



THE LOTTERY AND CALIFORNIA'S SCHOOLS

lot-ter-y, *n.* A scheme or arrangement for raising money, as for some public, charitable, or private purpose, by the sale of a large number of tickets, certain among which, as determined by chance after the sale, entitle the holders to prizes.

American College Dictionary

California has become the 21st state to establish a lottery. Combining rationale and enticement, the intended purpose is to provide "additional monies to benefit education without the imposition of additional or increased taxes." By November 1985, one year after voters approved the California Lottery, the first game was nearly completed, several ticket buyers had won \$2,000,000 prizes, and education was anticipating an initial quarterly installment of at least \$25 to \$30 per student.

This paper reviews the beginning of California's lottery, its current mechanisms, and the potential impact on funding for kindergarten through 12th grade schools.

GETTING STARTED

Placing an initiative on the ballot to legalize a lottery was easy: over 723,000 signatures were gathered within five months. Despite lack of enthusiasm from the Governor and the education establishment, passage of the measure was also easy: Proposition 37 was overwhelmingly approved by the voters in November 1984. The lottery was authorized through Section 19, Article IV in the California Constitution. Statutory guidelines for its operation and for the distribution of funds were simultaneously added to the Government Code.

Once the existence of a lottery was settled, Governor Deukmejian appointed the requisite five-person commission to oversee it and searched for a director to run it. The commissioners, who will serve staggered five-year terms, select the types of games, determine the number and value of prizes, and provide for the sale of tickets. They must meet in public and make quarterly reports. The director, Mark Michalko of Ohio, has a 500-person staff to operate what would rank in the top half of *Fortune's* 500 largest businesses in the United States.

Even before the official opening of the lottery, a significant amount of administrative

money was committed: an estimated \$40 million to Scientific Games, Inc. (the major lobbyist for the initiative) in a one-year contract to produce the tickets, and over \$22 million in direct advertising. Still more advertising was generated for televised coverage of the periodic spinning of the Grand Prize wheel for the biggest prizes.

About 20,000 retail outlets display the large green and orange "L" to signify their sale of lottery tickets. On October 3, 1985, the first "Instant Game" (immediate payoff up to \$5,000) began with much publicity — and an extremely enthusiastic public response. Over 370 million \$1 tickets were sold within six weeks, much faster than expected. The Grand Prize contests among ten to twenty randomly selected \$100 winners were telecast after Monday night football games through WIN, a "Winning Image Network" of 11 local stations. *Figure 1* shows the structure for the prizes in Game 1.

The weekly Grand Prize drawings continued, the second Instant Game began as soon as the first was sold out, and many Californians anticipated the computerized "on-line" lotto games with larger prizes scheduled to start in the spring or summer of 1986.

INITIAL IMPACT ON EDUCATION

A major selling point of the initiative, and a focus of subsequent mass media advertising, is the lottery's benefit to public education. Of the total proceeds, at least 34% is earmarked for the public kindergarten-through-college system, as shown in *Figure 2*. Half is targeted for prizes, and a maximum of 16% may be used for administration and operating expenses. Uncollected prizes and unspent administrative money also are to be channeled to public education.

Education's share is deposited directly into the California State Lottery Education Fund maintained by the State Controller, for distribution quarterly beginning in February 1986. Of the 5.4 million eligible

Figure 1
PRIZES IN GAME 1

Instant Prizes
(based on about 400,000,000 tickets)

Instant Prize	Winners
\$2	40,008,000
\$5	4,800,960
\$100	100,020
\$500	15,003
\$1000	10,002
\$5000	10,002

Grand Prize Wheel Slots

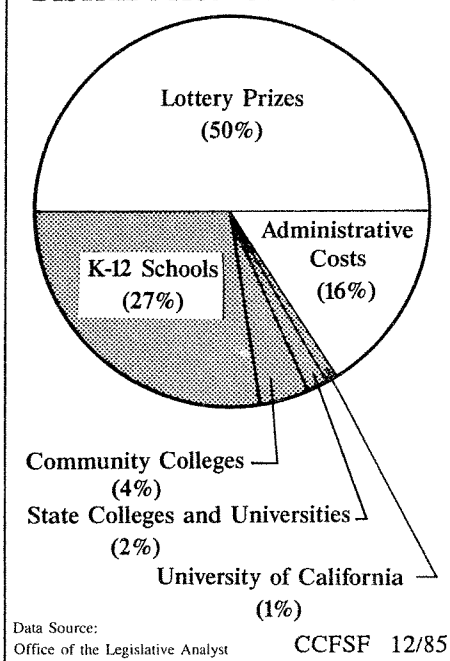
Number	Prizes
40	\$10,000
30	\$50,000
20	\$100,000
10	\$2,000,000

Data Source: Lottery Commission

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Figure 2

DISTRIBUTION OF PROCEEDS



kindergarten through college students in 1985, about 1 million are in community colleges, the state college system, and the University of California; all the others are in elementary and secondary schools and county and adult education programs. In other words, the 4.3 million K-12 students will receive about 81% of the amount for public education.

According to the California State Lottery Act of 1984, these funds must be "used exclusively for the education of pupils and students and no funds shall be spent for acquisition of real property, construction of facilities, financing of research or any other non-instructional purpose." Expenditures are otherwise left to local discretion. The law further states that "net revenues of the California State Lottery shall not be used as substitute funds but rather shall supplement the total amount of money allocated for public education in California."

What appeared to be straightforward provisions of the law needed clarification as the lottery became operational. The first step was to determine who qualified as "pupil." The Legislature decided to include the Hastings College of the Law, the California Maritime Academy, and classes run by county offices of education, for example, in the definition of full-time enrollment in public education institutions. Another step was to arrange for the actual distribution of the money. The receiving

districts and other agencies must maintain a separate "lottery education account" to record revenues and expenditures; the state has recognized its obligation to reimburse them for extra expenses caused by this mandate.

Even before the games had started, the Legislature and Governor showed strong interest in the lottery money. Estimated lottery receipts were included in the Governor's proposed 1985-86 budget as part of anticipated revenues for public education. Many bills influencing how the money would be used were introduced in the Legislature. These ranged from requirements that lottery income be spent for the replacement of unsafe school buses to permitting their use for building classrooms in overcrowded schools to deferring payment into a later fiscal period.

By the end of the legislative session, however, only three bills had passed and been signed by the Governor. Two of these (Senate Bills 832 and 374) affirmed local control over lottery funds as long as the Lottery Act is not violated, but warned that the Legislature would not "offset any future decline in lottery revenue." The third, Senate Bill 833, declared that the Legislature must never earmark lottery funds for any program mentioned in the 1984-85 Budget Act, Senate Bill 813 of 1983, the Community College Finance Act of 1984, or related legislation.

The question of how the lottery money would "supplement" the regular allocation for education was especially complicated.

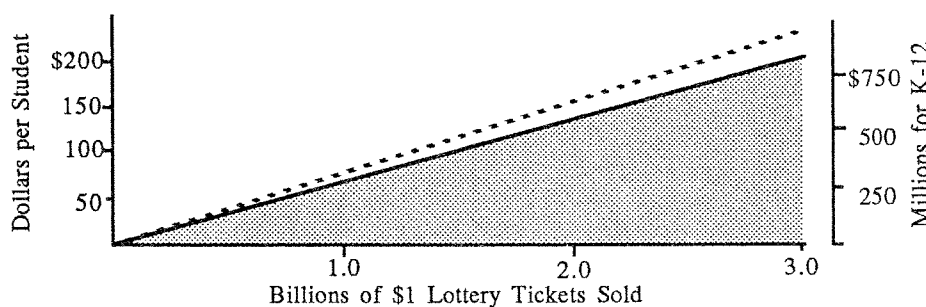
SB 833 was an attempt to specify the base, or starting point, against which to judge the supplement/supplant issue. The Legislature tried to limit the definition of the base by excluding any new allocations from it, but that language never became part of any law. Future legislative sessions could decide to keep the base at the 1984-85 level, as defined in SB 833, to narrow it further, or to expand it.

PREDICTIONS AND PROBLEMS

Based on the experiences in other large states, initial predictions were that education could expect from as little as \$50 to as much as \$200 annually per student from the lottery, depending on the volume of ticket sales. Viewed differently, according to the rules of the California Lottery every \$160,000 in lottery tickets purchased means 1 cent per student; \$100,000,000 means \$6.18 per student. The first game had 400,000,000 tickets, which is about \$25 per pupil. If ticket sales continue at the same fast pace, education could expect at least \$50 or \$60 per pupil during the 1985-86 school year. Figure 3 shows the relationship between sales and payments to schools during a full year of lottery games at the mandated 34% level and at a hypothetical 40% level if uncollected prizes or unspent administrative money were to accrue to education.

To give perspective to the numbers, a typical high school textbook costs \$13; an

Figure 3
PROJECTIONS FOR K-12 SCHOOLS



The solid line represents the 34% of lottery proceeds which must be distributed to kindergarten through college students. The dotted line shows the effect if unspent administrative money or uncollected prizes are added to education's share up to a hypothetical 40%.

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elementary field trip to a science museum might cost \$120. On a larger scale, reducing class size would mean hiring additional staff, a salary-benefit package of perhaps \$25,000 for one teacher. At the conservative estimate of lottery income of \$50 per pupil, it would take 500 pupils to generate the funds to hire one teacher. Leasing and installing a portable classroom for one year costs about \$30,000.

The primary sources of support for education since 1978 have been taxes on sales, income, and local property, in amounts determined by the Legislature and Governor. No one of those is strictly earmarked for education: lottery income is currently the only revenue source dedicated, by law, to schools. Along with the sale or lease of property or contributions and grants, it is also one of the few extra sources of funding for schools beyond the amount granted by the Legislature. However, a specific amount from the new additional source cannot be guaranteed or even relied upon because the total depends on how many lottery tickets are sold each year.

As Superintendent of Public Instruction Honig has said, "The money helps but will not solve our long-term problems." California still spends less per student than any other major industrialized state. Even if the lottery generates \$200 per student per year, it would be a small percentage of total funding, about 5%. And even if interest in the games remains that high, the substantial growth in student population which will occur in the next five years will mean a natural reduction in the per student share. Any future inflation will also reduce the purchasing power of lottery funds.

Of further concern is the possibility that financial pressures on the state budget will force the Legislature and Governor to recognize lottery funds as part of education's allocation, despite SB 333. Many people anticipate a public attitude that schools are "taken care of" by this new revenue source, with a reduction in pressure for support for education. Some fear that the Legislature will decide to control how lottery income is spent in the future.

The state itself will not realize any benefit from the lottery because the winnings are exempt from state, but not from federal, income taxes. However, all winners are checked against lists of people who are delinquent in such areas as child support

**Figure 4
OTHER STATES**

Gross Sales in Millions of Dollars for Fiscal Years 1981-84 in Selected States

State	1981	1982	1983	1984
Arizona	----	136.9	75.0	60.0
Colorado	----	----	208.0	120.0
Connecticut	151.0	169.8	188.0	254.4
Delaware	20.1	25.6	29.8	33.0
District of Columbia	----	----	54.1	68.2
Illinois	206.1	315.6	467.0	911.9
Maine	6.4	9.7	13.7	16.0
Maryland	385.6	457.4	462.8	485.8
Massachusetts	224.0	297.7	352.0	506.1
Michigan	502.3	535.2	557.6	620.0
New Hampshire	11.0	12.0	13.6	18.7
New Jersey	417.0	517.8	690.1	847.8
New York	236.2	424.9	646.0	888.7
Ohio	295.9	363.7	397.7	603.0
Pennsylvania	427.0	562.3	885.4	1,236.0
Rhode Island	36.2	37.9	44.0	52.9
Vermont	2.5	3.8	4.6	5.1
Washington	----	----	225.0	164.6

Data Source: *San Francisco Chronicle* CCFSF 12/85

payments, state income taxes, and outstanding student loans.

The only portion of Proposition 37 which is written in the State Constitution is the authorization to create the lottery (and prohibit casino gambling). Everything else is statutory; amendments must support the purpose of the original initiative and must be passed by a two-thirds vote of the Legislature. Changes which are inconsistent with the purpose or repeal of the law would require voter approval, according to the California Constitution.

EXPERIENCES IN OTHER STATES

All the parties involved in the lottery are carefully watching the experience of other states. In 1984 over \$8.1 billion was spent nationally on lotteries. In nine states, such as New Hampshire, a portion of lottery funds goes directly to education. New York's lottery law earmarks 45% of their lottery income for education, but the chairman of their Assembly Education Committee recently charged that, "contrary to public perception," the lottery revenues have really been used to free general fund revenues for other purposes. Other officials in New York disagreed, asserting that the lottery has helped raise the spending level for education and has alleviated the necessity of raising taxes to pay for schools.

The evidence from other states is that instant lottery games lose their appeal over time. The amounts spent on lotteries

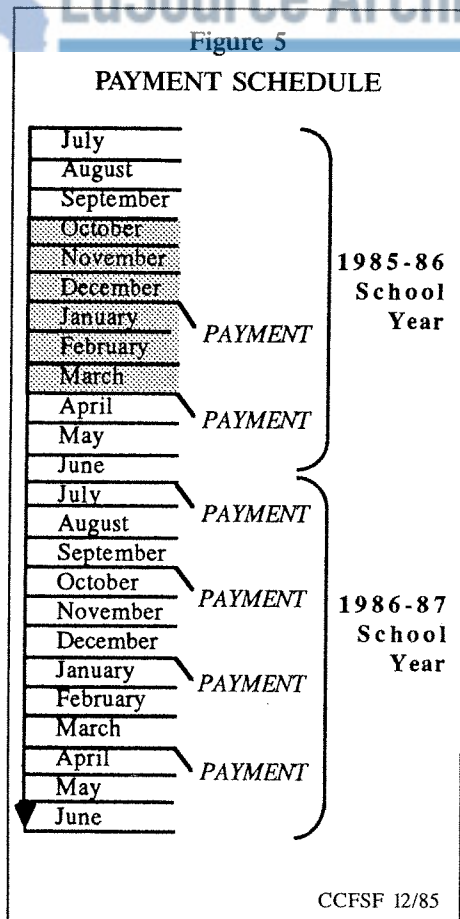
suddenly increased dramatically in those states which added the big payoff games. Figure 4 shows totals in selected states over the past five years. In 1984, 84% of the lottery money spent nationally was for lotto, the typical big payoff game in which players bet on several numbers out of very many possible combinations; the remaining 16% was for the instant winner scratch cards. The latter are considerably easier to run, since the complicated lotto games require many outlets with computers hooked into a central source. Curiously, numbers games like lotto have been more popular on the East Coast than in the West.

Lottery officials in Ohio found that retailers kept up their enthusiasm for selling tickets when their commission was 1% of the value of all winning tickets sold in their outlet plus a chance at a \$1 million drawing. California sellers currently receive 5 cents for each ticket sold but do not share any winnings.

THE OUTLOOK

As California's lottery moves into full swing, the publicity and human interest stories about the many small and few large winners overshadow questions about the game. Problems include how to deal with the agencies which want to give away tickets as bonuses or incentives for buying other products or how to tap into the large group of middle income residents, whose interest traditionally falls off quickly. Suggestions have been made to prohibit the sale of tickets, for example to convicted felons.

Figure 5



to the education of children. An historical complaint about lotteries — that they appeal to and take a larger proportion of the resources of lower income adults — has not been researched here, although early in the start of California's lottery the commissioners suggested that buying tickets was inappropriate for those with limited budgets.

Meanwhile, school districts waited for lottery money. They were optimistic but cautious in planning how to spend the unpredictable supplement to their 1985-86 budgets. Figure 5 shows the probable schedule of payments for the 1985-86 and 1986-87 school years.

Districts have asked questions about what restrictions would apply to the expenditure of lottery funds. Neither answers to those questions nor guidelines exist except for the categories described in the lottery law. However, Superintendent Honig has warned against targeting lottery funds for salaries, benefits, or other recurring expenses because of the uncertainty about the amount, particularly in the long run. He has encouraged districts to use the money for short-term, visible projects. Some districts have designated the income for purchase of textbooks and equipment which was curtailed during years of budget crises. Others intend to accumulate an account for a special activity. Many face pressure from employees to use the money directly for salary and benefit supplements. By September 1986 all districts must report to the Legislature about how lottery funds were spent and what expenditures are proposed in their 1986-87 budgets.

From educators' perspectives, decisions in Sacramento could be as important as the ticket-buying behavior of the population. The volatility of lottery income makes it undependable as an ongoing source of support. Therefore it is particularly important to schools that the Legislature and Governor not consider the lottery in their decisions about how much money to grant education each year.

Figure 6 summarizes the flow of funds to K-12 schools in real and constant dollars over the past 10 years. On the one hand, over \$16 billion in state and local money will be spent for K-12 education in 1985-86. At the current estimate of about \$60 per pupil for this school year, lottery funds would be less than 2% of the grand total. On the other hand, just \$50 of lottery funds would boost this year's per pupil income to the same level, in real terms, as last year's, and anything over \$50 would indeed be extra money. The lottery is simultaneously a splash in the pond and a welcome new source of revenue for schools.

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November 1985

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The entertainment and horseracing industries wonder about changes in spending patterns — whether consumers will shift from movies and tracks to lotteries.

On a larger issue, some people remain antagonistic in principle to a lottery, feeling it is particularly offensive to tie gambling

ABOUT CCFSF

The California Coalition for Fair School Finance is a nonprofit resource center for objective information about statewide education issues, especially school finance. The organization is known for its clear, impartial descriptions and explanations of complex subjects.

Supported by tax-deductible contributions and grants from corporations, foundations, and individuals, CCFSF enjoys continued sponsorship of the three founding groups—the California State PTA, League of Women Voters of California, and the American Association of University Women, California State Division.

CCFSF offers an Information Service to individuals, school districts, county offices of education, and organizations. Other services include workshops, speakers for meetings, two conferences in March, technical assistance, and a clearinghouse for more information.

A descriptive brochure and a list of publications are available from CCFSF, 525 Middlefield Road, Suite 100, Menlo Park, CA 94025 (415)323-8396.

Figure 6

A DECADE OF K-12 FUNDING

