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Recent Proposals Concerning the California Lottery

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Senate Governmental Organization Committee

Hon. Dean Florez, Chair

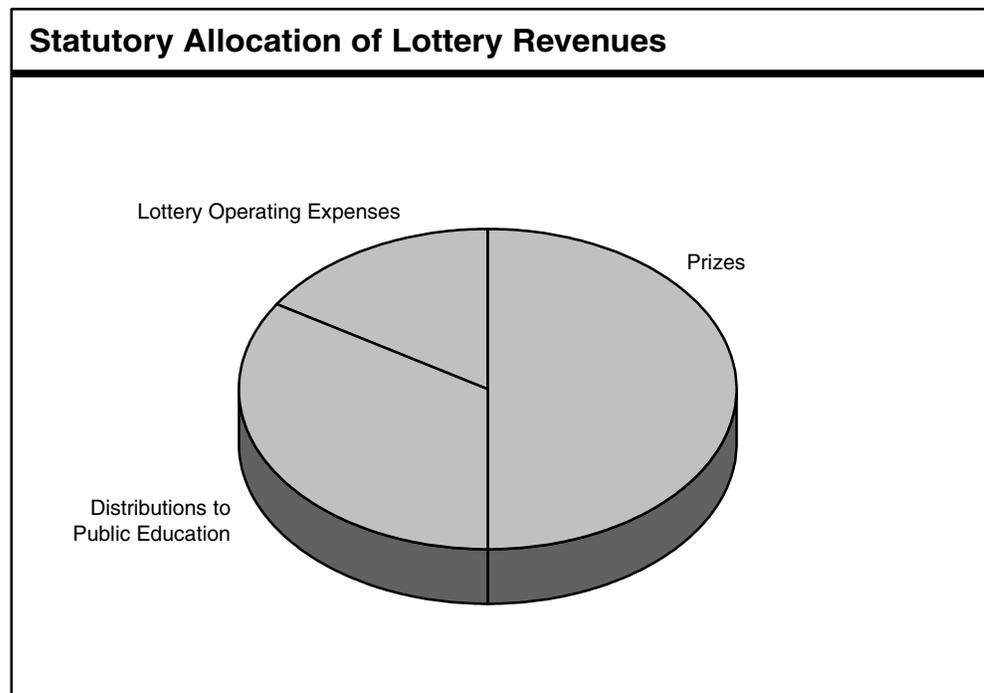




The California Lottery: Overview

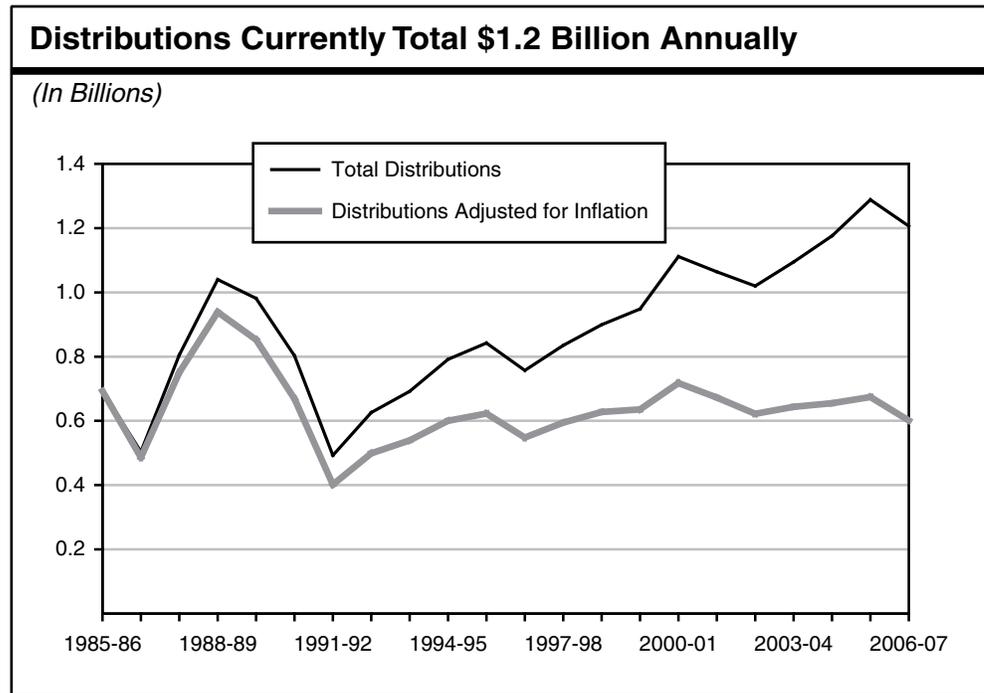
- ☑ **Proposition 37.** Voters approved the California State Lottery Act (the act) in 1984.
 - The act created the Lottery Commission, which has broad powers to oversee lottery operations.
 - The purpose of the act is to benefit public educational institutions by supplementing the total amount of money allocated to them.
 - The act may not be amended by the Legislature except to further the law's purpose. Such amendments must be in a bill approved by two-thirds of the Members of each house.

- ☑ **Voters Specified How Revenues Were to Be Used.** Proposition 37's requirements for the use of lottery revenues generally remain in place today.





Distributions to Education Have Been Volatile



Volatile Stream of Revenue. Trends in lottery distributions to education mirror trends in lottery sales. There have been several periods of pronounced weakness in sales since the lottery began on October 3, 1985.

- Adjusted for inflation, 2006-07 lottery distributions were about the same as they were in 1997-98 and less than they were in 1985-86.

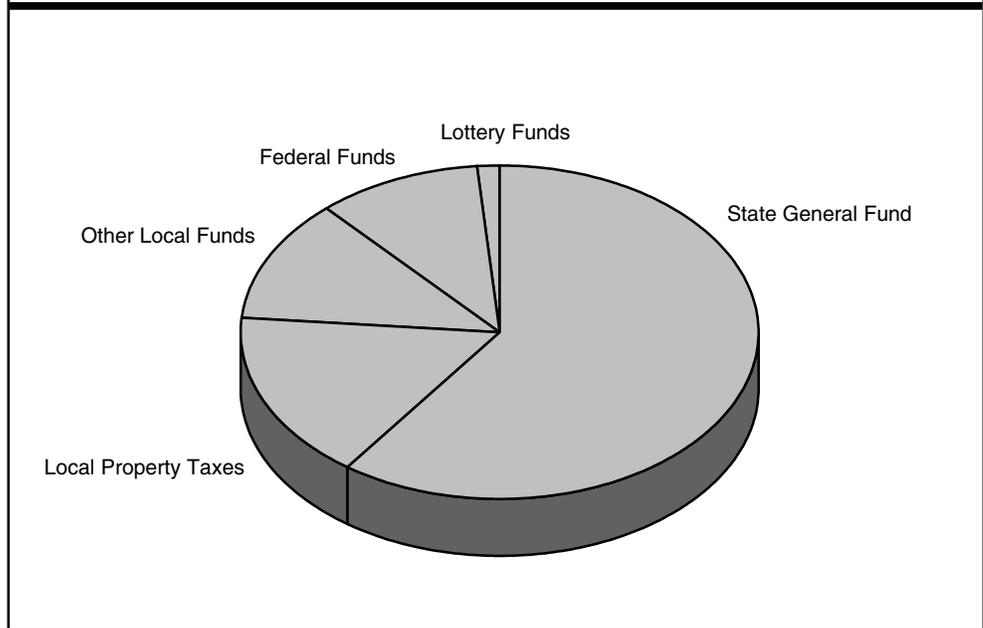


MEGA Millions Was Largely Unsuccessful in Increasing Overall Sales. In MEGA Millions' first full fiscal year (2005-06), it generated \$454 million of sales. During that year, the overall lotto game sales increased by a net amount of only \$78 million. This suggests that MEGA Millions largely "cannibalized," or reduced, revenues of existing games.



Lottery Is a Minor Funding Source For Schools

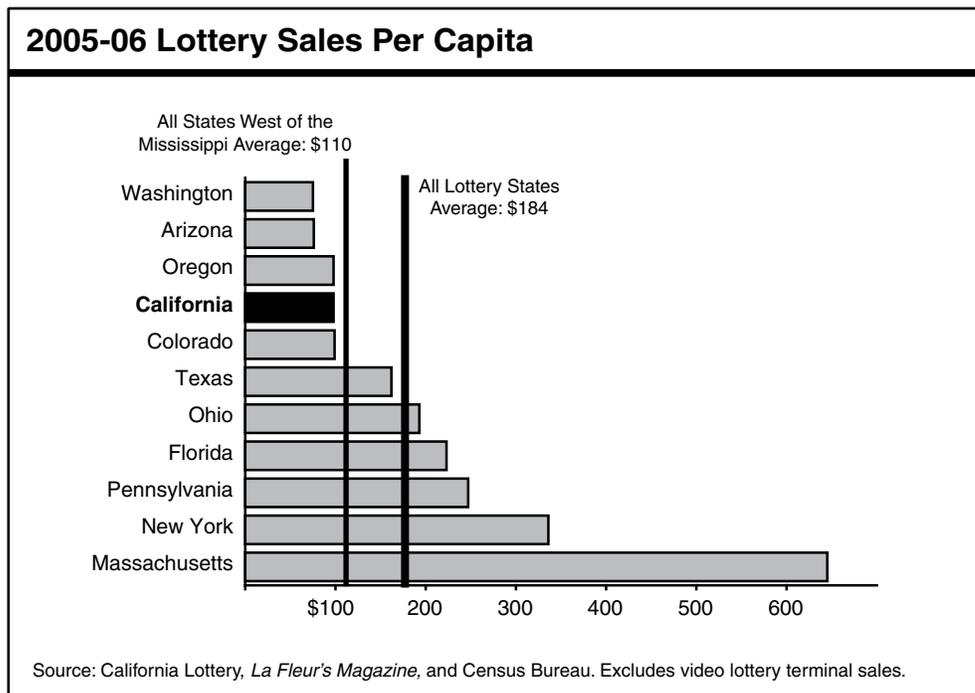
Lottery Funds Provide 1.5 Percent of K-12 Per-Pupil Funding



- ☑ **Many Californians Think the Lottery Provides More Funding Than It Does.** Surveys reportedly suggest that Californians think the lottery is a major funding source for education. It is not, as lottery funds provide only about 1.5 percent of total K-12 school funding.
- ☑ **The Lottery Will Never Be a Major Funding Source for Schools.** Even under the most optimistic assumptions for future lottery performance, lottery funds will never provide more than a tiny fraction of overall education revenues.



Lottery Sales Lag Those in Other States



✓ **Lottery Sales Improvement Is Possible.** Western states tend to have lower lottery sales than eastern states. Accordingly, while it may not be possible for sales per capita to reach the national average, the stronger sales performance of other states suggests that higher sales *may* be possible.

✓ **Lottery's 2007-2010 Business Plan.** Responding to recent sales trends and the lag in sales per capita relative to other states, the Lottery Commission has approved a new business plan with four key strategies.

- Long-term planning.
- Improving the California Lottery's brand image.
- Providing more winning experiences at lower prize levels and encouraging more regular game play.
- Investments in processes, systems, and infrastructure.



Governor's Proposal

- Noting Weak Lottery Sales, Governor Proposes Leasing It to Private Entity.*** The Governor proposed leasing the lottery to a private concessionaire to improve its sales and generate funds for public purposes.
- Freeing Up Restrictions on the Lottery Would Be Required.*** The plan would require significant loosening of restrictions on lottery operations, including prize payout percentages.
- Other States' Prize Payout Percentages.*** Several states with higher per capita sales pay out a *higher* percentage of lottery revenues in prizes. Some states that have increased payouts have found that this increases lottery profits.
- \$37 Billion Up-Front Payment Is Unlikely.*** The \$37 billion estimate discussed by the administration is unrealistic. The most that a lottery transaction could generate would probably be about one-half that amount or less.
- Plan Could Result in New Budgetary Pressures.*** The plan would require that some or all lottery profits not be allocated to education. The impact on education funding could result in new budgetary pressures for the General Fund.



Other Proposals

- Lottery Revenue Bonds—Up-Front Payment, but No Lease to the Private Sector.*** The state, while continuing to operate the lottery, could receive a significant up-front payment by selling bonds secured solely by lottery revenues. This payment could be used for various public purposes, such as capital projects, health care reform, or budget relief.
 - Because lottery profits would be required to pay debt service on the bonds, this plan also could result in new budgetary pressures related to education funding—similar to the Governor’s proposal.

- Continued State Operation of the Lottery, but Loosened Restrictions.*** Other proposals would keep the state as the operator of the lottery, while giving the Lottery Commission enhanced flexibility to pursue increased sales and profits. Such enhanced flexibility could involve (1) more flexibility to establish prize payout percentages, (2) broader flexibility on types of games offered, and (3) other changes.



LAO Comments

☑ ***Legislature Should Consider Strategies to Improve Lottery Performance.*** The Governor appropriately has raised the issue of whether the California Lottery is an underperforming state asset. We recommend that the Legislature explore various methods to improve the performance of the lottery, including changes in prize payout percentages.

☑ ***Consider Long-Term Budgetary Ramifications of Any Lottery Lease or Bond.*** The proposals for the state to receive a large up-front payment from the lottery all involve potential long-term budgetary pressures for the state, particularly concerning education funding. If the Legislature wishes to pursue such a transaction, it should carefully consider these pressures and avoid increasing the state's out-year budgetary problems.

☑ ***Leasing the Lottery Would Take Time.*** If the Legislature wishes to pursue the Governor's lease proposal, it should adopt a realistic timetable for receipt of any up-front proceeds. Such a transaction could take several years to complete.

☑ ***Broad Legal and Policy Issues for the Legislature's Consideration.*** Each of the lottery proposals involves various legal and policy trade-offs for the Legislature to consider.

- ***Problem and Pathological Gambling.*** Increasing lottery sales would involve an expansion of legalized gambling in the state—in addition to the large expansion of gambling authorized in recent years with approval of the tribal casino compacts—and could increase social costs related to problem and pathological gambling.



LAO Comments

(Continued)

- ***Competition for Other Gambling Interests.*** Improving the lottery's performance could negatively affect other gambling interests in the state, including tribes, cardrooms, horse racing establishments, and charitable bingo. This could result in declines of state and local revenues paid by those interests. Certain lottery changes could violate the state's casino compacts.

- ***Voter Approval.*** Because the lottery was approved by a voter initiative, voter approval may be required for certain changes.