Governor's lottery budget plan could shortchange education, state analyst says

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Gov. Arnold Schwarzenegger used overly optimistic assumptions in his lottery proposal and could wind up shortchanging education by billions in future years, the state's budget analyst said Monday.

Legislative Analyst Elizabeth Hill said she was skeptical that the state could repay the $15 billion from future lottery revenues and fund education.

Instead, she proposed borrowing against lottery income on a smaller scale, raising $5.6 billion over two years to help close the state's budget gap.

"We certainly have a concern with the magnitude of the governor's lottery proposal," Hill said Monday. "We think, in terms of our counterproposal, it's much more modest."
The governor last week proposed a $144.4 billion budget for the fiscal year that begins July 1. He would immediately use a chunk of the lottery proceeds to help close a $15.2 billion gap in the $101.8 billion general fund.

Such a move would require a measure on the November ballot to change existing lottery laws. If voters did not approve it, Schwarzenegger's plan would impose a temporary one-cent sales tax to raise the money.

Currently, the lottery produces about $1.2 billion a year for public education, providing just 1.5 percent of total K-12 school funding. Lottery officials blame game restrictions, citing rules that prevent ticket dispensers from giving change. They also said the state could attract more players if the lottery gave out bigger jackpots.

On Monday, Hill said the Schwarzenegger administration made "overly optimistic" assumptions about the potential growth in lottery sales. Instead, she examined changes in Florida after the state increased payouts.

Based on those more conservative growth estimates, Hill warned that public education funding "would fall well short of their current levels – perhaps by $5 billion over the next 12 years combined" because bondholders would have first claim on the money.

Schwarzenegger administration officials replied that they remain confident the state could increase income from the lottery enough to raise $15 million as long as they were given greater flexibility on games and technology. In 2007, California's per capita lottery sales were $91, about 50 percent of the national average.

Hill also questioned the logic of Schwarzenegger's plans for a "rainy-day" account, calling it overly complicated and seriously flawed.

She said the state already has ways to save cash in years when its income exceeds expenses.

She noted that the governor's plan would allow tapping the fund only when revenues fall by a specific rate. Otherwise, the state would be required to make automatic cuts – up to 5 percent each year – in spending if its income was insufficient.

The result, she said, could be "automatic multibillion dollar across-the-board reductions," without addressing the ongoing imbalance between income and spending.

The governor's proposed budget-system changes also undermine the Legislature's constitutional authority over spending, the analyst said.

Fred Klass, chief operating officer of Schwarzenegger's Finance Department, said the state's existing approach to saving hasn't worked well.

He said the governor's budget proposal would help the state cope with wide swings in its income from year to year.
And he noted the state could offset any drop in education funding from the lottery by taking the money from other programs.

Hill was also critical of the governor for continuing to propose 10 percent across-the-board cuts. She offered an alternative budget that uses a combination of program cuts and revenue increases, including reducing the state tax credit for dependents, to hold state services at their current levels.

Given that the state's budget picture has worsened since January, the analyst said she opted to borrow against lottery proceeds rather than add tax increases or program cuts.

"We think that none of the choices facing the governor and Legislature are easy," Hill said. "All of them involve trade-offs and significant consequences. But we need to level with the public in California that the state has a very major budget problem that will require sacrifice."

Both Democrats and Republicans, who oppose the governor's lottery idea for different reasons, said the report underscored the governor's failure to solve the state's long-term fiscal problem.

"His proposed budget is full of gimmicks and more borrowing that further jeopardizes California's future," said Senate President Pro Tem Don Perata. "The lottery plan is not only overvalued, it puts education dollars at greater risk."