax increase of less than half a cent or a rise in individual income tax rates of about one-forth of a percent would produce as much revenue.

Nearly all state lotteries are operated by a state commission that employs a commercial firm to develop games and guide operations. Tickets are sold through local convenience stores on a commission basis, and advertising is used to stimulate sales. Typically a state begins with one to three games. When sales start to sag, more games are added and advertising is increased. Finally, the state joins a multi-state consortium to maximize the pot and boost sales.

On average, a little more than half of

lottery revenue is paid out in prizes, and one-sixth is spent on operations and ads, leaving about one-third as income for the state (Figure 1). Over the last decade, the states' share has declined (Kiplinger 1997). This trend is due, in part, to an increase in prizes in response to more competition among states and rising advertising expenses. Even so, lottery players do not fare as well as casino or race track gamblers where winnings are substantially higher (Clotfelter and Cook 1989).

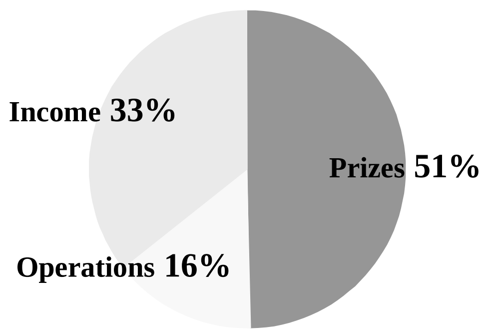

Figure 1. Disposition of Lottery Revenues

Pro and Cons for a State Lottery

Arguments for the Lottery

Pro-lottery Argument 1*:* There has been a groundswell of interest in gambling throughout the United States over the past six decades. If North Carolina citizens are given a chance to gamble in their home state, the Treasury can benefit. This will end - or at least reduce - the flow of money to the Virginia lottery and South Carolina video poker.

Rebuttal*:* It is inappropriate for the state to take on the role of business proprietor given its major responsibility to maintain business competition. State operation of an industry is likely to lead to inefficiency and increase the opportunity for bribery of public officials. Anyway, the gain in revenue is a hefty price to pay for encouraging gambling, an activity opposed by a sizeable minority in the state.

Pro-lottery Argument 2*:* Proceeds can be earmarked for increases in services such as education that would otherwise not be made available.

Rebuttal: Earmarking isn't effective given the power of the legislature to alter fund allocation (Jones and Amalfitano 1994). It is the legislature's responsibility to exercise final control on allocation of state funds. Also, evidence suggests that education earmarking results in fewer successful bond issues (Goodman 1995). State-sponsored gambling currently is a variable source of income that is likely to decline over time as Internet and other forms of gambling develop (Bell 1999).

Pro-lottery Argument 3: A state lottery would provide jobs and promote economic development in North Carolina.

Rebuttal*:* Lotteries can affect the location of employment, but they do not increase total employment. For a given household, money spent on the lottery reduces the funds available for essentials such as food as well as for other recreational activities. Consequently, county and city tax collections will go down as lottery players purchase fewer locally available goods and services (John Locke Foundation and the North Carolina Budget and Tax Center 1999).

Arguments Against the Lottery

Anti-lottery Argument 1: When the state is the proprietor, it will try to maximize net revenues through advertisement even to the point of overstating the chance of winning because its ads are not required to meet FTC standards (Karcher 1989).

Rebuttal: Voluntary restraints on advertising content and outlays can prevent most abuses.

Anti-lottery Argument 2: Some evidence indicates that gambling encourages compulsive behavior, especially among teenagers. According to one study, the share of players who develop problems may be as high as nine percent (National Commission 1999, p.11) - a figure that could rise if gambling becomes more readily available. Families of compulsive gamblers may try to sue states sponsoring games to recover damages (National Law Journal 1997). Finally, legal gaming may actually encourage illegal gambling, like sports betting.

Rebuttal*:* Funds can be set aside to provide for treatment. Legislation can prohibit suing. There is no proven connection between legal and illegal gambling (Clotfelter and Cook 1989, p.130).

Anti-lottery Argument 3: Gambling will actually decrease the income of the poor relative to the well off because low-income households spend a larger percentage of their income on lotteries than do well-to-do households (Borg, Mason and Shapiro 1991). Since lottery proceeds are frequently spent in ways that do not benefit the poor (Herring and Bledsoe 1994), this amounts to a transfer of resources from poorer households to better-off households.

Rebuttal: There is no reason to be concerned about the income distribution of players because gambling is recreational and citizens participate of their own free will. Anyway, the state's share of lottery revenues could be spent in ways that specifically benefit the poor.

What Should North Carolina's Policy Be on Gambling?

Currently, North Carolina law allows gambling only for occasional charitable bingo and raffles offering small prizes. North Carolinians can be prosecuted for owning a lottery ticket or for betting on sporting events. Cherokee, North Carolina is home to one of 150-plus Native American casinos that operate under 1987 and 1989 federal laws (Herring and Bledsoe 1994). Ten other states have the same general policy as North Carolina. Many states have state lotteries as well as privately-owned casinos and Native American gambling houses. Only Hawaii and Utah do not provide for any legal gambling.

There are three possible models for the state to follow in designing a policy toward gambling. The **suppression model**, the dominant stance of state governments throughout the U.S. for nearly a century, is a policy of prohibiting local gambling except for a few charitable purposes. Allowing gambling only at distant casinos and racetracks ensures that legal gambling is available only to those who can afford travel. North Carolina has traditionally taken a position that is compatible with this model.

Under the **state income model**, a state takes advantage of its citizens' desire to gamble by providing the game. Further, the state can ensure a substantial return by operating the gambling industry as a state monopoly and limiting market competition. The state lottery is not formally a tax since the rate of return on the activity can't be determined in advance. State operation of the lottery industry is not used as an argument for the development of other state monopolies.

The **libertarian model** holds that consumers should make their own consumption choices so long as the state maintains the role of supervisor of commercial activity, not as a proprietor. Advocates of this model take the position that there is no reason not to allow citizens to do what they want so long as free and competitive exchange is guaranteed and external effects such as compulsive gambling are properly managed (Calvert 1999). Under this philosophy, taxes would be levied on gambling at least to the level required to treat problem gamblers. The level of competition among private enterprise gaming firms determines the rate of payoff.

Some would argue that North Carolina does not have a clear public policy position on gambling. It would be more accurate to say that its traditional position is under challenge. The citizenry needs as much information as can be collected and presented as new alternatives are discussed. Unfortunately, it is not possible to see the future clearly. Will easy access to wagering and gaming make people happier, or will it lead to serious problems associated with compulsive gambling? Will state-sponsorship lead to more illegal sports betting with the temptation for an individual player to throw the game or shade the point spread to enrich himself or herself at the expense of the performance of the home team? The timing of the coming political debate will require North Carolinians to rely on research conducted over the past several decades. Fortunately a number of good studies can be found in the references below.

References

Bell, Tom W. 1999. "Internet Gambling: Popular, Inexorable, and (Eventually) Legal." Policy Analysis No. 336, Cato Institute, Washington, DC.

Borg, Mary O., Paul M. Mason and Stephen L. Shapiro. 1991. *The Economic Consequences of State Lotteries*. New York: Praeger.

Calvert, Guy. 1999. "Gambling America: Balancing the Risks of Gambling and Its Regulation." Policy Analysis No. 349, Cato Institute, Washington, DC.

Clotfelter, Charles T. and Phillip J. Cook. 1989. *Selling Hope: State Lotteries in America*. Boston, MA: Harvard University Press.

Goodman, Robert. 1995. *The Luck Business*. New York: Free Press.

Herring, Mary and Timothy Bledsoe. 1994. "A Model of Lottery Participation: Demographics, Context and Attitudes." *Policy Studies Journal* 22(Summer), pp. 245-57.

Jones, Thomas H. and John L. Amalfitano. 1994. *America's Gamble: Public School Finance and State Lotteries*. Lancaster, PA: Technomic Press.

John Locke Foundation and the North Carolina Budget and Tax Center. 1999. "Local Officials Doubt Fiscal Need for Lottery: A New Study Predicts Sales Tax Loss for Cities, Counties." Press release, March 1, 1999.

Karcher, Alan J. 1992. *Lotteries*. New Brunswick, NJ: Transaction Publishers.

Kiplinger's Personal Finance Magazine. February, 1997, p. 18.

National Law Journal. 1997. "Mother Fails to Recoup Son's $77,200 Gambling Losses," September 15, 1997, pp. B20 and B24.

Triangle Business Journal. 1999. "Weekly Report for Executives." September 6, 1999, p. 3.

Trussell, Tait. 1998. "The Florida Lottery: A Critical Examination." *James Madison Journal* 22(4): p. 6.

N.C. State Economist

Published bi-monthly by the Department of Agriculture and Resource Economics and the Cooperative Extension Service. Address correspondence to:

The Editor, N.C. State Economist
Box 8109, N.C. State University
Raleigh, NC 27695-8109

The N.C. State Economist is now on-line at:
http://www2.ncsu.edu/ncsu/cals/ag_rec/virtual_library.html

North Carolina Cooperative Extension Service
North Carolina State University
Agricultural and Resource Economics
Box 8109
Raleigh, North Carolina 27695-8109