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THINK NEW MEXICO

A Results-Oriented Think Tank Serving New Mexicans



AVERTING THE CRISIS

Making Lottery Success Scholarships Sustainable



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About Think New Mexico

Think New Mexico is a results-oriented think tank serving the citizens of New Mexico. Our mission is to improve the quality of life for all New Mexicans, especially working low and middle-income families. We fulfill this mission by educating the public, the media and policymakers about some of the most serious problems facing New Mexico and by developing effective, comprehensive, sustainable solutions to those problems.

As an independent, statewide, results-oriented think tank, Think New Mexico measures its success based on changes in law or policy that it is able to help achieve. We are best known for our successful campaigns that resulted in landmark laws making full-day kindergarten accessible to every child in New Mexico and repealing the state's regressive tax on food. More recently, we have led successful initiatives to create a Strategic River Reserve to protect and restore New Mexico's rivers, and to establish the Family Opportunity Accounts Act to alleviate the state's persistent poverty.

Our approach is to perform and publish sound, nonpartisan, independent research. Unlike many think tanks, Think New Mexico does not subscribe to any particular ideology. Instead, because New Mexico is at or near the bottom of so many national rankings, our focus is on promoting workable solutions. We use advocacy and, as a last resort, legal action in accordance with federal tax law.

Consistent with our nonpartisan approach, Think New Mexico's board is composed of Democrats, Independents and Republicans. They are statesmen and stateswomen, who have no agenda other than to see New Mexico succeed. They are also the brain trust of this think tank.

Think New Mexico began its operations on January 1, 1999. It is a tax-exempt organization under section 501(c)(3) of the Internal Revenue Code. In order to maintain its independence, Think New Mexico does not accept government money. However, contributions from individuals, businesses and foundations are welcomed, encouraged and tax-deductible.

Think New Mexico's Board of Directors



Edward Archuleta, a 13th generation New Mexican, is a consultant and activist on issues including responsible land-use planning, growth management, and sustainable development. Edward previously served as the top assistant to former New Mexico Secretary of State Stephanie Gonzales.



Paul Bardacke served as Attorney General of New Mexico from 1983–1986. Paul was Chairman of Bill Richardson's successful 2002 gubernatorial campaign. He is a Fellow in the American College of Trial Lawyers. Paul currently handles complex commercial litigation and mediation with the firm of Sutin, Thayer, and Browne.



David Buchholtz has advised more than a dozen Governors and Cabinet Secretaries of Economic Development on fiscal matters. David recently served as Chairman of the Association of Commerce and Industry. He is the senior member of the New Mexico office of Brownstein, Hyatt, and Farber.



Garrey Carruthers served as Governor of New Mexico from 1987–1990. Garrey is Dean of New Mexico State University's College of Business, and was formerly President and CEO of Cimarron Health Plan. He is a member of the Board of Directors of the U.S. Chamber of Commerce.



Dr. F. Chris Garcia is a former President of the University of New Mexico and is currently a Distinguished Professor of Political Science. He is the co-editor of, among other books, *Latinos and the Political System* and *New Mexico Government (3rd edition)*. Dr. Garcia recently received the Governor's Distinguished Public Service Award.



Elizabeth Gutierrez is the Director of Policy and Program Development for the New Mexico Higher Education Department. She holds a PhD in educational leadership and public policy. Liz was a marketing executive with IBM for nearly two decades. *She is on leave from Think New Mexico's Board while she works for the state.*

LaDonna Harris is an enrolled member of the Comanche Nation. LaDonna is Chairman of the Board and Founder of Americans for Indian Opportunity. She is also a founder of the National Women's Political Caucus. LaDonna was a leader in the effort to return the Taos Blue Lake to Taos Pueblo.



Rebecca Koch is the owner of Rebecca Koch & Associates which provides management consulting services, development, and strategic planning for local and national nonprofits. Rebecca was the organizational development consultant for the Santa Fe Business Incubator, Inc. She is a former President of the Board of New Mexico Literary Arts.



Edward Lujan is the former CEO of Manuel Lujan Agencies, the largest privately owned insurance agency in New Mexico. Ed is a former Chairman of the National Hispanic Cultural Center of New Mexico, the Republican Party of New Mexico and the New Mexico Economic Development Commission.



Fred Nathan founded Think New Mexico and is its Executive Director. Fred served as Special Counsel to New Mexico Attorney General Tom Udall. In that capacity, he was the architect of several successful legislative initiatives and was in charge of New Mexico's lawsuit against the tobacco industry.



Roberta Cooper Ramo is the first woman elected President of the American Bar Association. Roberta serves on the State Board of Finance and is a former President of the Board of Regents of the University of New Mexico. She is a shareholder with the Modrall law firm and serves on many national boards.



Stewart Udall served as Secretary of the Interior under Presidents Kennedy and Johnson. Prior to that, Stewart served three terms in Congress. He is the author of *The Quiet Crisis* (1963), which tells the story of humankind's stewardship over the planet's resources, and *To the Inland Empire: Coronado and Our Spanish Legacy* (1987), which celebrates Hispanic contributions to our history.



Dear New Mexican:

Lotteries date back to around 195 B.C. when the warlords of the Han Dynasty used them as a way to finance the construction of the Great Wall of China.

Here in the United States, some of the first lotteries were used to help finance infrastructure at 47 different colleges, including Harvard, Yale and Princeton. Because of widespread corruption, lotteries disappeared by the late 1800's and did not reappear until New Hampshire passed the first state lottery law in 1964.

Elected officials in New Mexico began debating the advantages and disadvantages of lotteries a few years later, but did not pass any legislation until 1987, when Think New Mexico board member and then-Governor of New Mexico, Garrey Carruthers, vetoed a sweepstakes lottery bill.

In 1994, New Mexico voters passed a constitutional amendment approving a lottery as well as video gambling. The New Mexico Supreme Court, however, struck down the amendment because it violated the state's constitutional prohibition on combined ballot questions. (I played a minor role in that lawsuit as one of four assistant attorneys general of record, representing the state, who intervened in favor of striking down the amendment.) The next year the Legislature passed a lottery law that is still in effect.

Think New Mexico does not address the merits of the lottery in this policy report. Instead, accepting that the lottery is a political reality, we examine reforming its operating and administrative expenses to make Lottery Success Scholarships sustainable.

This report continues a discussion that we opened last year, when we proposed cutting the lottery's disproportionate operating and administrative costs to fund Individual Development Accounts. While that initiative was ultimately launched with General Fund dollars, we became convinced in the course of our investigation that the lottery had to be reformed for it to continue fulfilling its goal: making an affordable college education accessible to New Mexico's many deserving high school graduates.

While we admittedly have misgivings about the lottery, we are strong proponents of using the proceeds to fund Lottery Success Scholarships. We know their benefits well, as a Lottery Success Scholarship helped Chris Chavez, Think New Mexico's ace Field Director, earn his degree from the University of New Mexico.

In developing this report, we consulted dozens of government documents, statutes, articles and reports related to state lotteries. For example, to help us better understand the New Mexico Lottery's financials, we analyzed the Lottery's Annual Reports and audits for the past three years, and to learn how to maximize revenues for the scholarships, we compared New Mexico's Lottery to the 42 other state lotteries on a wide spectrum of different metrics.

We also used the Inspection of Public Records Act to obtain internal documents, like the Lottery's sole source contract with its online vendor, GTech. More of the documents we consulted can be found in the Bibliography on pages 26 to 28.

In addition, we conducted several interviews, including one with the Lottery's new CEO, Tom Romero, who was very cooperative and who impresses us as being cost-conscious and open to reform. Think New Mexico's staff even conducted a field trip to Bert's Burger Bowl in Santa Fe where we purchased \$5 of lottery tickets. (Full disclosure: we used our own hard-earned money and won back \$3, for a net loss of \$2.)

Special thanks to my colleagues at Think New Mexico who are so skilled, dedicated, and like family. This summer the staff received significant help from our intern, Anya Bershad, a former Valedictorian at Santa Fe Prep who returns to Stanford this fall for her sophomore year.

If you like what you read on the following pages, I encourage you to support Think New Mexico's work by making a tax-deductible contribution in the conveniently enclosed reply envelope. As always, we promise to put it to good use.

Fred Nathan

Founder and Executive Director



Anya Bershad
Summer Intern



Lynne Loucks Buchen
Business Manager



Chris Chavez
Field Director



Kristina Fisher
Research Director



Fred Nathan
Executive Director

THE CRISIS FACING LOTTERY SCHOLARSHIPS

The essence of the American Dream is a good job, your own home, and the resources to send your children to college. While more than 96% of New Mexicans who want a job have one, and 70% own their own homes, only 25% have a college degree.

One night, about a dozen years ago, Senator Michael Sanchez and his wife stayed up late talking about how the growing cost of college in New Mexico was out of reach of more and more working low and middle-income families. That discussion led Senator Sanchez to introduce legislation in 1995 to give more New Mexicans the opportunity to earn a college degree.

The bipartisan bill, which was co-sponsored by Senators Sanchez, Stuart Ingle and Tim Jennings,

and signed by Governor Gary Johnson, established the New Mexico Lottery. It directed a portion of the profits to award every deserving high school graduate and GED recipient a full-tuition scholarship at any public university or community college in New Mexico.

Since 1997, Lottery Success Scholarships have kept about 38,000 of our best students in New Mexico, including some who are the first members of their family to attend college.

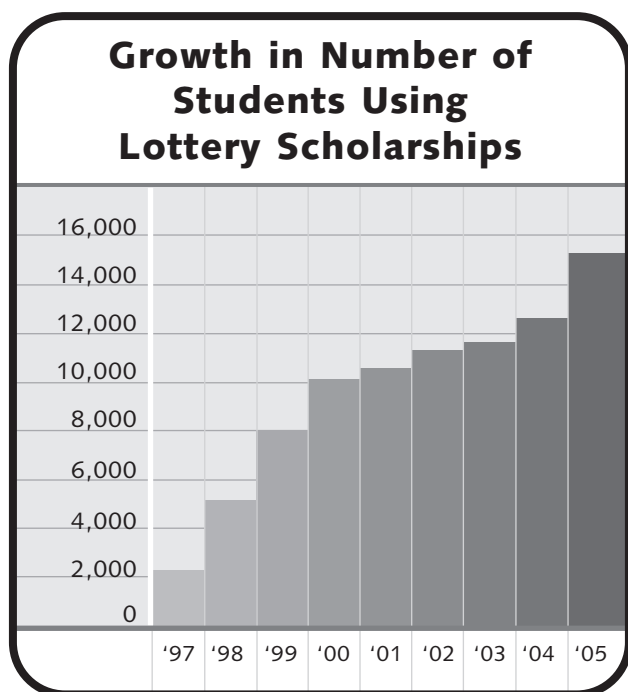
The good news is that Lottery Success Scholarships have helped to boost New Mexico to 8th in the nation for the percentage of the state's population enrolled in college (18% higher than the national average), according to the National Center for Education Statistics.

The bad news is that projections from the New Mexico Higher Education Department indicate that Lottery Success Scholarships face a potential shortfall of about \$18 million in 2011, when the cost of scholarships will exceed annual revenues and current cash reserves will be depleted.

This shortfall is projected because the money that the lottery generates for scholarships is not expected to keep pace with the steadily increasing student demand and rapidly rising tuition costs.

In fact, this year for the first time scholarship expenditures will exceed the Lottery's profits and the Higher Education Department will be forced to begin dipping into the scholarship reserves, reducing them by an estimated \$4.7 million to fund all the eligible students.

New Mexico law provides that once the scholarship reserves are depleted, the Higher Education Department will "establish the percentage of tuition



Source: New Mexico Higher Education Department, 2005, "Lottery Success Scholarship Individual Cohort Results."

Projected Lottery Revenues vs. Expenditures



Source: New Mexico Higher Education Department, "Lottery Program Projections," 2006.

that shall be awarded." When that occurs the scholarships will pay for a shrinking percentage of tuition, increasing the financial burden on already stretched New Mexico families. Another option that has been discussed is to cut back on eligibility and provide the scholarships to fewer students.

Either of these options would be a tragic mistake because both would damage one of the principal benefits of Lottery Success Scholarships: the powerful incentive they provide New Mexico high school students to stay in school, work hard, and earn satisfactory grades. If students do that, they are guaranteed the opportunity of a college education. Reducing the value of the scholarship or eligibility, therefore, would send the wrong message.

Think New Mexico proposes a different strategy for making Lottery Success Scholarships sustain-

able by cutting the disproportionately high operating and administrative costs at the New Mexico Lottery and re-allocating those savings back to scholarships.

Doing nothing is not a viable option. If we fail to fix this problem before we completely drain the scholarship cash reserves, the cost of our inaction will be borne by New Mexico's future high school graduates.

THE VALUE OF LOTTERY SUCCESS SCHOLARSHIPS

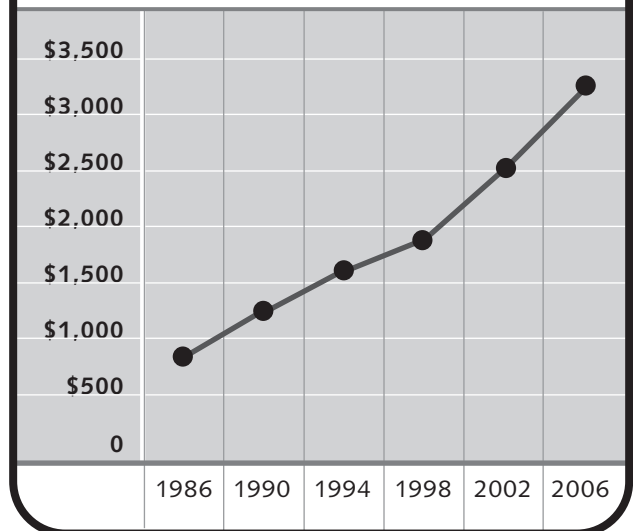
While college tuition has more than quadrupled over the past two decades – from an average of \$802 to \$3,255 annually at New Mexico's four-year public universities – the value of a college education has never been higher.

A typical New Mexican who holds only a high school diploma earns approximately \$17,000 a year, while one with a bachelor's degree earns nearly double that, at an average of \$30,000 according to data from the U.S. Census Bureau. Even those who attend some college without graduating earn more on average than those who never attend.

The benefits of a college education accrue not only to the graduates themselves, but also to everyone in their communities. According to research compiled by the Institute for Higher Education Policy, an increase in the number of college graduates leads to a reduction in the crime rate, decreased reliance on welfare, greater workforce productivity and flexibility as well as increased tax revenues.

While a lottery has drawbacks as a method for raising public funds, it is extremely commendable that the proceeds of New Mexico's lottery are dedicated entirely to college scholarships. Of the other 42 states with lotteries, only seven use a portion of their profits for college scholarships and only New Mexico dedicates 100% of lottery profits for college scholarships. (By contrast, many states divert a portion of their lottery profits for luxuries. Maryland and Washington, for example, earmark a portion of their net lottery profits for the construction and maintenance of private and public stadiums.)

Average Annual Tuition and Fees at New Mexico's Four-Year Public Universities



Source: New Mexico Higher Education Department, "Tuition and Fees History for New Mexico's Public Universities," 2005.

When the lottery was first established in New Mexico, only 40% of its profits were directed to scholarships, while the remaining 60% was used to supplement the funding for infrastructure at K-12 schools. Due to the unexpectedly high demand for the scholarships in the lottery's first three years, there were many concerns that the scholarship fund would run out of money as early as 2003. As a result, Senator Sanchez sponsored and won passage of a bill in 2002 that amended the law to direct 100% of the proceeds to scholarships.

The scholarships are accessible to every high school student who graduates with at least a 2.5 grade point average (GPA) and who enrolls in one of New Mexico's public universities or community colleges immediately after graduating from a New Mexico high school. To maintain the scholarship,

students must stay enrolled in college full-time and earn a minimum GPA of 2.5.

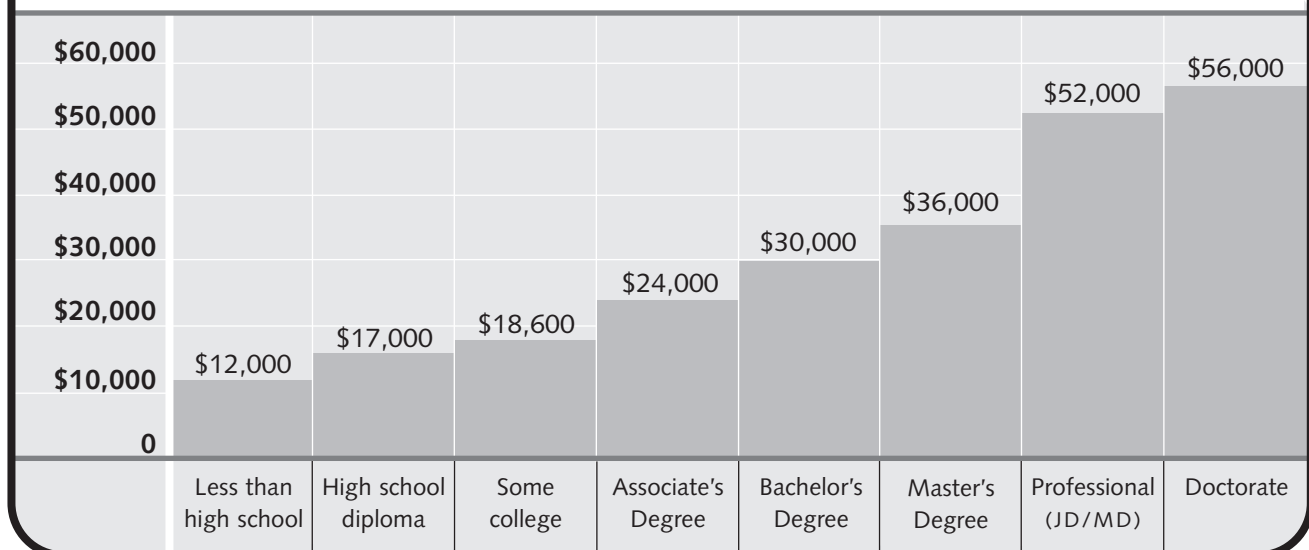
Since the inception of Lottery Success Scholarships, overall student enrollment in New Mexico's public universities has risen 16%, according to research by University of New Mexico economics professors Melissa Binder and Philip Ganderton. Further, the percentages of students graduating with bachelor's degrees who are Hispanic and Native American have risen by 24% and 30% respectively since 1997, according to the New Mexico Higher Education Department.

The Lottery Success Scholarships' most significant impact has been increasing accessibility to an affordable college education. (Students are still responsible for paying for room & board, books, fees and transportation.) The growing burden of college loans on New Mexico's working middle-

class families makes the Lottery Success Scholarship especially important. For example, 10,207 University of New Mexico students borrowed an average of \$7,268 in 2004–2005, according to a June 12, 2006 Associated Press article. After four years these students will graduate with a loan burden of more than \$29,000 on average.

Governor Bill Richardson and members of the legislature from both parties have taken action to keep college accessible and affordable by enacting Governor Richardson's College Affordability Act, which last year established a \$49 million endowment to provide need-based scholarships at New Mexico's public universities. Ensuring the sustainability of these need-based and the merit-based Lottery Success Scholarships, is critical to ensuring access to education and opportunity for all of New Mexico's students.

Average Annual Earnings by Educational Degree in New Mexico



Source: U.S. Census Bureau, "5% Public Use Microdata Samples," 2000.

THE NEED TO MAXIMIZE REVENUE FOR LOTTERY SUCCESS SCHOLARSHIPS

The law establishing the New Mexico Lottery states that its purpose is to “provide the maximum amount of revenues...for the purpose of providing tuition assistance to resident undergraduates at New Mexico post-secondary educational institutions.”

Unfortunately, by our estimation, the Lottery has not succeeded in fulfilling this important objective.

The Lottery Spends Too Much on Operating & Administrative Costs

Today fewer than one in four dollars bet on the New Mexico Lottery makes its way to the deserving high school graduates who receive Lottery Success Scholarships.

Specifically, in 2005, the New Mexico Lottery spent approximately 56.5% of every dollar of revenue

on prizes for players and spent approximately 19.6% on various forms of operating costs and administration like vendor contracts, advertising, promotion, retailer commissions, and salaries. After paying for prizes, operating costs and administration, what is left over goes to college scholarships. In 2005, that was approximately 24 cents of each dollar of lottery revenue.¹

In fact, New Mexico ranked fifth highest of 41 state lotteries for the percentage of lottery revenue spent on operating costs and administration in 2005, according to data collected directly from

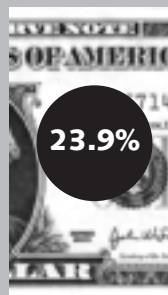
¹ In its annual report, the Lottery calculates the amounts going to prizes, scholarships, and operating costs as percentages of sales, rather than revenue. Revenue differs from sales because it incorporates gains or losses from other sources, such as fees. We use revenue here because the funds available to scholarships are determined as a percentage of revenue, rather than sales. However, the difference between the two calculations is negligible.

Where New Mexico's Lottery Revenue Goes

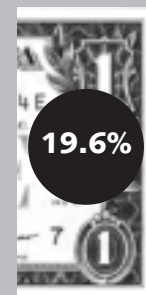
Prizes



Success Scholarships



Operating Costs



Sources: New Mexico Lottery Authority 2005 Annual Report, Statement of Revenues, Expenses, & Changes in Net Assets.

the lotteries themselves and compiled by La Fleur's 2006 World Lottery Almanac ("La Fleur's"), the respected independent source on lotteries.²

The New Mexico Lottery does a little better with International Gaming and Wagering Business (IGWB), an industry trade magazine, which ranked it as the 7th highest of 39 lotteries in 2004 for the percentage of lottery revenue spent on operating costs and administration.

However, IGWB stopped producing these rankings after 2004. In an article entitled "Goodbye Efficiency Study, Hello Revenue Analysis," the magazine explained that "just because we dropped the rankings does not mean that lotteries will stop being scrutinized. Legislators are on the warpath like never before, often irrationally deciding to limit lottery [operating costs and administration] in order to get more revenue..."

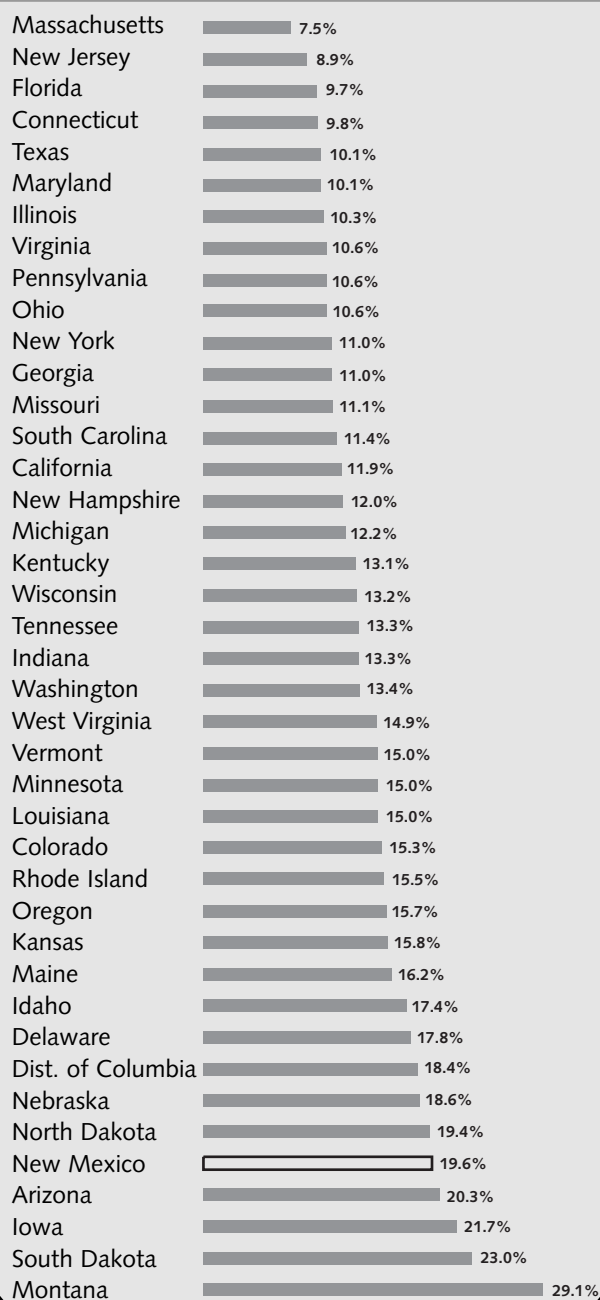
New Mexico's Low Population Size, Ruralness and Sales Do Not Explain the Lottery's High Costs

Remarkably, the New Mexico Lottery ranks very high for the percentage of lottery revenues spent on operating and administrative costs, even when taking into consideration population size, ruralness, and total annual lottery sales.

One might expect states with larger populations to have relatively lower operating and administrative costs, since these lotteries can benefit from

² The lotteries in North Carolina and Oklahoma were not ranked because they were just beginning operations and had not yet had a full year of operations in 2005.

Percent of Lottery Revenues Spent on Lottery Administration



Source: La Fleur's 2006 World Lottery Almanac.

The New Mexico Lottery's Operating Costs are Higher than Comparable States

Population Size

State	Population (millions)	Operating Cost
New Mexico	1.9	19.6%
Nebraska	1.8	18.6%
West Virginia	1.8	14.9%
Idaho	1.4	17.4%
Maine	1.3	16.2%
New Hampshire	1.3	12.0%
Montana	0.9	29.1%
South Dakota	0.8	23.0%
Delaware	0.8	17.8%
North Dakota	0.6	19.4%
Vermont	0.6	15.0%
D.C.	0.6	18.4%

Ruralness

State	Urban Population	Operating Cost
New Mexico	59.5%	19.6%
Idaho	53.1%	17.4%
North Dakota	52.8%	19.4%
Montana	47.3%	29.1%
South Dakota	45.8%	23.0%
West Virginia	44.8%	14.9%
New Hampshire	41.6%	12.0%
Maine	38.8%	16.2%
Vermont	37.8%	15.0%

Lottery Ticket Sales

State	2005 Total Sales (mil)	Operating Cost
New Mexico	\$139.2	19.6%
Delaware	\$114.3	17.8%
Idaho	\$113.5	17.4%
Nebraska	\$100.7	18.6%
Vermont	\$ 92.6	15.0%
Montana	\$ 33.8	29.1%
South Dakota	\$ 32.5	23.0%
North Dakota	\$ 19.1	19.4%

economies of scale (e.g. receiving volume discounts). However, when New Mexico's lottery is compared to the eleven lotteries in states with less population than New Mexico, it ranks 3rd highest for the percentage of lottery revenues spent for operating costs and administration. If the size of a state determines how expensive it is to run its lottery, then all of these smaller states should have higher operating and administrative costs than New Mexico.

Similarly, ruralness does not explain the New Mexico Lottery's relatively high operating and administrative costs. One would expect more sparsely populated states than New Mexico to also have higher operating and administrative costs, because they would have to spend more money on supplying and servicing far-flung retailers.

However, New Mexico ranks 3rd highest for the percentage of lottery revenues spent on operating costs and administration among the eight lotteries in more rural states than New Mexico. If operating costs and administration were purely a factor of ruralness, New Mexico should have the lowest operating costs and administration among these eight states.

Finally, the amount of annual gross lottery sales also does not explain the New Mexico Lottery's relatively high operating and administrative costs. One would expect lotteries with lower sales to have relatively higher operating and administrative costs because the fixed overhead expenses are taken out of smaller revenues. Yet once again New Mexico ranks 3rd highest for the percentage

Chart Source: *La Fleur's 2006 World Lottery Almanac*; Urban population information from U.S. Dept. of Transportation, "Highway Statistics 2003." Compiled by Think New Mexico.



The New Mexico Lottery headquarters building in Albuquerque. *Photo by Stephen Dunn.*

of lottery revenues spent for operating and administrative costs among the seven lottery states with lower sales than New Mexico in 2005. If operating costs and administration were purely a factor of lottery sales, one would expect New Mexico to have the lowest operating costs and administration among these eight states.

We believe that, ultimately, low operating and administrative costs are mostly a result of discipline and commitment. This is true whether the enterprise is a business, a quasi-private lottery, a government agency, or even a non-profit organization.

The Zero-Sum Game: Higher Costs Means Fewer Dollars for Scholarships

The New Mexico Lottery budget is a classic zero-sum game: every dollar of revenue spent on administrative and operating costs is a dollar less to invest in scholarships.

While the New Mexico Lottery has generally received high marks for increasing lottery gross sales, the percentage of revenues for scholarships has not kept up. The Lottery has grown its gross sales from \$82.1 million in its first full year of existence in 1997 to \$139.3 million in 2005, according to the Lottery's most recent Annual Report. However, at the same time the New Mexico Lottery has struggled with persistently low returns for scholarships (i.e. profits) as a percentage of gross

Percentage of New Mexico Lottery Revenues Going to Success Scholarships

FY '96	22.18%
FY '97	26.67%
FY '98	23.67%
FY '99	21.89%
FY '00	22.13%
FY '01	22.38%
FY '02	22.09%
FY '03	24.16%
FY '04	24.14%
FY '05	23.97%
FY '06 (projected)	23.93%
FY '07 (projected)	22.90%
FY '08 (projected)	22.27%
FY '09 (projected)	21.38%
FY '10 (projected)	22.07%

Sources: 2005 New Mexico Lottery Authority Annual Report, "Historical Review: A History of New Mexico Lottery Performance"; New Mexico Lottery Authority Budget Forecast, July 2006. Historical data based on sales, current and projected on revenues.

sales since its first year. Specifically, that percentage has fallen from 26.67% in 1997 to 23.97% in 2005.

When asked about the relatively low percentages going to scholarships in 1997 by the Albuquerque Journal in an article entitled "N.M. Lottery Costs

Rank High," then-New Mexico Lottery Chief Executive Officer Ralph Decker said:

"We'd like to not worry about the percent [available for scholarships]. To me, the bottom line to the kids of New Mexico should be how much money is coming in. If the amount returned is more this next year, you should be happy."

Taking Decker's argument to its logical extreme, if revenues for the Lottery increase by \$10 million and the scholarship fund rises by only \$1.00, then we should be happy. Since the lottery exists to fund the scholarships, we believe that if lottery revenues rise substantially, then the money available for scholarships should rise by a corresponding amount.

Decker's statement was made in 1997 when 26.67% of New Mexico Lottery revenue was going to the beneficiaries for college scholarships. That percentage represents the high water mark and has declined since then, as the nearby chart illustrates.

In fact, the New Mexico Lottery itself projects that the percentage of lottery revenues that will be left for scholarships, after paying prizes and operating administrative costs, will continue to decline over the next five years.

The decline from 24% of revenues for scholarships this year to 22% in 2010 represents a loss of enough money to fund nearly 1,000 scholarships for deserving high school graduates. The real bottom line, according to its own figures, is that the New Mexico Lottery will be moving in the wrong direction in terms of maximizing revenues for scholarships.

The 30% Solution

To achieve the Lottery's goal of providing the maximum amount of revenue for Lottery Success Scholarships, Think New Mexico recommends that the Legislature follow the example of ten other states that have adopted the philosophy that their lotteries exist primarily to serve some specific public good. These states prioritize the beneficiaries—in New Mexico, the deserving high school seniors who receive lottery scholarships—by setting statutory minimum percentages that range from 30% to 35% of lottery revenues that must go to the beneficiaries before paying operating and administrative costs.³

To be fair to the New Mexico Lottery, it should be acknowledged that all of these states, except Delaware, are larger than New Mexico in terms of population size. However, lotteries in states with smaller populations than New Mexico like New Hampshire, North Dakota, West Virginia and Washington D.C. have all managed to deliver more than 30% of their lottery revenues to the beneficiaries in their states in 2005, according to La Fleur's.

3] It should be noted that Tennessee's law is different than the other states listed nearby, as their statutory minimum percentage for their beneficiaries is merely a "goal." However, Tennessee still returned 30.3% to its beneficiaries in 2005, according to La Fleur's. Similarly, New Jersey, which has a statutory minimum of 30%, exceeded this return and delivered 34.9% to its beneficiaries in 2005. In addition to a statutory minimum amendment to New Mexico's lottery law, there needs to be a provision for a performance bonus, or a penalty if the minimum for the beneficiaries is not achieved. Georgia, for example, requires a minimum of 35% but has fallen shy of that statutory requirement several times.

States with Specified Minimum % of Lottery Revenues for Beneficiaries

Georgia	35.0%
Kentucky	35.0%
Louisiana	35.0%
North Carolina	35.0%
Oklahoma	35.0%
Tennessee	35.0%
California	34.0%
Delaware	30.0%
Kansas	30.0%
New Jersey	30.0%
Pennsylvania	30.0%

Source: State Statutes. Compiled by Think New Mexico.

North Dakota's Lottery returned 33.5% to their beneficiaries, Washington D.C. returned 30.4%, New Hampshire returned 30.2%, and West Virginia returned 30%.⁴

While some might argue that 30% is an arbitrary figure, we would point out that it was probably the expectation of many of the legislators who voted to pass the New Mexico Lottery Act. That is because when legislators voted on that bill, it was accompa-

4] These percentages, which come from La Fleur's, reflect only the traditional lottery operations in each state, and do not include Keno or Video Lottery Terminals (VLTs), because those games have such low administrative costs that they would skew the results.

nied by a Fiscal Impact Report, an official financial analysis that specifically stated that the amount available to the beneficiaries would be 30%.

The Lottery Act passed the House by a slim margin of 37-31. We wonder whether legislators would still have passed the Lottery Act if they had known that the beneficiaries would only receive between 22% and 26%, rather than the 30% that was advertised to them.

New Mexico law does establish a statutory minimum percentage of lottery sales that must be given away to players as prizes: 50%. Because New Mexico sets a statutory minimum percentage that must be paid out to players, it seems only reasonable to also set a statutory minimum percentage of lottery revenues that is reserved for the deserving high school seniors who are the ultimate beneficiaries of the New Mexico Lottery. They are, frankly, the primary purpose justifying the lottery's existence in spite of its regressive impact on the general public.

Alternatively, there is no reason why New Mexico could not establish a statutory percentage cap on operating costs and administration, which includes vendor contracts, advertising, promotion, retail commissions and salaries. For example, if the New Mexico Legislature capped the Lottery's operating and administrative expense at 15%, without taking any further action, that would make more than 4.5% of lottery revenues, or approximately \$6.3 million annually, available to invest in nearly 2,000 more college scholarships per year.

This strategy has worked elsewhere. By state law, the lotteries in Massachusetts, South Carolina and

States with Caps on Lottery Operating Costs

State	Operating Cost Cap	2005 Actual
Massachusetts	15.0 %	7.5 %
South Carolina	15.0 %	11.4 %
West Virginia	15.0 %	14.8 %
Texas	12.0 %	10.0 %

Source: State lottery statutes, compiled by Think New Mexico, and *La Fleur's 2006 World Lottery Almanac*.

West Virginia cannot spend more than 15%, while the lottery in Texas cannot exceed 12%. As the nearby chart demonstrates, every one of these lotteries came in below their respective caps in 2005. North Carolina recently joined these states by passing a 15% cap on its lottery operating and administrative costs.

Since New Mexico's lottery law has no percentage floor for beneficiaries and no percentage ceiling for operating and administrative costs, it would not be illegal for the Lottery to exceed the operating and administrative costs of even the least efficient state lottery, Montana, which has no cap and spends over 29% on these expenses. Without a required percentage that must go to scholarships, any such increases will come at their expense.

Some might ask: why not increase the percentage for beneficiaries by cutting the percentage for prizes? The problem with that plan is that when



The 30% solution: dedicate 30 cents of every dollar bet on the lottery to scholarships. *Photo by Stephen Dunn.*

Texas lowered the percentage it paid to players in prizes from 60% to 50% in 1997, it saw an approximate 30% decline in lottery sales because the lower prizes discouraged players from participating. As a result, the funds available to beneficiaries fell significantly, leading Texas legislators to reverse themselves two years later, raising the prize payout rate back to 60%.

Rather than cut, New Mexico's prize payout floor could be raised from 50% to 55% to ensure that prize payouts are not decreased in order to pay for beneficiaries.

The New Mexico Lottery's disproportionately high operating and administrative budget is where the state will find the savings to reach the 30% minimum for scholarships.

POTENTIAL FOR SAVINGS

So where are the operating and administrative costs going? We decided to take a look under the hood of the New Mexico Lottery, and we found several areas where savings could be achieved and re-allocated to scholarships.

Re-Bid the Sole Source Contract with GTech

In 2002, the New Mexico Lottery distributed a press release announcing that it had negotiated a new contract with its online gaming vendor⁵ GTech, which reduced the percentage it paid GTech from about 10.35% to 8.52% starting in 2003. It seemed like a good deal for New Mexico.

However, the new contract was far less of an improvement than it might appear. In the chart on the following page, we rank all of the lotteries with 2005 online sales between \$25 million and \$100 million by the percentage they paid to their online vendor, using data collected from state lotteries by La Fleur's, the respected independent source on lotteries.

The chart reveals that New Mexico pays a higher percentage of its online sales to its vendor than any of the seven states with sales between \$25 million and \$100 million: 8.52%. By contrast, New

5] Online games are drawing-based, like Powerball and Roadrunner Cash, as opposed to instant scratch-off games. Online vendors make and maintain the ticket vending machines and computer systems necessary to operate online games. In return, the online vendor typically receives a percentage of the sales.



The New Mexico Lottery shares parking and adjoining buildings with GTech. *Photo by Chris Chavez.*

Hampshire pays only 2.16%, or less than a third of what New Mexico pays.

Even tiny Montana, whose sales of slightly more than \$23 million (less than half of New Mexico's sales of approximately \$48 million) were not high enough to qualify for our chart, pays only 5.8% of sales to its online vendor. Because of its greater lottery ticket sales, greater population size, and greater economies of scale, one would expect New Mexico to enjoy a lower contract rate than Montana.

Nebraska, which with approximately \$44 million in online sales is closest to New Mexico, also pays significantly less: 2.39%. Nebraska makes for a good comparison to New Mexico because in addition to its comparable gross online sales, it is also a sparsely populated state and has about the same number of people living within its boundaries.

New Mexico's current contract with GTech contains an "Online Pricing Matrix" which lowers the percentage of online sales payable to GTech to

Percentages of Revenues Paid to Online Vendors by States with \$25–100 million in Lottery Ticket Sales

State	Percent Paid to Vendor	2005 Online Sales	Online Vendor	Year of Contract
New Mexico	8.52%	\$48.4 million	GTECH	2003
Maine	5.10%	\$57.4 million	Scientific Games	2001
Delaware	4.18%	\$85.4 million	Scientific Games	2001
West Virginia	3.00%	\$82.4 million	Scientific Games	1999
Idaho	2.99%	\$34.4 million	GTECH	1999
Nebraska	2.39%	\$44.1 million	Intralot	2004
New Hampshire	2.16%	\$66.6 million	Scientific Games	2000

Source: *La Fleur's 2006 World Lottery Almanac*, 2005 lottery annual reports. Compiled by Think New Mexico.

slightly more than 7.5% if online lottery sales climb from their current level to a range between \$60 million and \$100 million.

In contrast to that 7.5% figure, Delaware, West Virginia and New Hampshire already have online lottery sales between \$60 million and \$100 million and smaller population sizes than New Mexico, yet they pay only 4.18%, 3% and 2.16% of online sales, respectively, to Scientific Games, a GTech competitor.

Idaho, the only other state in New Mexico's sales range with a GTech contract, pays a rate of 2.99%, nearly a third of New Mexico's contract rate.

New Mexico's payments to GTech extend even beyond the 8.52% of sales specified in the contract. The Lottery also pays GTech fees of \$24 per week for each of the state's more than 1,100 terminals, for a total of \$1,372,800 in 2005. Last year,

Gtech also charged the Lottery approximately \$380,000 in additional assorted fees that are not broken out in the contract. All told, last year New Mexico paid GTech a grand total of 12.14% of its online sales, which comes to \$5.9 million.

So what might explain why New Mexico's Lottery pays such a high percentage of its sales to GTech? One explanation might be that GTech won the current New Mexico lottery vendor contract without having to compete because GTech was the sole bidder.

GTech is a publicly traded Rhode Island company that operates lotteries in over 50 countries. It has a market capitalization in excess of \$4 billion and is in the process of being bought out by gambling giant Lottomatica SpA, a multinational corporation based in Italy. The sale would create the world's biggest lottery operator.

GTech has provided the New Mexico Lottery's on-line machines and online gaming services since it entered into its original contract with the Lottery in 1996 when the first online games were introduced in New Mexico. A November 11, 1996 article in *Fortune* magazine reported that "[I]n New Mexico, where GTech was the only bidder, the company was able to submit a bid millions higher than if it had faced real competition."

That same article concluded that "rare is the company that has faced as many allegations of baldly sleazy conduct as GTech" and observed that its executives have "perfected the backroom art of lottery politics: rewarding political friends, annihilating enemies and crushing the competition."

GTech received some attention during last year's fight over the Harriet Miers Supreme Court nomination because she chaired the Texas Lottery Commission when GTech had a contract with the Texas lottery. According to an October 7, 2005 *New York Times* article, Lawrence Littwin, the former director of the Texas Lottery, has "said that he was dismissed after a little over four months on the job when he tried to look into the GTech contract and the company's campaign contributions...[Another] issue was whether to extend GTech's contract or open it to other bidders, as Mr. Littwin preferred."

In 2002 the New Mexico Lottery, under the leadership of former CEO Tom Shaheen, extended GTech's contract for five years rather than opening the state's contract for online sales to other bidders. (No members of the 2006 New Mexico Lottery Authority were serving on the Board in 2002.) Although legal, this is curious because there



New Mexico pays GTech 12.14% of online sales from popular games like Powerball. *Photo by Stephen Dunn.*

were other online vendors available, such as Scientific Games.

Unfortunately, this unconscionable contract with GTech does not expire until November 20, 2008 (although the parties are, of course, always free to re-negotiate the rate if both parties consent).

Setting aside the question of whether it is a good idea to award a sole-bid contract to a company with GTech's history and then extend that contract for five years without opening it to other bids, there can be no question that it is fundamentally inconsistent with the Lottery's statutory mandate to maximize revenues for scholarships.

By comparing New Mexico to Nebraska, the lottery most comparable to ours, we estimate that the New Mexico Lottery is overpaying GTech by at least \$2.9 million annually or about \$17.5 million over the life of the extended contract.⁶ That represents more than 800 scholarships per year and nearly 5,000 annual scholarships over the extended contract. Every dollar that the New Mexico Lottery overspends on its contract with this multinational gambling giant is a dollar less to invest in deserving high school graduates here in New Mexico.

Reduce High Retailer Commissions

In return for selling lottery tickets, each New Mexico Lottery retailer receives a commission of 6% of gross ticket sales from their store plus a 1% bonus every time they cash a winning ticket for prizes up to \$600. In addition, they are eligible for winning ticket and promotional incentives.

In 2005, through sales and cashing commissions as well as winning ticket and promotional incentives, the 1,106 lottery retailers collectively received slightly more than \$9.5 million, according to the Lottery's most recent annual report. Given the Lottery's sales, that works out to an effective commission rate of 6.8% of each dollar collected by the lottery.

The retail commissions for the majority of state lotteries fall in the 5% to 6% range. Only 15 states,

including California and New York, spend 6% or more. Surprisingly, New Mexico is in this category.

Studying the various base commission rates in different state lotteries yields few if any patterns. We were left to conclude that base commission rates reflect the relative political power of the lottery retailers in the various states.

We recommend that the New Mexico Lottery Authority Board reduce New Mexico's relatively high commissions from 6% to 5% or an effective rate of 5.8% when the base commission plus cashing bonuses, incentives and promotional awards are included. Such a decrease would represent an annual savings of about \$1.4 million or enough to fund about 400 scholarships per year.

Of course, this will not be easy because the lottery retailers are a very strong political lobby. From our survey of the retailers listed on the Lottery's website, it appears that more than half of them are owned by out-of-state corporations like Chevron Redi-Mart (Ever-Ready Oil Company), Diamond Shamrock, Philips 66, Circle K Corporation, Giant Industries and 7-Eleven.

Reducing the commission from an effective rate of 6.8% to 5.8% would admittedly be a significant sacrifice for retailers, but we wonder whether they might be willing to accept it as their contribution to a larger campaign dedicated to making Lottery Success Scholarships sustainable.

⁶] These savings were calculated by applying Nebraska's 2.39% online vendor payment rate to New Mexico's 2005 online sales, assuming sales and online terminal fees remain constant.

Reform the Reserve Fund

Under the New Mexico Lottery Act, the Legislature established that “an amount up to 2% of the gross annual revenues shall be set aside as a Reserve Fund to cover bonuses and incentive plans for Lottery retailers, special promotions for retailers, purchasing special promotional giveaways, sponsoring special promotional events, compulsive gambling rehabilitation and other purposes as the Board deems necessary to maintain the integrity and meet the revenue goals of the Lottery.”

In 2004, the Lottery spent \$91,027 from this reserve fund. In 2005 the expenditures increased to \$767,634, and in 2006, they climbed to \$1,071,934. In 2007, the Lottery has budgeted expenditures of \$1,310,000 from this fund, but does not break them out by category.

There is, of course, a big difference between a dollar spent to help compulsive gamblers and a dollar spent on promotional giveaways. Unfortunately, due to the statutory language, reserve fund expenditures are not transparent. Even in the Lottery’s annual audit, the public is never given an accounting of how the dollars in the fund were spent (although the fine print of the 2005 annual report notes that \$564,000 went to retailers that year). Lumping this diverse collection of expenditures together decreases financial accountability and may lead to wasteful spending.

We recommend that the legislature eliminate the statutory language setting aside this fund, and have the Lottery instead incorporate all of those expenditures into its annual line-item budget, where they can be scrutinized.

The Bottom Line

Re-bidding the contract with Gtech, reducing high retailer commissions, and reforming the reserve fund are simply suggestions as to how the Lottery can cut operating and administrative costs so that more revenues would be available to invest in scholarships. We believe, however, that the best way to cut costs would be for the Legislature to set budget parameters within statute (e.g. a 30% floor for the scholarships or a 15% ceiling for operating and administrative costs) and then allow the Lottery to decide how best to achieve the legislature’s objectives.

The Lottery’s new CEO, Tom Romero, informed us when we interviewed him that he intends to obtain a performance audit to identify ways to cut costs. This audit should reveal additional savings.

If the percentage of lottery revenue earmarked for scholarships were gradually raised from 24% to 30%, as recommended here, it would represent an increase of approximately \$8.4 million dollars annually, plus any interest earned by investing this money in the scholarship reserve fund. That \$8.4 million of annual recurring money would go a long way toward making Lottery Success Scholarships sustainable.

MINNESOTA: CUTTING COSTS WITHOUT REDUCING REVENUES

Cutting lottery operating and administrative costs is not a new idea. In Oregon, Florida, and most recently, Minnesota, state lotteries have successfully cut their operating and administrative costs without harming the amount for beneficiaries.

In 2003, the Minnesota Lottery came under heavy public scrutiny for its excessive operating costs, which legislators and citizen groups noted were significantly higher than those of comparable state lotteries. At the time, Minnesota's lottery was even less efficient than New Mexico's, spending 19.6% of every dollar of revenue on operations and administration, compared to New Mexico's 19.4%.

A legislative audit found that the lottery had greater ticket production and distribution costs, staff, office, and warehouse space than comparable lotteries, as well as more assistant agency heads, man-



Photo by Stephen Dunn.

Lottery Operating & Administrative Costs: Minnesota vs. New Mexico

	Minnesota	New Mexico
2003 Operating Costs	19.6% 34th in nation	19.4% 33rd in nation
2005 Operating Costs	15.0% 25th in nation	19.6% 37th in nation

Source: International Gaming and Wagering Business and *La Fleur's 2006 World Lottery Almanac*.

agers, and supervisors per employee than the vast majority of Minnesota's other state agencies. It was also spending money on questionable promotional events like the Minnesota Pro/Am Bass Fishing Tour and, ironically, a specially designed RV intended to showcase how the lottery dollars are used for environmental purposes.

In response, the Minnesota legislature and governor took action to increase the accountability and efficiency of the lottery. In early 2004, they enacted legislation that, among other things, dramatically cut the allowable operating expense budget by \$16.1 million.⁷ The legislature appropriated the reduced budget as a lump sum and refrained from issuing line-item appropriations or micromanaging

7] In New Mexico, the Lottery is a quasi-private agency that does not go to the Legislature for its budget. Instead its budget comes directly from lottery revenues. The Lottery takes as much as it believes it needs for operating and administrative costs, after paying prizes, and sends what is left over to the scholarship fund.

the lottery, noting that the lottery needs a reasonable degree of flexibility to remain competitive and fulfill its mission.

The Minnesota lottery was able to cut its costs a whopping 26.5% by trimming staff, renegotiating contracts and leases, and ending ineffective promotional events. The lottery continued to find savings throughout 2005.

Between 2003 and 2005, the Minnesota Lottery cut its operating costs from 19.6% to 15.0% of revenue and rose from 34th most efficient in the nation to 25th. Even after making all of those cuts, sales increased and the lottery brought in a record return of \$100.7 million to beneficiaries in 2004, an increase of more than \$21 million.

Minnesota's experience proves that a lottery can cut its operating and administrative costs without harming the beneficiaries. In fact, thoughtfully increasing efficiency will almost certainly lead to higher yields for beneficiaries.



Photo by Stephen Dunn.

KEEPING THE PROMISE

A college education has never been more necessary to achieving the American Dream than it is today. The Bureau of Labor Statistics reports that 42% of the new jobs this decade will require post-secondary education, as compared to 29% as recently as 2000.

Ensuring that all of New Mexico's deserving high school graduates have access to college does more than simply equip them with the tools they need for a competitive job market. It also benefits every New Mexican with the rewards of a better-educated, more engaged citizenry, and the stronger workforce necessary to attract the best possible jobs to the state.

If we fail to act now, the Lottery Success Scholarship's reserve fund will be exhausted in less than five years. All the eligible students in New Mexico's high school graduating class of 2011 will have done their part, worked hard to complete high school, and kept their grades up and, in return, they will receive a broken promise.

That broken promise will take the form of raising eligibility requirements so that many deserving students will no longer qualify for the Lottery Success Scholarship, cutting the value of the scholarship, or some combination of both.

It is imperative, therefore, to amend the New Mexico Lottery Act now and create a floor for the Lottery Success Scholarships of no less than 30% of the lottery's revenues in order to make certain that the scholarships are sustainable. As such, this proposal would reinforce and make real the statu-

[illegible]

tory purpose of the Lottery Act to maximize revenues for scholarships.

The Lottery Success Scholarships demand accountability from students. The state must be accountable to them as well, ensuring that the college

Ultimately, this proposal presents our policymakers with a choice: should more of these lottery proceeds contributed by the citizens of New Mexico go to the state's deserving high school graduates or to out-of-state special interests like GTech?

Governor Bill Richardson, and legislators of both parties led by Senate Majority Leader Michael Sanchez, have made impressive strides in making a college education accessible and affordable to every New Mexico student who seeks one.

As Senator Michael Sanchez states, “We made a promise to the people of the state of New Mexico that the Lottery Scholarship was going to be available for their kids and we need to keep that promise.”

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