



PUBLIC POLICY ADVISOR

The Lottery and School Aid

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This is an update of a report that was first published in March 1986. The issue remains timely, as the public is still confused about the use of the money from the lottery, and the legislature continues to introduce bills to insure that lottery money supplements rather than replaces money from the general fund. This was clearly the case until the mid-1980s, but since that time the increase in the general fund contribution has been substantially greater than the increase in lottery revenue.

The conversation often goes like this . . .

- Harry: I see the school district is asking for another millage increase.
Josephine: I don't understand it, I thought the lottery money was supposed to take care of education.
Harry: That's right. I heard the state is taking in over one billion dollars from the Lotto game.
Josephine: A billion dollars should buy a lot of education. What do you think they're doing with all that money?
Harry: I don't know. They must be wasting a lot of it.
Josephine: Somebody ought to find out what the state is doing with that money.
Harry: That's right. I'm not voting for more taxes until I find out.

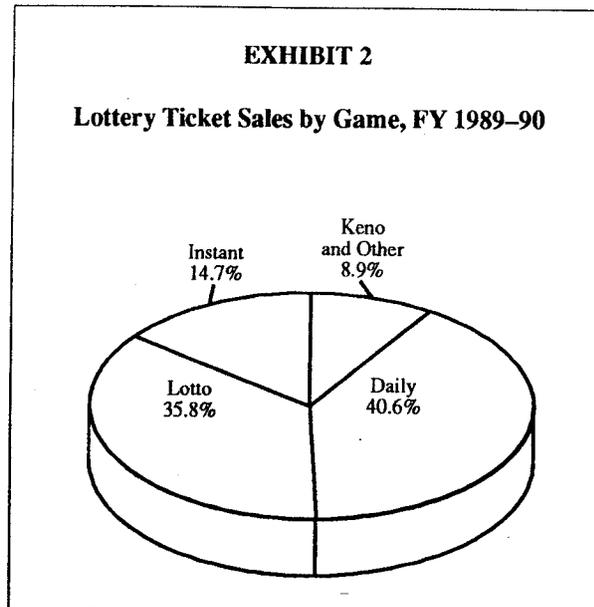
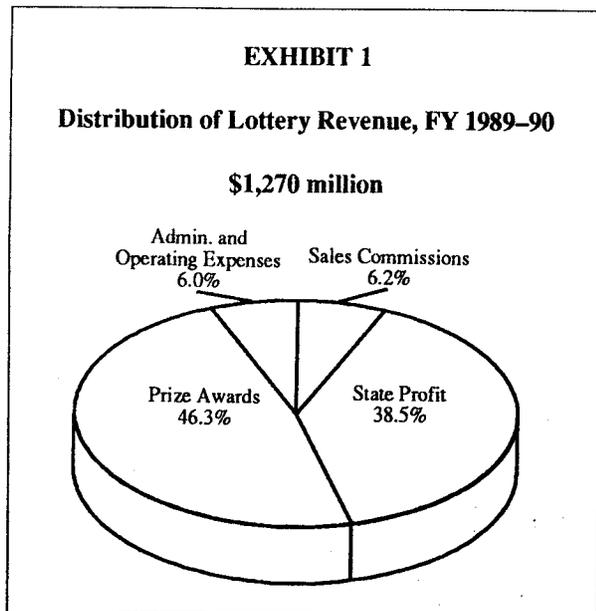
The relationship of the lottery to school financing is one of the most misunderstood aspects of the state budget. When the lottery was approved by the electorate in 1972, many voters believed the money was to be earmarked for education. Although doing so was widely discussed, the implementing law did not earmark the lottery money for education. Finally, in 1981 legislation was approved that restricted the lottery money to the state school aid fund (SAF). This, however, does not necessarily mean more money for education, as will be explained below.

THE STATE LOTTERY

The distribution of revenue from the sale of lottery tickets is shown in Exhibit 1. In fiscal year (FY) 1989-90, total ticket sales (and other revenues) were \$1,269.7 million and the profit was \$489.1 million. The percentage of ticket sales for each of the various games is shown in Exhibit 2. The new Keno game has been a major success story, with sales exceeding \$40 million in its first year of operation. As a result, total ticket sales increased 3.7 percent from the previous year despite a nearly 3 percent decline in Lotto ticket sales. Despite its continued growth, the lottery still provides only 6.2 percent of the \$8 billion spent on K-12 education.

SOURCES OF SCHOOL FINANCING

School operating revenues come from three main sources: local property taxes, state aid, and federal aid. Exhibit 3 compares the percentages of revenues from each of these sources for selected fiscal years. Of particular interest is the decline in state aid as a share of total support from 45 percent in FY 1976-77 to 37



percent in FY 1989-90. This decline was due to the state's poor fiscal condition in the early 1980s, the rapid increase in property taxes during the same period, and declining enrollments. From 1977 to 1981 the assessed value of Michigan property increased 54.3 percent, as raging inflation caused property values to skyrocket. During those years, the average millage rate for all jurisdictions declined about one-half mill, while the average millage rate for schools increased by about the same amount. Property values rose slowly from 1981 to 1987, an annual rate of 3.2 percent, but the growth rate jumped to 8.1 percent from 1989 to 1990. Since 1981 the average millage rate for all jurisdictions has increased by 4.6 mills, and almost the entire increase was accounted for by the increase in school millage rates.

Because a large share of state aid is tied to the value of property per pupil, the increase in property values caused a decrease in the amount of aid from the state (see the explanation of school aid formula below). On a per-pupil basis, total school operating revenues increased 180.3 percent from FY 1976-77 to FY 1989-90 (latest data available) with state aid increasing only 129.6 percent and local property tax revenue increasing 232.9 percent.

STATE SCHOOL AID FUND

The school aid fund receives revenue from five restricted sources; the sales tax (60 percent of all collections), the cigarette tax (2 cents per pack), the liquor tax (4 percent on each bottle), commercial and

EXHIBIT 3

Percentage of School Operating Revenues by Source, Selected Years

| Fiscal Year | Local Property Taxes | State Aid | Federal and Other |
|-------------|----------------------|-----------|-------------------|
| 1969-70 | 50.9% | 45.4% | 3.7% |
| 1976-77 | 50.2 | 45.0 | 4.8 |
| 1981-82 | 62.9 | 32.6 | 4.5 |
| 1984-85 | 58.6 | 37.4 | 4.0 |
| 1989-90 | 59.7 | 37.1 | 3.2 |

SOURCES: Senate Fiscal Agency, *1990 Statistical Report*, and Department of Management and Budget.

industrial facilities taxes (100 percent of all collections), and the lottery (100 percent of the state profit). In addition, the SAF receives an appropriation from the general fund (GF). The amount of the GF appropriation is determined by the governor and the legislature based on their assessment of the needs of elementary and secondary education, the estimated tax revenue and lottery profit available to the SAF, and the revenue per pupil at the local level from the property tax. Exhibit 4 shows percentages of the total SAF contributed by its several sources in FY 1989–90. Exhibit 5 shows the various sources of SAF revenue for selected years since FY 1971–72.

The GF appropriation to the SAF declined about 62 percent from its FY 1980 peak to its FY 1983 trough. Since FY 1983 the GF appropriation has increased sharply, and in FY 1992 it is expected to approach the FY 1980 peak. During that period, however, restricted revenue has increased 142.3 percent (see Exhibit 6). As a share of total GF spending, the GF appropriation to the SAF declined from 27 percent in FY 1971–72 to 6.8 percent in FY 1988–89 but is projected to increase to 11.6 percent in FY 1991–92.

Since FY 1979–80, the last year before revenue from the lottery was first restricted to the SAF, the GF appropriation to the SAF has declined slightly (FY 1992 estimate) because other sources—mainly the lottery, which has risen to \$500 million—have filled the gap.

STATE SCHOOL AID FORMULA

The state school aid formula is one of the mechanisms used to distribute monies from the school aid fund to school districts. The formula is based on the power equalizing concept; that is, the state attempts to equalize the resources of the various school districts, because the property tax base [state equalized valuation (SEV)]

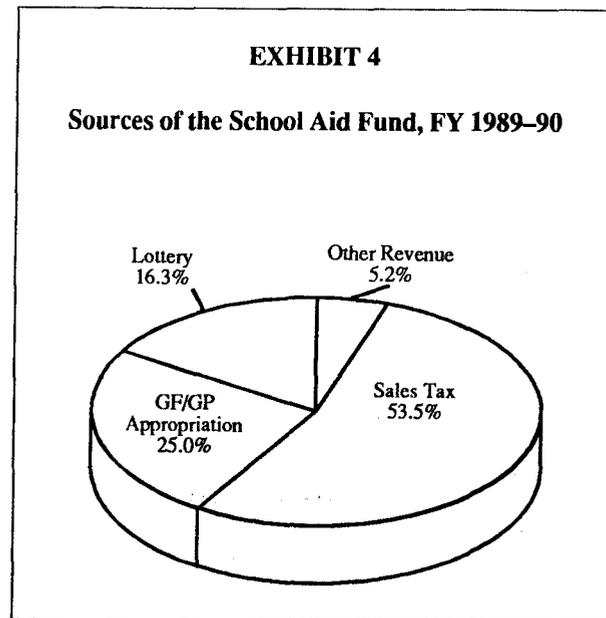
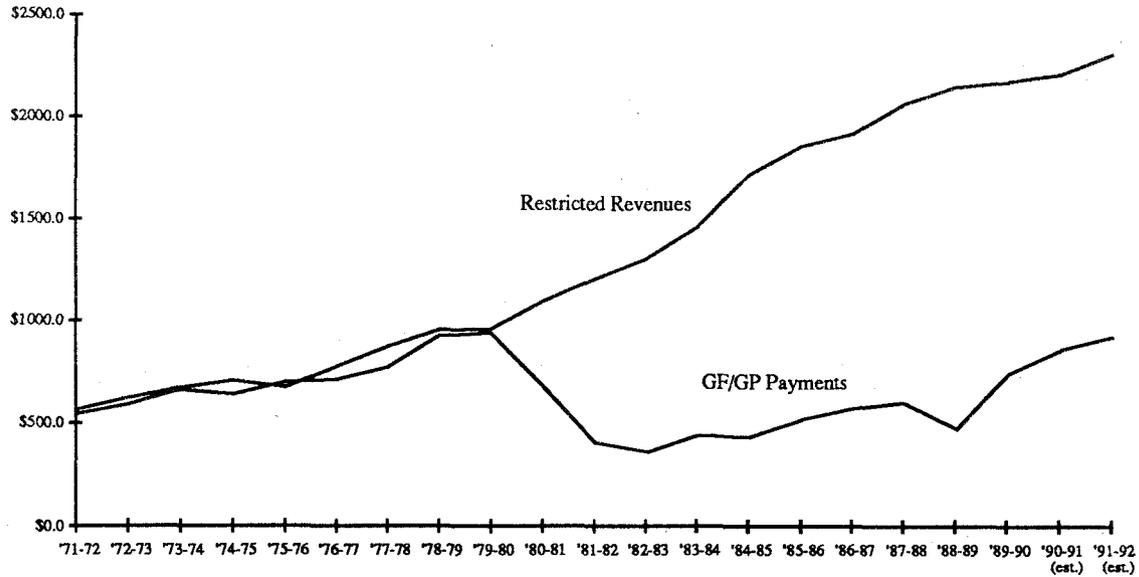


EXHIBIT 5
State School Aid Fund Revenue by Source, Selected Years
(dollars in millions)

| Fiscal Year | Sales Tax | Lottery | Other Taxes | GF/GP Appropriation | Total SAF | Total SAF Revenue Per Pupil | GF/GP Appropriation as % of Total GF/GP Budget |
|----------------|-----------|---------|-------------|---------------------|-----------|-----------------------------|--|
| 1971–72 | \$528.2 | 0.0 | \$36.9 | \$542.3 | \$1,107.4 | \$531 | 27.1% |
| 1978–79 | 903.8 | 0.0 | 62.2 | 927.9 | 1,893.9 | 1,107 | 22.1 |
| 1979–80 | 902.4 | 0.0 | 62.4 | 945.2 | 1,910.0 | 1,137 | 19.5 |
| 1982–83 | 1,019.4 | \$221.9 | 74.5 | 360.1 | 1,675.9 | 1,011 | 7.5 |
| 1984–85 | 1,283.4 | 359.6 | 88.3 | 435.7 | 2,167.0 | 1,309 | 7.4 |
| 1988–89 | 1,569.1 | 484.0 | 114.8 | 477.3 | 2,645.2 | 1,607 | 6.8 |
| 1989–90 | 1,602.8 | 489.1 | 103.9 | 749.1 | 2,944.9 | 1,796 | 9.7 |
| 1991–92 (est.) | 1,731.0 | 500.0 | 107.0 | 932.8 | 3,270.8 | 1,964 | 11.6 |

EXHIBIT 6

General Fund Payment to School Aid Fund and Restricted Sources, FY 1971-72 to FY 1991-92



SOURCE: Senate Fiscal Agency, *Statistical Report*, 1985 and 1990.

per pupil varies widely among districts. For example, the property tax base in Detroit is \$28,325 per pupil compared with \$289,911 per pupil in Birmingham (FY 1989-90 data). This means that in Detroit one mill raises only \$28.32 per pupil, while in Birmingham one mill raises \$280.91 per pupil.

The 1990-91 school aid formula adopted by the legislature guarantees \$335 plus \$90 per mill for each pupil. (School districts must meet certain requirements to receive the full amount, but most in-formula districts are expected to receive the full guarantee.) The grant from the state is equal to the guarantee less the amount of revenue raised locally. For example, a school district levying 30 mills would be guaranteed \$3,035 per pupil. If that school district raised \$1,500 per pupil locally, it would receive a state payment of \$1,535 per pupil. There are about 164 out-of-formula school districts, or 29 percent of all districts, that raise more locally than the guarantee and therefore receive no state aid from the formula.

CONCLUSION

The lottery is an important state revenue source, but contrary to public perception it provides a relatively small share (6 percent) of the funding for K-12 education. In fact, as long as the annual GF appropriation to the SAF is variable, there can be no guarantee that increased lottery revenue will result in more spending on education, because as lottery and other contributions to the SAF grow, the GF contribution can shrink.

There are a number of legislative efforts aimed at reversing the decline in general fund support for K-12 education. Given Governor Engler's pledge to make education his highest priority, these efforts are likely to be successful. However, any growth in revenues improves the state's ability to increase spending on state services, among which education is likely to remain a high priority.