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Dan Walters: Schwarzenegger makes a bad lottery bet

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Gov. Arnold Schwarzenegger and his minions insist that "securitizing" the state lottery – floating \$18.4 billion in bonds that would be repaid from presumably larger lottery profits in the future – to reduce the budget deficit is not piling on more debt.

"It's not a loan," Schwarzenegger's lottery point man, David Crane, said in a radio broadcast over the weekend. "We don't have any obligation to repay. It's a sale and every penny goes to no other purpose than to jump-start our rainy-day fund."

However, floating bonds is, by its nature, a form of debt, even if the bondholders would be, as Crane insists, assuming the risk that a "modernized" lottery would generate enough additional income to retire the bonds. In fact, the detailed documents released by the administration project use the term "debt service" to describe payments over as much as 30 years – including interest of more than \$23 billion.

Moreover, the proposal includes a proviso that bondholders could tap into the share of lottery money earmarked for schools if lottery profits fall short of expectations, thus forcing the state's deficit-prone general fund to "backfill" the school money.

It's difficult to create a metaphor for the lottery plan. It resembles the state's borrowing against future payments from tobacco companies from the nationwide cigarette lawsuit settlement, or perhaps the willingness of some lenders to provide lump-sum payments in return for a diversion of personal annuity payments.

Notwithstanding the quibbling over semantics – Senate President Pro Tem Don Perata describes Schwarzenegger's revised budget as "full of gimmicks and more borrowing" – the essential question is whether it makes good sense in financial and public policy terms. And on those grounds, it's a highly dubious scheme.

Were it to be approved by voters and work exactly as envisioned, it would cost California, in the form of lottery profits, a whale of a lot of interest for a relatively small, short-term financial injection.

The governor would use \$5 billion of the bonds' net proceeds immediately for the 2008-09 budget while holding another \$10 billion in a so-called "rainy-day" fund to cover future shortfalls. Another nearly \$3 billion-plus would guarantee lottery payments to schools for a few years, create a repayment reserve and cover lenders' fees.

Given the immensity of the deficit, however, it's virtually certain that the remaining \$10 billion would be gobbled up in the 2009-10 and 2010-11 budgets, which neatly coincide with Schwarzenegger's last years in office. Thus, this plan appears truly aimed at making it easier for the governor to get through his governorship without, technically at least, raising taxes.

Chances are very great, however, that it would not work as envisioned because it hinges on doubling lottery revenues, bringing California to the national per capita average. While that sounds superficially plausible, it's probably very unrealistic.

California doesn't have the lottery (or illegal numbers) tradition ingrained in Eastern states, and its per-capita ticket sales are very similar to those of other Western states. Elizabeth Hill, the Legislature's budget analyst, cited that likely shortfall – and its impact on schools – in proposing a "much more modest," two-year sale of lottery-backed bonds Monday.

Were lottery sales to double, however, it probably would depend on lower-income residents responding more heavily to the get-rich-quick pitch of lottery marketers. There's something wrong with balancing the budget by borrowing from Wall Street, based on extracting more money from the poor, while simultaneously reducing their welfare and health benefits.

If that's the best Schwarzenegger can do, the sooner his governorship ends the better.
