

League of Women Voters of California

OPPOSES

Proposition 1C Lottery-Based Borrowing

LOTTERY MODERNIZATION ACT Legislative Constitutional Amendment and Statute

Note: The Background, Proposal, and Fiscal Effect sections are taken from the LWVCEF *In Depth* publication, based in part on the Legislative Analyst's Office analysis included in the Secretary of State's official *Voter Information Guide*.

BACKGROUND

Lottery Operations. Proposition 37, approved by the voters in 1984, created the California State Lottery (the "lottery") and the California State Lottery Commission (the "Commission"). The measure provided that 50 percent of lottery ticket sales must be paid out as prizes and that no more than 16 percent of ticket sales can be spent on lottery operating expenses. Lottery profits—the funds remaining after payment of prizes and operating expenses—must be dedicated to public education and paid directly to schools, community colleges and universities. Lottery profits cannot be used to help balance the state budget, and the state cannot borrow from future lottery profits.

Funding Education. In fiscal 2007-08 the lottery sold over \$3 billion of tickets, paid out \$1.6 billion in prizes, and spent \$380 million on operating expenses. The remaining \$1.1 billion (lottery profits) were distributed to public educational entities based on their number of students. This represented a very small part of the overall budget of these institutions. For example, for kindergarten through twelfth grade (K-12) schools, lottery profits made up just over 1 percent of all their revenues in 2007-08. Between 1997-98 and 2007-08, lottery payments grew at an average rate of 2.8 percent per year—slightly less than the rate of inflation. However, lottery payments to education have gone up and down over time, including drops in each of the last two fiscal years. By contrast, funding provided under Proposition 98—which makes up about three-fourths of K-12 education budgets—grew at an average rate of 5.6 percent per year during this same time period. Prior to the current fiscal year, Proposition 98 funding had increased every year during the last decade.

THE PROPOSAL

Proposition 1C would amend the state Constitution to allow lottery profits to go to education indirectly and to allow borrowing from future lottery profits; it would enact laws to carry out these changes. The Legislative Analyst has summarized key parts of the measure for the official Voter Information Guide (see text box on next page).

Lottery Operations. Proposition 1C would allow the lottery to increase the percentage of lottery funds returned to players as prizes above 50 percent in order to attract more spending for lottery tickets and increase lottery profits. The measure would expand the lottery's flexibility by:

- Limiting the number of contracts with private entities that the Commission must submit for competitive bidding.

- Reducing maximum operating expenses from 16 percent to 13 percent. The lottery now spends less than 13 percent on operating expenses.
- Allowing the lottery to carry over unused operating funds to a future year.

	<u>Current Law</u>	<u>Proposition 1C</u>
State borrowing from future lottery profits	Not allowed.	Allows \$5 billion in borrowing to help balance the state's 2009-10 budget. Additional borrowing allowed in the future. Repayment from future lottery profits.
Lottery prize payouts	Fixed at 50 percent of lottery sales	Flexibility given to California State Lottery Commission to set prizes at a level above 50 percent that generates the most profits.
Use of lottery profits	Paid to public schools, community colleges, and universities.	Not paid to educational institutions. Proceeds instead are used first to repay state borrowing described above. Remaining profits would be available to benefit the state General Fund by paying state debts and budgetary obligations.
School and community college district funding	Annual minimum funding guarantee established by Proposition 98.	An increased Proposition 98 guarantee to make up for districts' loss of payments from lottery profits.

Proposition 1C makes no changes to existing laws about the types of technologies the lottery may use in its games or the machines it may use to dispense lottery tickets. However, as discussed below, it gives the Legislature the authority to do so. In addition, the lottery would continue to be operated by the state and not by a private company.

Funding Education. Under Proposition 1C, beginning in fiscal 2009-10 lottery profits would no longer be paid directly to public educational institutions. Instead, the state would increase payments to educational institutions from the General Fund to compensate for the loss of those lottery profits. Specifically, the proposition would require the General Fund to make payments to educational institutions in that year equal to (1) the amount of lottery profits paid to these institutions in fiscal 2008-09, plus (2) an adjustment for changes in the number of students and the cost of living. For K-12 schools and community colleges, the General Fund payments in fiscal 2009-10 would be in addition to those already required under the Proposition 98 funding guarantee, while in later years, such new payments would become part of their annual Proposition 98 funding. These future General Fund payments would continue to be adjusted each year for changes in the number of students, as well as in

the cost of living, and would be distributed to public educational institutions based on their number of students.

General Fund. Proposition 1C would allow the state to borrow from future lottery profits. In fact, the state budget plan for fiscal 2009-10 relies on the state being able to borrow \$5 billion from such profits. Subsequent lottery profits would then be used to repay the investors, with interest. There is no limit imposed on how much state officials may borrow in fiscal 2009-10 or in future years.

In the future, lottery profits not needed to pay off lottery borrowing would be transferred to a new state government account called the Debt Retirement Fund (“DRF”). Funds in the DRF could be used by the Legislature to satisfy other General Fund obligations, including bonds and amounts borrowed from other state funds.

Other Provisions. The proposition would require the lottery to direct \$1 million of its funds each year to the state’s existing Office of Problem Gambling for its awareness and treatment programs. Currently, the lottery commits about \$250,000 per year to this office to help pay for the state’s 1-800-GAMBLER problem gambling telephone line.

Currently, the Legislature (with a two-thirds vote) can amend the lottery law to further the purposes of the original 1984 lottery law. This proposition gives the Legislature (still with a two-thirds vote) more flexibility to amend the lottery law in the future. For example, such amendments could authorize new operating rules, games, or devices that increase the lottery’s ability to generate profits for public purposes. The Legislature, however, would not be able to amend the parts of this measure that increase state General Fund payments to educational institutions without approval of the voters.

FISCAL EFFECT

State’s 2009-10 Budget Plan. In their February 2009 budget plan, the Legislature and the governor assumed the state would borrow \$5 billion from future lottery profits in 2009-10. If voters reject Proposition 1C, the Legislature and Governor will have to balance the budget in another way, probably through billions of dollars of spending cuts, tax increases, or other solutions.

If the state successfully borrows about \$5 billion from future lottery profits, annual debt payments of about \$400 million a year would be paid from lottery profits before the profits are used for any other purpose. Due to the current “credit crunch,” however, the Legislative Analyst is uncertain as to whether California will be able to achieve all of the planned \$5 billion lottery borrowing in 2009-10.

Future Strain on the General Fund. Proposition 1C requires increased General Fund payments to education. While the provisions of the measure probably would allow the lottery to generate increased profits, the first priority of the profits would be debt-service payments to investors. The Legislative Analyst says that the remaining profits probably would not be enough to cover the General Fund’s higher payments to education for most of the next 20 to 30 years. In the years after the \$5 billion borrowing, the Legislature would probably have to identify hundreds of millions of dollars per year in revenue increases or spending decreases to cover these costs.

Proposition 1C allows the state to borrow against future lottery profits at any time in the future. Any such additional borrowing, however, would increase debt-service costs even more and further reduce the portion of lottery profits available to cover the General Fund’s higher payments to education.

Should state officials decide to borrow more than \$5 billion from future lottery profits, budgetary decisions could be more difficult in the years after such borrowing.

Fiscal Effects if the State Never Borrows from Lottery Profits. While the state budget plan assumes \$5 billion of lottery borrowing in 2009-10, this measure does not require the state to undertake such a borrowing. If Proposition 1C passes and the state never borrows from future lottery profits, all lottery profits would flow to the DRF and be available to cover General Fund costs, including the required payments to education. The Legislative Analyst says that in such a case it is possible that increased lottery profits would roughly offset the General Fund's increased payments to education in the long term.

Lottery Operations. Californians currently spend an average of \$83 a person each year on lottery tickets, considerably less than the \$190 national average. California's payout of 50 percent is relatively low compared to other states. Based on evidence from other states, the Legislative Analyst concludes that if Proposition 1C passes, sales could grow between 30 and 80 percent. Profits would grow at a smaller percentage because a higher proportion of lottery funds would be given to players as prizes. Profits could increase by hundreds of millions of dollars a year compared to what they would be under current law. Actual sales and profits would depend on how California consumers react to products offered by the lottery and by decisions made by the Commission and the lottery staff.

Educational Institutions. Under Proposition 1C, schools, community colleges, and universities would no longer receive payments from the lottery. Instead, these institutions would receive higher payments from the state General Fund. These payments would grow over time—likely faster and in a more consistent way than the schools' existing lottery payments.

LEAGUE POSITIONS AND DISCUSSION

The LWVC State and Local Finances position on long term debt financing supports the use of bond financing for construction of capital projects or purchase of facilities for public use, or repair and retrofitting of existing public facilities and structures when other means of financing are not available. The only exception considered is for current urgent needs, such as repairs following a disaster, which may not fall within adopted infrastructure plans. The position calls for bond issues which take into account the current bond rating status of the state or local jurisdiction, including cumulative impacts and . . . levels of debt service within a budget.

We have no position on reliance on state-approved gambling as a source of state revenue and took no position on the original lottery proposal.

The LWVC Education: Pre-Kindergarten through 12 position supports a system of public education funding that is adequate, flexible, equitable, reliable and sustainable; derived from a combination of revenue sources; and distributed fairly to support access and equitable opportunities for all students.

The LWVC Community College System position supports a statewide community college system with sufficient resources to fulfill its overall goal: to offer all Californians access to a quality higher education.

Discussion

The questions we need to consider with this measure are the use of lottery revenue to repay more borrowing and the potential effect on education funding and on the General Fund. Our positions clearly do not advocate temporarily filling a General Fund deficit with borrowing. They do call for consideration of how a bond issue fits within debt management plans and of recommended debt levels within the budget. California's bond rating is now among the lowest in the country, and our debt service level is also higher than usual as a result of both the infrastructure bonds we have passed in recent years and previous borrowing to cover budget deficits.

Prop. 1C would authorize the state to issue bonds that would be "securitized," that is, guaranteed, by repaying investors from future lottery revenues. In light of California's poor credit rating and the state of the economy, these bonds would presumably have to be sold at interest rates very unfavorable to the state, if indeed they could be sold at all.

Bond proceeds of \$5 billion would be used to help balance the budget in 2009-10, but over the life of the bonds approximately \$400 million per year would come off the top of future lottery revenues for repayment to investors. Other lottery profits would benefit the General Fund by paying state debts and budgetary obligations, but Prop. 1C would put a strain on the General Fund by requiring payments to education to replace the loss of lottery payments. The League believes that the benefit to education of payments that would grow over time is outweighed by the negative effect on the state budget overall. The nonpartisan Legislative Analyst's Office says that in the long term, lottery profits probably would not cover the higher payments to education required by Prop 1C.

Altogether, success of the Prop. 1C scheme assumes the lottery would quickly produce more revenue than it now does. Prop. 1C also means that we would be continuing to borrow to fund current operating costs.

SUPPORTERS

Signing the ballot argument for:

Ed Bonner *President*
California State Sheriffs' Association

Dr. Glen W. Thomas
California Secretary of Education

Bill Hauck *Vice-Chairman*
California Business for Education Excellence

OPPONENTS

Signing the ballot argument against:

Honorable Bob Huff
State Senator

The rebuttal to the supporters' argument was signed by Honorable Bob Huff, State Senator.

The rebuttal to the opponents' argument was signed by Ed Bonner, President, California State Sheriffs' Association; Sheldon D. Gilbert, President, California Fire Chiefs Association; and Dr. Glen W. Thomas, California Secretary of Education.

Others opposing Proposition 1C include the LWVC; American Federation of State, County and Municipal Employees (AFSCME); California Church IMPACT; California Federation of Teachers;

California School Boards Association; and Tom Campbell, former California Director of Finance and member of Congress from California.

RESOURCES

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SAMPLE LETTER TO THE EDITOR

Note: Please adapt this letter to your own community and check your local paper's word limit for published letters.

Editor:

Proposition 1C on the May ballot would allow the sale of billions of dollars of long-term bonds secured by and repaid by future state lottery revenue. The League of Women Voters feels this kind of borrowing is a bad idea.

Bonds makes sense for long-term capital projects like schools and roads, but these bonds are a one-time fix to cover part of our budget deficit.

With California's low credit rating and the tough economy, the bonds could sell at very unfavorable rates for the state—if they sell at all.

Prop. 1C relies on changes to the lottery that may or may not result in enough increased revenue. Considering the many years of debt payments on the bonds, and changes in the funding of education required by Prop. 1C, the nonpartisan Legislative Analyst says this measure will potentially make it harder to balance future state budgets.

Vote NO on Proposition 1C.

Sincerely,

(name of president)

President

League of Women Voters of _____

No on Prop. 1C, Borrowing Lottery Money

Excerpted from an Editorial in the *Contra Costa Times*
BAY AREA NEWS GROUP
Posted: 03/21/2009

. . . The billions in borrowing from future lottery revenues called for in Prop. 1C would inexcusably strap future generations with hefty additional bond payments and make the state more dependent than ever on gambling that creates even more societal costs. . . .

This measure would allow the state to borrow against future lottery profits. It would also further increase the state obligation for education—even if the state opts not to borrow against lottery profits. This morally and fiscally misguided proposal should be rejected.

California voters established the lottery in 1984 when they passed Prop. 37. As a condition of that approval, voters were promised that lottery profits would go toward education. About 80 percent of profits go toward K-12 education, with most of the rest directed at community colleges and the four-year state college and university systems. Currently the lottery provides about 1 percent of all K-12 revenues.

Prop. 1C would allow the state to borrow money by selling bonds that would be repaid from future lottery profits. The budget for the upcoming fiscal year calls for the state to borrow \$5 billion this way, although there is no limit in Prop. 1C on how much could be borrowed next year or in future years.

It makes sense to issue bonds to pay for capital projects that would benefit future generations. But it's irresponsible to borrow to pay for ongoing expenses, as Prop. 1C proposes. Such borrowing would saddle the state for decades with inexcusable debt. For example, if the state borrowed \$5 billion next year, repayment over the next 20 to 30 years would cost between \$350 million and \$450 million annually. That's money that would otherwise go to state services.

To sell this crazy idea, backers of the plan argue that they can make improvements to the lottery to make it more profitable. That's a highly dubious argument. But even if it were true, any additional profits could be realized only if Californians lost more money gambling on the lottery each week—money they would often otherwise spend to care for their families. In other words, not only would we strap future generations with more debt, we would be banking on increased gambling, which would come with its own rising societal cost.

Then there's the education-funding component of Prop. 1C. If some of the future lottery revenues went to pay off debt, that money could not be used to help fund education. So, Prop. 1C would transfer the remaining lottery profits to the state general fund. The general fund, in turn, would become the source for paying schools the money that previously came from the lottery.

But there's a hitch: That money would be added to the Prop. 98 formula for minimum education funding levels, which is increased each year to account for school population and economic conditions. Those payments to education from the general fund would grow faster than the existing lottery payments for schools, thereby further driving up required spending on schools.

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NO on Proposition 1C Lottery-Based Borrowing

OPPOSE THE “LOTTERY MODERNIZATION ACT”

- **Proposition 1C on the May 19 ballot is bad fiscal and public policy.** It attempts to raise money for the short term by the sale of bonds that would be paid off by future revenue from a restructured state lottery. We cannot rely on a cooperative financial market for such a scheme in these tough economic times
- **Prop. 1C would permit the sale of bonds secured by uncertain future revenues.** There is no guarantee that the changes in the lottery permitted by Prop. 1C would increase lottery profits enough to cover all the costs of this risky proposal.
- **Using bonds to support operating programs is not good policy.** Long-term financing makes sense for capital improvements like roads, schools, prisons, and other infrastructure projects, but not for current operation of government programs.
- **Prop. 1C trades a short term gain for the 2009-10 budget for billions of dollars to be repaid over many years in the future.** The nonpartisan Legislative Analyst says that in the long-term, Prop. 1C would likely make it more difficult to balance the state budget.
- **Prop. 1C is part of an irresponsible approach to California’s budget problems.** Californians deserve better solutions from our elected representatives.

VOTE NO ON PROP. 1C ON MAY 19!