

PACE

POLICY ANALYSIS FOR CALIFORNIA EDUCATION

Policy Paper No. PP87-4-7

Do "Our Schools Win, Too"?

School Uses Of Lottery Revenues: Year One

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April 1987

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Executive Summary

Since its passage in the fall of 1984, the California State Lottery has been widely and enthusiastically supported by players while receiving more guarded support from educators. Now the largest state operated lottery in the nation, California's program generated an unheard of \$1.77 billion in ticket sales during its first fiscal year of operation, a year that included only nine months of sales, due to a later-than-anticipated start up. The lottery's contribution to all public education that year amounted to \$689 million. Elementary and secondary schools received approximately \$555 million, a windfall equal to about 2.6 percent of California's total budget for K-12 public education. On a per-pupil basis, the lottery's contribution in fiscal year 1985-86 amounted to \$125.67 for every unit of average daily attendance or full time equivalent in the state's public K-12, community college, state college, and state university systems.

Because the Lottery Act imposes only the broadest restrictions on use of the education funds generated by the lottery, the program has been plagued by a degree of uncertainty as to what constitutes appropriate use of funds. Additionally, despite specific language in the Lottery Act and in subsequent legislation that requires lottery funds for education to be treated as supplementary revenues, school district administrators are torn between pressures to restore badly eroded basic operations and programs and pressures to "live up" to the lottery's promise of enhancement of public education.

Overshadowing these two issues are concerns about the reliability of the California State Lottery as a source of education revenue and the possibility that lottery revenues will be "planned into" the state budget process so that, in time, the program will contribute no "new" or "extra" money for education.

This study surveyed a sample of California K-12 public school districts regarding their actual or planned uses of 1985-86 lottery revenues and their attitudes about and experiences with the lottery program. Figure 1 displays a general breakdown of the sample districts' uses of lottery revenues. In addition, it was learned that:

Districts are being prudent with their lottery revenues.

- Although districts, generally the larger ones, are using nearly a third of their revenues for personnel, either for raises or for new personnel, they are, in most cases, granting bonuses and hiring temporary personnel.
- They are resisting pressure to make long-term commitments of lottery funds.
- Some districts are placing some or all of their lottery revenues into reserves, pending district decision-making processes and trends in future lottery revenues for education.

- Some districts are building up depleted contingency reserves.

Lottery funds are being used to enhance instruction.

- Nearly a third of lottery revenues are being used for instructional materials and supplies, frequently for equipment such as computers, projectors, and microscopes.
- "Poorer" districts are spending twice as much of their lottery revenues on instructional materials than are districts with above-average resources.
- Nearly a third of the surveyed districts are extending hours or adding new personnel in order to provide new programs such as foreign language, librarians, resource centers, or aides.
- A fifth of lottery revenues are being allocated directly to school sites, to be used at their discretion for site-specific needs.
- Many districts report using lottery money for a variety of staff development and professional growth activities.
- Some districts are using lottery revenues to reduce class sizes.

Few districts have comprehensive and open planning processes.

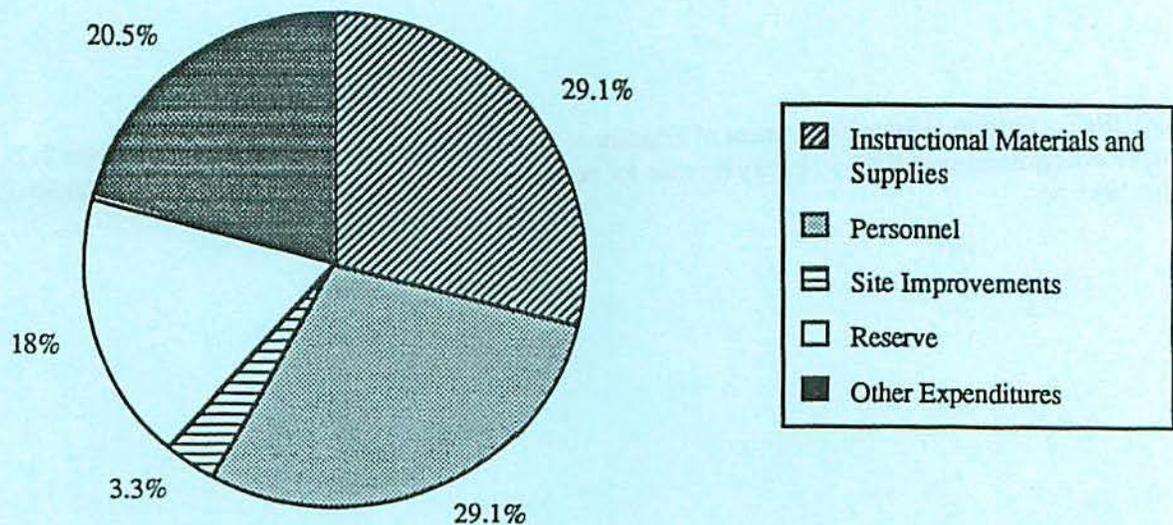
- Most districts report using some degree of needs assessment or planning process, but few report using procedures that guarantee input and participation from all stakeholders.
- There is concern that some student populations that "earn" lottery revenues are not receiving benefits from the revenues.
- Some districts bow to pressure from strong employee organizations to use lottery funds for salary improvements despite more strongly perceived needs on the part of district management.
- Some districts treat lottery revenues as a de facto grant program, disbursing funds upon receipt of meritorious requests by district staff, although often criteria for acceptance are vague or nonexistent.

Superintendents are extremely apprehensive about the program's future.

- Their chief concern is that, at the state level, lottery revenue will be "folded into" the education budget, eradicating the special intent and discretionary nature of the funds and supplanting traditional sources of funding.
- Many superintendents fear that publicity surrounding the lottery program is fostering in the public a false sense that education is now well funded.
- Superintendents are also worried that recurring costs and employee benefits will, in years to come, absorb increasing proportions of lottery revenues to the detriment of the intention of the Lottery Initiative.

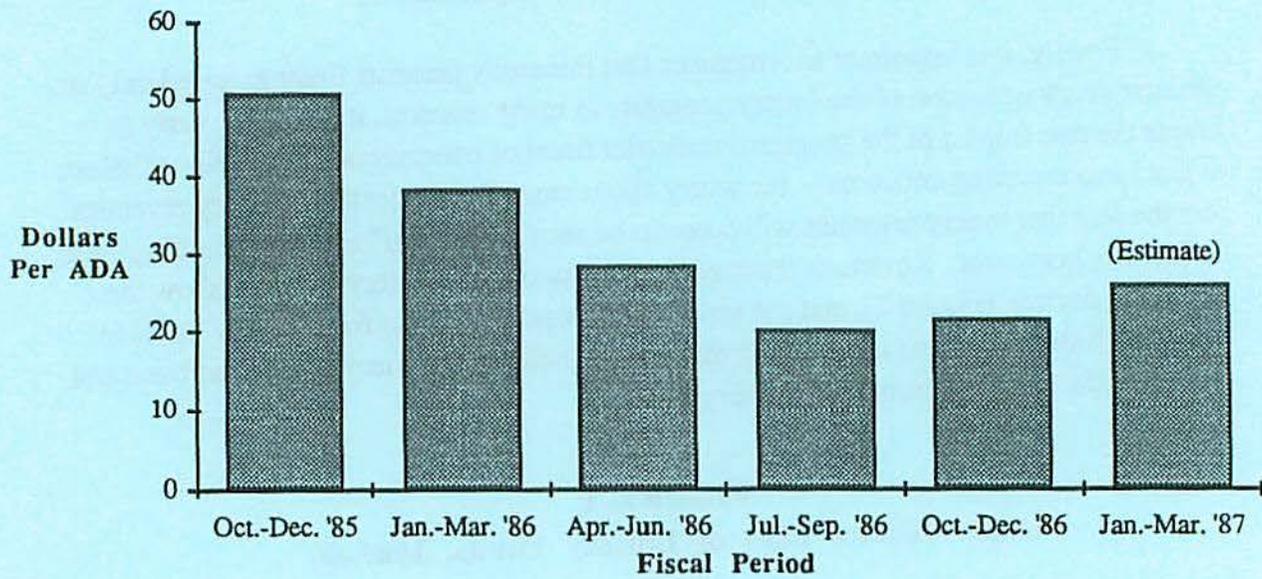
Finally, it is important to remember that this study presents findings based only on the first year's operation of the lottery program; in many respects, it is still too early to assess the true impact of the program on district fiscal or educational policy. Nevertheless, at least two recurring concerns – the worry about unstable and declining lottery revenues and the fear that lottery revenues will come to be seen as "normal" education funding – are now being borne out. Revenues reported for year two of the lottery program show the predicted decline (Figure 2), and the governor's proposed budget for 1987-88 "folds in" projected lottery revenues in a manner that clearly indicates his intention to fund basic and ongoing education programs with lottery money.

FIGURE 1
School District Uses of Lottery Funds, 1985-86



SOURCE: PACE analysis based on a statewide sample of school districts. For additional details, see Figure 10.

FIGURE 2
Lottery Revenue per ADA



SOURCE: California State Department of Education. The first three quarters' total of slightly over \$125 per ADA, representing fiscal year 1985-86 lottery revenue for public education, equals nearly 3 percent of total funding per ADA for 1985-86.

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Policy Analysis for California Education

Policy Analysis for California Education, PACE, is a university-based research center focusing on issues of state educational policy and practice. PACE is located in the Schools of Education at the University of California, Berkeley and Stanford University. It is funded by the William and Flora Hewlett Foundation and directed jointly by James W. Guthrie and Michael W. Kirst. PACE operates satellite centers in Sacramento and Southern California. These are directed by Gerald C. Hayward (Sacramento) and Allan R. Odden (University of Southern California).

PACE efforts center on five tasks: (1) collecting and distributing objective information about the conditions of education in California, (2) analyzing state educational policy issues and the policy environment, (3) evaluating school reforms and state educational practices, (4) providing technical support to policy makers, and (5) facilitating discussion of educational issues.

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Do "Our Schools Win, Too"?

School Uses of Lottery Revenues: Year One

Background

On November 6, 1984, California voters passed Proposition 37, the California Lottery Initiative, by a margin of 58 percent to 42 percent. The ease with which backers qualified the initiative for the ballot—723,000 signatures were collected in only five months—was probably the first public indication that California was ready to support a state-sanctioned lottery. Despite the fact that California's voters and lawmakers had during the previous 20 years rejected numerous proposals to legalize various forms of gambling, and despite the fact that the initiative lacked the governor's support and had only lukewarm support among education lobbies, the Lottery Initiative's resounding success seems, in retrospect, to have been inevitable.

By linking the lottery to public education, the backers did more than merely imbue the initiative with a broad altruistic appeal; they also positioned the initiative to benefit from two well established trends, one national and one statewide. Nationally, the concept of funding selected state obligations through a lottery had been gaining acceptance since 1963 when New Hampshire passed a state lottery directing its profits to education. During the next decade, 12 other states authorized lotteries, and in 1974 Congress passed legislation relaxing many of the federal restrictions on use of the mails and the media for promoting lotteries. Improvements in marketing and technology, along with the development of new games, enhanced the appeal of state-operated lotteries. By 1984, the Legislative Analyst could note in the voter's handbook that 17 states and the District of Columbia, representing half the nation's population, conducted lotteries totaling \$6.6 billion in sales, 40 percent of which was retained by the sponsoring governments (Figures 3 and 4).¹

Concurrent with increasing support for state lotteries was a profound decrease, during the 1970s and early 1980s, of funding for public education in California. The well documented effects of a major recession, runaway inflation, the "taxpayers' revolt" of Proposition 13 and the subsequent realignment of responsibility for funding public schools, the advent of income tax indexing, and widespread disappointment in the performance of public schools all combined to profoundly erode financial support for public schools. Between 1973-74 and 1983-84, California slipped from sixteenth in the nation in per-pupil expenditures to thirty-first. By 1981-82 California ranked forty-sixth in

¹ For a brief history of state-operated lotteries, see Public Gaming Research Institute, Inc., "A History of United States Lotteries," *California School Boards* Summer 1986: 12-14. For more detailed studies, the reader is directed to G. Robert Blakey, "State Conducted Lotteries: History, Problems, and Promises," *Journal of Social Issues* 35 (3) 1979; John Samuel Ezell, *Fortune's Merry Wheel: The Lottery in America* (Cambridge, MA: Harvard University Press, 1960); and Vicky Abt, James F. Smith, and Eugene Martin Christiansen, *The Business of Risk: Commercial Gambling in Mainstream America* (Lawrence, KN: University Press of Kansas, 1985).

FIGURE 3
Profile of State Lotteries

<u>State</u>	<u>Year Began</u>	<u>1984-85 Total Sales (millions)</u>	<u>Primary Uses</u>	<u>Prizes Percent</u>	<u>Administration Commissions Percent</u>
Arizona	N/A	69.0	30% General Fund	45	25
California	1985	1,765.6*	34% Education	50	16
Colorado	1983	102.0	30% General Fund	50	20
Connecticut	1971	345.0	41% General Fund	47**	12***
Delaware	1975	37.0	39% General Fund	50	11
Dist. of Col.	1982	85.6	30% General Fund	51	19
Illinois	1974	912.0	40% General Fund	48	12
Maine	1973	15.9	28% General Fund	50	22
Maryland	1973	681.0	39% General Fund	54	7
Massachusetts	1972	727.0	40% General Fund	50	10
Michigan	1973	585.0	41% Education	45	14
New Hampshire	1963	15.2	30% Education	50	20
New Jersey	1970	848.0	42% Education and Institutions	50	8
New York	1976	1,250.0	50% Education	40	10
Ohio	1974	850.0	40% Education	49	11
Oregon	1985	110.0	34% Econ. Devel. & Jobs	50	16
Pennsylvania	1972	1,300.0	43% Sr. Citizens Ben. Prog.	48	9
Rhode Island	1974	43.0	35% General Fund	51	14
Vermont	1978	5.0	25% General Fund	50	25
Washington	1982	149.0	40% General Fund	45	15

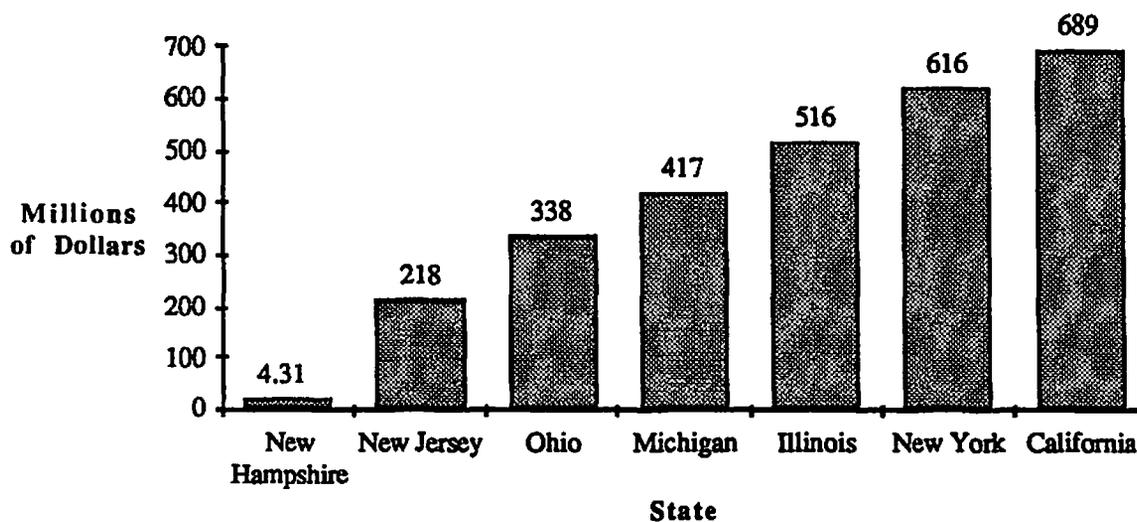
SOURCE: Alameda County Office of Education, *Focus* 1 (2) Spring 1986: 4.

* Fiscal Year 1985-86, for nine months of operation.

** Estimate

*** Estimate

FIGURE 4
Lottery Revenue for Public Education, 1985-86



SOURCE: Nina Bulware, "The Lottery and Education - Seven States," *California School Boards* Summer 1986: 18

the nation in taxing effort for schools, raising in state and local taxes an amount equal only to 3.75 percent of personal income, and its state and local expenditures for schools (22.2 percent of total state and local expenditures in 1980-81) placed California forty-first in the nation.² One analyst cites the zero increase in revenue limits contained in the 1982-83 Budget Act as the coup de grace that set the stage for passage of the Lottery Initiative.³

Thus, a growing acceptance of the legitimacy of state-operated lotteries combined with a growing concern over California's level of support for public education gave the ballot initiative a momentum and currency that was difficult to refute. Proponents also argued that benefits would flow directly to schools, ensuring local control, and that the language of the amendment would guarantee that lottery-derived revenues would be used solely to supplement and not supplant existing resources. Language would also enter the constitution that would prohibit Las Vegas-type gambling casinos, effectively neutralizing opponents' claims that a state-operated lottery would open the gates for big gambling interests and organized crime. Opponents' concerns that the lottery would provide no tax relief or guaranteed long-term support for schools and that it would be an unstable and inefficient revenue source were overshadowed by appeal of a "voluntary" tax paid primarily by, claimed the initiative's backers, middle-income residents.

When the initiative became law (Section 19, Article IV of the California Constitution), California became the twenty-first state to adopt a state-operated lottery and the ninth state to direct a portion of lottery revenues to education. The governor quickly appointed the required five-member commission, and the legislature set about to clarify and modify the intent of the initiative. The first lottery tickets went on sale one year later on October 3, 1985.

Implementation of the Lottery's Education Provisions

Proposition 37, "The California State Lottery Act of 1984," amends the California constitution to permit the establishment of a state lottery in California and at the same time modifies the constitution to prohibit the establishment of gambling casinos. Language is also included that authorizes the establishment of a five-member California State Lottery Commission, appointed by the governor, which has the power to oversee all operations of the lottery. The commission, among other responsibilities, is charged with determining the types of games that will be played and their frequencies, the price of tickets, the number and amount of prizes, and the methods and locations of ticket sales. The commission is

² Will S. Meyers, Compiler, et al., *How States Rate: Measures of Educational Excellence* (Washington, DC: National Education Association, 1984).

³ Owen R. Walters, "Education's Gamble on the Lottery," *California School Boards* Summer 1986: 32.

also responsible for making quarterly reports on lottery operations and for conducting studies of the lottery's efficiency.

The Lottery Act requires that 50 percent of the proceeds from sales be allocated for prizes; a maximum of 16 percent is allocated for administrative costs and commissions to sellers; and the remainder, at least 34 percent of proceeds, is reserved for a fund which benefits public education. Unclaimed prizes, interest on lottery funds, and unspent administrative funds are also deposited into the education fund.

Funds generated by the lottery for public education are divided among public K-12 schools, community colleges, the California State University, the University of California, the Hastings School of Law, and the California Maritime Academy. Funds are apportioned on the basis of equal dollars per average daily attendance (ADA) for K-14 schools and on numbers of full-time-equivalent (FTE) enrollments at the college level. California's total (ADA +FTE) for lottery purposes amounted to 5,367,036 in the 1985-86 fiscal year, of which 81 percent was K-12 ADA, 12 percent community college ADA, 4.5 percent California State University FTE, and 2.5 percent University of California FTE.

For K-12 schools, lottery funds are apportioned to all ADA that are eligible for state funding, including adult education ADA in specifically authorized classes, ROC/ROP ADA, and state hospital students. ADA is not "earned" by adult ADA in nonmandated classes or by ADA associated with hourly-basis-funded programs such as summer school and apprenticeship programs. County offices of education "earn" ADA for all county-operated programs such as special education programs and juvenile hall programs, but no ADA is derived by direct-service districts.⁴

For the K-12 system, funds earmarked for education by the lottery are deposited into the State Lottery Education Fund every quarter, and the state controller, using ADA data supplied by the State Department of Education, calculates each district's share and issues warrants in the districts' names to the appropriate county treasurer, who deposits them in a special lottery account. Local districts may then withdraw from this account amounts up to their allocation limit.

Lottery revenues for districts are deposited into the district's general fund, but they must be credited to a separate account (8695—State Lottery Income) for the receipt and expenditures of lottery funds. Lottery income may be transferred to other funds (within the limits established by law) following normal interfund transfer procedures, provided separate accounting of the receipt and expenditure of the income is maintained. Interest earned by the State Lottery Education Fund is credited to that fund, and local interest accrued at the local level is credited to the district's general fund and can be spent without

⁴ For a brief description of California State Lottery operations as they effect K-12 districts, see Paul M. Goldfinger, *Reforms, Revenues, and Revenue Limits* (Sacramento, CA: School Services of California, Inc., 1986), 165-173.

restrictions. Ending balances are reported in a special lottery category and are carried over to the next year. Districts are required to report lottery expenditures, both actual and proposed, within the existing array of programs. This accounting, along with a description of major new or expanded activities made possible by lottery funds, are submitted with the Annual Financial and Budget Report of Programs (J-41).

The Lottery Act stipulates that the intent of the law is to provide funds to augment rather than replace funds allocated by the state for public education and that revenues earned by the lottery are to be used solely for instructional purposes. Other than these broad guidelines, the law places few actual restrictions on districts' uses of lottery revenues. Funds cannot be used for (1) acquisition of real property, (2) research (a provision aimed at the higher education recipients of lottery funds), or (3) construction of facilities.

Because of the law's broad language, a fair amount of controversy has emerged around interpretation and implementation of the law. For example, how does one distinguish between augmenting support for programs and supplanting support for programs? The superintendent of public instruction and the president of the State Board of Education attempted to address this question in a memorandum issued to superintendents in November 1985. They strongly urged districts to "...utilize Lottery funds for visible, high-impact activities. Consider using Lottery funds for items such as additional textbooks or supplementary materials, refurbishing of science laboratories, restocking of school libraries and special teacher training programs."⁵ Such use of lottery funds would reinforce educators' and the public's perceptions of lottery funds as supplementary rather than as basic.

The legislature also attempted to pin down the concept of supplementary funding when it passed SB 333 (Dills) and SB 832 (Watson) in 1985. The Dills legislation, now Chapter 1517, Statutes of 1985, stipulates that no Budget Act or law can require that lottery funds be used to finance programs authorized by the 1984 Budget Act or SB 813 and its trailer bills. In effect the law further clarified the Lottery Act's intent that districts not use lottery income to finance mandated programs, thus delegating to local districts the autonomy to decide individually whether and how they might enhance or improve their educational programs. The Watson bill, now Chapter 872, Statutes of 1985, further explicitly specifies that use of lottery funds shall not be subject to state control (See Figure 5 for a summary of legislation affecting the lottery program).

The question of what constitutes "instructional purposes" also has generated debate and concern among policy makers and district officials. The State Department of Education attempted to clarify this issue in an advisory to county and district superintendents in

⁵ Memorandum addressed to county and district superintendents and fiscal officers, dated November 1, 1985, from Bill Honig, Superintendent of Public Instruction, and Sandee Boese, President, State Board of Education.

FIGURE 5
Legislation Affecting the
California State Lottery

Bill Number and Author	Effective Date	Summary
SB 333 (Dills)	October 2, 1985	<ul style="list-style-type: none"> • Establishes ADA and FTE formulas for allocation of lottery revenues to K-12 public schools, county superintendents, community colleges, CSU system, and UC system • Authorizes payments to the Hastings College of the Law and to the California Maritime Academy • Requires controller to make quarterly payments to LEA's • Further defines the Lottery Act's prohibition against using lottery revenues to supplant existing funding levels by prohibiting the legislature from requiring that lottery revenues be used to support programs mandated in previous legislative sessions
SB 832 (Watson)	September 23, 1985	<ul style="list-style-type: none"> • States that the purpose of the Lottery Act is to provide local educational agencies with additional funds free of state control
AB 71 (Bane)	September 30, 1985	<ul style="list-style-type: none"> • Provides that it is a misdemeanor for any person over the age of 18 to purchase a ticket on behalf of a minor and directs the lottery commission to develop safeguards to prevent the sale of tickets to those under 18 years of age
SB 374 (Carpenter)	January 1, 1986	<ul style="list-style-type: none"> • States that lottery revenues may be spent at the discretion of the local educational agency • States that it is the intent of the legislature that no additional funds be provided to offset any decline in lottery revenues
AB 3145 (Vasconcellos)	January 1, 1987	<ul style="list-style-type: none"> • Requires the controller to distribute lottery funds to the California Youth Authority for its K-12 program.

January 1986.⁶ While affirming that the authority to determine proper use of lottery funds resides at the local level, the advisory suggests that districts be guided by case law interpretations of the term "instructional." The advisory cites, among other cases, *Hartzell v. Connell*, 35 Cal. 3d 899, in which the court found "instructional" to be synonymous with "educational," a broad interpretation allowing districts wide latitude.

Most analysts acknowledge that, the *Hartzell* case notwithstanding, there remains a large "gray area" regarding what is permissible. Paul Goldfinger, for example, states that "...while transportation expenditures including bus purchases may be allowable from Lottery revenues, the purchase of equipment to maintain school buses is even further removed from the instructional setting."⁷ He goes on to suggest that districts either refrain from spending lottery funds in "gray areas" or that they seek the advice of county counsel before making such expenditures. Other analysts have pointed out that districts that wish to make "questionable" expenditures may avoid controversy by merely shifting funds from other accounts to the "gray areas" and then replenish the "raided" accounts with lottery funds.

The restriction on real property acquisition and on facility construction, while inconvenient for many districts, is not meant to prohibit the refurbishing or improvement of existing structures through capital outlay expenditures, a point reinforced in the superintendent of public instruction's memorandum of November 1, 1985. Thus, by adopting a broad definition of "instructional" and by making liberal use of capital outlay expenditures, it appears that districts who so desire are permitted to use lottery revenues to modify, enhance, improve, maintain, or upgrade existing facilities, as long as they stop short of building new structures.

Another potential controversy regarding proper use of lottery funds stems from the guarantees of local control contained in SB 832 (Watson, Chapter 872, Statutes of 1985) and SB 374 (Carpenter, Chapter 1052, Statutes of 1985). Ordinarily, a number of Education Code provisions require that certain formulas apply when districts compute ADA and resource allocations. The deputy superintendent for administration, in his advisory of January 10, 1986, specifically cites Education Code Section 52501.5, which requires districts to spend adult ADA-derived revenues on adult education programs, and Education Code Section 41372, which requires districts to spend a specified minimum percent of their expense of education for the payment of salaries of classroom teachers. Both of these provisions are nullified with regards to lottery income, the deputy superintendent for administration states, because to comply would conflict with the Watson and Carpenter

⁶ "Fiscal Management Advisory 86-01," to County and District Superintendents and Financial Officers, from William C. Pieper, Deputy Superintendent for Administration, California State Department of Education, January 10, 1986.

⁷ Paul M. Goldfinger, *Revenue Limits*, 169.

bills' protection of local control over use of lottery funds. As a result, districts are directed to deposit adult ADA-derived lottery revenue into their general funds and to ignore lottery revenues when computing proportions of expenditures expended on teacher salaries, actions that are bound to seem unfair to employee organizations.

The Lottery's Financial Contribution to Schools: Year One

When the first tickets went on sale on October 3, 1985, the public responded with enthusiasm beyond even the rosiest predictions. In the first half year of operation, from October 1985 through the end of March 1986, the lottery collected \$1.77 billion, or \$95 for every adult resident of California.⁸ If it were a corporation, the phenomenal sales would have instantly placed the California lottery as the fifty-first largest corporation among the *Fortune 500* list. At the six month mark, nearly 40 individuals had become millionaires on the "Big Spin," and over \$800 million had been awarded in prizes.

The first year of operation was accompanied by aggressive planning for expansion and by fine tuning of its operations. The first scratch-off games proved so popular that the lottery commission decided to cycle the games more quickly in order to maintain public interest. The "Big Spin" was adjusted to give higher odds of winning a fixed \$1 million or \$2 million top prize, rather than paying a larger cumulative prize with smaller odds of winning, as is done in other states. Meanwhile, mammoth contracts were awarded to firms to provide computer hardware and software and communication lines for the on-line Lotto game that began in October 1986.⁹

By the summer of 1986, ticket sales were slipping substantially, but interest increased with the introduction of Lotto on October 14, 1986 (Figure 6). Early studies of lottery participants, such as the *California Poll* released in December 1985, indicated that a higher proportion of players were from poor or under-educated groups, but the lottery commission claims that the average player is a middle-income individual spending discretionary income.¹⁰

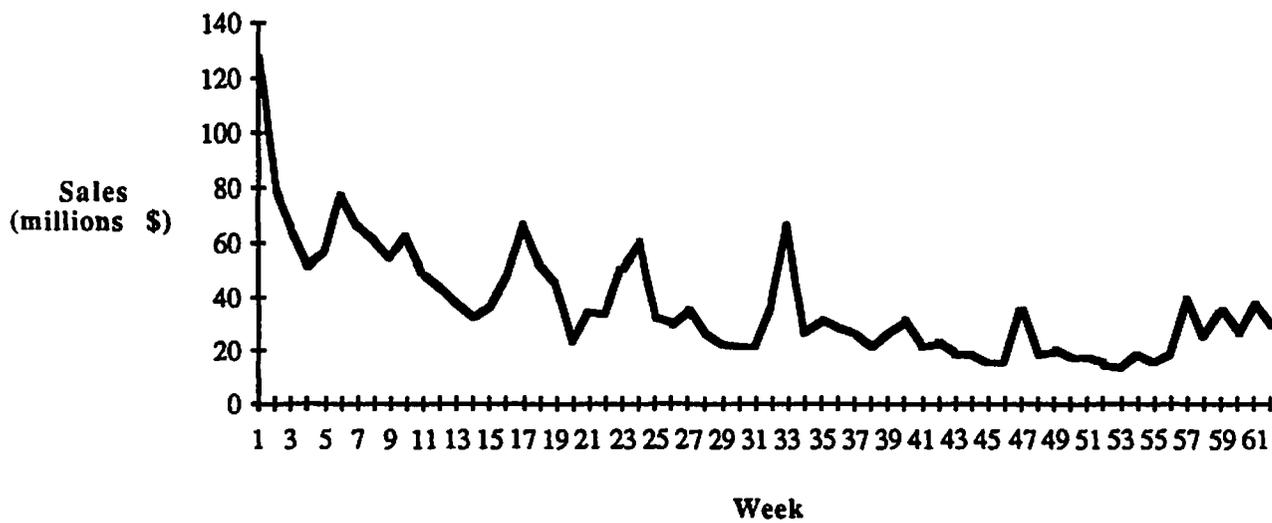
In February 1987, the lottery commission, in compliance with Section 8880.44 of the Lottery Act, released the results of a demographic study designed to ascertain the demographic characteristics of the players of each lottery game. M. Mark Michalko,

⁸ Sales figures as reported by the State Department of Education in a memorandum by Beth Larson of the Local Assistance Bureau, October 8, 1986 (revised).

⁹ The \$121 million contract to GTECH to furnish 5,000 computer terminals for the sale of Lotto tickets was the largest single contract ever awarded by the California government, according to Steve Wiegand in "State Lottery Makes *Fortune 500* Income," *California Journal* June 1986: 287.

¹⁰ Ellen Chapman, "A Pandora's Box of Social Change," *California Journal* June 1986: 292.

FIGURE 6
California State Lottery Sales for First 62 Weeks
(October 3, 1985 through December 13, 1986)



SOURCE: California State Lottery Commission. Peaks indicate introduction of new scratch-off games and Lotto.

director of the California State Lottery, summarized the findings of the study in a memorandum to the commission:

...the Lottery appeals to all adult Californians with only slight variations across demographic variables. It is noteworthy that incidence of play is greatest among the middle demographics, and least among the extremes; both the lowest and highest income segments are slightly less likely to participate. The same consideration applies to age and education. The Lottery is clearly a product for the average adult Californian. We are pleased with the progress in the acceptance of both Lotto and Instant by Californians. This analysis shows that 72% of adult Californians have played the California Lottery. This varies slightly from the 80% figure that has been found in other studies, due to forgetting and differences in methodology.¹¹

Although the study indicates that about 70 percent of lower-income households (annual income under \$20,000) play the lottery and that more than 75 percent of middle- and upper-income households play, data aren't presented that would indicate whether these differences are statistically significant. Because the study was designed to assess "penetration" rather than actual spending patterns, data are not included that would indicate the dollar contributions of various ethnic, gender, age, occupational, or income groups to total lottery sales; consequently, it is impossible to determine whether any particular groups are participating disproportionately.

In spite of the ease with which the lottery initiative passed at the polls and the subsequent interest shown by the media, the public, and the legislature, nobody was able to predict accurately the first-year success the enterprise would show. The governor's budget for 1985-86 estimated that education revenues from the lottery would amount to \$300 million. He was off by a factor of more than two. Figures prepared by the State Department of Education indicate that total 1985-86 fiscal year lottery allocations for all public education amounted to \$689 million, or \$125.67 for every student in California's public schools and colleges.¹²

Estimates provided the the State Department of Education indicate that the lottery income for 1985-86 contributed about 2.6 percent of the total budget for K-12 public education. While this is a small fraction of the total education budget, the money provided

¹¹ Memorandum dated February 6, 1987, published by the lottery commission in a media packet prepared for the February 11, 1987 public meeting of the California State Lottery Commission. The demographic study, entitled "Demographic Study California State Lottery Game Penetration," was conducted by Maritz Market Research and is published in the same packet.

¹² This is slightly less than the widely reported figure of \$128.37 due to recent recomputations of 1985-86 ADA counts.

to K-12 education by the lottery has been instrumental in bringing California's per-pupil funding close to the national average. Indeed, without the infusion of lottery money in 1985-86, California's per-pupil funding level would have remained at about \$194 below the national average (less even than the low point of \$187 below average reported in 1982-83) rather than at \$69 below average.¹³ Thus, the lottery's contribution to public education, while sizable and heartily welcomed in all quarters, will remain a small proportion of the total need.

Studies of School District Uses of Lottery Income

Within months of the first ticket sales in October 1985, reports, studies, and surveys designed to evaluate school uses of lottery funds began to emerge. By February 1986, when the first disbursements of lottery income were made to districts, virtually every newspaper in the state ran local interest stories on school uses of and attitudes towards the lottery.

The Alameda County Office of Education conducted one of the first wide-scale surveys in early 1986 when it questioned each district in the county and published the results in the Winter/Spring edition of its newsletter, *Focus*.¹⁴ Nine of the 19 districts in the county responded, reporting that a wide variety of local participants and decision-making procedures were used by districts as they decided how to allocate their lottery funds. Most frequently cited participants were employee organizations, the superintendent's cabinet, the district board, and the public. Reported uses included purchase of textbooks and supplementary materials, employee salaries in the form of bonuses as well as increases in the salary schedule, retirement of debt, school site allocations, site maintenance, and refurbishment and reopening of school sites. The study also noted that some districts had not developed policies regarding use of lottery funds, and others were intentionally postponing the process until exact amounts of revenues were known and in hand.

The State Department of Education used the survey developed by the Alameda County Office of Education to conduct a telephone survey in January 1986 of 21 school

¹³ Per-pupil funding figures from James W. Guthrie et al., *Conditions of Education in California, 1986-87* (Berkeley, CA: Policy Analysis for California, PACE, 1986), 45. Although the Department of Finance and the State Department of Education report slightly different figures, depending on definitions of ADA and types of funding considered, all analyses show marked improvement in California towards the national average in per-pupil funding since 1982-83. What is less widely noted is the substantial role the lottery has played in this trend.

¹⁴ "The Lottery: Who's Doing What With The Money?" in *Alameda County Office of Education Focus* 1 (2) Winter/Spring 1986.

districts and county offices of education.¹⁵ The sample represented approximately 25 percent of statewide ADA and included the five largest unified, high school, and elementary districts; the four largest county offices; and two small rural counties. This study also found that the planning process usually involved employee organizations, other district staff, advisory groups, and the school board. Nine of the 15 school districts had not developed or finalized spending plans, but the six others reported using funds on one-time expenditures such as air conditioning equipment, off-schedule salary adjustments, supplementary materials, deferred maintenance, classroom furniture, and computer equipment. Respondents acknowledged that the lottery income allowed them to provide services not currently budgeted but expressed concern that the legislature and public will begin to perceive education as "being taken care of through the lottery thus making additional new funding through the legislature and budget process more difficult."

In May 1986, the California School Boards Association (CSBA) conducted a survey of local schools relative to the processes being used to determine lottery fund expenditures and planned uses of lottery income. The study, based on 114 districts responding to an open request in a CSBA publication, found that the majority of boards used some sort of community input process, usually involving parents, teachers, administrators, community members, or site-level committees, to set district priorities for the use of lottery income. The survey also found that two-thirds of the districts utilized revenues for nonrecurring expenses such as data collections systems, staff development, copying machines, feed lots, salary bonuses, science materials, satellite dishes, VCRs, and air conditioning units.

In May 1986, the Commission on California State Government Organization and Economy (the "Little Hoover Commission") conducted public hearings that "...focused on determining if the state has established a sound system to allocate, use and account for lottery funds distributed to education."¹⁶ It also reviewed the processes used by school districts to develop priorities for spending lottery funds and the expenditures that school districts have made with these funds. The commission's report, released on June 30, 1986, cited the highly discretionary nature of lottery revenues and urged immediate attention to the problems it perceived to be occurring in the administration of the program:

The Commission is extremely concerned with the lack of parameters for school districts' expenditure of lottery funds and the general lack of assurance that these funds are being used for instructional activities.

Although the Commission respects the right of local boards of education to

¹⁵ Les Axelrod, in a summary memorandum that was circulated within the State Department of Education, January 31, 1986; since the intent was to obtain a preliminary view of lottery fund use, the results were not published.

¹⁶ Nathan Shapell, Chairman, *Report to the Governor and Members of the Legislature by the Commission on California State Government Organization and Economy* (Sacramento, CA: Commission on California State Government Organization and Economy, June 30, 1986), 1.

decide how lottery funds are spent, our review showed that the processes used by some school districts to determine spending priorities for lottery funds do not provide for full participation by all interested groups. Moreover, since lottery funds are among the least restricted funds that school districts receive, we believe that it is imperative that the State have an adequate system of financial accountability and control in place to ensure that the public has confidence that lottery funds are being well-spent.¹⁷

The commission specified five problem areas that it perceived to plague the lottery program. First, it found that districts were using a wide variety of processes for setting priorities for spending lottery funds and that the processes were often inconsistent and inadequate. It expressed the concern that certain stakeholders were not afforded opportunities to participate in the decision-making process, thereby risking an erosion of the public's confidence in the use of lottery funds. While some districts adopted elaborate and thorough procedures designed to guarantee timely and informed input from the public and educators, others used vague and poorly defined processes that were difficult to understand, that were not open, and that were not publicized enough to ensure citizen review and comment on priorities and uses of the funds.

Secondly, the commission determined that districts demonstrated a high degree of confusion regarding the allowable uses of lottery funds. The vagueness of the language in the Lottery Act and the lack of statutory parameters has allowed some districts to make highly questionable but legal uses of lottery funds. Problems arise, the commission claims, when districts depart from the Lottery Act's intent that funds be strictly supplementary to regularly allocated funds and that they be used solely for instructional purposes. Intense and long-standing fiscal pressures tempt districts to use lottery revenues for normal operations, while an extremely broad interpretation of "instructional" often allows them to allocate funds to such uses as deferred and regular maintenance, liability insurance, transportation, and equipment and fixtures such as air conditioning and carpets.

Third, the commission also concluded that some school districts are not making prudent use of lottery revenues, particularly when they commit them to on-going expenses such as increases in teacher salary schedules. The report cites cases of districts spending large portions of their lottery funds to settle teacher strikes, to reduce class sizes, and to improve salary schedules. In addition, some districts made long-term recurring commitments of lottery funds when they allocated funds for maintenance, custodial, and clerical services. Such practices are risky, the commission warned, because the lottery revenues are an unstable and unpredictable source of money.

Fourth, the commission found fault with the state's accounting and reporting procedures for lottery funds. Because use of the funds is highly discretionary and because

¹⁷ Shapell, *Report to the Governor*, 1-2.

the funds constitute only about three percent of a district's budget, audit routines were deemed to be not powerful enough to ensure proper use of funds. In addition, the required reporting by districts on their Annual Financial and Budget Report (J-41) asks districts to aggregate lottery expenditures by object code, a level of analysis the commission felt was too high to determine how lottery funds were actually being spent.

Fifth, the commission found that the state should include certain omitted education programs in the allocation of lottery funds. State-funded summer school, apprenticeship, and state special schools programs were singled out as programs that the State Controller's Office had not included in the ADA calculations for eligible lottery funds. Thus, an estimated 43,000 pupils statewide are omitted, and districts operating certain programs have not received lottery funds for the students in these programs.

The commission's report concluded with recommendations that the State Department of Education develop guidelines for districts to use in setting spending priorities and that it improve its accounting and data collection procedures regarding lottery funds. The commission also urged the legislature to enact legislation that would define "instructional purposes," that would urge districts to use lottery funds for supplemental nonrecurring expenses, and that would include certain omitted student populations in ADA calculations for lottery funds.

On November 21, 1986, the State Department of Education, as required by law, submitted to the Joint Legislative Budget Committee a report describing the amount of lottery funds that school districts received and the purposes for which there were expended in 1985-86 (actual) and 1986-87 (projected). Data were submitted by 95 percent of the state's local education agencies (school districts and county superintendents of schools) representing 95 percent of the state's K-12 ADA. LEAs were required to report expenditures by major object of expenditure and also to provide written statements describing programmatic uses of lottery funds.

The reports submitted by LEAs indicate that districts actually spent only 24 percent of the lottery funds available during 1985-86. Over 30 percent of the districts did not spend any of their lottery revenues, choosing instead to carry their 1985-86 lottery funds into the 1986-87 fiscal year. For 1986-87, districts have completed expenditure plans for nearly 60 percent of anticipated 1986-87 lottery funds (Figure 7).

In 1985-86 about 30 percent of districts reported using some of their lottery funds for certificated salaries, expending approximately 41 percent of all *allocated* lottery funds for this purpose. For 1986-87, nearly 49 percent of districts have budgeted some lottery funds for certificated salaries, designating nearly 27 percent of all lottery expenditures for this purpose. For both years, more than half of the districts allocating lottery funds for certificated salaries did so by making adjustments to the salary schedule, apparently making commitments to higher wage bases for subsequent years (Figure 8).

FIGURE 7
Lottery Expenditures as a
Percent of Lottery Revenue Available

<u>Account Code and Description</u>	<u>1985-86 (Actual)</u>	<u>1986-87 (Proposed)</u>
1000 Certificated Salaries	10.0%	16.2%
2000 Classified Salaries	2.2%	3.3%
3000 Fringe Benefits	2.0%	2.8%
4000 Books and Supplies	3.1%	14.3%
5000 Services and Operating Expenditures	1.1%	5.0%
6000 Capital Outlay	4.7%	13.3%
7000 Other Outgo	0.8%	5.6%
7490 Other Transfers	<u>0.1%</u>	<u>0.3%</u>
Expenditures—All Categories	<u>24.0%</u>	<u>60.8%</u>
Restricted Ending Balance	75.9%	39.5%

SOURCE: "Report on Lottery Revenues and Expenditures for K-12 Education in 1985-86 and 1986-87," A Report to the Legislature as Required by Contol Section 24.60 of the Budget Act of 1985 (Sacramento, CA: California State Department of Education, November 1986), 3. Based on reports from 697 LEAs. The remaining 335 LEAs reported that they made no expenditures during 1985-86.

FIGURE 8
Programmatic Uses of Lottery Funds
by Major Object of Expenditure
for All LEAs

<u>Category</u>	<u>1985-86</u> <u>(Actual)</u>	<u>1986-87</u> <u>(Proposed)</u>
<u>Certificated Salaries</u>		
Amount Reported (millions)	\$49.7	\$134.0
LEAs Reporting	321	503
Percent of LEAs Providing for:		
Raises on the Schedule	21%	22%
Raises off the Schedule (bonuses)	10%	6%
Hiring New Staff	13%	21%
<u>Classified Salaries</u>		
Amount Reported (millions)	\$11.1	\$27.4
LEAs Reporting	242	414
Percent of LEAs Providing for:		
Raises on the Schedule	11%	12%
Raises off the Schedule (bonuses)	6%	3%
Hiring New Aides	6%	13%
Hiring Other New Staff	6%	9%
<u>Employee Benefits</u>		
Amount Reported (millions)	\$10.0	\$23.0
LEAs Reporting	305	435
<u>Books and Supplies</u>		
Amount Reported (millions)	\$15.6	\$118.0
LEAs Reporting	473	781
Percent of LEAs Providing for:		
Classroom Materials	51%	62%
Math and Scienc Materials	8%	15%
Library Reference Materials	13%	16%
<u>Services and Other Operating Expenditures</u>		
Amount Reported (millions)	\$5.7	\$41.2
LEAs Reporting	329	583
Percent of LEAs Providing for:		
Classroom Services	19%	22%
Other Instructional Uses	12%	18%
Other Services	14%	22%

FIGURE 8
(continued)
Programmatic Uses of Lottery Funds
by Major Object of Expenditure
for All LEAs

Category	1985-86 (Actual)	1986-87 (Proposed)
<u>Capital Outlay</u>		
Amount Reported (millions)	\$32.1	\$110.0
LEAs Reporting	469	739
Percent of LEAs Providing for:		
Building and Improvements	16%	21%
Classroom Equipment	30%	34%
Athletic Equipment	5%	5%
Playground Equipment	6%	6%
Computer, A.V., and Electronic Equipment	28%	28%
Replacement Equipment	12%	12%
Transportation Equipment	5%	9%
<u>Other Program Expenditures - Not Differentiated</u>		
Percent of LEAs Providing for:		
Development of New Programs	8%	19%
Transfers to Other Agencies	3%	4%
Administrative Costs	2%	3%
Other	6%	7%
<u>All Expenditure Categories</u>		
Amount Reported (millions)	\$121.0	\$503.0
LEAs Reporting	697	959

SOURCE: "Report on Lottery Revenues and Expenditures for K-12 Education in 1985-86 and 1986-87," A Report to the Legislature as Required by Contol Section 24.60 of the Budget Act of 1985 (Sacramento, CA: California State Department of Education, November 1986) 4-5.

The SDE report also noted that for both years combined, the majority of lottery expenditures are for nonrecurring costs and that for 1986-87 districts budgeted 61 percent of the funds they expect to have available. Additionally, district uncertainty about the stability of lottery funding is evidenced in the fact that they reported expecting to receive an average of only \$107.75 per ADA in 1986-87, an amount equal to 90 percent of their reported 1985-86 lottery allocation.

The PACE Survey of District Uses of Lottery Revenues

Anticipating the extremely broad level of analysis inherent in SDE's official reporting form for use of lottery funds (the J-L attachment to the J-41) and that report's absence of attitudinal data, PACE undertook a survey designed to reveal in finer detail districts' uses and attitudes towards lottery funds.

During the summer of 1986, surveys were distributed to 88 superintendents throughout the state. Districts were randomly selected from a list of the state's K-12 public school districts, and selected districts were grouped by type (elementary, high school, or unified), by size, and by expenditure per pupil category. Districts were classified as small if their enrollments are below the median for their type and as large if their enrollments are above the median.¹⁸ District expenditure level classification was based on the district's expenditure per ADA as reported by the Department of Finance for the year 1984-85. If a district spent less than the mean for its type in that year, it was classified as below average; if it spent above the average for its type, it was classified as spending above the average per ADA.¹⁹

Selections were made such that an expected response rate of 70 percent would yield a minimum of five districts of each type for each size and expenditure category, thus making it possible to compare, for example, large high-spending elementary districts with large low-spending elementary districts. Although the overall response rate was 72 percent, high variation within categories (57 percent of high-spending districts responded while 88 percent of districts spending below the average responded) made it necessary to limit analyses to comparisons by type, size, and spending level.

Follow-up phone calls revealed that most districts that did not respond had not completed the local decision-making process by September 31, 1986. Some of these districts were quite large, and superintendents described lengthy and often highly politicized procedures for deciding how to spend lottery funds. Others indicated that, as policy, all

¹⁸ The median enrollment for elementary districts in 1985-86 was 393; for high school districts, 1,595; and for unified districts, 4083.

¹⁹ In 1984-85, the average expenditure per ADA for elementary districts was \$2,420; for high school districts, \$2,738; and for unified districts, \$2,603.

decision making would take place in the following year after the exact amount of lottery revenue was known; these districts would, in effect, decide each year how to spend the previous year's lottery revenues, thus avoiding making imprudent commitments based on uncertain revenues. Some districts decided not to participate because they thought that the required end-of-the-year accounting to the state would be adequate, and there were some indications that these districts did not want to go into detail about their actual lottery expenditures.

Completed responses were obtained from 63 districts, and follow-ups and data analysis were conducted during November and December 1986. The sample represents 6.1 percent of the state's K-12 districts and 8.0 percent of the state's K-12 pupils. Sample characteristics are displayed in Figure 9. It should be noted that because a number of districts responded before receiving their final 1985-86 lottery payment, there is a wide variance in reported anticipated lottery receipts per ADA (from \$50 to \$145 with a standard deviation of \$18.40), and the mean anticipated receipts of \$105.01 is substantially less than the actual \$125.67 that was eventually disbursed.

The survey sought three types of data from superintendents: quantitative data regarding actual or planned uses of lottery funds, attitudinal data that could be measured quantitatively, and qualitative data concerning respondents' experiences with and attitudes towards the lottery program.

In interpreting superintendents' responses to the survey, particularly their reports of uses of lottery funds, it is important to keep two points in mind. First, the superintendents were asked to report their actual or *intended* uses of lottery funds, so responses that indicated only possible or likely uses or that indicated that the local decision-making process was incomplete were not included in the analysis. Thus, the uses described in this study are derived from a combination of reported expenditures and formally adopted spending plans. Nevertheless, the likelihood exists that, due of a number of factors such as changes in local plans or needs, the actual spending behavior will vary from that reported in the survey.

Second, even the most diligent and accurate reporting of lottery fund uses may not pinpoint the true effect of the added revenues on district spending. Because the funds are distributed with only the broadest restrictions on use, and because the current reporting procedures require only that districts aggregate lottery expenditures by object code, lottery revenues become highly fungible, and there is a potential for significant shifting of general funds when this new and relatively unrestricted money becomes available. For example, a district might report spending its lottery money on new and perhaps "supplementary" instructional equipment, but there is no way of determining how much the district might have spent in this area if there were no lottery funds. In addition, it is impossible to learn

FIGURE 9
District Characteristics

Sample Characteristics

<u>Category</u>	<u>Number of Responses</u>	<u>Response Rate</u>	<u>Percent of Sample</u>
District Type:			
Elementary	17	61%	27%
High School	20	77%	32%
Unified	<u>26</u>	<u>77%</u>	<u>41%</u>
Total	63	72%	100%
Expenditure Per Pupil:*			
Above Average	37	57%	43%
Below Average	<u>26</u>	<u>88%</u>	<u>57%</u>
Total	63	72%	100%
Size of District:**			
Large	25	74%	40%
Small	<u>38</u>	<u>70%</u>	<u>60%</u>
Total	63	72%	100%

Mean District Characteristics

Anticipated Lottery Revenue for 1985-86: Actual Lottery Revenue for 1985-86:

High	\$9,500,000	High	\$14,112,741
Low	\$4,000	Low	\$5,404
Mean	\$569,270	Mean	\$683,465
Median	\$160,000	Median	\$188,505

Mean Per ADA \$104.30 Mean Per ADA \$125.67
Median Per ADA \$105.88

Enrollment:	
High	112,300
Low	43
Mean	5,440
Median	1,500

* Districts are classified as above average if they spend more than the statewide mean for their type.

** Districts are classified as small if their enrollments are below the median for their type.

whether the availability of lottery funds for this purpose "freed up" money that could then be used for pressing but less glamorous district operations.²⁰ Indeed, given the intense public and bureaucratic pressure to use lottery funds for enhancement, combined with a decade of scarce resources and difficult choices, it would be surprising if such shifting did not occur.²¹

District Uses of Lottery Revenues

Respondents were asked to indicate the amounts and proportion of lottery revenues that were allocated for specific purposes. Figure 10 displays district responses from four viewpoints. The first column shows the percent of responding districts that allocated some of their lottery revenues in each category. The second column presents the average percent of lottery revenues allocated for each category for all responding districts. For this tabulation, districts reporting no expenditure in a category are computed as allocating zero percent to that purpose. The third column presents a more accurate picture of the lottery's impact on school children by weighting the district responses by district size. The last column incorporates the findings of a survey of site principals regarding site use of discretionary allocations to schools, thus making it possible to calculate the ultimate uses to which district lottery revenues were put.

As Figure 10 indicates, the majority (68.3%) of districts are allocating at least some of their lottery funds for instructional materials and supplies, with nearly 59 percent of districts allocating some of their funds for purchase of items such as overhead projectors, video cassette recorders, computers, microscopes, science equipment, monitors, musical instruments, and physical education equipment. Less frequently mentioned are classroom furnishings such as desks, tables, chairs, shelves, and blackout curtains.

Included as equipment for instruction are several instances of copying machines purchased for joint teacher and office use and for exclusive office use. Computer purchases generally are for use in classroom and computer lab settings, although, again, there are instances of major computer purchases that are intended for office use in bookkeeping, attendance, and student record management. Such use of lottery funds constitutes one of the "grey areas" of instructional use, and respondents were quick to point

²⁰ The tendency for grants, particularly general aid and block grants, to free up local money or to support other unintended public goods is well documented. See Henry M. Levin and Mun C. Tsang, "Federal Grants and National Educational Policy" (Stanford, CA: Institute for Research on Educational Finance and Governance, Stanford University, July 1982).

²¹ In fact, only 7.5 percent of responding superintendents admitted that their districts had allocated greater than usual funding to "nonlottery" categories as a result of receiving lottery money.

**FIGURE 10
District Uses of
Lottery Funds, 1985-86**

	I Percent of Districts Reporting Use *	II Average Percent Use All Respondents	III Average Percent Use Weighted by Size	IV Average Percent Use By Object **
Instructional Materials/Supplies:	68.3%	30.4%	16.2%	29.1%
Texts	31.7%	4.4%	2.8%	3.9%
Library Books	20.6%	2.2%	1.0%	1.6%
Other Instructional Materials	49.2%	9.3%	4.1%	7.7%
Equipment for Instruction	58.7%	14.5%	8.3%	16.0% ***
Allocations to Schools	30.2%	10.2%	19.2%	(Reassigned)
Personnel:	49.2%	20.8%	28.0%	29.1%
Salary Adjustments	30.2%	12.1%	18.3%	18.3%
Additional Staff	28.6%	8.6%	9.7%	10.8%
Site Modifications	14.3%	4.3%	2.3%	3.3%
Reserve	42.9%	22.7%	18.0%	18.0%
Other	57.1%	11.6%	16.3%	20.5%

* Because districts usually allocated funds to more than one category, percentages will not add to 100 percent.

** Discretionary Allocations to School Sites are reassigned to the ultimate expenditure category in proportion to uses reported by principals. Percentages are weighted by district size.

*** Includes equipment described as "used for operations."

out that "you can't instruct the students if the administration can't schedule them in classes or keep track of the truants."

Although a majority of districts report spending some lottery money on equipment for instruction, a weighted average of all respondents indicates that slightly over eight percent of lottery money was spent on such items. Analysis of data suggests that the smaller districts tend to make district-wide decisions to purchase specific hardware, while larger districts tend to leave such purchases to the discretion of school sites. Nearly half the respondents also report spending a portion of their lottery revenues on other instructional materials such as consumables, recordings, computer software, science supplies, art supplies, music, posters, and commercial curricula. Weighted by district size, Other Instructional Materials accounts for 4.1 percent of all allocated lottery funds.

However, while the data, weighted by district size, show that a total of 16.2 percent of allocated lottery revenues are being specifically devoted to purchase of instructional materials (texts, library books, equipment, and other instructional materials), this figure is actually an understatement. Because over 19 percent of lottery revenues are being disbursed by districts as discretionary allocations to school sites, it becomes necessary to study site use of these allocations in order to calculate the final use, by object, of the district's lottery funds.

A random sample of site administrators who received discretionary allocations reveals that a major proportion of these funds (totalling 57.2 percent) are earmarked for purposes that otherwise would seem, through analysis of district-level decision making, to be under represented (Figure 11). In fact, reassigning the discretionary allocations to the categories indicated by responding principals indicates that, in the final analysis, 29.1 percent of all allocated lottery funds are being spent on instructional materials (Column IV, Figure 10). It is also likely that the surprisingly low commitment to purchase of books is due to the recent availability (since 1983) of funds for this purpose in SB 813.

Half the responding districts (49.2%) are using lottery revenues for personnel. Adjustments to employee salaries are being made by 30.2 percent of districts, a use that utilizes over 18 percent of the total allocated lottery funds, weighted by district enrollment. The majority (70%) of the districts that have used lottery money for employee raises describe the adjustments as "bonuses" or "one-time only raises," while the remainder indicate that lottery money has been added to the regular salary schedule.²² Half the

²² This finding appears to conflict with figures reported to the State Department of Education as summarized in Figure 6. While both the PACE survey and the SDE report show slightly over 30 percent of districts spending lottery funds on raises, SDE reports only 32 percent of these raises to be bonuses. Since the PACE data were collected mainly in June and July, while the SDE data were submitted at the end of September 1986, the SDE data may reflect the effects of negotiations with teacher groups.

FIGURE 11
School Uses of Discretionary
Allocations of Lottery Funds

	Percent of Schools Reporting Use	Percent of Discretionary Allocations Used*
Instructional Materials and Supplies:	97%	57.2%
Textbooks	46%	5.6%
Library Books	33%	3.3%
Instructional Materials	71%	18.6%
Equipment for Instruction	79%	29.7%
Equipment for Operations	46%	10.2%
Additional Staff	13%	5.6%
Maintenance and Repair	29%	7.4%
Site Additions or Modifications	13%	4.9%
Curriculum or Instruction Improvement	21%	5.3%
Extra Curricular Activities	17%	3.4%
Other Allocations	21%	6.0%

Sample Characteristics

Type of School:		ADA:	
Elementary School	8	High	3,412
Junior High School	3	Low	24
High School	<u>13</u>	Mean	910
Total	24		
Lottery Funds Received:		Lottery Funds Per ADA:	
High	\$90,000	High	\$125.67
Low	\$1,000	Low	\$2.70
Mean	\$24,174	Mean	\$39.74
Weighted Mean	\$32,745	Weighted Mean	\$24.16

* Averaged for all schools, weighted by school size.

districts using lottery money to provide raises are doing so for teachers alone; in the remainder, classified personnel and administrators also are receiving raises.

Nearly as many (28.6%) districts are using lottery revenue to add personnel or to extend the hours of existing personnel. Many districts (42%) that are adding personnel are doing so in order to reduce class size, and some (26%) are adding new programs such as foreign language, after school librarians, classroom aides, resource centers, and tutors. Not surprisingly, districts that are giving employees raises or that are adding personnel also express concern that they are incurring future obligations that they may be unable to meet. Since lottery revenues are uncertain, these districts could find themselves having to curtail programs if lottery revenues decline.

A small number of districts (14.3%) report making modifications or additions to school sites such as resurfacing playgrounds, adding air conditioning, remodeling science laboratories, and adding lights to parking lots and athletic fields.²³ Given the oft-repeated plea by districts to use lottery funds for building improvements, additions, and construction, it is possible that some districts used general funds for these purposes and replaced them with lottery funds, thus avoiding using lottery funds directly for prohibited uses.

Nearly half (42.9%) indicated that a portion of their lottery revenues were committed to reserve accounts.²⁴ About 60 percent of districts placing lottery money in reserve accounts are doing so in order to build up their depleted contingency funds. These districts report average current reserves of 1.4 percent and an average desired reserve level of 4.4 percent. Approximately 40 percent of districts which reported placing lottery money into reserves are doing so because they have lottery money that is unallocated pending future decisions.

A variety of expenditures constitute the 20.5 percent of lottery funds that are designated as other expenditures. Most frequently mentioned are staff development; repairs, maintenance, and maintenance equipment; and purchase or lease of school busses. Other expenditures include field trips and activities for students, curriculum development, insurance, dues for organizations and media consortia, distributions to ROP/ROC programs and adult programs, rentals, conferences, travel, summer school, summer camp, scholarships, and class projects.

²³ Expenditures that could be classified as maintenance or repairs are recorded as "Other" expenditures.

²⁴ Districts that reported 100 percent of their lottery funds being placed in a reserve account pending future decisions were not included in the analysis, since the purpose was to study the results of local decision-making processes. Allocations to reserves were counted if districts allocated some of their lottery funds to objects or programs and the remainder to a reserve account pending further decision making. Districts that reported placing lottery money into a contingency reserve account in order to build up a "rainy day" fund were included in the analysis.

Differences in District Use By District Type

Analyses were conducted on the various expenditure categories in order to determine whether the different types and classifications of school districts are allocating their lottery funds differently.²⁵ Several interesting differences emerged. Elementary and high school districts are spending more on other instructional materials than are unified districts. Taken as a group, the elementary and high school districts average 12.5 percent allocation to that category, compared to the unified average of 5.0 percent.

At first glance, it may thus appear that unified districts, for whatever reason, are allocating fewer lottery dollars to consumables, recordings, software, science and art supplies, and curricular materials. The truth is, however, that unified districts spend significantly more of their lottery revenues on discretionary allocations to school sites, 19.2 percent compared to the elementary district level of 2.9 percent and the high school district level of 4.7 percent. And, as Figure 11 suggests, when site administrators in districts receive their discretionary lottery allocations, they are spending the majority of the money on various instructional materials and supplies. The difference is that in elementary and high school districts, perhaps because they tend to be smaller, the decision to purchase instructional supplies is being made at the district level. In unified districts, site administrators and personnel are being given a freer hand in deciding exactly how to use lottery funds.

Elementary districts are allocating less of their lottery money to textbooks than are unified districts, 1.2 percent compared to 5.9 percent. While neither figure is large (perhaps due to the recent infusion of SB 813 money for texts), the higher level of spending among unified districts may reflect the greater variety of curricula and greater flexibility of textbook selection characteristic of the secondary level, or it may be indicative of heavier use and deteriorating conditions of their texts.

Large districts are spending significantly more (an average of 19.7 percent of their lottery income) on salary and benefits than are small districts (7.2%). Clearly, in large districts the available lottery funds amount to a more impressive figure that attracts the attention of the larger and better organized employee organizations.

Districts whose total expenditures per pupil are less than the state average are allocating nearly twice as much of their lottery revenues to instructional materials than are districts whose per-pupil expenditures are above the state average. The "poorer" districts

²⁵ For differences between the three types of school districts, planned paired contrasts were used employing a one-way analysis of variance. Contrasts are considered significant if the probability of the T value is less than .05; since there are four planned contrasts in each category (Elementary/High School, Elementary/Unified, High School/Unified, and combined Elementary and High School/Unified), the overall experiment error rate is .20. For differences between small and large districts and between above- and below-average-expenditure-per-pupil districts, T-tests were used employing an alpha level of .05.

spend an average of 43.5 percent of their lottery funds on books, instructional equipment, instructional supplies, and media, compared to the "wealthier" districts' average of 21.2 percent. Districts that traditionally have had less money to spend apparently are attempting to "catch up" on equipping and supplying their classrooms.

Attitudinal Data

As Figure 12 indicates, nearly two-thirds of the respondents think that lottery income available to districts will decrease. The strength of this response mirrors the often repeated exhortations of state officials and other commentators regarding the stability of lottery-derived revenues. Thus, while approximately one-fourth of the respondents think that lottery revenues will fluctuate, the overwhelming consensus is that they will decline. Indeed, recent projections by the State Department of Education indicate that public schools will receive a total of \$87.67 per ADA during fiscal year 1986-87, compared to the previous year's \$125.67.

Although nearly all of the respondents agree that the lottery will have an adverse impact on the legislature's willingness to fund education programs, the superintendents from districts spending less than the state average in per-pupil expenditures are unanimous in that sentiment, differing significantly from the superintendents from the higher-spending districts.²⁶ Thus, not only are the "poorer" districts spending more of their lottery funds on materials and equipment for instruction, but the leaders of these districts are more pessimistic about the long-term outlook for sustained state support for education programs. Predictably, virtually all the respondents support legislation that would require the state to regard lottery revenues as supplementary rather than as a replacement for traditional sources of education funding.²⁷

Slightly more than half the respondents (58.1%) disagree with the statement "The lottery program is *not* likely to play an important role in the *improvement* of educational services in my district." This finding is hardly evidence for unbridled enthusiasm for the program, however, as a third of the respondents agree with the statement. Moreover, the wording of the question leaves it unclear whether the respondents are disagreeing with the notion of "important" or "improvement."

²⁶ As measured by T-test of mean response for each category, significant at alpha = .05.

²⁷ Although SB 333 (Dills), enacted in October 1985, includes language to this effect (Figure 5), superintendents obviously are extremely skeptical about the efficacy of such language.

FIGURE 12
Respondents Attitudes Towards
the Lottery Program

1. During the next three years my district's lottery income will:

<u>significantly decrease</u>	<u>decrease</u>	<u>slightly decrease</u>	<u>fluctuate</u>	<u>slightly increase</u>	<u>increase</u>	<u>significantly increase</u>
3.2%	32.3%	25.8%	27.4%	11.3%		

2. The lottery program will have an adverse impact on the legislature's willingness to fund education programs.

<u>strongly disagree</u>	<u>disagree</u>	<u>slightly disagree</u>	<u>neither agree nor disagree</u>	<u>slightly agree</u>	<u>agree</u>	<u>strongly agree</u>
	1.6%	1.6%	6.5%	24.2%	43.5%	22.6%

3. I favor legislation that would require the state to regard lottery revenues as supplementary rather than as a replacement for traditional sources of education funding.

<u>strongly disagree</u>	<u>disagree</u>	<u>slightly disagree</u>	<u>neither agree nor disagree</u>	<u>slightly agree</u>	<u>agree</u>	<u>strongly agree</u>
	1.6%	3.3%	1.6%	1.6%	18.0%	75.4%

4. The lottery program is *not* likely to play an important role in the *improvement* of educational services in my district.

<u>strongly disagree</u>	<u>disagree</u>	<u>slightly disagree</u>	<u>neither agree nor disagree</u>	<u>slightly agree</u>	<u>agree</u>	<u>strongly agree</u>
19.4%	16.1%	22.6%	9.7%	12.9%	17.7%	1.6%

Analysis of Qualitative Data

Review of open-ended responses that superintendents provided affords a rich and unambiguous view of problems and implications of the lottery program as they are perceived at the district level. Respondents outlined in considerable detail their concerns with the long-range local and statewide implications of the program, described the decision-making processes used in their districts, and elaborated in telling detail the impact the lottery funds are having in their districts.

Future Obligations in the Face of Uncertain Revenues. Many superintendents are concerned that their districts will embark on policies that will create future obligations that the lottery program may not be able to sustain. Already, in the first year of operation, one-fourth of responding superintendents acknowledge that their districts' spending decisions have created risky commitments for subsequent years. Many of these districts hired new personnel such as librarians, curriculum and reading specialists, and classroom aides. Others hired more teachers in order to reduce class sizes. Although the majority of these new hires are classified as temporary, superintendents are still worried that the creation and filling of these positions sets precedents and expectations that will be difficult to reverse in coming years. In addition, some districts have allocated lottery funds for such continuing expenditures as leases for portable classrooms and busses, long-term contracts with consulting firms, and multi-year staff development programs.

Even more disconcerting to superintendents is the use of lottery funds for salary improvements. While only 10 percent of responding districts report making permanent adjustments to salary schedules, another 20 percent report granting "one-time-only" bonuses. The superintendents of districts granting bonuses express concern that, as in the case of hiring "temporary" employees, precedents will accrue that legitimize a link between salary bonuses and lottery income, thus embedding this expenditure in future budgets.

Although only a tenth of the respondents report making permanent adjustments to salary schedules, and only a fourth of the superintendents indicate that their districts have made long-term commitments of lottery funds, nearly all the superintendents are wary of increasing pressure from employee groups to "put lottery money on the table for contract negotiations." While only 15.5 percent of responding districts reported having employee contracts that include language requiring lottery funds be subject to negotiations, superintendents frequently expressed the concern that new contracts and "reopened" contracts will include such language. Repeatedly, superintendents noted that political and financial pressures will tend to erode the "special" nature of lottery monies and that eventually these revenues in reality will be "folded into" general funds, the state's accounting requirements notwithstanding. Such prognoses, when combined with uncertainties about future levels of lottery revenues, lead superintendents to make guarded,

and often pessimistic, assessments of the lottery's long-term impact on local educational programs.

Difficulties Associated With "Proper" Uses of Lottery Funds. Over half (53.6%) of respondents indicate that they would allocate lottery revenues differently if there were no restrictions on uses of lottery funds. Most frequently mentioned were desires to build or lease additional classroom facilities or to make substantial renovations of existing structures. One superintendent interpreted the Lottery Act's prohibition of construction to prevent his district from installing sprinkling systems at school sites; others felt constrained from repairing or expanding play areas or from repairing and reopening closed facilities such as gymnasiums or storage areas.

While some districts spent lottery money on school busses, other superintendents felt that the Lottery Act prohibited such expenditures. In one instance, a school district allocated its lottery revenues for texts, materials and supplies, additional personnel (a librarian, a counselor, and a coach), and teacher raises, but when the state cut small school transportation funds in late August 1986, the district had to channel its entire lottery allocation to pupil transportation. Thus, while the district's year-end financial report would indicate that lottery revenues were being used for instructional purposes, in reality it was being used to transport students.²⁸

Districts' Decision-Making Processes. Narrative data supplied by superintendents corroborate the Little Hoover Commission's finding that decision-making processes employed by many districts in 1985-86 did not allow for full participation by all interested groups. Generally, the larger the district, the more elaborate and thorough was the decision-making process. Most frequently, school boards set priorities based on input supplied by teachers and administrators. Occasionally, district officials conducted needs assessments; in other districts the superintendent's cabinet submitted priorities to the school board.

In many districts, lottery fund allocations were described as occurring within the regular budget process. Less frequently, school site councils were involved, and in fewer than 10 percent of cases was the public at large specifically invited to participate in the setting of priorities. In some districts, not all of them small, it is clear that the superintendent or other top-level district administrator presided over lottery revenues as a sort of grant program, disbursing funds upon receipt of a meritorious "request" by a teacher or administrator. In these cases, criteria for acceptable lottery fund requests were either vague or nonexistent.

²⁸ But only 7.5 percent of respondents acknowledged that their districts had allocated greater than usual funding to "nonlottery" categories as a result of receiving lottery money.

It is also apparent that decision-making processes, as they are currently being employed, are neglecting some student populations entirely. Several principals, in responding to the mini-survey of site uses of discretionary allocations, pointed out that adult students in "authorized areas"²⁹ earn lottery ADA for their districts, yet districts rarely allocate a portion of their lottery funds back to adult programs. With "caps" that limit the regular ADA a district can earn for adult programs already in place, and with increasing demands on adult programs brought about by increased high school graduation requirements, increasing dropout rates, increases in non-English-speaking adult immigrants, and quickly changing workplace skills, adult educators feel particularly shortchanged when they are overlooked as lottery revenues are allocated.

The Enhancement Question. The Lottery Act clearly states that it is the initiative's intent to provide funds to augment rather than to replace regular education funding, and the superintendent of public instruction urged districts to keep that distinction in mind as they developed spending plans for their lottery revenues. Recognizing, and even reinforcing, this distinction, it was assumed, would lessen the likelihood that "traditional" funding would "dry up" in the face of the lottery's largesse. Yet, preoccupation with this distinction has led to some paradoxical behavior on the part of superintendents and, perhaps, it is feared, to some misconceptions on the part of the public.

Most superintendents who responded to the survey state that the influx of lottery funds is a major boon to their districts. Frequently, they describe in enthusiastic and appreciative detail the difference lottery money has made in their district. Among the many worthy "additions," "enhancements," and "embellishments" to their educational programs, purchase of additional materials and supplies for teachers, acquisition of equipment for classes, extra staff development programs, and teacher projects such as curriculum development and release time for program observations are most frequently mentioned. Superintendents also cite enhancements such as block grants to schools, increased textbook and library book purchases, fine arts supplies, extra personnel for special needs, and augmented summer school programs.

Yet, very frequently, superintendents, after cataloging the "enhancements" that the lottery program has brought to their districts, add that the revenues are helping to make up for years of underfunding and that they are now able to address a long list of unmet needs. In addition, a substantial number of respondents do not characterize the program as "enhancing" at all, preferring to point out, sometimes in a very acerbic manner, that the lottery funds help, at best, to neutralize or reverse years of fiscal neglect. They cite such uses as purchasing textbooks, restoring personnel such as reading specialists and librarians, repairing and maintaining playgrounds and buildings, offsetting budget deficit,

²⁹ "Authorized areas" are skills or vocational classes such as ESL, citizenship, parent education, health and safety, substantially handicapped, apprenticeship programs, basic skills under eighth grade level, and high school diploma programs. They should not be confused with community fee-based classes which charge for participation and are generally considered to be enrichment classes.

purchasing liability insurance so that athletic programs may resume, and providing salary increases as examples of using lottery revenues to "catch up" on basic district needs.

Determining whether lottery funds are being used to "enhance" educational programs becomes, in the final analysis, a question of semantics. This is not to say that some uses, such as establishment of scholarship funds, sending sixth graders to science camp, financing field trips, and outfitting bands and athletic teams, aren't true "enhancements" to a district's educational program. Rather, whether a particular use of lottery revenue augments the normal educational program depends on the point of view of the superintendent and on the history of the district. To one superintendent, providing a microscope for every two students in a science class where before the school had one for every four students is an enhancement; to another it would be "catching up." To one superintendent, hiring a librarian, buying reading materials, and providing staff development would be "enhancements;" another would regard these expenditures as long-overdue support for basic programs.

Thus, superintendents, when they are asked to comment on the lottery program, find themselves in a paradoxical situation. On the one hand, they extol the "enhanced" and "augmented" programs that the Lottery funds make possible and perpetuate the impression that lottery monies are not commingling with regular revenues, hoping, presumably, that the public and the legislature will not come to regard lottery revenues as "regular" funding for education. Yet, on the other hand, they also acknowledge the miniscule portion lottery funds are of their total budgets and admit that the new revenues are "only a drop in the bucket" of what is needed.³⁰

Other Concerns Expressed By Respondents

A number of superintendents worried that lottery revenues will increasingly become part of employee salary negotiations. The money is highly visible, it can be spent at the district's discretion, and teachers can argue that better (or happier, or more) teachers are the surest route to improved instruction. Similarly, many superintendents are concerned about spending lottery funds on other recurring costs such as insurance, maintenance contracts, and lease of classrooms. Superintendents regard such expenditures, for personnel costs or for other recurring costs, as particularly risky given the unpredictable nature of lottery revenues.

³⁰ The battle over the governor's proposed 1987-88 budget is evidence that the superintendents' fears are well founded: by including anticipated lottery revenues in a proposed budget for public education that fails even to keep up with enrollment growth, the governor is sending the message that lottery revenues should be regarded as merely another revenue source for basic aid for public education.

Some superintendents are concerned that the "special purposes" of lottery funds will be lost if they become just another part of a district's general fund. They have enjoyed the process of "identifying needs and solving problems," and in so doing they have accrued a degree of good will and good publicity. Such opportunities would vanish if lottery funds were "folded into" the regular budget.

Many superintendents wondered whether all the publicity attending the lottery program — the fanfare surrounding huge jackpots as well as advertising campaigns pointing out the lottery's benefit to schools — will create the mistaken impression among the public that "schools are taken care of." They worried about the impact the lottery will have on local Gann limit override elections and on local parcel tax elections, and they expressed concern that the governor's and legislators' resolve to support aid for schools would flag.

Several respondents pointed out the irony of the Lottery Act's emphasis on "augmenting" educational programs and of the superintendent of public instruction's recommendation that districts use lottery funds for visible, high impact, supplemental uses. By stressing "enhancements," won't districts be suggesting to taxpayers that the basics are under control? Some superintendents wondered whether long-term support for education would suffer if such a misconception were to gain currency.

Summary Findings and Policy Implications

There are numerous indications that school districts are being prudent in their administration of the lottery program. Data collected by the State Department of Education shows that by October 1, 1986, California's K-12 public school districts had spent only 24 percent of their available lottery funds. While respondents to the PACE survey indicate that approximately nine percent of their lottery funds are unallocated, it must be remembered that districts that had allocated none of their lottery funds were not tabulated and that almost a third of the districts surveyed by PACE in summer and autumn of 1986 did not respond to the survey or had not finalized their spending plans. It is also worth noting that several districts that returned surveys noting that spending plans had not been developed mentioned that they planned to build a one-year lag time in their spending plans so that they would not be hostage to unknown or fluctuating lottery revenues. Finally, the PACE survey records districts' *intended* or *actual allocations* of lottery revenues, while the State Department of Education collected data on actual expenditures. Thus, it is clear that generally districts assumed a wait-and-see approach during the first year of the lottery program and that the PACE survey probably depicts the behavior of districts that adopted a more aggressive approach towards the lottery program.

Respondents to the PACE survey indicate a reluctance to make long-term commitments of lottery funds and an uncertainty about the reliability of the funds. When they allocate funds to employee raises, usually they are in the form of bonuses. In addition, many districts are hesitating to allocate funds to "grey areas" such as building repair and modification or to purchase or lease school busses. Some districts are building up long-neglected contingency reserves.

Districts that have developed spending plans seem to be concentrating on rebuilding the infrastructure necessary for effective education. They are allocating money to purchase of instructional supplies, to improving employee salaries, and to restoring or rounding out programs by hiring new personnel. They also are committing portions of their funds to staff development, maintenance and repair, and pupil transportation. Superintendents' narratives clearly indicate that they regard their districts' spending decisions as supporting the restoration of the basic underpinnings of public education.

Districts are experiencing several types of pressure that could alter the nature of lottery revenues. First, employee organizations are expecting districts to treat lottery funds as if they are merely windfall increases in general funds, subject to negotiations. Second, economic reality is causing districts to allocate the revenues to basic needs rather than to the enhancements envisioned by the authors of the Lottery Act. Third, district discretion to allocate lottery funds, a right coveted by districts and guaranteed by statute, is becoming increasingly threatened as advocates for special student populations press for legislation requiring proportional distribution of lottery funds to the student populations that "earn" the funds.

If districts are to protect the "special nature" of lottery funds and their right to make decisions regarding the use of these funds, they will have to develop more comprehensive and farsighted planning processes, processes that guarantee that the funds are allocated in a manner that preserves their integrity while serving the needs of the pupils on whose behalf the funds are being paid.