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# STATE POLICY & ECONOMIC DEVELOPMENT IN OKLAHOMA: 1994

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## PREFACE

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The approval of State Question 640 has altered the structure and processes of state finance. It requires that tax measures must go to a vote of the people if they fail to get a supermajority in both houses of the Oklahoma Legislature. The supermajority requirement sets Oklahoma apart from the many budget limitation policies recently established in many states. Six professors at the University of Oklahoma and Oklahoma State University began an analysis of the impact of the State Question 640 upon the processes of state finance nearly two years ago. The team's primary research interest has been on the longer-term implications for economic development.

This report, the first published from this longer-term study, is an analysis of several important issues in the fiscal 1995 budgeting. Taken together they characterize the emerging structural change to state finance. The research team's findings indicate that these developments are evidence of a longer-term pattern of state finance in Oklahoma, and in that regard, this pattern previews the state's revenue-expenditure future.

The project has been co-directed by Dr. Donald Murry, Professor of Economics at OU and Dr. Larkin Warner, Regents Professor at OSU. Other members of the research team are Dr. Robert Dauffenbach, Director of the Center for Economic and Management Research, OU, Dr. Mary Gade, Associate Professor of Economics, OSU, Dr. Alexander Holmes, Regents Professor of Economics, OU, and Dr. Kent Olson, Professor of Economics, OSU.

As in previous reports by Oklahoma 2000, Inc., the research team has determined the research direction and the topics selected for study. The views selected herein are those of the authors and should not be attributed to the officers and directors of Oklahoma 2000, Inc.

# CHAPTER I

## THE NEW STATE FINANCE ENVIRONMENT

State Question 640, adopted by a 57 percent majority of Oklahoma's voters on March 10, 1992, was an effort by the electorate to capture control of state level taxation. Simply stated, the measure requires that the voters review all state tax changes in the next general election if a "revenue bill" passes either house of the legislature with less than a three-quarters majority.

The limitations imposed by State Question 640, coupled with the restraining influence of Oklahoma's budget balancing amendment, will unquestionably alter the revenue and expenditure structure of Oklahoma state government. A new pattern of funding state government services is emerging and, while its outlines are not yet fully apparent, certain implications are becoming clear. Careful observation can help Oklahomans gain insight into what their new-found power to control taxes will mean for the future of state government finance.

This special report addresses some of the near-term effects of State Question 640's passage—effects that are likely to be important issues in the current and next fiscal years' budgeting process. It is part of a more extensive study of the long-term impact of State Question 640 upon state revenues and budgeting in Oklahoma.

### Budget Implications

To put the revenue implications of State Question 640 in perspective, the authors investigated the constitutional amendment in the context of Oklahoma's taxing and budgeting history, compared the tax limitation measure with those in other states, and surveyed current attitudes of Oklahoma voters.

Historically, Oklahomans have limited the spending authority of state officials, and, in that regard, State Question 640 is not an anomaly. Limits upon appropriations or taxes in other state governments are also not uncommon, but bypassing those limits is easier in most states than in Oklahoma. In comparison to tax limitation measures in other states, State Question 640 stands out because it contains the "supermajority" provision. The requirement that a tax proposal be

approved by a 75 percent vote in each house of the legislature or be referred to the electorate for a decision means that future tax measures in Oklahoma are likely to go to a vote of the people. Even if the voters would approve a tax increase that fails to achieve the necessary legislative majority, most new tax measures will have to wait to get on a ballot at a subsequent general election. This built-in delay in getting revenue items to the electorate compels the Governor and the legislature to structure any given year's budget by taking into account only the forecasted revenues from existing sources.

Using the current budget year to assess the impact of State Question 640 is illuminating. A budget shortfall existed in fiscal year 1994 and another is likely to occur for fiscal 1995. Although the economy is expanding and some important funding sources will surely increase, revenue forecasts suggest that new revenues will fail to keep pace with the expected growth in expenditures. The shortfall in 1994 was handled by using one-time funds from reserves; however, that potential is diminished for fiscal 1995. Consequently, the fiscal 1995 budget is likely to pose the first real test of government actions in the post-State Question 640 era. Already, this environment is stimulating proposals for expanding government services through mechanisms that bypass the state's revenue constraints. These proposals are the early manifestations of longer-term structural changes that will affect Oklahoma's financial future.

### Survey Results

This study included a telephone survey of Oklahoma voter attitudes toward governmental finance. The survey was undertaken by the University of Oklahoma's Center for Economic and Management Research in September and October of 1993. The survey results indicate that the state's voters are strongly opposed to tax increases, prefer expenditure reductions to tax increases, support balanced government budgets, and have a general distrust of politicians and government officials.

The respondents, however, were not uniformly and consistently anti-government. Views of taxation are negative; for example, 82 percent oppose

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raising the personal income tax and 73 percent oppose raising the sales tax to meet state needs. However, there are also strong demands for key state government services in the fields of education, health care, public welfare, and services related to the quality of life. Respondents demonstrated a greater willingness to increase taxes for specific purposes than if the proceeds are for government in general. This suggests some degree of acceptance of earmarked taxes. Moreover, the survey suggested that Oklahomans tend to accept use taxes linked to particular services.

## Revenues

Given the combined effects of the budget balancing amendment and State Question 640, Oklahoma is moving toward alternative forms of financing state government services. This study specifically examined three types of funding alternatives: a state lottery, an increase in higher education tuition, and turnpike construction.

The current lottery proposal would provide a new source of revenue for Oklahoma's state government, although there are indications that voter approval would simply signal a desire to "play the game," rather than exhibit willingness to fund another tax source. Lottery revenues are likely to be earmarked for specific services but, under the circumstances, that may not be a factor in voter approval. In any event, approval of a lottery would establish only a relatively minor new revenue source.

The other two major proposals for revenue investigated here are increases in fees for service. One is the current proposal for a tuition increase for higher education; the other is the proposal to expand the state highway system through new turnpike construction. Although each is a special case, together these plans suggest a pattern. It is difficult to enhance the funding sources that are capable of producing the most revenue; thus, alternative proposals are likely to target smaller revenue sources or services that generate their own revenues.

## Expenditure Impacts

The current budgeting mechanism in Oklahoma becomes an effective limit when there is a shortfall in revenues relative to the growth in expenditures

for existing services. That raises the question of the prospects for increases in expenditures. In this context, the research team investigated three areas of hard-to-avoid pressures upon the state budget—education, criminal justice, and health care.

An increase in elementary and secondary education funding for fiscal 1995 was mandated by earlier legislation—House Bill 1017. In addition, enrollments have exceeded levels forecasted at the time of the education reform measure's passage and, if these enrollment gains are included in the calculation of costs to fund House Bill 1017 in fiscal 1995, common education will claim a large share of growth in state appropriations. The Oklahoma State Regents for Higher Education are requesting an even larger share of new revenues than the common schools as they face the task of developing a new budget that builds on a fiscal 1994 budget funded partially with one-time funds.

Concerns about crime and violence are given a high priority in Oklahoma by the public and by political leaders. Responding to these concerns will mean additional allocations to the criminal justice system and could lead to some new funding methods, such as the proposed Criminal Justice Trust Authority.

Health care is a major national issue that will affect Oklahoma's budget during fiscal 1995. State government, which in 1993 spent at least \$1.9 billion on health related services, is an operator of hospitals, an insurer of employees, and a provider of health services. These functions will be affected by the tax limitation measure (as well as by national health care reform), but in ways that are as yet uncertain.

## Perspective

The combined effects of the budget balancing amendment and State Question 640 have altered the methods by which Oklahoma's state government performs its business. One can observe the adjustments already in the emerging revenue and expenditure issues of fiscal 1995. Proposals are being offered to expand programs that can generate revenues through fees-for-service. New concepts for raising revenue are being introduced. What is more important, these adjustments are probably not short-lived; they appear to be a preview of the future for funding state government in Oklahoma.

## CHAPTER II

### THE STATE BUDGETING CYCLE AND THE BALANCED BUDGET REQUIREMENT

Since 1941, Oklahoma's constitution has required that every state budget be balanced, both at the time it is passed into law and month-to-month throughout the fiscal year. There is no provision for exceptions. No state checks may be written unless funds are currently on hand to cover the expenditures. If revenues do not come into the state treasury at the projected level, the constitution prescribes the method by which appropriations are to be cut in order to achieve a balance.

Oklahoma's state budget cycle follows an orderly and rigid process each year. Its foundation is the constitutional balanced budget requirement first put in place in 1941 and amended in 1968, 1975, and 1985.

The current balanced budget requirement provides for two points at which the estimated revenues available for appropriation are certified. The preliminary certification by the State Board of Equalization (composed of the Governor, Lieutenant Governor, State Auditor and Inspector, Attorney General, State Superintendent of Public Instruction, State Treasurer, and president of the State Board of Agriculture) occurs approximately at Christmas time. This arrangement assures that the Governor's budget recommendations, presented to the legislature on the first day of the session (the first Monday in February), are in balance. The final certification of revenues occurs about mid-February, and may be amended only if statutory changes in the tax laws are passed during the session. Figure II-1 presents the time line of Oklahoma's budget cycle.

The constitutional balanced budget requirement allows the legislature to appropriate only 95 percent of the revenue estimate certified for the next fiscal year, thus building in a margin for error in the estimates. If actual revenues received exceed the certified estimate, the difference—the so-called “5 percent money”—becomes available for appropriation from the Cash Flow Reserve Fund in the next fiscal year.

An important feature of the current balanced budget requirement is the creation of the “rainy day fund,” formally titled the Constitutional Reserve Fund. Any and all funds received above 100 percent

of the certified estimate are deposited to this fund at the end of the fiscal year. In actuality, the Constitutional Reserve Fund is composed of two parts: the Emergency Fund and the Budget Stabilization Fund. These funds are computed as one-half each of all monies in the Constitutional Reserve Fund at the end of the fiscal year.

The Emergency Fund may be accessed by the legislature with a three-quarters affirmative vote in both houses and the signature of the Governor without an emergency declaration of the Governor, or through a two-thirds affirmative vote in both houses and the Governor's signature upon a declaration of an emergency by the Governor. There are no provisions regarding what constitutes an emergency.

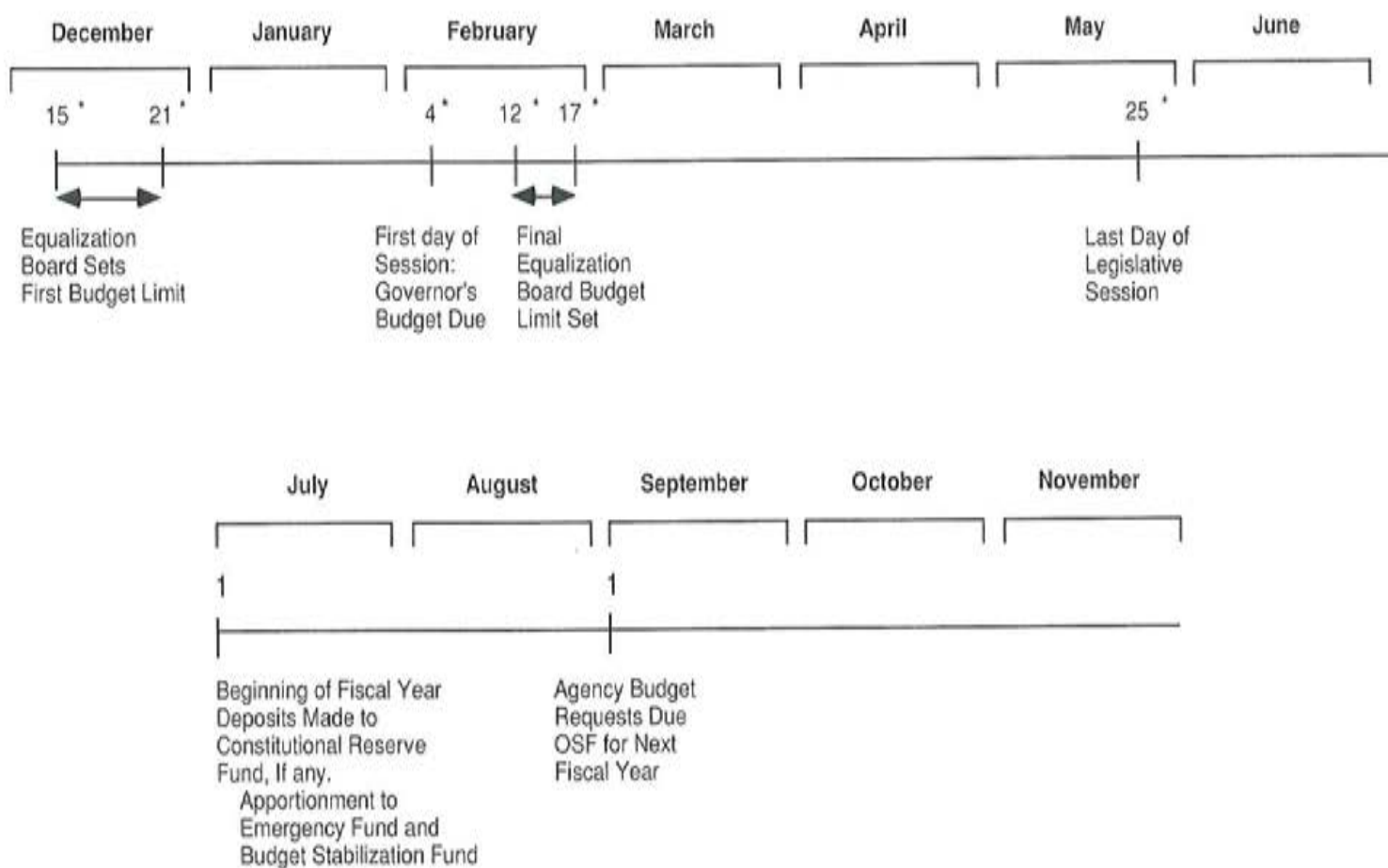
The Budget Stabilization Fund may be accessed only when the certified revenues for the next fiscal year fall below those of the current fiscal year. Under these circumstances, monies are automatically credited to the General Revenue Fund to the extent of the difference between the two levels of certification or the available funds in the Budget Stabilization Fund, whichever is smallest.

#### The History of the Constitutional Reserve Fund

Since the creation of the Constitutional Reserve Fund in 1985, there have been four deposits and six withdrawals (two in fiscal 1989) under the emergency declaration provisions. In the past three fiscal years, this so-called “rainy day fund” has been an important source to supplement state revenues.

The history of deposits and withdrawals and the current balance available for appropriation for fiscal year 1995 are presented in Table II-1. Some of the \$45.6 million available for appropriation from the Emergency Fund will be used in the development of the fiscal 1995 budget, and this money will be used for continuing operations of state government services, rather than one-time expenditures. This type of use is typical of recent years.

**FIGURE II-1**  
**Oklahoma's Budget Cycle**



\* Approximate dates, depending upon the date of the first Monday in February and last Friday in May



State Question 640 changes the method by which the appropriations process will proceed. Balancing the budget with tax increases, no matter how small, is an unlikely option for state officials during the same session as a budget pinch, no matter how great the pinch. Because tax increases that do not receive a three-quarters vote in both houses must go to a vote of the people in the next *general* election, budgets now must be written for the next fiscal year, at least, on the assumption that no new taxes are available.

### Certified Funds for Fiscal Year 1995

On December 30, 1993, the State Board of Equalization made its preliminary certification of estimated funds for the 1995 fiscal year. In accordance with tradition, the Board also received an updated estimate of revenues for fiscal year 1994. While the December figure is not "the last word," there is usually little variation between the preliminary certification and the final certification made in February. All indicators point to another extremely tight budget for fiscal 1995.

On the surface, the comparison of the fiscal 1994 estimated revenues with the fiscal 1995 certification would not suggest a particularly difficult budget year. For the General Revenue Fund, there is a

projected growth of 2.7 percent. Estimates of the three major tax sources all indicate healthy growth: individual income taxes are expected to rise by 5.3 percent, sales taxes by 4.4 percent, and motor vehicle taxes by 7.2 percent. While gross production taxes on oil are estimated to take a steep decline in fiscal 1995, they are now almost a trivial part of the state budget, comprising only 2.4 percent of the General Revenue Fund. This decline is estimated to be nearly offset by an increase in the gross production tax on natural gas, which also represents a very small part of the General Revenue Fund—2.5 percent. From an economic perspective, using tax revenues as an indicator of economic activity, the Oklahoma economy has come through the national recession and is growing at a respectable rate in comparison to other states. Nevertheless, there are weaknesses in several sectors, most notably petroleum.

The reality of the state budget, however, is quite different. Difficulties become apparent when comparing the certified revenues available for appropriation during the next fiscal year with the actual level of funding for the current fiscal year. Table II-2 contrasts the budget situation as the 1994 session of the legislature begins to prepare the budget for fiscal year 1995 with circumstances at the beginning of the 1993 session as the 1994 budget was being written. These figures do not include the appropriation of restricted funds to the Department of Transportation or the School Land Commission.

TABLE II-1

#### Constitutional Reserve 'Rainy Day' Fund History (Millions)<sup>a</sup>

	FY-88	FY-89	FY-90	FY-91	FY-92	FY-93	FY-94
Deposits	\$77.99	\$100.81	\$73.93	\$75.12	\$0	\$0	\$0 <sup>c</sup>
Appropriated	\$0	\$26	\$75	\$30	\$61.88	\$43.87	NA
Balance <sup>b</sup>	\$0	\$152.80	\$151.73	\$196.86	\$135.01	\$91.14	NA
Revenues collected as a percentage of the certified estimate	103.36%	104.03%	102.78%	102.50%	98.40%	96.80%	98% <sup>c</sup>

<sup>a</sup>For Deposits, fiscal year is the year during which the revenue accrued

<sup>b</sup>Only one-half of the balance is deposited in the Emergency Fund and is available for appropriation

<sup>c</sup>Estimated as of December 30, 1993 State Board of Equalization meeting

Source: Adapted from *Oklahoma Revenue*, Issue 93-11, Office of State Finance, June 29, 1993 and State Board of Equalization minutes, December 30, 1993.

TABLE II-2

**Comparison of Certified Revenue Estimates and Previous Year Appropriations<sup>a</sup>**  
(Millions)

FY-93 <sup>b</sup> Actual Appropriations	FY-94 Certified Available Funds	Variance	FY-94 <sup>b</sup> Actual Appropriations	FY-95 Certified Available Appropriations	Variance
\$3,411.0	\$3,278.8	(\$132.2) (3.8%)	\$3,379.0	\$3,371.0	(\$8.0) (0.2%)

<sup>a</sup>Excludes restricted use funds to the Department of Transportation and the School Land Commission

<sup>b</sup>Includes appropriations from the Cash Flow Reserve Fund and the Rainy Day Fund

Source: Adapted from *FY-95 General Revenue Forecast and FY-94 Update*, Presentation to the State Board of Equalization, December 30, 1993, Office of State Finance and *FY-94 General Revenue Forecast and FY-93 Update*, Presentation to the State Board of Equalization, December 22, 1992, Office of State Finance

Table II-2 reveals two very important features of the budgeting problem. First, the fiscal 1995 budget must be written with estimated revenues which are \$8 million below the fiscal 1994 spending levels, exclusive of nonappropriated fee revenue. By comparison, the fiscal 1994 budgeting process began with a deficit of \$132.2 million in terms of money available for appropriation relative to the previous year's spending level. The Oklahoma economy is expected, therefore, to grow nearly enough to offset the use of one-time money in the fiscal 1994 budget, but not enough to provide any revenue for program expansion or to cover increasing costs of government services.

As noted in Table II-2, the fiscal 1994 budget was written with \$100.2 million *more* than was certified as available for appropriation. This was possible only through the extensive use of one-time money drawn primarily from the Cash Flow Reserve Fund and the Constitutional Reserve Fund. A total of \$71.4 million was drawn from these sources to finance/underwrite the fiscal 1994 budget. In writing the fiscal 1995 budget, only \$45.6 million is available from the "rainy day fund" for "emergency" appropriations; and perhaps another \$30 million is available from the Cash Flow Reserve Fund. If the remaining one-time cash reserves are used to finance the fiscal 1995 budget, then the state's economy must continue to grow enough to make up the one-time money.

Not present in Table II-2, but just as critical to the budgeting process, is the condition of the State Transportation Fund. This fund is composed of motor fuel taxes earmarked for road construction and maintenance. The certified estimate for fiscal 1995

indicates a decline of 6.6 percent in available revenues for this function of government. This decline is in addition to a 13.7 percent drop in revenues to the Transportation Fund from fiscal 1993 to fiscal 1994.

From fiscal 1988 to date, the Oklahoma Department of Transportation (ODOT) has been funded virtually exclusively from these earmarked revenues and the federal matching funds these state tax dollars are able to draw. Previously, ODOT received extensive appropriations from the General Revenue Fund so that no federal matching dollars would be lost. The decline in the Transportation Fund will no doubt generate pressure to tap the General Revenue Fund and funds earmarked for county road programs in order to finance state highway construction and maintenance. The development of more direct fee-funded highways, such as turnpikes, may also receive closer scrutiny as the ability of ODOT to meet service demands declines. Revenues from turnpike tolls have been an historically important source to supplement the tax revenues which support vital highway transportation links across the state.

### **The Growth of Fees to Fund State Government**

A number of state agencies have the ability to finance their operations with nonappropriated funds, most notably fees. The largest users of fees are the state's colleges and universities. Student tuition and fees represent 40 percent of all fee revenue to the state, but cover only about 23 percent of the cost of education. During the past few fiscal years, growth

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in appropriations to higher education has been unusually low, but this has been partially offset by increases in student fees. From fiscal 1990 through fiscal 1993, college and university fees and tuition grew from \$130.9 million to \$159.4 million—an increase of 21.7 percent—while appropriations remained virtually constant.

The reliance upon increases in fees to fund government activities has also occurred in other agencies. The Department of Veterans Affairs, for example, increased fee revenue by 49 percent for medical services in long-term care facilities during the same fiscal 1990-93 period.

Overall, fee revenue to the state rose from \$315.9 million to \$394.9 million from fiscal 1990 through fiscal 1993, an increase of 25 percent. Just over one-third of this growth can be attributed to higher fees and tuition at the state's colleges and universities. Changes in fees for government services do not require a vote of the people, as do tax increases under the provisions of State Question 640.

It is reasonable to expect further reliance on fees to fund state government services. Among the likely places for future fee increases are the Corporation Commission, to fund regulatory activities; at insti-

tutions of higher education; at the Department of Environmental Quality; and at various agencies that provide services to local units of government, such as the Water Resources Board, the Department of Transportation, the Conservation Commission, the Oklahoma Highway Patrol, and the Oklahoma State Bureau of Investigation. Increased fees for services provided to local units of government will place greater stress on local government budgets.

## References

- Office of State Finance, *Fiscal Year 1994 General Revenue Forecast and Fiscal Year 1993 Update*, Presentation to the State Board of Equalization, December 22, 1992.
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- Office of State Finance, *Oklahoma Revenue*, Issue 93-11, June 29, 1993.
- Office of State Finance, *Schedule of Fees*, various years.

## CHAPTER III

# ATTITUDES OF OKLAHOMANS TOWARD STATE AND LOCAL TAXES AND EXPENDITURES

The objective of this study is to examine the likely future course of public expenditure and revenue pressures in Oklahoma. To obtain greater insight into the probable future, the research team surveyed the Oklahoma populace.

State Question 640 now virtually mandates a “survey,” of the grand sort, of voter attitudes for practically every tax increase, with the will of the majority ruling. This ominous fact is the primary impetus for an in-depth exploration of citizen attitudes on public finance issues.

There are other reasons, however, for conducting survey research on citizen attitudes. Among them is a need to better understand the attitudes of Oklahomans in regard to the public sector. There is a need, as well, to gauge the intensity of reaction to possible future courses of action: just how strongly is the electorate opposed to new revenue sources? Survey research is also a useful tool for assessing the extent of citizen knowledge of public sector issues. Voters, it could be argued, have taken on new responsibilities with passage of State Question 640, greatly increasing their need for informed judgments.

Surveys are useful, too, in exploring general levels of satisfaction of Oklahoma citizens with state and local government. Is widespread dissatisfaction with the services government provides a root cause of discontent? Finally, there is a need to “get inside the heads” of Oklahoma taxpayers to see what they want from government and to check for inconsistencies and conflicts in goals. Fiscal constraints are such, at present, that government may be called on for more than it can hope to provide.

Following careful review of the literature on the design of state and local government surveys and a review of hundreds of questions asked in previous efforts, we defined five types of information needs: (1) national benchmarks; (2) perceptions of value and knowledge indicators; (3) attitudes toward specific government programs; (4) attitudes toward sources of revenue; and (5) the citizen psyche—an exploration of voter values, beliefs, and attitudes. The survey was conducted over the period September 9 through October 5, 1993. Responses were obtained randomly from 1,091 adults, providing an error rate of slightly better than plus or minus three

percentage points. The following sections present the survey’s major findings.

### National Norms

The researchers took two questions directly from a national survey administered by the Advisory Commission on Intergovernmental Relations (ACIR). The comparisons given below contrast Oklahoma respondents’ answers to results of the 1991 ACIR survey.

- The Oklahoma citizen regards local government much more favorably relative to national benchmarks (44 percent versus 31 percent) as the level of government from which the most is gained for the money. The federal and state governments are regarded about equally favorably in comparison with national norms. A much lower proportion of Oklahoma respondents than national respondents said they didn’t know or provided no definite answer (11 percent versus 22 percent).
- A much larger percentage of Oklahomans regard the federal income tax as the least-fair tax compared to other forms of taxation (38 percent versus 26 percent in the national poll). The property tax ranks second among Oklahomans, with 26 percent of respondents stating that it is the least-fair tax. The state income tax and the state sales tax scored similarly in relation to national norms.

### Perception of Value and Knowledge Indicators

- Several questions addressed voter perceptions regarding the value of state and local government and awareness of state revenue issues. The results were mixed. Oklahomans strongly believe that they do not receive good value from state and local government. More than three-fifths responded negatively to the statement

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“Oklahomans generally receive good value for the state and local tax dollars they pay.” Only about one-third said that they agreed with this statement and only 2 percent said that they strongly agreed.

- Respondents appeared somewhat knowledgeable about comparative reliance on various forms of taxation at the state and local level. Oklahoma’s state income and sales taxes are generally higher than those in many other states, and about two-fifths responded that this is so. In addition, 31 percent responded correctly that property taxes are lower. Those responding that they did not know ranged from 10 to 20 percent for these questions.
- Respondents were also asked whether Oklahoma has a state constitution. Sixty-two percent said that it did; only 6 percent said that it did not. The remaining 32 percent said that they did not know. The percentage who know that their state has a constitution may seem astonishingly low, but Oklahomans actually compare quite favorably with a national norm. In the ACIR survey, 52 percent responded affirmatively; 11 percent negatively; and 37 percent did not know.

### Attitudes Toward Specific Programs

Because voters are likely to face decisions regarding specific services, the survey attempted to distinguish among attitudes about various services. For example, the survey asked respondents to “suppose government funding is limited and a decision must be made whether to reduce services or raise taxes. Would you favor or oppose additional taxes for the purpose of supporting the following activities?” For various categories of public spending, there were some notable differences. The responses were as follows:

- Education: strong support was shown. For education in kindergarten through grade twelve, 73 percent favored additional taxes to provide support. For higher education, 63 percent indicated favor.
- Social problems: strong to moderate support was shown. In terms of health care for the elderly, handicapped, and poor, 74 percent would favor additional taxes. For drug educa-

tion and treatment, 60 percent favored; for health and social services for children, 56 percent favored higher taxes over reduced services. For assistance for the poor and homeless, 56 percent favored, while in the area of crime prevention and prison facilities, 58 percent would choose additional taxes rather than reduce services.

- Physical infrastructure: varying support was recorded. Sixty-one percent favored more support for maintenance of roads and bridges. Yet, 71 percent *opposed* higher taxes for new highway construction. Sixty-two percent would support higher taxes for water and sewage treatment, while 66 percent *opposed* increased taxation for public transportation.
- Other activities also met with varying support. Additional taxes for parks and recreation facilities, wildlife preserves, and tourism were *opposed* by 61 percent of survey respondents. For environmental regulation and cleanup, 50 percent *opposed*. For economic development, including location incentives, 49 percent *opposed*.

These results indicate moderately strong support for government programs, especially in view of the question’s wording, which asked whether the citizen would prefer more taxes in support of these functions instead of service reductions. Many of the unfavorable responses bordered on the 50 percent mark. Very few programs or services were strongly opposed.

### Attitudes Toward Sources of Revenue

In probing attitudes toward sources of revenue, the survey asked respondents: “If the state needed additional money for a program that voters have approved, would you favor or oppose increases in each of the following revenue sources?” The ordering of the responses by the percentage opposing increases in the corresponding source of revenue is shown in Table III-1.

Only two tax sources—on games such as bingo and on tobacco and liquor—were favored by a majority of respondents. Sale of state assets had the blessing of slightly more than one-half the respondents, and fees to users of government services scored near the 50 percent mark.

**TABLE III-1**  
**Rank Ordering of Various Revenue Sources**  
**by Percent Opposed to Increases**

Taxes on utilities	86%
Taxes on residential property	83%
State personal income tax	82%
Taxes on motor vehicles	79%
State sales tax rate increases	73%
Gasoline tax	71%
Sales taxes on services	71%
Oil and gas production taxes	69%
Taxes on businesses and corporations	55%
Fees to users of government services	45%
Sale of state assets	40%
Tobacco and liquor taxes	33%
Taxes on games such as bingo	19%

With the exception of these minor sources of revenue, however, survey respondents decisively indicated opposition to tax increases. Results even reveal opposition to expansion of the sales tax base to services. Services constitute a growing proportion of household consumption expenditures, and thus, a growing proportion of consumption expenditures escapes sales taxation.

### The Citizen Psyche

As noted, the researchers asked a series of questions of respondents in order to assess citizen thinking on a variety of issues related to state and local government taxes and expenditures. Sixteen questions were submitted to each respondent and, while the ordering of the questions was random, the questions fell naturally into five categories: (1) state and

local intergovernmental relations, (2) the role of government, (3) tax burdens on higher-income families and corporations, (4) attitudes toward politicians and government workers, and (5) other tax and budget issues. For each question, respondents were asked whether they strongly agreed, agreed, disagreed, strongly disagreed, or did not know or have an opinion. An example of detailed responses to the *other tax and budget issues* questions is provided in Table III-2.

### State and Local Intergovernmental Relations

In the questions on intergovernmental relations, 85 percent of the respondents agreed or strongly agreed that the state should be involved in funding and quality assurance of local public education. This result is in contrast to a virtually equal plurality (86 percent) who believe that state government provides too much support to local government functions. Almost 90 percent believe that local governments should be free to set their own sales and property tax rates, presumably free from any encumbrances on that process from the state government.

### Role of Government

The tabulations on questions related to the role of government reveal strong and consistent preference by Oklahomans for an activist role for state government. For example, one-half of the respondents agreed or strongly agreed that state government should aggressively seek to improve the quality of life, the environment, educational attainments, and the economic vitality of Oklahoma. Only 31 percent disagreed or strongly disagreed.

**TABLE III-2**  
**Detailed Survey Results**  
**Other Tax and Budget Issues**  
**(in percent)**

Other Tax and Budget Issues	Strongly Agree	Agree	Disagree	Strongly Disagree	Don't Know
Taxes should not be increased unless linked to specific government programs.	27	63	7	1	3
Balancing the state budget is a first priority, even if we must reduce services.	28	47	18	4	3
Revenue problems in Oklahoma government are matters of serious concern.	6	37	30	2	26

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In a similar vein, respondents believe that government should not be limited to provision of just basic services, defined in the questionnaire as education, transportation, and crime prevention. The desire for an activist role extends to health care. Fifty-eight percent think that state government should provide a minimum level of health insurance for all citizens. In addition, respondents indicated that the state should provide financial incentives for businesses to locate in Oklahoma. The state also has a responsibility to provide financial assistance to families in need, said 71 percent of those surveyed, but that support is highly constrained: almost 93 percent of the respondents stated that people are on public welfare much too long.

### **Tax Burdens**

Respondents were split on the question of whether higher-income families pay their fair share of state taxes; 48 percent agreed and 44 percent disagreed. Fifty-seven percent believe that corporations and businesses are paying their fair share.

### **Attitudes Toward Politicians and Government Workers**

Respondents apparently do not hold politicians in high esteem, according to their responses to the statement "Politicians are, for the most part, in public life for their own financial gain." Over three-quarters of respondents agreed with this statement. Government workers were perceived by 88 percent of those surveyed as having done better in job security and pay increases than workers in the private sector.

### **Other Tax and Budget Issues**

Almost 90 percent of respondents strongly believe that taxes should not be raised unless they are linked to specific government programs. Furthermore, three-fourths of the sample favored balancing the state budget as a first priority, even if it means that services must be reduced. Differences were found among Oklahomans on whether revenue problems are matters of serious concern in the state. A slightly higher percentage of the sample agreed than disagreed, but of special note is the one-fourth of respondents who did not know or have an opinion on this issue.

## **Conclusions**

State Question 640 gives the voter new power over state taxes. These survey results indicate that the tax sources preferred by Oklahomans are those that are unlikely to yield significantly higher revenues. Opposition is uniform and strong across the full spectrum of major tax sources.

Problems of state and local finance are likely to be made more difficult by the high expectations that citizens have of government. Citizens apparently want more education, better health care, more public welfare, a higher quality of life, a cleaner environment, improved physical infrastructure, and a myriad of other government programs. However, these wants will certainly clash with unwillingness to pay for programs. Indeed, the survey results show that the demand for public services bears little or no relation to willingness to pay.

Oklahomans are divided when it comes to locally provided government services. Local government is viewed as the level of government offering the most value, and citizens want to have control over taxes at the local level. However, there is strong opposition to relying more heavily on the property tax—a principal source of local revenue. Only one in seven Oklahomans favors higher property taxes as a means of financing approved programs, in spite of the fact that citizens know that this source is underrepresented as a source of revenue in Oklahoma in comparison to other states.

Oklahoma citizens want state government involved in local education, yet a high proportion believes that state government provides too much support for local government functions. Oklahomans believe that government should provide financial assistance to the poor, but nearly unanimously agree that people are on welfare much too long. These views suggest either that poverty is viewed as a transitional phase, rather than a permanent problem, or perhaps that the respondents believe that the poor can do more to help themselves after they have received a boost from the state.

Although the survey results show that the Oklahoma voter is not likely to favor significant tax increases in a State Question 640 election, they also show that voter preferences for services are inconsistent with this rigidity. Perhaps the Oklahoma voters have not yet reconciled the inherent conflict between tax rigidity and its implication for levels of state services.

## CHAPTER IV

### PROSPECTS FOR STATE EXPENDITURES

The 1994 session of the Oklahoma legislature will present lawmakers with an all-too-familiar difficulty: a probable shortage of new funds available for appropriation for fiscal year 1995 relative to demands for increased government support. As indicated earlier in this report, there will be some growth in available funds, especially if lawmakers summon the political will to tap the Constitutional Reserve Fund and to use the revenues that will accumulate during fiscal year 1994 in the Cash Flow Reserve Fund.

It seems unlikely, however, that available funds will grow enough to meet all of the demands the legislature is likely to face. The State Superintendent of Public Instruction has already staked a claim for \$81 million in new money from the General Revenue Fund to cover the cost of the fifth year of House Bill 1017's reforms. The Oklahoma State Regents for Higher Education have requested nearly \$88 million in additional funds to meet the needs of the state's colleges and universities. Some \$35-40 million will probably be needed to meet the increased costs of Medicaid. The state will likely have to pay \$36 million to federal retirees to replace taxes that allegedly were levied on them illegally in the past, and there is strong bipartisan support for new programs in corrections and juvenile justice.

The state's General Revenue, Cash Flow Reserve, and Constitutional Reserve Funds together cannot fund all of these needs, let alone the additional requests still to be articulated by other state agencies. Hence, efforts may be launched to tap revenue sources not subject to the limitations imposed by State Question 640, including turnpikes, a lottery, a tuition increase, and bond issues for new prison facilities (repaid, perhaps, from lottery receipts). There are even some signs of direct challenges to State Question 640's limits, in the form of a repeal of the state income tax exemption for retired public employees and an organized campaign for a tax hike for higher education modeled after House Bill 1017.

Proposals for a lottery, a tuition increase, and fees for new turnpike projects were examined in some detail in Chapter V, because they appear to be the most likely candidates for nontax revenue in-

creases in the coming year. This chapter explores the demands for new expenditures faced by the legislature in the areas of elementary and secondary education, higher education, corrections, juvenile justice, and health care.

#### Elementary and Secondary Education

The \$81 million requested to finance the fifth year of House Bill 1017's initiatives represents a significant increase over the amount many people thought would be required.<sup>1</sup> As such, it deserves a closer look.

House Bill 1017, the Education Reform Act, was passed by the legislature in 1990. In fiscal year 1990, common schools received \$882 million in state appropriated funds. At the time of passage, the costs of this legislation's many provisions were projected to reach \$597 million per year by fiscal year 1995.<sup>2</sup> This projection was scaled down to \$574 million in July, 1991.<sup>3</sup> The sum of the latter projection and the level of appropriations in fiscal year 1990, or \$1,456 million, is one benchmark for the appropriations promised to common schools in fiscal year 1995 by the passage of House Bill 1017.

Common schools will receive \$1,364 million in state appropriations in fiscal year 1994—\$92 million less than the amount apparently promised for fiscal year 1995 by House Bill 1017. In this sense, then, the legislature still "owes" the common schools all that is being requested for fiscal year 1995.

There is an alternative way, however, to view the situation: namely, how does the amount being requested compare to the sum that was *mandated* by House Bill 1017 for fiscal year 1995? The 1991 revised projections indicate that the legislature would need to appropriate about \$26 million in fiscal year 1995 to meet that year's obligations mandated in House Bill 1017. Approximately \$17 million may be needed for money that was supposed to be, but wasn't, appropriated in fiscal year 1994 to cover the costs of the extended school year and healthy living initiatives. These obligations together amount to only \$43 million of the \$82 million request.



The extra amount requested has been defended on the grounds that school enrollments have grown much more than expected when House Bill 1017 was passed. Projections likely to have been available at that time indicate that enrollment in kindergarten through grade twelve could have been expected to increase by 13,000 students between the 1990 and 1995 school years.<sup>4</sup> Presumably, enrollment has already grown by over 25,000. There is probably little basis for doubting this claim, because a 12,000 student error on a base of roughly 600,000 students seems well within the bounds of what could be attributed to inability to accurately forecast the growth in enrollment due to migration.

An *unexpected* increase in enrollment would cost the same as an *expected* increase in enrollment of the same size. Oklahoma schools spent almost \$4,000 per student in fiscal year 1992, nearly \$2,400 of which came from state appropriations. The state's tab for the unexpected 12,000 students, therefore, is around \$29 million.

Whether House Bill 1017 *mandates* that the state pick up these unexpected costs may be technically debatable, but paying for them is probably within both the spirit and the intent of House Bill 1017. Given this interpretation, the Department of Education can establish a need for \$72 million of the \$82 million at issue. An extra 2,500 students in 1995 could account for the remainder.

According to the latest available projections of the National Center for Education Statistics, however, the number of students in Oklahoma in grades kindergarten through twelve will start dropping in 1995, and continue falling at least until 2002.<sup>5</sup> The average annual rate of decline over this period is projected to be about 2 percent, or approximately 12,000 students. If this projection is accurate, the \$10 million unaccounted for above may be difficult to defend—at least on the basis of expected enrollment growth. In fact, some of the money spent on enrollment increases to date may no longer be defensible on that basis. A turning point in enrollment growth may or may not occur in 1995, but the matter seems to deserve close study by the legislature and the Department of Education.

### Higher Education

Oklahoma's public colleges and universities are slated to receive \$556 million in appropriated funds in fiscal year 1994, \$21 million of it in the form of one-time appropriations from reserve funds. The total is

\$19 million less than the \$575 million appropriated in fiscal year 1993.

The State Regents are asking the legislature to fund the \$21 million on a recurring basis, and to provide \$88 million in new funds.<sup>6</sup> Nineteen million dollars of the new funds would replace the money cut from appropriations in fiscal year 1994. According to the Regents, the fiscal year 1994 cut resulted in the deletion of nearly 700 course offerings, the elimination of almost 140 faculty positions, and budget cuts for student services.

The remaining \$69 million in new funds would be used for a variety of purposes. The Oklahoma Tuition Aid Grant Program would receive \$2.3 million, and \$9 million would be used for system development. Much of the remaining \$58 million would be used to fund an increase in faculty and staff compensation (wages, salaries, and fringe benefits), and new faculty positions.

TABLE IV-1

Educational and General Expenditures, by Object,  
Oklahoma Public Colleges and Universities  
Fiscal 1980 and 1990  
(Millions)

Object	1980		1990	
	Expend	Percent	Expend	Percent
Teaching Salaries	\$84.9	38.4	163.5	35.6
Other Prof Salaries	31.7	14.4	74.8	15.8
Nonprofit Salaries	34.4	15.6	65.8	13.9
Staff Benefits	17.6	7.9	65.5	13.2
Total Comp	168.6	76.3	369.6	78.5
Utilities	10.2	4.6	20.3	4.3
Supplies/Materials	9.8	4.4	14.5	3.0
Other	32.3	14.7	66.4	14.2
Total Expend	\$220.9	100.0	\$470.8	100.0

Source: Oklahoma State Regents for Higher Education, Current Operating Income and Expenditures, Fiscal Year 1979-80 and Fiscal Year 1989-90/

The Regents' emphasis on employee compensation is not surprising; colleges and universities are very labor-intensive enterprises. As indicated in Table IV-1, employee compensation accounted for 78.5 percent of total educational and general expenditures for Oklahoma's 25 public colleges and universities in fiscal 1990. By way of contrast, employee compensation was only 59.7 percent of the total cost of producing national output in 1990. Table IV-1 also shows that employee compensation accounted for nearly the same percent of expenditures 10 years earlier.

Table IV-2 contains the latest generally available information on total compensation paid college and university faculty in Oklahoma relative to compensation paid by the State Regents' peer institutions. The peer institutions serve as the Regents' benchmarks for judging resource adequacy and institutional quality. The research universities in Oklahoma are Oklahoma State University and the University of Oklahoma; their peers consist of the other Big Eight universities and the Big Ten universities, with the exceptions of Northwestern and Penn State. There are ten universities in the comprehensive four-year category in Oklahoma—the six regional universities and Cameron, Langston, Panhandle, and the University of Sciences and Arts of Oklahoma. Their peers consist of forty-nine institutions in seventeen states. Oklahoma has fourteen public two-year colleges, with 136 peer institutions in seventeen states.

TABLE IV-2

**Average Compensation  
of College and University Faculty,  
Oklahoma Institutions and Peer Institutions, 1992-93**

Category	Peer Institutions	OK Institutions
Research Univ.	\$65,100	\$56,200
Comprehensive 4-Yr	47,600	43,600
Two-Year College	43,100	38,400

Source: "Treading Water: The Annual Report of the Economic Status of the Profession, 1992-93," *Academe*, March-April, 1993, 8-88.

Notes: This survey contains data on both of Oklahoma's public Research Universities, on 8 of Oklahoma's 10 Comprehensive 4-Year public Universities (University of Central Oklahoma and Langston University not included), and on all 13 of Oklahoma's 2-Year public Colleges. The survey provides information on all 15 of the Regent's peer institutions in the Research University category, on 48 of the 49 peer institutions in the Comprehensive 4-Year category, and on 64 of the 136 institutions in the 2-Year College category.

The data in Table IV-2 indicate that faculty compensation in Oklahoma's public colleges and universities was lower than compensation paid in the Regent's peer institutions in 1992-93. Given the cut in appropriations to higher education for the 1993-94 school year, Oklahoma schools may have fallen even further behind their peers than these data indicate. Based on these data alone, however, it would have taken average increases in compensation of 16 percent, 9 percent, and 12 percent to come up to the peer averages in the research university, four-year comprehensive university, and two-year college categories, respectively. The Regents' request for a salary increase and additional funds to cover mandated cost increases for fringe benefits represent an 8-9 percent increase in compensation.

The Regents have also requested funds for 204 new faculty positions in 1994-95. One way to put this request in perspective is to examine what has happened to the ratio of full-time-equivalent (FTE) students to full-time-equivalent faculty in the state's colleges and universities. In 1982-83, the state system of higher education had 104,315 FTE students taught by 4,114 FTE faculty, or 25.4 students per faculty member. In 1992-93, the state system had approximately 127,000 FTE students and 4,150 FTE faculty, or about 30.6 FTE students per faculty member. It would have taken an additional 850 faculty members in 1992-93 to achieve the 1982-83 ratio of students to faculty. The number required to achieve this ratio in 1994-95 may be somewhat higher, given the positions cut in 1993-94.

## Corrections and Juvenile Justice

Crime and violence have prompted public outcry throughout the United States. In Oklahoma, respondents to recent public opinion polls have tabbed crime as the number one issue facing the state. The Governor and state lawmakers from both political parties and both legislative bodies have indicated that concerns about crime and juvenile justice will be given high priority in the 1994 legislative session.

Ironically, the alarm over crime seems to be sounding just when the overall crime rate may be starting to fall. The U.S. Department of Justice reported in October, 1993, for example, that reported crimes fell in 1992 by 2 percent, the first decline since 1984.<sup>7</sup> Violent crime is up, however, and the violence is more and more attributable to youthful offenders. While arrests of adults for murder and other forms of homicide rose by 11 percent from 1982 to 1991, arrests of juveniles for these

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crimes rose by 93 percent. Violent crimes that have been highly publicized by the media have led state legislators to enact an array of mandatory and determinate sentencing laws that are packing juvenile detention centers and training schools around the country, even though most juveniles are in custody for nonviolent or property offenses.

Judging from the public and political reaction to increased violence and repeat offenses, there is strong support for locking up violent and repeat offenders and for keeping them locked up for longer periods of time. This attitude has been common in Oklahoma over the past decade for adult criminals, and it seems to be growing in regard to juvenile offenders, as well.

The outcome for adult criminals has been a greatly increased probability of incarceration. In 1980, Oklahoma locked up criminals at the rate of 134 per 100,000. By 1992, the incarceration rate had grown to 414 per 100,000, the fourth highest rate in the nation.<sup>8</sup> Some of this increase can be attributed to the adoption of "get tough" sentencing policies for violent crimes, but incarceration rates for nonviolent offenses have also increased.

One consequence of these policies has been extremely rapid growth in the corrections budget. Between 1980 and 1992, expenditures for corrections grew at an annual rate of 17 percent per year, the fastest rate of growth among the major state government agencies.

Juvenile offenders have been handled much differently from adults. Most of them have ended up in community-based treatment under the jurisdiction of the Department of Human Services, rather than in the custody of the Department of Corrections.

Even a casual reading of the state's major newspapers indicates that the legislature will be dealing with a large number of proposals for changing the systems of both adult and juvenile justice in Oklahoma. On the adult side, the emphasis is on stricter and more certain penalties for violent and repeat offenders. Especially popular are variations of the "three strikes and you're out" theme; that is, mandatory long-term sentences without parole for criminals with three or more offenses. Lawmakers are also attracted to "truth in sentencing" laws, the essence of which is to make incarceration more certain and early release less likely. Serious consideration will also be given to efforts to repeal the unpopular Prison Population Management Act, which allows for early release of criminals when prisons become too crowded.

Much of the proposed juvenile justice legislation also will deal with various means of providing stricter and more certain punishment. Among the numerous items on this agenda will be gun control for minors, provisions for waiving juvenile cases to adult court when an offense is considered serious, and less lenient release programs for juveniles in detention.

Should the legislature approve proposals such as these, the numbers of adults and juveniles incarcerated will increase. The state's prison and detention facilities are already overcrowded. So, too, are the county jails. Thus, new facilities would have to be constructed at both the state and county levels.

Some legislators and the Governor are calling for a complete overhaul of the juvenile justice system. This, they argue, requires the establishment of a new Department of Juvenile Justice.

There is little doubt that a full law-and-order agenda would be quite expensive; exactly how much would depend on the actions proposed. At this time, only preliminary estimates have been made. Among them are the claims that a Department of Juvenile Justice could require an initial budget of \$40 million, that as much as \$250 million may be needed to construct new state adult and juvenile facilities, and that \$50-60 million a year could be required to operate the new facilities. No estimates, however preliminary, have emerged on the amount of money needed to construct new county jail facilities, nor on the cost of the criminal justice resources that would be required in addition to those for corrections, per se.

Several suggestions have been made regarding funding sources for criminal justice. The Governor has proposed that the large construction items be paid for by the proceeds of a bond issue that could be repaid over time, at least partly out of the receipts of a state lottery. Another suggested source of repayment is state revenues from the excise tax on cigarettes. State Representative Michael Thornburgh has recommended the creation of a Criminal Justice Trust Authority to operate county jails, with the Authority given the right to ask county voters to approve up to a five-mill increase in property taxes to build, operate, and maintain jail facilities.

So far, there have been few suggestions to raise state taxes in order to fund new initiatives in corrections and criminal justice. This may seem surprising, given the strong demands by the public that something be done about crime, but it is probably testimony to the even stronger constraining influence of State Question 640 and the public attitude on taxes. In the environment created by this tax

limitation measure, state government is likely to turn increasingly to bond finance and the creation of trust authorities to accomplish what it might otherwise accomplish through tax increases.

It would be premature to try to evaluate the rash of proposals in adult and juvenile justice; all of them are, as yet, in preliminary form. However, it is possible, and perhaps instructive, to put the juvenile justice initiatives in context.

The apparently greater demand for punishment than for rehabilitation appears to be something of a throwback to the past. Oklahoma was sued in 1978 because children who didn't need secure settings were being locked up in institutions under questionable conditions. Eventually, state officials closed the institutions and resources were redirected toward community-based alternatives. Public sentiment in Oklahoma for this change may never have been strong, and all that the sentiment for punishment needed to become dominant once again was a mounting level of concern about crime. In any event, Oklahomans will likely be engaged in a spirited debate once again over the respective merits of juvenile rehabilitation and incarceration. The costs and benefits associated with each will be carefully identified, measured, and considered.

### Health Care

In the fall of 1993, President Clinton and his Domestic Policy Council unveiled recommendations for major changes in the nation's health care delivery system. Other strategies for health care reform have also been proposed. Whatever the relative merits of the various measures being examined by the U.S. Congress, it is likely that the federal government will soon make some changes in the health care system. Because Oklahoma state government is deeply involved in health care, it is likely that actions by the federal government will have significant impacts on the state's finances.

During fiscal year 1993, roughly one out of every four dollars of Oklahoma state government expenditures was related to health care. Table IV-3 lists selected expenditures on health-related activities amounting to nearly \$1.9 billion. This is a conservative measure because it does not include state employee health insurance, some health-related education programs, and some environmental expenditures directly related to health.

At an expenditure level of \$1.1 billion, Medicaid dominates state government health expenditures. During fiscal year 1993, Medicaid provided medical

benefits to 381,000 low-income persons in Oklahoma. Medicaid payments were for hospital care (34 percent); physicians' services (21 percent); intermediate care facilities, such as nursing homes (34 percent); in-home care (3 percent); and drugs (8 percent). About 70 percent of Oklahoma's Medicaid outlays are financed by reimbursements from the federal government. The program is referred to as an "entitlement" because benefits must be paid to those who meet eligibility criteria. During fiscal years 1987-93, the state's Medicaid outlays rose 110 percent, while total state outlays increased 44 percent.

The recent rapid relative growth of Medicaid expenditures cannot be sustained over long periods without forcing a major restructuring of state government expenditure priorities. In recognition of this, the 1993 session of the Oklahoma legislature removed the program from administration by the Department of Human Services and placed it in a

TABLE IV-3

Selected Expenditures Related to Health Care,  
Oklahoma State Government  
Fiscal 1993  
(Millions)

Program	Amount
Medicaid, Dept. of Human Services (DHS)	\$1,103.5
Oklahoma Medical Center (hospitals, DHS)	204.8
Department of Health	149.2
Department of Mental Health	147.9
Health Sciences Center, Univ. of Oklahoma	137.5
Department of Veterans Affairs (hospitals)	44.5
State Insurance Fund and Special Indemnity Fund (workers compensation)	40.0
DHS, Other Medical Services	24.9
Health Regulatory Agencies <sup>a</sup>	3.5
Other <sup>b</sup>	14.2
<b>Total</b>	<b>\$1,870.0</b>

<sup>a</sup>Regulatory boards controlling podiatrists, chiropractors, dentists, medical doctors (M.D.s), nursing home administrators, nurses, osteopaths, pharmacists, psychologists, optometrists, and speech pathology and audiology specialists.

<sup>b</sup>Includes the College of Osteopathic Medicine, Oklahoma State University; the J.D. McCarty Center; and the Workers Compensation Court.

Source: Office of State Finance, Schedule III, Fiscal 1993; Department of Human Services, *FY93 Annual Report*, p. 13.

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new agency, the Oklahoma Health Care Authority. A new approach to administration of Medicaid is to be implemented, in which the state will enter into contracts with health care providers for services to those eligible for Medicaid benefits. The payments will be based on a fixed amount per person. If the price of health care continues to grow at the same rate as in the past, even this new framework will not be able to keep the Medicaid program from absorbing ever-larger shares of the state budget.

The Medicaid program illustrates three of the major problems faced by the nation's health care system. First, Medicaid provides health benefits to those who, because of low incomes, would not otherwise have any health insurance. In fact, however, many persons under 65 (and, therefore, not on Medicare), have no health insurance and are not eligible for Medicaid. In Oklahoma, it is estimated that during the period 1989-91, 21 percent of the population under 65 had no health benefit coverage at all. Nationwide, 16 percent of that population group was without coverage.<sup>9</sup>

A second problem is the rapid rise of health care costs. Although the rate of inflation in health costs appears to be slowing down, in recent years it has not been unusual for health care costs to inflate twice as rapidly as the overall price level.

A third problem is labeled "cost-shifting." It is argued that Medicaid reimbursement rates are insufficient to cover the actual costs of providing services. Moreover, many without health insurance cannot pay their medical bills. Since someone has to pay, the typical response by health care providers has been to charge higher prices to those with insurance to offset inadequate or no payment from others. In recent years, health insurance organizations and employers have become increasingly resistant to cost shifting.

On September 22, 1993, President Clinton addressed a joint session of Congress to set forth his health care reform proposals. The proposals were based on six principles.<sup>10</sup>

1. Security: universal coverage with a comprehensive and irrevocable set of benefits;
2. Simplicity: a program that is easy to understand and administer;
3. Savings: greater efficiency and the reduction of health care inflation;
4. Choice: freedom for individuals to choose their doctors and health care plans;
5. Quality: provision of better information to

health care consumers about comparative qualities of care;

6. Responsibility: avoidance of health-impairing behavior and price consciousness in health care purchases.

The administration then submitted a very complicated 1,342-page Health Security Act proposing major changes in the nation's health care delivery system. At the heart of the proposals is an adaptation of a concept referred to as "managed competition." If the act is adopted, all employers will be required to provide health benefits. Each state will have one or more "health alliances" which will make arrangements for the purchase of health insurance or other medical care plans from a variety of health care providers. Premiums paid by employers will be channeled through the health alliance organization to the various approved providers. Employees can choose among approved programs, but the basic purchase of coverage must be through a health alliance serving a particular area. Very large employers can become their own health alliance. The theory underlying managed competition is that employers and workers will benefit from economies of scale in the purchase of coverage, and from the massive bargaining power which the alliances will exercise over the providers. It is likely that the health alliance for Oklahoma will be the above-mentioned Oklahoma Health Care Authority or a similar entity created by state government.

There have been negative reactions to the President's proposals—though many critics are not inclined to attack the six basic principles of reform and the need for some change. This leads to speculation that there will be federal health care measures adopted before the general elections in the fall of 1994. What this means for Oklahoma state government finance, of course, depends on the specifics.

The existence of a single health alliance agency would represent a remarkable change in the structure of state government. Nationally, the health care sector accounts for about 14 percent of Gross Domestic Product. If the ratio is about the same in Oklahoma, this sector stands at about \$10 billion in 1994. The current entire state budget of Oklahoma is about \$8 billion. It is not clear what share of the \$10 billion spending flow would be channeled through state government's health alliance, but the share is likely to be very large and could easily result in an alliance that is half the size of the current budget. It is difficult to imagine such an

activity without a significant and costly new administrative infrastructure in state government. Moreover, should a state health alliance run into financial difficulty, it is likely that state, rather than federal, financial resources will be required to honor health coverage commitments.

Although the Clinton administration anticipates that its health care program will save money, many observers are less sanguine. In Oklahoma, for example, it will be difficult to provide coverage at no net additional cost to the 500,000 or so persons currently not insured. Since the percent of Oklahomans without coverage is well above the national average, the increased coverage will be especially expensive in this state. If employer financing is mandated, the impact on small business costs in Oklahoma may be particularly burdensome.

Even conservative critics of the administration's plan appear to accept the principle of universal coverage. The Consumer Choice and Health Security Act offered by twenty-five senators relies on a system of insurance reforms and tax reforms, but they assert that it provides universal health care coverage.<sup>11</sup> The head of the conservative think-tank, The Cato Institute, supports expanding coverage for the poor by replacing Medicaid with a voucher system and raising the eligibility threshold to 150 percent of the poverty level.<sup>12</sup> Given the perilous status of the federal government's budget, it is likely that federal measures providing universal coverage will foster attempts to shift part of the burden to state governments.

As Table IV-3 indicates, state government in Oklahoma has a big involvement in hospitals. Cost containment measures may generate pressure to fund deficits at state hospitals through appropriation of general revenue funds. State government's outlays on its own employee health insurance could be decreased as a result of health care reforms which eliminate cost-shifting. It is even possible that health care reforms would reduce the costs of workers' compensation to the state, itself, and to employers throughout the state. Universal health care coverage might shrink the responsibilities of county health departments and reduce the need for state financial aid to those agencies. Currently, the state must use a good deal of its own-source revenues to finance mental health and substance abuse services—though some federal block grant monies are available. Depending on the treatment of mental health in the basic benefits package of a universal care system, the state might be relieved of some expenditure responsibilities in this area of treatment.

In early 1994, uncertainty is the most salient feature of the health care dialogue. It is obviously important for state government and for private employers to remain very much involved in the debate which is unfolding at the national level. This is a sector in which changes in policy are likely to be associated with major restructuring of budgets. Even the "incremental" changes called for by opponents of the national administration's proposals are likely to have large impacts.

## Footnotes

<sup>1</sup>"Unexpected Enrollment Drives Up 1017 Costs," *Stillwater NewsPress*, January 18, 1994, p. 14.

<sup>2</sup>Craig Knutson, et al., "House Bill 1017: The Education Reform Act of 1990," in *State Policy for Economic Development, 1991*, Oklahoma City: Oklahoma 2000, Inc., pp. 19-28.

<sup>3</sup>Joint Staff Information Sheets on Major Topics Addressed in House Bill 1017," August, 1991, Oklahoma City: Oklahoma State Legislature.

<sup>4</sup>U.S. Department of Education, *Projections of Education Statistics to 2001, An Update*, 1991, Washington, D.C.: U.S. Government Printing Office.

<sup>5</sup>U.S. Department of Education, *Projections of Education Statistics to 2002*, 1991, Washington, D.C.: U.S. Government Printing Office.

<sup>6</sup>Oklahoma State Regents for Higher Education, "State Regents Outline 1994-95 Budget Priorities, Approve Appropriations Request," *Leader*, 8(1), 1994, pp. 1-2.

<sup>7</sup>U.S. Department of Justice, *Crime in the United States, 1992*, Washington, D.C.: U.S. Government Printing Office.

<sup>8</sup>"Corrections Out of Control," *State Policy Reports*, 11(16), p. 4.

<sup>9</sup>Pamela Loprest and Michael Gates, *State-Level Data Book on Health Care Access and Financing*, Washington, D.C.: The Urban Institute, 1993, p. 12.

<sup>10</sup>The White House Domestic Policy Council, *Health Security, The President's Report to the American People*, Washington, D.C.: U.S. Government Printing Office, October, 1993, pp. 89-106.

<sup>11</sup>See Don Nickles, "Health Plan for Consumers," *Washington Post*, December 14, 1993, p. A25, and "Consumer Choice and Health Security Act, Fact Sheet," November 16, 1993.

<sup>12</sup>William A. Niskanen, speech before the Society of Government Economists, Washington, D.C., January 12, 1994.

## CHAPTER V

### RESPONDING TO TAX LIMITATIONS BY DEVELOPING NON-TAX REVENUES

The limitations imposed by State Question 640 and the attitudes of Oklahomans toward tax increases reduce the options for policymakers seeking to expand state-supplied services. These constraints will not, however, slow down the growing demand for government programs. Under these circumstances, Oklahomans are turning to various means of raising non-tax revenues. They have, in fact, already started to do so.

More than 200,000 registered voters have signed an initiative petition for a vote on a lottery, and polls indicate that it will have a good chance of passing if the state Supreme Court denies the horse racing industry's challenge to the lottery. The voters approved a \$350 million bond issue last year to meet some long-standing needs for physical capital, especially in higher education. The Governor has proposed a \$250 million bond issue to fund new correctional facilities for adult and juvenile offenders, part of which he proposes would be repaid with the state's take from a lottery. The Governor has pushed hard for construction of additional turnpikes under the Oklahoma Turnpike Authority. The legislature has established the Oklahoma Health Care Authority to restructure the state's Medicaid program. The people may get an opportunity in the future to vote on a proposed Criminal Justice Trust Authority, which would have the right to ask county voters to approve up to a five-mill increase in property taxes to build, operate, and maintain county jail facilities. And both the Governor and the State Regents for Higher Education have indicated that they will push for a tuition increase for the state's colleges and universities.

Some of these alternatives are in such an embryonic stage that an evaluation would be premature. This is not the case, however, for proposals which seek to establish a state lottery, increase higher education tuition, and expand the state's turnpike system.

#### An Oklahoma Lottery

Governor Walters and the Oklahoma BEST '93 organization are vigorously campaigning to create a

statewide lottery. Three forces add momentum to their effort: the lottery's popular appeal, the success of similar efforts in other states, and Oklahoma's need for revenue.

Currently, thirty-nine states and the District of Columbia have government-run lotteries.<sup>1</sup> People apparently want to play the game, and Oklahomans appear to be no exception. A recent poll in this state suggested that 61 percent of Oklahoma's population favors a lottery.<sup>2</sup> This is close to the 65 percent average level of support in the states where lotteries have been approved over the last thirty years.<sup>3</sup>

Texas, Kansas, Missouri, Colorado, and Louisiana operate state-run lotteries, and by doing so have created an environment of interstate competition for revenues. Many Oklahomans purportedly drive to Texas or Kansas to play the lotteries in those states. Some policymakers see this as a source of potential revenue for Oklahoma that is being lost to other states, and that could be claimed with an Oklahoma lottery.

The third force at work in favor of a lottery in Oklahoma is the state's need for revenue. One of the expected effects of the passage of State Question 640 is that Oklahoma policymakers will look for pressure valves to escape the constraints imposed by this measure. One type of pressure valve is new or existing non-tax revenue sources that are not subject to the limits. The lottery fits into this category. Seventeen of the twenty-two states that have adopted limits on total appropriations or taxes since 1976 conduct a state-run lottery. In light of the anti-tax sentiment surrounding the passage of State Question 640, Oklahoma may join this group.

Opposition to the lottery in the press tends to focus on the moral and ethical objections to gambling. With state-run lotteries, state governments are in the business of providing a new source of gambling. It is legalized gambling, but it is still gambling, and opponents argue that it is morally wrong. They argue that it also contributes to personal financial problems, leads to illegal gambling, and creates an aura of crime and corruption. The lottery campaign has attempted to defuse these objections by promising to earmark a majority of the revenues for education. In this way, a vote for the

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lottery becomes a vote for better schools. In Oklahoma, the need for better schools may garner support from groups who might otherwise be opposed to a state-run lottery.

Whatever their merits, the objections just noted are beyond our purview. Subsequent discussion is confined to the economic aspects of the lottery.

There are two economic perspectives on lotteries. One is that a lottery is essentially a service provided by government to satisfy consumer demand; i.e., a lottery is like a government-operated utility providing water or electricity. The second perspective is that a lottery is basically a source of taxes to the state. In this perspective, the profits from a state-run lottery essentially are an implicit tax that can be raised or lowered just like conventional taxes. In the utility perspective, the lottery is judged by how effectively it meets consumer demand. In the tax perspective, one judges the lottery as a revenue source by the same economic standards that one judges other taxes.

The primary point to be made from the utility perspective is that if Oklahoma voters approve a lottery, it meets the first test of consumer acceptance. It is then incumbent upon the government to provide the lottery service in a cost-effective manner.

There is extensive literature on whether lotteries are an effective means of raising tax revenues. Thus, the focus here is primarily on seven key points that are supported in the economics literature on lotteries.

One feature of a lottery that separates it from other state tax sources is that it is a voluntary action. That is, the choice to participate in the lottery, and the payment of the tax, is left entirely to the discretion of the taxpayer.

### **Lotteries as a Revenue Source**

Net lottery revenues generally amount to a small portion of a state's budget. On average, about 38 percent of lottery revenues are turned over to the state government.<sup>4</sup> This contributes an average of about 2 percent to total state revenue,<sup>5</sup> and represents the eighth largest source of revenue (on average) for the lottery states.<sup>6</sup>

Oklahoma BEST '93 projects that an Oklahoma lottery will gross about \$183 million annually, with a net return of \$64 million.<sup>7</sup> If that is true, the net proceeds would represent less than 2 percent of the total revenues collected by the state in fiscal year 1992. Given the state's income tax base, Oklahoma could raise approximately the same amount by raising

the average state income tax rate 0.2 percentage points.

Lottery revenues tend to be more volatile than other sources of state revenue. Lottery sales very rarely decline, even in real terms. However, as lotteries mature, their annual rate of growth in sales tends to diminish, like many consumer goods and services.<sup>8</sup> Also, as more states enact lotteries in a particular region, sales growth in any one state tends to slow down due to competition from surrounding states. Thus, most lottery states, after a time, have become more aggressive in their advertising and development of new lottery games in an attempt to maintain the rate of growth in sales experienced in the first few years. This may partly explain why lottery revenues have been more volatile than other state revenue sources. Part of the apparent variability in lottery revenues also is due to their rapid growth over time. But even when this secular trend is accounted for, lottery revenues are still relatively more volatile around their trend than other state revenue sources.<sup>9</sup>

Some states are more successful than others in generating a high rate of growth in lottery sales. While it is true that introducing a lottery in Oklahoma will generate revenue, experience elsewhere indicates that it is difficult to keep per capita sales growing. Lottery officials would apparently have to be very aggressive to generate consumer interest year after year, especially since Oklahoma may have difficulty attracting many out-of-state players, given the success of pre-existing lotteries in Kansas, Missouri, Colorado, and Texas.

Of course, the more aggressive state government has to be to maintain a particular rate of growth in sales, the greater cost of product innovation and promotion. That, in turn, increases the ratio of administrative costs to revenue. The operating expenses associated with a state-run lottery averaged over 25 percent of lottery revenues in 1986.<sup>10</sup> Compared with other state revenue sources, this ratio is extremely high. If the lottery is viewed as a state run monopoly, however, this ratio may not be excessive.

Clotfelter and Cook, in a 1989 report on state lotteries, suggest that the administrative costs of state-run lotteries should not be compared to the administrative costs of other state revenue sources.<sup>11</sup> They view lottery agencies as state monopoly enterprises selling a product to consumers, not as tax collectors. Therefore, the administrative costs associated with the lottery represent the costs of providing a commodity, not collecting revenue.



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There is some evidence of economies of scale in lottery administration. The operating expenses per dollar of revenues raised for the state decline as sales increase.<sup>12</sup> However, because of its small population base, the likelihood that Oklahoma can take advantage of this phenomenon appears to be slim. It will be difficult for the state to realize any significant economies of scale if it operates a lottery on its own. Many states demographically similar to Oklahoma have taken advantage of the economies of scale in lottery administration by combining their lottery operations with other states.

Evaluation of lotteries as a potential revenue source for the state requires that the effects of the lottery on other state revenue sources be considered. States lose an average of fifteen cents of other revenue per dollar of lottery revenue collected.<sup>13</sup> If consumer expenditures on lottery tickets crowd out expenditures on other goods, then sales tax revenue will decrease. Pari-mutuel tax revenues will decline as the lottery substitutes for betting at the track. In fact, for every one dollar increase in spending on the lottery, there is about an eighteen-cent decrease in pari-mutuel wagering.<sup>14</sup>

State income tax revenues will increase, however, to the extent that the winnings are subject to the state income tax. There is some evidence that those states with no state income tax and a high proportion of state revenue collected by sales or excise taxes are at higher risk of losing alternative revenues as a result of their lotteries. Oklahoma uses a combination of both income and sales taxes and could lose between seven cents and twenty-three cents per dollar of lottery revenue gained.<sup>15</sup>

### **The Implicit Lottery Tax**

Three prior claims are made on lottery revenue collected by a state before the remainder goes into the state treasury. Prizes, administrative costs, and sales agent commissions must be paid. Viewed as a consumer item, the net revenue or profit from a state-run lottery, similar to an excise tax, is the portion of each ticket sale that ends up in the state treasury. The implicit lottery tax is high when compared to other excise taxes. In 1985, the implicit tax on lotteries averaged 85 percent of the net price, while tobacco was taxed at 49 percent and liquor at 43 percent.<sup>16</sup>

Most state excise taxes are regressive with respect to income; as income increases, taxes paid as a percentage of income decrease. The implicit tax associated with the lottery also has been found

regressive with respect to income. Studies on lottery participation have shown that lower-income households tend to play the lottery more often than households in other classes of income. In fact, no other state tax exhibits the degree of regressivity as that associated with the implicit lottery tax.<sup>17</sup>

Opponents of a lottery may argue that this is a good reason to oppose a lottery. Proponents may argue that they should have the right to play, just as people have the right to smoke, and that the "sin" tax likely to be levied is merely excessive. Generally, lower-income households are not the largest group of voters who vote "yes" on the lottery issue. Although higher-income voters tend to vote yes, they play the game less frequently.<sup>18</sup>

Of course, any discussion of the distributional impacts of a state lottery also must consider the incidence of the benefits generated by the lottery revenues. If the net lottery revenues fund programs that benefit low-income households, then lotteries would be less regressive overall.

It is difficult to identify which specific programs state lottery revenues support. When the money is added to the state's General Revenue Fund, it is spent the same as any other revenue source. And even if the additional funds are earmarked for a particular program, there is no guarantee that the money will not be just a substitute for funds that would have been spent on a program anyway.

For example, many states earmark their lottery revenues for education. In most cases, however, the additional lottery revenue has substituted for other funds that would have supported education.<sup>19</sup> Earmarking lottery revenues will have the most effect when the earmarked revenues contribute a large proportion of the total spending on a particular program.<sup>20</sup> In the states with lotteries where funds were earmarked for education, lottery revenues contributed only 11.6 percent of total state revenues to education in 1991, and only 3.8 percent of total state and local revenues to education.<sup>21</sup> Apparently, this was not a large enough contribution to preclude the substitution of lottery funds for general revenue funds.

### **A Tuition Increase**

As this report was being written, it was clear that a tuition increase would be up for consideration in the 1994 legislative session, but its size was less certain. Governor Walters has called for an increase of \$15 million, or a little over 9 percent of the \$159.4

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million collected in tuition and fees in 1992-93. The State Regents have not yet recommended a specific tuition increase for 1994-95. Their long-term goal, however, is to increase students' share of total appropriations and tuition from the current 23 percent to 33 percent by the year 2000.<sup>22</sup> To achieve this goal, tuition would have to be increased an average of 7 percent per year for each of the next six years.

Governor Walters appears to be pushing for a tuition increase as a means of offsetting a proposed 2.75 percent across-the-board cut in appropriations to most state agencies. Such a cut would take approximately \$15 million from higher education, the same amount as the proposed tuition increase. Currently, Oklahoma students are funded at only 66 percent of the average amount per student at similar colleges and universities in other states. To close this gap would require an additional \$280 million in appropriated funds *plus* attainment of the Regents' tuition goal.<sup>23</sup>

Proposing a tuition increase is one thing, obtaining legislative approval is quite another. In fact, there may be significant opposition to such an increase. Tuition increases are normally opposed on several grounds. Chief among them are the fears that a tuition increase will cause a significant decline in enrollment, and that it will reduce access to higher education for low- and/or middle-income students. Tuition increases can, but they need not, have these effects.

Enrollment is negatively associated with tuition: i.e., enrollment will fall when tuition increases. Enrollment is positively associated, however, with personal income, student aid, the number of high school graduates, and tuitions charged by competing educational systems.<sup>24</sup> An increase in tuition in Oklahoma need not cause an enrollment decline if personal income, student aid, the number of high school graduates, and tuitions in other systems (especially in Kansas, Arkansas, and Texas) are growing fast enough at the same time that Oklahoma's tuition is increasing.

Normally, modest increases in personal income are enough by themselves to offset increases in tuition. This happens because the positive effect on enrollment of a 1 percent increase in personal income is much stronger than the negative effect on enrollment of a 1 percent increase in tuition. Studies of the factors influencing college enrollment indicate that a 1 percent increase in tuition will decrease total enrollment by about 0.6 percent.<sup>25</sup> An increase of 1 percent in personal income will increase total enrollment by about 1.6 percent.<sup>26</sup> Applying these

findings, a 7 percent increase in tuition (the annual increase required to meet the Regents' long-term goal) would cause a 4.2 percent decrease in total enrollment, but this could be offset entirely by a 4.2 percent enrollment increase resulting from a 2.6 percent increase in income. Oklahoma personal income is projected to grow in 1994 by 6 percent. Thus, the level of tuition increase likely to be suggested on a sustained basis by the Regents probably will not reduce total enrollment next year. In fact, a 6 percent increase in personal income is more than enough to offset the 9 percent increase in tuition that the Governor has suggested.

These calculations apply only to the total population of college students; they do not necessarily apply to each part of the college population. A 7 percent tuition increase may have a greater effect on some groups of students than on others. The ratio of a 0.6 percent decline in enrollment for a 1 percent increase in tuition is the average—a larger ratio may apply to some groups of students and a smaller ratio may apply to other groups. An increase of 6 percent in state personal income is also an average increase; personal incomes used to finance a college education will grow faster than 6 percent for some students' families and slower than 6 percent for others. There is no guarantee, either, that the students who are most affected by tuition increases will be the students who are experiencing the fastest increases in personal income. Thus, one must look more closely at specific segments of the student population.

The effect of a tuition increase, *per se* (that is, independent of any changes in personal income, number of high school graduates, student aid, and tuitions charged in other states or systems) is generally larger (1) for freshmen than for continuing students, (2) for students with lower academic achievements than for students with higher academic achievements, and (3) for students supported by smaller personal incomes than for students supported by larger personal incomes.

The number of high school graduates in Oklahoma is projected to increase by a little over 2 percent per year for the next six years.<sup>27</sup> This may be a large enough increase in the pool of prospective freshmen to offset the somewhat larger effect of a tuition increase on the total number of freshmen enrolled. There is no denying, however, that the number of freshmen enrolled would be larger in the absence of any tuition increases. The differential effect on freshmen can be avoided, of course, by avoiding tuition increases, but in doing so the State

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Regents would come up short of achieving their goal of more funding for higher education in Oklahoma. Alternatively, the State Regents can achieve their funding goals and minimize the differential effect of a tuition increase on freshmen by (1) providing more financial aid to freshmen, and/or (2) raising tuition more for continuing students than for freshmen.

The second problem associated with higher tuition is that a tuition increase will have a greater effect on lower-achieving students than on higher-achieving students. Simply put, higher achievers will, on average, be more motivated to pursue a college education in the face of tuition increases than will lower achievers. It is doubtful that there is much public sentiment in Oklahoma for providing long-term financial aid to lower-achieving students, or for charging higher achievers more tuition than lower achievers simply as a means of offsetting the larger effect of higher tuition on the group of lower achievers. There may be some public sentiment, however, for giving lower achievers a "second chance." The Regents could accommodate these sentiments and achieve their funding goals by using one of the alternatives noted as a solution to the "tuition-affects-freshmen-more" dilemma; namely, they could provide more financial aid to freshmen (only) that is not based on performance in high school. This would help to lower the barrier posed by higher tuition and give lower-achieving students the "second chance" that some of the public may favor.

Perhaps the fact that is most troubling is that the effect of a tuition hike increases as the personal income supporting the student decreases. This problem could be avoided either by providing more income-conditioned financial aid (the amount of financial aid would increase as personal income decreases) or by making tuition income-conditioned (tuition would decrease as personal income decreases). The public would probably favor income-conditioned financial aid, but the two alternatives are equivalent in their effects.

Two issues must be resolved whenever an income-conditioned subsidy is considered. The first is whether the subsidy should be specific or general. The second is how much the subsidy should increase as family income decreases.

A specific subsidy is one that is provided only for the purchase of a specific good or service; income-conditioned financial aid and income-conditioned tuition are specific subsidies. A general subsidy is one that is provided for the purchase of many different kinds of goods or services. Most economists believe that the *recipient households* benefit more

from a general subsidy, by making their own consumption choices, than from a specific subsidy. However economists also recognize that the welfare of *taxpayers* may be higher when the subsidy is given for the purchase of specific "merit" goods. Subsidies for higher education clearly fall in the latter category.

This still leaves the question of deciding how large the subsidy for higher education should be at each income level. Actually, the most important part of this decision has already been made: students at *all* income levels are going to have at least two-thirds of the cost of their public college education subsidized directly by general taxpayers. Still to be decided is *who* is going to pay *how much* of the remaining one-third.

Few would argue with the proposition that students from poor and near poor families should pay a smaller share of the cost of their college educations than students from middle-income and upper-income families.<sup>28</sup> There may even be quite a bit of sentiment for providing the poor and near-poor with financial aid that pays virtually all of their tuition, and for providing upper-income students with no financial aid. But it is unlikely that the case is this clear for students from middle-income families.

It is difficult to separate the effect of the sheer weight of numbers from considerations of equity. For example, educators and lawmakers who oppose an increase in tuition on the grounds that it will harm the middle class may simply be counting votes, instead of acting on the basis of evidence that it will pose a severe hardship on this group.

If votes are what matters, the issue may be far from clear. The middle class has already let it be known through its support of State Question 640 that it does not, in general, favor more taxes. The survey described in Chapter III, however, indicates that the vote on State Question 640 was not necessarily a vote against government programs, in general, or higher education, in particular. There may be other concerns in addition to the impact of tuition increases, however, e.g., cost for value received or a structure thought to be wasteful.

It is possible that the concern really is that higher tuition will constitute a severe hardship for the middle class. This aspect of the issue is resolvable with the accumulation of enough information on the true impact of a tuition increase and the crafting of a financial aid package that offsets, to some degree at least, the harm imposed on middle-income families. This is largely an empirical matter, not a matter of principle.

## Fee For Service: The Turnpike Authority

The state financing of highways, roads, and bridges in Oklahoma has taken several forms. Earmarked state revenues, principally from fuel excise taxes and motor vehicle fees, flow to the State Transportation Fund to support the construction and maintenance of the state highway system by the Oklahoma Department of Transportation (ODOT). Earmarked state revenues from these sources also support city and county road programs and flow into the Oklahoma Turnpike Authority (OTA) Trust Fund. The limitations of State Question 640 offer virtually no prospect for increasing tax rates of these traditional taxes in the near term, and the tax bases of these revenue sources change very slowly. On the other hand, since the OTA collects tolls to fund its operations, it is isolated somewhat from the direct constraints imposed by State Question 640.

Even before passage of the tax limitation measure, there was little likelihood that revenue sources would keep up with maintenance and construction requirements for state highways. Now, significant shortfalls are even more likely. Various proposals to expand the turnpike system through debt financing backed with toll revenues are currently at issue, and are probably precursors of a longer-term pattern of funding state highway construction in Oklahoma.

### Highway Needs

The building of new highways, roads, and bridges and the maintenance of the existing system are critical needs independent from funds available. According to the ODOT's assessment, 3,329 miles of Oklahoma highways are presently inadequate to serve their traffic demands.<sup>29</sup> In addition, ODOT calls for 102 miles of interstate highway construction and 62 miles of new roads in urban areas. The projected cost of fulfilling these needs is approximately \$3.5 billion.

ODOT has annualized the cost of Oklahoma's highway needs, distinguishing among interstate, principal arterial, minor arterial, and collector roads and defining whether they are in rural or municipal areas. The approximate annual cost to supply the necessary roads—75 percent of which are in rural areas—is estimated by ODOT to be \$827 million. Fifty-four percent of the required construction and maintenance relates to minor arterial or collector roads.

### Revenues for Roads

Historically, revenues for roads and bridges in Oklahoma come principally from excise taxes on fuel and various fees charged to road users. These collections are apportioned to the ODOT and to state, county, and local governments to support roads in their jurisdictions. OTA, of course, relies upon tolls collected from turnpike users.

**State Apportionment.** In fiscal year 1993, apportionments of earmarked revenues to the State Transportation Fund totaled \$192.6 million, as shown in Table V-1. In addition, the apportionments for county highways and bridges from fuel excise taxes and motor vehicle fees totaled \$159.2 million. These are the two largest categories of state support for the road infrastructure. In addition, \$23.6 million was apportioned to the OTA Trust Fund to finance debt service in case other funds were inadequate. However, when funds are not needed for OTA debt service, as was the case in 1993, OTA turns them over to the ODOT. In fiscal year 1993, an additional \$29.0 million from gross production taxes was apportioned to counties for highways.

Also evident from Table V-1 is that a large portion of the revenues collected from fees on motor vehicles and the excise taxes on fuels goes to state services other than highways. For example, \$149.3 million (19.3 percent of the revenues from these two sources) went to school districts and \$209.8 million (27 percent) went to the General Revenue Fund.

TABLE V-1

**Fuel and Vehicle Revenue  
Total Apportionments Fiscal 1993  
(Millions)**

	Amount	Percent
State Transportation Fund	\$192.6	24.9
General Revenue	209.8	27.2
Cities and Towns	17.8	2.3
School Districts	149.3	19.3
County Highways and Bridges	159.2	20.6
Other - Non-Highway	20.1	2.6
Turnpike Authority Trust Fund	23.6	3.1
	\$772.2	100.0

Source: Oklahoma Department of Transportation.

Further examination of the revenue sources for highways suggests the possibility of future funding impacts. For example, approximately 74 percent of the State Transportation Fund apportionment came from the 15.92-cents-per-gallon gasoline excise tax during fiscal 1993. An additional 18 percent came from the 13-cent-per-gallon diesel fuel excise tax. A stable fuel consumption tax base means that revenues will not grow with income or economic expansion; i.e., fuel excise taxes are a very income inelastic tax source. Although, over time, increased gasoline efficiencies will reduce consumption, recently there has been a slight increase in fuel usage. Indeed, the state's Transportation Fund has been more or less stable for several years.

Table V-2 compares the 1989 receipts for highways by all units of government in Oklahoma with the contiguous states. Most of these states also rely on user fees to support their road infrastructure. Because of Oklahoma's relatively extensive turnpike system, it is not surprising that this state has a higher percentage of its road expenditures supported by toll revenues than the surrounding states. On the other hand, the neighboring states use the property tax to support their highways; Oklahoma does not.

**TABLE V-2**  
**Receipts for Roads**  
**for All Units of Government: 1989**  
**(Percent)**

	User	Tolls	General	Property
Oklahoma	69.7	5.5	10.3	0.9
Arkansas	76.5	0.0	5.0	4.1
Colorado	59.9	0.1	8.0	9.4
Kansas	39.9	3.4	27.1	9.6
Missouri	68.9	0.1	0.6	4.2
New Mexico	83.0	0.0	9.3	0.9
Texas	55.1	1.4	16.0	16.4

Source: Federal Highway Administration.

**Federal Funds.** Federal funds are an important source of revenue for highway construction in Oklahoma, as in any state. Oklahoma selects the routes that will be eligible for federal funds.

Oklahoma has not fared well, compared to neighboring states, in receiving federal funds for highways. For example, the ratio of federal apportionment-to-payments for the 1956-1990 period in Oklahoma is very low. That ratio (comparing the road funds coming to Oklahoma with those leaving) is .85.

By contrast, the ratio for New Mexico was 1.45, for Colorado 1.42, and for Louisiana 1.40.

Under provisions of the Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991, Oklahoma is now able to certify OTA toll revenues as a "soft match" for federal funds. The certification of state funds associated with recent turnpike construction has the potential of generating federal funds for Oklahoma's highway system if, in some year, the match from state programs is inadequate. Federal funding could offset otherwise limited revenue prospects for the road system in Oklahoma.

**The Oklahoma Turnpike Authority.** Operating as a somewhat independent entity, OTA projects an operating budget for calendar year 1994 of \$96.2 million, supported by the tolls from the ten operating turnpikes.<sup>30</sup> But only three turnpikes—the Turner, Will Rogers, and H.E. Bailey—account for approximately two-thirds of total OTA revenues. The OTA, which is possibly unique among state turnpike authorities in this regard, can use the total revenues of the entire system to support all of the system's bonded indebtedness. This provision provides OTA the flexibility of initiating new turnpikes based on the tolls of the existing system. However, it is also a source of controversy, because it means that drivers on heavily-used turnpikes support drivers on lesser-used turnpikes.

Passenger cars account for 58.1 percent, and five-axle trucks for 33.2 percent, of OTA's budgeted revenues. Meeting the debt service of the three classes of debt requires 54 percent of the Authority's budget. Operating and maintenance expenses require 38 percent of the total expenditures.<sup>31</sup>

### Intergovernmental Funding of Roads

State highways benefit the economies and the general well-being of the counties and local governments where they are located. The state financing of highways within their boundaries is a form of support for the county and local governmental units. As noted, a large proportion of current highway needs are in Oklahoma's rural areas. As pressures mount on the relatively stable highway funds, the level of state support for roads serving regional needs is an area of almost certain intergovernmental controversy.

### Turnpike Construction

At the beginning of the 1994 fiscal year, the OTA had \$686.7 million in debt outstanding, and, according to its own assessment, an additional bonding

capacity of \$600 million to \$700 million.<sup>32</sup> To support that incremental debt, the tolls on the turnpike system would have to approximately double. (Of course, an increase in the rate of turnpike usage would reduce the level of toll increase required to support that level of debt.)

At this time, 32 road projects (beyond the ten roads completed or partially completed) are authorized by the legislature for construction. Likely to be among the earliest projects undertaken by OTA are (1) rehabilitating the Turner and Will Rogers turnpikes and expanding them to six lanes to serve commuter traffic, (2) continuing the John Kilpatrick turnpike to Interstate 40, (3) connecting the Creek turnpike to the Turner turnpike, and (4) extending the Muskogee turnpike to the southeast.

If built, these projects most likely will require increased tolls because of the added debt service requirements. Because of the price inelasticity of highway use at current toll levels, usage may not decline significantly from such a toll increase. However, tolls will not be raised without controversy.

## Footnotes

<sup>1</sup>James Alm, Michael McKee, and Mark Skidmore, "Fiscal Pressure, Tax Competition, and the Introduction of State Lotteries," *National Tax Journal*, 46(4), 1993, p. 463.

<sup>2</sup>*Stillwater NewsPress*, "Walters Asks Fast Petition Ruling," January 11, 1994, p. B-1.

<sup>3</sup>Charles T. Clotfelter and Philip J. Cook, *Selling Hope: State Lotteries in America*, Harvard University Press, Cambridge, Massachusetts, 1989, p. 146.

<sup>4</sup>*Ibid.*, p. 216

<sup>5</sup>Educational Research Service "State-Run Lotteries: Their Effects on School Funding," Prepared by David P. Brandon, Arlington, VA, 1993, p. 5.

<sup>6</sup>John L. Mikesell and C. Kurt Zorn, "State Lotteries for Public Revenue," *Public Budgeting and Finance*, Spring, 1988, p. 39.

<sup>7</sup>Oklahoma BEST '93, "A Lottery Initiative Petition Campaign," Lynn White, ed., Oklahoma City, OK, September, 1993.

<sup>8</sup>John L. Mikesell, and C. Kurt Zorn, "State Lottery Sales: Separating the Influence of Markets and Game Structure," *Growth and Change*, 18(4), Fall, 1987, p. 17.

<sup>9</sup>Clotfelter and Cook, p. 218.

<sup>10</sup>*Ibid.*, p. 219.

<sup>11</sup>*Ibid.*, p. 219.

<sup>12</sup>Larry Deboer, "Administrative Costs of State Lotteries," *National Tax Journal*, 38(4), 1985, p. 484.

<sup>13</sup>Mary O. Borg, Paul M. Mason, and Stephen L. Shapiro, "The Cross Effects of Lottery Taxes on Alternative State Tax Revenue," *Public Finance Quarterly*, 21(2), April, 1993, p. 133.

<sup>14</sup>O. David Gulley and Frank A. Scott, Jr., "Lottery Effects on Pari-Mutuel Tax Revenues," *National Tax Journal*, 42(1), 1989, p. 91.

<sup>15</sup>Borg, et al., 1993, p. 133.

<sup>16</sup>Clotfelter and Cook, p. 232.

<sup>17</sup>*Ibid.*, p. 226.

<sup>18</sup>Philip L. Hersch and Gerald S. McDougall, "Do People Put Their Money Where Their Votes Are? The Case of Lottery Tickets," *Southern Economic Journal*, 56(1), July, 1989, p. 36.

<sup>19</sup>Mary O. Borg and Paul M. Mason, "The Budgetary Incidence of a Lottery to Support Education," *National Tax Journal*, 41(1), March, 1988, p. 81.

<sup>20</sup>Clotfelter and Cook, p. 228.

<sup>21</sup>Educational Research Service, p. 5.

<sup>22</sup>Oklahoma State Regents for Higher Education, *Leader*, 8(1), p. 2.

<sup>23</sup>*Ibid.*, p. 2.

<sup>24</sup>This is by no means a complete list of the determinants of the demand for a college education. It does include many of the principal factors which would tend to offset the adverse effect of a tuition increase on enrollment.

<sup>25</sup>This is the consensus estimate deduced by Larry Leslie and Paul Brinkman from their thorough review of the literature in "Student Price Response in Higher Education," *Journal of Higher Education*, 1987, 58(2), pp. 181-204.

<sup>26</sup>Robert Campbell and Barry Siegel, "The Demand for Higher Education in the United States, 1919-1964," *American Economic Review*, 1967, 57(3), pp. 482-94.

<sup>27</sup>U.S. Department of Education, *Projections of Education Statistics to 2002*, 1991, Washington, D.C.: U.S. Government Printing Office.

<sup>28</sup>"Poor" is defined as having income below the poverty line, "near-poor" as having income between the poverty line and 150 percent of the poverty line.

<sup>29</sup>Oklahoma Department of Transportation, *Needs Study and Sufficiency Rating Report*, 1993 Vol. I, p. III.

<sup>30</sup>Oklahoma Turnpike Authority, *Annual Budget*, 1994, p. 2.

<sup>31</sup>*Ibid.*

<sup>32</sup>Oklahoma Turnpike Authority, *Financial Report*, March 5, 1993, p. 511-12

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**STATE GOVERNMENT FINANCE  
IN OKLAHOMA AFTER SQ 640**

**A REPORT TO  
OKLAHOMA 2000, INC.  
by**

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