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Perspective
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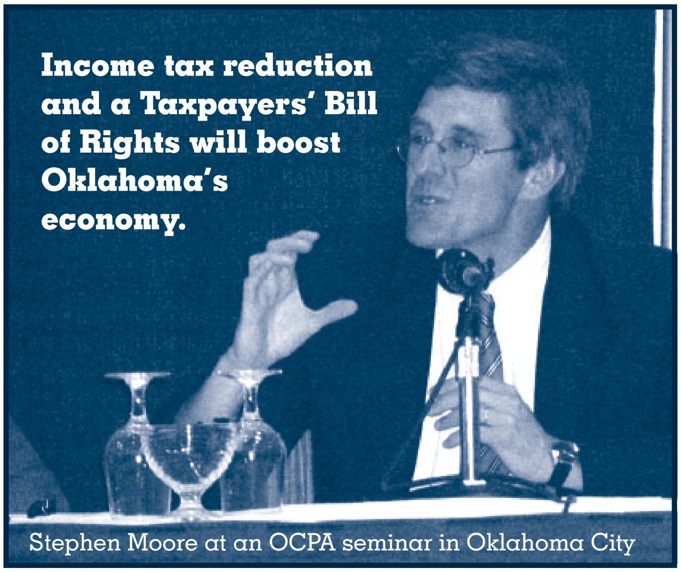
Oklahoma Faces 'Growth Deficit'

By Stephen Moore

It would be an understatement to say that Oklahoma faces a grave fiscal crisis. Tax revenues declined more than seven percent from 2001 to 2003, and for the past several years the state has had to scramble to balance its budget. I would make the case that Oklahoma faces not just a budget deficit today, but a more serious growth deficit. The state isn't growing fast enough in jobs, capital, new businesses, or population to create the tax revenue base to sustain government spending.

As a result of this growth deficit in Oklahoma, balancing the budget has been like watching a dog chase its tail. As John F. Kennedy, Ronald Reagan, and now Arnold Schwarzenegger have shown us, when economic growth is too low because of taxes being too high, there is never enough revenue to balance the budget or enough jobs to put workers to work.



Stephen Moore at an OCPA seminar in Oklahoma City

In 2003, the Oklahoma budget gap was addressed the right way. Appropriations were cut by some five percent. Fees were raised (unfortunately), but there were no general tax increases. The credit for avoiding a tax hike in the face of such a budget gap goes squarely to the measure passed by Oklahoma voters in 1992 known as State Question 640. SQ 640 created a 75 percent supermajority requirement for passing tax increases – the highest supermajority requirement of any state. Oklahoma's appropriations process worked: The equalization board certified projected revenues, and appropriations were limited by those projections.

There are two problems with the process in place right now. First, although the process rightly makes it very difficult to raise taxes, it has also been difficult to cut taxes. While he was governor, Frank Keating attempted to cut Oklahoma income taxes in half, but that plan was thwarted by the legislature and income taxes were only trimmed. I maintain that income taxes on businesses and individuals are too high to maximize growth in Oklahoma. They should be lowered by at least half. I would also propose a long-term plan to eliminate the state personal income tax entirely. There are nine states today without income taxes, and they tend to be the high-growth states. Texas and Florida are the two most prominent no-income-tax states.

The second problem with the Oklahoma budget process is that although the state has a very strict constitutional taxation limit, there is no meaningful restriction on the growth of government spending other than available revenues. As a result, when income tax revenues spiked with the prosperity of the tech boom, spending skyrocketed uncontrollably. In fact, appropriations shot up by about 19 percent in just three years from 1998 to 2001, capped by a stunning 9.1 percent surge in appropriations in 2001 alone. If Oklahoma had limited expenditures during this period to a benchmark of population growth plus inflation, not only would the budget crisis have been avoided, but hundreds of millions of dollars would have been returned to taxpayers, fueling economic growth and job creation.

My research indicates that states with strictly enforced caps on spending and taxes tended to have the smallest budget problems in this last recession.

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Colorado, which has the most effective tax and expenditure limit in the nation, was one of the few states to provide its residents with a tax cut this year. Looking ahead, Oklahoma should adopt the Colorado budget limit mechanism, rather than continuing the chaotic budget fluctuations of recent years.

What I propose is something OCPA has been touting for quite some time now: a Taxpayers' Bill of Rights. As I will discuss below, this measure would restrict Oklahoma's state spending to the rate of inflation plus population growth in any year. It would also require that any surplus revenues above inflation and population growth be returned to the taxpayers of Oklahoma. This provides a taxpayer dividend for fiscal responsibility on the part of the elected officials. It has worked well in fast-growing Colorado and would also work well in Oklahoma.

Lessons from Other States

In fiscal 2002 and 2003 more than half of the states raised taxes to balance their budgets. Cigarette taxes were the most common revenue raisers, and have been called the "fiscal savior" for the states. New York raised its cigarette taxes by more than $1 a pack, and Maryland hiked its tax by 50 cents a pack. Given the rise in Internet sales of tobacco and in cross-border purchases, cigarette tax hikes will not likely gain the revenues that are expected. In addition, higher cigarette taxes will have the negative effect of creating larger black markets and strengthening organized crime.

Several states, including Florida, Kansas, Illinois, Louisiana, Massachusetts, New York, Pennsylvania, Tennessee, and Virginia, considered or enacted broad-based tax increases in business, income, or sales taxes to close so-called "structural, long-term deficits."

And very recently this year, Virginia and New Jersey have raised income and sales taxes to increase funding for government programs.

But the experience of the 1980s and 1990s shows that rapid revenue growth is typically the cause of the later budget shortfalls as politicians ratchet up spending to unsustainable levels. States such as Colorado that were restrained from spending revenue windfalls in the 1990s are now in the strongest fiscal health.

A recent Cato Institute study shows that the 1990s were a period of rapid revenue growth for the states. By fiscal year 2000, real per capita state revenues had reached a high of $4,463, representing an increase of 28 percent since 1990. State revenues even grew at a faster rate in the 1990s than in the prosperous 1980s. Growth was especially fast in recent years, with revenue growing more than seven percent annually in 1999, 2000, and 2001.[1]

It is striking that when media stories discuss state budget gaps, they typically describe the problem as a state "revenue shortfall."

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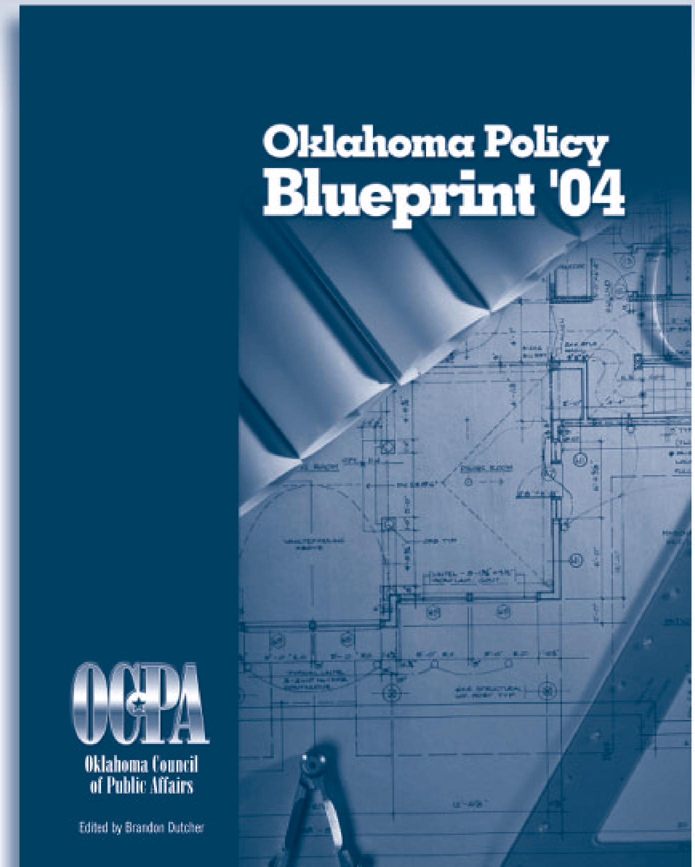

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But there has been no revenue shortfall over the past decade. Quite the opposite. Even in 2002, with most governors pleading poverty, state revenues grew by two percent.[2] It only seemed like a revenue drought compared to the blistering pace of revenue growth during the 1990s.

One reason that states enjoy revenue windfalls during boom periods like the 1990s is that most state income tax codes have a graduated rate structure, so that revenues automatically rise faster than income growth, unless state lawmakers repeatedly cut taxes. Only six states index their tax brackets for inflation, something the federal government wisely did as part of the Reagan tax cut in 1981.[3] A recent OCPA study found that Oklahoma in particular has a much more steeply progressive structure than its border states, and more progressive than the rest of the country as well.[4] This exacerbates the revenue windfall problem and is a persistent drag on economic growth.

Oklahoma's $4 Billion Revenue Bonanza

Oklahoma had a huge revenue surplus during the go-go 1990s – and has squandered those resources.

Let's look at Oklahoma's excess tax burden that emerged from 1993 to 2003. To calculate this burden, I use as a benchmark the state's population growth plus the inflation rate, as measured by change in the CPI. I then measure how much Oklahoma's actual revenue growth exceeded the benchmark over the last ten years.

If Oklahoma had strictly adhered to such a benchmark growth cap from 1993 through 2003, taxpayers would have saved nearly $4 billion in excess taxes. In just one year, 2001, they would have saved a billion dollars, or $291 per capita, per year. By limiting spending growth to this benchmark, Oklahoma would have had balanced budgets every year without the chaotic explosion of spending and subsequent political agony over steep budget cuts, and Oklahoma taxpayers would be nearly $4 billion richer.

The Case for Oklahoma Tax Cuts

State and local tax and budget policies have a significant impact on the relative economic performance of states. States with high and rising tax burdens are more likely to suffer economic decline, while those with lower and falling tax burdens are more likely to enjoy robust economic growth.[5] For example, a 1996 study by the Federal Reserve Board of Atlanta examined state economic performance from 1960 to 1992 and found that "tax rates [average and marginal] are negatively related to growth and are sufficiently variable over time to reasonably explain variations in growth rates."[6]

A study by the Joint Economic Committee of Congress examined the economic growth records of the 10 states that raised taxes the most and the 10 that cut taxes the most between 1990 and 1993. The top 10 tax-hiking states experienced a net gain of only 3,000 new jobs, an increase in the unemployment rate of 2.2 percentage points, and a $484 real *decline* in personal income per family of four.[7] In contrast, the top 10 tax-cutting states saw 653,000 net new jobs, an increase in the unemployment rate of only 0.6 percentage points, and a $300 real *increase* in personal income per family of four.

The contrast was even greater when only income tax changes were considered. The top 10 income-tax-hiking states experienced a net *loss* of 182,000 jobs, a 2.3 percentage point increase in the unemployment rate, and a $613 real *decline* in personal income per family of four. The top 10 income-tax-cutting states saw 975,000 net new jobs, an increase in the unemployment rate of only 0.3 percentage points, and a $148 real *increase* in personal income per family of four.

This analysis was updated with data through 2000 in a recent Cato Institute study that found that the negative relationship between taxes and growth at the state level is still as pronounced as ever. The 10 states with the highest tax

Oklahoma's Tax Revenue Windfall

	Tax Revenue	Population	CPI	Population Growth	Inflation	Pop + Inflation	Capped Revenue	Windfall
	Millions						Millions	
1993	$4,097	3.25	144.5					
1994	$4,263	3.28	148.2	0.9%	2.6%	3.4%	$4,238	$25
1995	$4,416	3.31	152.4	0.8%	2.8%	3.7%	$4,394	$23
1996	$4,618	3.34	156.9	1.0%	3.0%	3.9%	$4,566	$52
1997	$5,061	3.37	160.5	1.0%	2.3%	3.3%	$4,715	$345
1998	$5,301	3.41	163	1.0%	1.6%	2.5%	$4,834	$467
1999	$5,417	3.44	166.6	0.9%	2.2%	3.1%	$4,986	$431
2000	$5,840	3.45	172.2	0.4%	3.4%	3.8%	$5,173	$667
2001	$6,342	3.46	177.1	0.3%	2.8%	3.1%	$5,335	$1,007
2002	$6,053	3.49	179.9	0.9%	1.6%	2.4%	$5,465	$587
2003	$5,906	3.51	184	0.6%	2.3%	2.9%	$5,624	$282
							Total Windfall	$3,885

Source: Census Bureau

burdens in 1990 experienced economic growth that was about half the rate of that of the 10 states with the lowest tax burdens.[8]

Oklahoma's tax mix is damaging to the business environment because of its reliance on personal income taxes, with high tax rates and a progressive structure. Income tax revenues in Oklahoma skyrocketed from 30 percent of tax revenues in 1994 to 38 percent in 1999.

I believe this excessive dependence on high income tax rates has caused the growth deficit in Oklahoma that I described above. Oklahoma's economic growth has slowed in the 1990s at an alarming rate. Oklahoma's national rank in personal income growth among the states has slipped from 11th in 2000 to 15th in 2001 to 32nd in both 2002 and 2003.

The state's largest newspaper, *The Oklahoman*, has argued that "in the long term, this state simply has to rely less on the income tax. Eliminating the tax is not realistic any time soon, but a gradual phase-down to a 3 or 3.5 percent maximum rate is possible." And given Oklahoma's growth deficit, now would be a particularly opportune time to cut income tax rates and accelerate the state's economic recovery.

The income tax should be cut in half, and a 10-year plan should be put into effect to eliminate the income tax altogether by dedicating some portion of the natural growth in tax revenues to phasing down the tax rate to zero.

In other words, use the growth dividend to cut taxes rather than to increase spending. The effect would be like putting steroids into the Oklahoma economy.

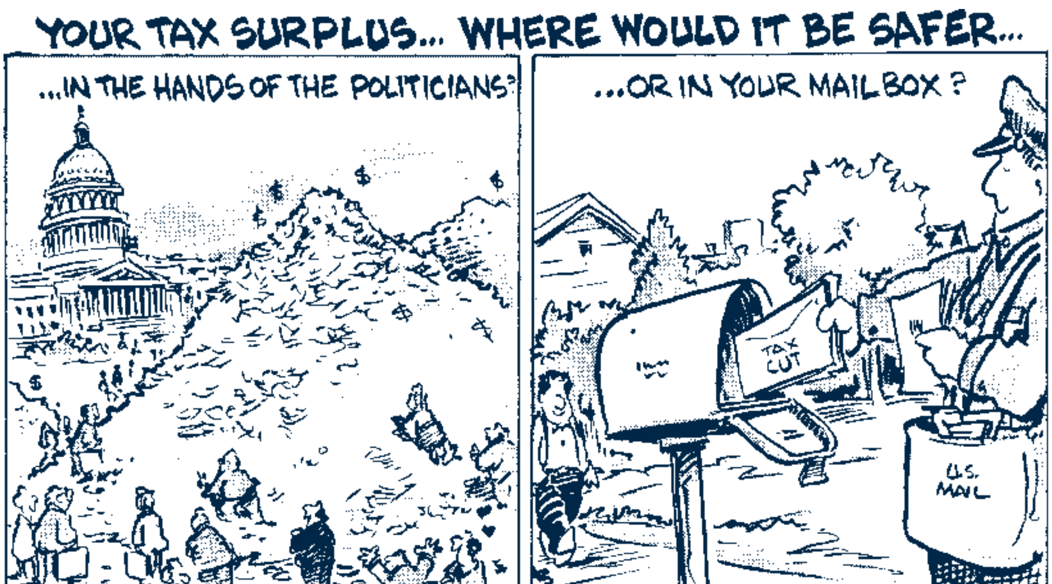
I also believe that voters should reject the massive cigarette tax hike in November. Experience has shown that cigarette tax hikes raise significantly less revenue than promised and reduce retail sales in the state, as demonstrated conclusively by a recent Tax Foundation study. It shows that cigarette tax hikes do not significantly reduce smoking, but significantly increase out-of-state purchases of cigarettes. If Oklahomans are going to smoke, at least they should pay Oklahoma taxes on those cigarettes.

Enforce Fiscal Discipline with TABOR

The other step to restoring fiscal sanity in Oklahoma is to implement an Oklahoma Taxpayers' Bill of Rights (TABOR). Colorado is the model here. Colorado has avoided the huge budget problems that are epidemic in most states today. In fact, while almost half the states were raising taxes in 2002, Colorado was the only state in the nation that cut taxes through a mandated tax rebate.

Colorado has probably the strictest tax and expenditure limitation (TEL) law of the 26 states that have such limits. TELs are statutory or constitutional restrictions on the growth rate of revenues and/or spending. A number of studies over the years have found that states with TELs have restrained state government growth. California, Colorado, Missouri, and Washington have constitutional limitations that restrict the growth of revenues to the rate of population growth plus inflation. California's TEL had been working until the early 1990s when the legislature exempted education and other spending from the constitutional limitation, thus eviscerating its effectiveness.

Some of those states require that revenue in excess of limits be rebated to the people. Colorado rebated $139 million in 1997, $563 million in 1998, $679 million in 1999, and $941 million in 2000.[9] Indeed, Colorado's TEL (the Taxpayers' Bill of Rights) is the model for other states. Revenue growth above the growth rate of population plus



inflation must be rebated. This bars the state government from building up budget spending too quickly during periods of strong revenue growth.

Oklahoma should adopt a Colorado-style TABOR to limit spending more effectively than the current budget process. This TABOR for Oklahoma would have four features:

1) It would limit annual appropriations increases to the increase in state population plus inflation.
2) It would require that any increase in tax revenues above this amount would be dedicated to a percentage reduction in the income tax rate in the next year.
3) It would phase out the income tax in Oklahoma over 10 years.
4) It would preserve the annual balanced budget requirement and would continue the SQ 640 requirement that tax increases be approved by the people.

Conclusion

Some public finance analysts are recommending broadening state tax bases and boosting tax rates to close "structural budget gaps." This has been the argument for large tax hikes in Alaska, Florida, Massachusetts, New Hampshire, Virginia, and Tennessee, and we hear this argument urged on Oklahoma during times of tight budgets. Yet this analysis fails to account for the fact that increased state and local revenues are the driving force behind higher state and local spending. In other words, revenue increases impel politicians to spend more, so that a broader tax base will not stabilize budgets – just as the rapid tax revenue growth in the 1990s did not stabilize budgets.

The evidence from other states is crystal clear: More taxes will simply ratchet up demands for government services, and budget deficits would persist, but at a higher level of overall spending.

In fact, my research suggests that if states had cut taxes more during the 1990s boom, they would be in better, not worse, fiscal health than they are in today. Those states that cut tax rates in the 1990s not only aided state economic growth, but also avoided the massive budget buildups and budget gaps that characterize states that did not cut taxes.

Oklahoma fell victim to the spending craze of the 1990s. Now as the national economy starts to pick up steam and states are finally seeing big boosts in revenues after three or four lean years, it is time to fix the budget process in Oklahoma for good. That means combining a pro-growth tax policy of lower rates with constitutional protections for taxpayers – not repeating the reckless spending patterns of the 1990s.

Oklahoma needs a Taxpayers' Bill of Rights and it needs it now. This will close the twin deficits facing Oklahoma: the budget deficit and the more damaging growth deficit. ✪

Oklahoma's growth dividend should be paid to taxpayers, not government.

Stephen Moore is president of the Club for Growth, a senior fellow at the Cato Institute, and an adviser to California Governor Arnold Schwarzenegger. He serves on the economic board of advisors for *Time* magazine, and is a regular contributor to *The Wall Street Journal*, *Reader's Digest*, *National Review*, and many other publications.

Endnotes

[1] Chris Edwards, Stephen Moore, and Phil Kerpen, "States Face Fiscal Crunch after 1990s Spending Surge," Briefing Paper No. 80, February 12, 2003, www.cato.org/pubs/briefs/bp-080es.html

[2] NASBO, "Fiscal Survey of the States," May 2002, p. 5.

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[8] Chris Edwards, Stephen Moore, and Phil Kerpen, "States Face Fiscal Crunch after 1990s Spending Surge," Briefing Paper No. 80 February 12, 2003, www.cato.org/pubs/briefs/bp-080es.html

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Excess State Employees Harm Oklahoma's Economy

By Rex J. Pjesky

The debate about the proper size of government has existed for centuries. Recently, this debate has continued between OCPA and the Oklahoma Public Employees Association (OPEA). OCPA's position is that Oklahoma's state government is too large and hence is inefficient.

If Oklahoma's government is too large and inefficient, there should be some way of measuring the impact that a big government has on a state. Also, there should be some story explaining why a large government could harm a state's economy. This article does just that. In this article, I will first estimate how many "excess" employees Oklahoma has relative to the national average. Next I will measure the impact that a large government has on per-capita personal income. Then I will discuss the advantages of downsizing in the private sector and how "lean and mean" corporations better serve the economy. Finally I will discuss some of the differences and similarities between the goals and incentives private corporations and governments face in their actions.

With 6,100 too many employees, Oklahoma's state government is too large and inefficient. This waste and inefficiency is a drag on Oklahoma's economy.

Excess Employees

If I am going to explore the size of Oklahoma's government, my first task should be to answer the question, "How large should Oklahoma's government be?" Although there may be better and more sophisticated ways of answering the above question, I am going to compare the size of Oklahoma's government to the national average. I will measure size as the ratio of state employees to all employees.

According to the Bureau of Economic Analysis (BEA), approximately four percent of people working in Oklahoma worked for the state government (about 81,000 state government employees out of about two million total employees) in 2001. Is this figure too large compared with the norm of other states? To answer this question, I estimated a statistical model using 50 states that predicts size as a function of population density, the relative wage of state government employees to all employees, the percentage of the population between the ages of 5 and 17 and the percentage of the population 65 and older.[1]

According to this model, Oklahoma's state government employment should constitute 3.7 percent of total employment. In other words, Oklahoma's state government has about 6,100 too many employees,[2] compared to the national average.[3] Oklahoma should have about 74,900 employees instead of 81,000.[4]

Impact on Oklahomans' Income

But does this matter? Is there an association between large state governments and economic performance? If there is, one should be able to measure the impact of bloated state governments on some variable related to economic well-being – like per-capita personal income.

To measure the effect between large state governments and economic growth, I estimate a model where per-capita personal income growth in the 50 states from 1979-2001[5] is the dependent variable and the ratio of state employees to all employees is the independent variable.[6]

The results of this model are astonishing. A one percentage point increase in the ratio of state employees to all employees in 1979 is associated with a nine percent decrease in per-capita personal income during the period.[7]

Using the model which estimated the size of government relative to the average of all states, Oklahoma's state government was too large by one half of one percent in 1979. In 1979, Oklahoma had 63,000 state employees out of a labor force of 1.5 million. Oklahoma should have had about 55,000 employees to be consistent with the national average of all states. So, if Oklahoma had a number of state employees consistent with the national average, its per-capita personal income would have been 4.5 percent larger. Oklahoma's per-capita personal income was $8,485 in 1979 and grew 200 percent to $25,447 in 2001. The model suggests if Oklahoma's state government employment had been smaller by one half of one percent of the labor force (bringing it to the average of all states), per-capita personal income would have grown approximately 204.5 percent to $25,829, a $382 difference.

In one respect, these differences are small. Oklahoma's per-capita personal income ranking would not increase. In 2001, Oklahoma would still have been ranked 39th, between South Carolina and North Dakota. Also, in terms of growth, even the extra 4.5 percent would still place Oklahoma near the bottom performers of the last 25 years. But, on the other hand, would you like an extra $382 dollars per year to spend?

Since there seems to be a link between high growth and few employees, there must be a mechanism driving it. At first thought, one may blame the salary the state pays these employees as wasteful and a drain on our economy because it would be better spent elsewhere. While this argument may have merit, I am not entirely satisfied with it.

Downsizing and Economic Progress

I think one can understand the benefits of small size in government if one understands the benefits of small size in the private sector. Corporations (all businesses, for that matter) exist to provide goods and services to the consumers in the economy. They do not exist to generate jobs.

Innovation and structural changes in the economy drive the need for downsizing. As time proceeds, production of a certain amount of goods and services will require less labor – production processes become more efficient. Or a good or service will become obsolete. Business will respond to both phenomena using less labor in the particular activity.

Profits guide businesses. Lower profits are a signal to business that it needs to downsize.[8] As innovation causes gains in efficiency, or as a product goes out of style, profits will lag beneath what is "normal" in the economy and businesses will respond by reducing the amount of labor and other resources devoted to the production of the product. For example, automation has caused downsizing in manufacturing, innovation in information technology and new management techniques have caused downsizing in middle management, and the computer has caused downsizing in the typewriter industry.

"On the one hand, eliminating the middleman would result in lower costs, increased sales, and greater consumer satisfaction; on the other hand, we're the middleman."

What is more interesting and more relevant to this discussion is what happens if a business does *not* downsize when the economy signals it to do so. When this happens, the firm becomes a drag on the economy. The efforts of the excess workers are wasted. Too many employees producing a good or service means the economy misses out on the production it would have enjoyed had the workers been released back into the economy. The market would have provided those workers with more productive activities that better satisfy consumers.

So downsizing plays a very important role in economic progress. This is a very difficult concept for many to accept. Most people's view of the economy is tainted by the notion that the economy's purpose is to create employment for employment's own sake. This notion is false. The purpose of the economy is to direct resources to their most highly valued use.

Government and Economic Efficiency

If one believes, as I do, that government has an important role in providing goods and services to the economy, then we must concede that government responds to conditions in the economy just as private firms do. But governments do not have the profit signal to guide them.

Profits are a clear signal to private firms, guiding their actions. Firms' decisions are a simple game of "hot and cold." Maximizing the value of society's resources is the goal of economic activity. Firms in a private market are (inadvertent) participants in this process when they pursue profits.[9] When profits increase it is society telling the firm "hot" and rewarding the owners of the firm for using society's resources wisely. When profits decrease it is society telling the firm "cold" and punishing the owners of the firm for using society's resources foolishly. Consumers drive this game by voting with their dollars, buying products they like while passing on those they don't.

Governments, however, do not exist in such a framework. The ultimate goal of government should be the same as the private sector: Guide resources to their most valued use. The game of hot and cold in the government framework consists not of firms pursuing profits but of politicians pursuing reelection. Voters are analogous to consumers in this process, but are unable to vote their preferences as precisely as consumers.

Think about the different ways consumers and voters make decisions. The consumer's choice is straightforward: Is this product the best use of my money? In making this decision, consumers tend to evaluate their decisions a great deal. They control the decision: If they buy the product, they will consume it; if they don't buy the product, they will not consume it. All the incentives in the private sector force consumers and firms to realize the value of resources in alternative uses. This moves the economy toward the preferred outcome.

Voters, however, face a choice considerably less straightforward. When a voter chooses a candidate, they face at least three difficulties. First, the preferred candidate may not win. Second, there are hundreds or thousands of decisions politicians make for society. A voter may like some of the decisions a politician makes, but not all. Finally, a politician, once elected, may be unable or unwilling to deliver on his or her promises.[10] The concept that resources have value in alternative uses is lost in the noise of the political decision-making process.

Conclusion

In summary, the process determining the size of a private firm is sensitive to the idea that workers have alternative uses in the market. This pushes the efficient outcome. Government does not operate under such conditions, so there is no guarantee of the efficient outcome. This argument, I believe, explains why states with fewer employees perform well relative to those with many. They have achieved the desired outcome with the fewest resources, leaving those resources to other endeavors.

This article has provided new information to the debate about the size of our government. I have found a small, but significant, negative relationship between the size of government and economic performance. This relationship can be measured as a lag in per-capita personal income. Specifically, a one percentage point increase in the proportion of state employees to all employees in a state is associated with a nine percent drop in economic growth (as measured by per-capita personal income) during the period 1979-2001.

For Oklahoma, a state that has a larger government than average, a reduction in size to the national average would have translated into a $382 increase in per-capita personal income. While this figure is small (it would not have resulted in us "passing" any other state in terms of income), it cannot be ignored. It is a considerable amount of money (I am sure no one would have trouble spending it), and contrary to what some politicians have stated about similar amounts in other contexts, $382 would make a difference in the budgets of almost everyone, especially the poor.

Furthermore, every day in Oklahoma we are bombarded by reports listing us as worst or almost worst in health, child welfare, women's health, teen pregnancy, drug use – the list goes on and on. Nearly without exception, these rankings seem to be highly correlated with per-capita personal income. States with high incomes are burdened less with these social ills. So, increasing our incomes provides benefits beyond more consumption.

Businesses in the private sector must react to market forces that keep them "lean and mean." Private firms must maximize profits and produce outputs as cheaply as possible. Firms that do this serve the economy and are rewarded. Firms that do not do this are punished and forced out of business.

Governments do not operate under the same incentives as firms in the private sector. Oklahoma's state government is not going to go bankrupt if they have too many employees. But, as noted above, the drag on the economy is just like it would be if an inefficient firm remained open.

So, if we are of the opinion that government has a positive role in the economy, we must be diligent and encourage politicians to provide the right services to the economy in the most efficient way possible. To do otherwise will produce a drag on the state's economy as a result of wasted opportunities.

There is good news, however. As a percentage of total employment, state governments are getting smaller. Also, Oklahoma's government is shrinking relative to other state governments. In 2001, the size of state government is only one third of a percent too large, based on the national average. According to the BEA, Oklahoma had about 81,000 state employees in 2001. This is only 6,100 too many, based on the model presented in this article. In 1979, Oklahoma's government was too large, again based on the national average, by one half of one percent of the total work force (about 7,000 excess employees.)

The results presented here are compelling. Although I would consider my findings as preliminary, there is a significant association between small state governments (in terms of employees) and economic performance. The fight against government waste and redundancy is a worthy one. Politicians, voters, and taxpayers should be vigilant and make sure our government is efficient at providing the goods and services we demand. ✪

OCPA adjunct scholar Rex J. Pjesky (Ph.D., University of Oklahoma) is assistant professor of economics at Northeastern State University.

Endnotes

1 The demographic data is readily available from the U.S. Census. All other data in the article comes from the BEA.

2 Other work by OCPA scholars suggests Oklahoma has 15,481 too many employees compared to the national average. This figure is based on state and local employment combined, not just state employment, as is the case with my estimate.

3 Some may think Oklahoma relies on state employees for tasks that other states delegate to local authorities. This argument carries little weight, however. Although there is some evidence of a negative correlation between state and local employment, states with large local governments also have large state governments. This is certainly the case with Oklahoma.

4 These figures are rounded.

5 1979 is the first year the BEA published state government employment. 2001 is the latest year where solid numbers are currently available.

6 Included in the model are other factors that may impact economic growth as well. I included a variable controlling for the importance of farming in a state, the importance of unions in a state, and the state's weather.

7 The t-statistic on this coefficient was -2.5, suggesting a significant statistical relationship.

8 Lower profits signal many other things to businesses as well.

9 Let me qualify this discussion. These remarks are true in a properly functioning market with no fraud.

10 This mainly stems from the fact that no one politician acts unilaterally. A senator, for instance, must get a majority of senators and representatives to agree with her. Then the executive must agree and the judiciary must not object.

School Choice Would Boost Economy

By Lewis M. Andrews

The idea of giving parents control over what schools their children attend, including private and parochial institutions, is increasingly viewed as a way to improve publicly funded education, especially in America's cities. Yet there is growing evidence to suggest that widespread adoption of school choice would not only have great educational benefits, but dramatic *economic* benefits as well.

Indeed, a persuasive case can be made that, even if school choice were educationally neutral, proving to be no better or worse than the current government monopoly, its adoption would give the U.S. economy a powerful and sustainable economic boost.

State Budgets

Let's start with this important fact: According to the National Center for Education Statistics, per pupil spending at religious and independent schools averages $4,600, versus $6,857 at public schools – a difference of $2,257. In 2003, the Yankee Institute conducted a study, published in the October/November issue of *The American Enterprise*, showing that if all 47.6 million American public school students were educated in private or parochial schools the national savings would be greater than the annual total of all state budget deficits. In other words, were public education delivered with private efficiency, *there would be no state budget crisis*.

Since the appearance of the Yankee Institute study, Brian Gottlob, a former vice president of the Business and Industry Association of New Hampshire, has published a revealing paper on the fiscal impact of school choice in his own state. Taking into account all the complex education finance arrangements between the New Hampshire legislature and the towns it governs, Gottlob was able to show that even a modest school choice program would yield significant savings, resulting by 2010 in overall education expenditures 8.5 percent lower, and local education tax rates 7.2 lower, than they otherwise would have been.

The economies promised by both the Yankee and Gottlob studies would undoubtedly be augmented by the freedom of independent schools to avoid the two most common management deficiencies in public education: the tendency of district bureaucrats to spend their entire annual funding allocation, even when the full amount is not needed, and the creation of cost structures that are difficult to streamline in lean or changing times.

Yet as dramatic as the overall savings would be, reducing state and local budgets for public education represents but a fraction of the stimulus that would come from making school choice a universal option.

Hard-Pressed Families

Consider the financial implications of releasing American families from the burden of having to compete for expensive homes in the relatively small number of communities with good public schools. In her 2003 book *The Two-Income Trap: Why Middle-Class Mothers and Fathers Are Going Broke*, co-authored with Amelia Warren Tyagi, Harvard Law professor Elizabeth Warren argues that, in spite of a 75 percent increase in inflation-adjusted wages over the last 30 years, the average family with two working parents actually has less discretionary income than the traditional family with a single wage earner had a generation ago. As a result, "1.6 million Americans will file for bankruptcy this year," she says, while "9 million families … are in credit counseling." Home mortgage foreclosures, credit card defaults, and car foreclosures are all at record levels.

Contrary to common belief, these statistics are not the result of too many undisciplined trips to the mall or buying the latest designer clothes or electronic games for the kids. Apart from higher premiums for health insurance and the second car for the working spouse, Professor Warren finds that the biggest squeeze on middle-class families comes from high mortgage payments for housing in towns with desirable public schools. "What's happening today," says Warren, "is that young parents buy houses with just three thoughts in mind: schools, schools, and schools." The problem is that "in inflation-adjusted dollars, they're paying more than 70 percent more then their parents paid for a house."

Not surprisingly, Warren is sympathetic to the concept of universal school choice. Giving all parents a taxpayer-funded voucher that they could spend at any school, public or private, would "relieve parents from the terrible choice of leaving their kids in lousy schools or bankrupting themselves to escape those schools." Although she does not take her case for school choice to its macro-economic conclusion, it is not hard to see why an education policy that leaves millions of parents with thousands more after-mortgage dollars every year is good for America's financial health. The resulting drop in credit card delinquencies, allowing banks to significantly reduce monthly interest charges, would by itself be a significant economic boost.

Urban Revitalization

The intriguing complement of freeing parents from the need to buy high-priced high real estate in suburbs with above-average public schools is the creation of powerful incentives to revitalize decaying cities and, in the process, retard urban sprawl. As Duke University economist Thomas Nechyba points out, using choice to sever "the link between school quality and residential location" would encourage many middle class families to purchase and renovate homes in blighted urban areas. And since the tuition at many private and parochial schools is less than a third of the per pupil cost at state-subsidized urban schools, municipalities which lure new residents with the promise of school choice would effectively free up millions of dollars to refurbish infrastructure and make their streets safer and more attractive.

In the longer term, school choice would lead to a dramatic increase in the property values of currently distressed city neighborhoods, creating a tax base that would further stimulate local economies. In 1997 economists William Bogart and Brian Cromwell conducted a study for the *National Tax Journal* on "How Much More Is A Good School District Worth?" They compared home prices in an area of Cleveland where some children were permitted to attend highly rated schools in suburban Shaker Heights with other city communities served only by the Cleveland Municipal School District. Bogart and Cromwell found that the opportunity for a family's children to attend superior schools added between $5,303 and $11,648 to the value of a city home. Another study of 134 school districts in six Ohio metropolitan areas found that for every ten percentage points a school district improved its performance relative to neighboring communities, local property values increased by 2.2 percent, or approximately $1,720.

Technology and Travel

If the elimination of state and local budget deficits, the dramatic reduction of mortgage payments by hard-pressed middle class families, and the cost-saving revitalization of America's cities were not enough to spark an economic boom, consider the interesting relationship between the growth in the number of charter schools and the increasing popularity of online education. According to Kathleen Vail, associate editor of the *American School Board Journal*, a growing number of charters are meeting the needs of their communities by becoming "cyber schools," offering online courses to an estimated 40,000 to 50,000 students in the 2001-02 academic year. Already twelve states have virtual high schools, and five more will soon permit similar institutions. Some, such as the Florida Virtual School, offer Internet-based courses to students nationwide.

School choice as economic stimulus

A National School Boards Foundation survey of prominent educators confirms that the more schooling options parents are allowed, the more their children naturally gravitate to online education. What this means from an economic point of view is that further expanding school choice, with vouchers or tax credits for private education, would at the very least give a boost to the software industry. Having students take more courses at home or in school computer labs would also reduce the need for expensive new school construction, the cost of which is inflated in many states by laws requiring that construction workers on municipal projects be paid at the highest prevailing wage.

Another likely beneficiary of a choice-inspired increase in online education is the leisure travel industry, which currently sees most of its profits confined to the few weeks between winter and spring, and the months of July and August, when most families with school aged children are free to travel. One of the intriguing findings about Internet-based education is that most children can learn just as much from so-called "asynchronous courses" – that is, courses offered at any time or at the student's own pace – as they do from being connected simultaneously with other students and a teacher. As school choice allows more and more children to take advantage of online education, their families would be free to vacation during less crowded off-peak periods, allowing a fuller utilization of hotels, airlines, and related travel facilities.

Lessons from Abroad

Traditionally liberal policymakers have sought to stimulate the U.S. economy, not by improving domestic education policy, but by restricting the free flow of labor and goods with rapidly developing countries such as India, Brazil, and China. Perhaps they ought to be paying attention to the fact that these same developing countries are pioneers in the privatization of public education.

India is a leader in Internet-based teaching with the biggest education software center in the world. Brazil has encouraged the growth of large chains of independent schools, with nearly 20 percent of students in the state of São Paulo being educated privately. And in China, school choice has gone from being completely outlawed in the mid-1980s to the point where today 54 percent of pre-schools and nine percent of vocational high schools are privately managed.

What do these "less developed" countries know about stimulating growth that liberal policymakers have yet to discover? Giving parents control over the education of their children is not just sound pedagogy – it's pretty good economics, too. ✪

Lewis M. Andrews, Ph.D. is executive director of the Yankee Institute for Public Policy, a free-market think tank in Hartford, Connecticut. A shorter version of this article appeared June 7 and is reprinted with permission from Investor's Business Daily, Inc.

Beware the OEA's 'Adequacy and Equity' Litigation

By Eric A. Hanushek

Many states are currently locked in court battles in which they are being sued to provide "adequate" funding for their schools. These adequacy suits, which have spilled over into legislatures, represent yet another example of a situation where words and slogans do not match reality.

For three decades state school funding has been driven by a series of court cases concerned with fiscal equity. These cases have a common argument: the individual state constitutions require a greater parity in spending between rich and poor school districts than is typically observed under mixed state and local funding.

But the supporters of the lawsuits were dismayed by the end results. In fact, some state legislatures that were required by the courts to equalize spending across districts did not come up to the highest-spending districts but instead kept the overall level constant. The proponents of these suits were unhappy because their desire had been to pry more school spending out of the states.

In reaction to this apparently unfortunate outcome, a new kind of lawsuit and argument developed – the need for *adequate* spending. Under this new legal strategy, a system could be equalized but could still be inadequate to provide an appropriate education. For example, one group claimed that New York State was not providing the constitutionally required adequate spending to New York City, even though New York City schools were spending more than the average being spent in 42 states.

For the proponents of greater school spending, adopting the word "adequate" was a great coup, similar to adopting the word "equity" many years before. Surely we all want both equitable and adequate spending.

The crucial ingredient to these arguments is an implicit presumption that spending translates directly to school quality. Unfortunately, *a massive amount of evidence indicates that spending on schools is not closely related to school quality or student learning*.

How could this be? In the simplest terms there are too few incentives that reward good performance and too few disincentives to penalize poor performance in our public schools. Schools introduce unproven and unproductive programs. They overpay poor teachers (and underpay good teachers). They tolerate ineffective administrators at the state, district, and individual school level. In sum, they do not ensure that any additional funds will be spent in ways that improve student learning.

Because funding is not related either to overall student performance or to the performance of specific groups – minorities, disadvantaged students, or urban students – it is not a good index of equity. Nor is it possible to calculate how much needs to be spent to ensure adequate student performance.

Thus, when legislatures search for adequacy in funding or when courts demand it, they do not realize that it is a search for the

But Can We Sue for All the Educational Malpractice?

On May 18, State Rep. Odilia Dank (R-Oklahoma City), a former schoolteacher, administered swats to the state's largest school employee labor union. In a delicious press release (available at http://www.lsb.state.ok.us/house/news6809.html), Rep. Dank accused the Oklahoma Education Association's leadership of being "totally irresponsible" and of attempting to threaten the Oklahoma Legislature. (The OEA is filing a lawsuit trying to compel the government to spend more money on its education system.) Rep. Dank reminded the OEA that education *already* receives a large chunk of the state budget, and that the state has "other critical needs, too, such as deteriorating highways and bridges, crowded prisons, and overworked district attorneys. The OEA leadership desperately needs a reality check." For good measure, Rep. Dank pointed out that, "according to the OEA's 2000 tax returns, the president of the OEA received $95,630 in salary, $32,335 in fringe benefits, and $21,192 in compensated expenses. The executive director of the OEA received a salary of $74,400 plus $32,003 in benefits and $20,622 in expenses. Do these highly paid individuals really represent the thinking, and speak on behalf of, the rank-and-file members of their union? I just wonder."

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Holy Grail – a noble but ultimately futile effort. The proponents of adequacy on the other hand know exactly what is going on. By exploiting this term, they are able to press for greater spending, knowing that whatever is spent now will be insufficient and that more will be needed tomorrow.

When asked to rally around equity and adequacy in education, be skeptical because those words do not mean what you think they do. ✪

Dr. Hanushek (Ph.D. in economics, Massachusetts Institute of Technology) is the Paul and Jean Hanna Senior Fellow at the Hoover Institution and a research associate at the National Bureau of Economic Research.

Why Don't Teachers Get Paid Like Doctors?

By David W. Kirkpatrick

That was a question Chris Matthews once posed to William Bennett on the program "Hardball with Chris Matthews." It's a question often posed by teachers themselves, and their unions. Bennett replied that teachers don't reach that level because their unions object to merit pay, or to some teachers earning more than others with equivalent experience and credits.

That is part of the story. But teachers didn't receive equivalent pay with doctors before there were effective teacher unions, nor will they should unions disappear.

For one thing, teachers don't undergo the intensive preparation required of doctors. Qualifications required to enter a medical training program exceed anything required by any of the nation's 1,200 teaching preparation programs.

Another reason is that there are several times as many public school teachers as doctors. Thus it would cost far more to pay teachers at the same average level as doctors.

In addition, while education has more specialized certificates than any other profession, the differences don't begin to match the distinctions in medicine between family practitioners, surgeons, anesthesiologists, and so on. All of these require lengthier, more detailed and costlier training than in education, and much stricter entry qualifications.

A key role that teacher unions, and most teachers themselves, play in limiting teacher salaries is their constant effort to reduce class size. Class size does make a difference, but it is a difference that depends on many variables, including the subject matter, teacher qualities, grade level, and teaching method. That there is a difference based on some arbitrary number of students – 25, 20, 15, whatever – is incorrect. From an economic standpoint, this is about the most expensive "reform" that can be made. In the past few years California has spent billions of dollars reducing class sizes. Nowhere has it justified the cost and in some places student achievement has declined.

If teachers functioned like professionals – having to attract students on a voluntary basis – then they could be paid accordingly.

The insistence that more and more teachers should teach fewer and fewer pupils is a guarantee that average teacher salaries will be lower than would otherwise be the case. By and large, the public is not concerned about the salaries of individual teachers, any more than they are concerned about the income of individual doctors. What does concern them is the total bill, that is, the taxes they pay.

Finally, while not exhaustive of this subject, teachers don't get paid like doctors because they don't get paid on a similar basis. Doctors work in a mutually acceptable relationship with their patients. With rare exceptions, such as in the military and prisons, no one is required to use the services of a particular doctor and/or pay that doctor's fees. It is the number of patients they attract, and the fees they can charge, that determine how much each doctor is paid.

Parents rarely have a say as to which teacher(s) their children have, or what teachers do, and even less to say about what teachers get paid.

In brief, too many teachers, who want to be paid as much as doctors or other professionals, are afraid to function like doctors and other professionals – on a mutually acceptable basis with those they serve. To their own detriment, they oppose implementing the constitutional right of parental choice (*Pierce vs. the Society of Sisters*, U.S. Supreme Court, 268 U.S. 510, June 1, 1925). If school choice was widely implemented and teachers had to attract students on a voluntary basis, they could then be paid accordingly.

Parental choice will free teachers more than students or parents – just as in medicine it is the doctors who are freer than their patients. Doctors make the basic medical decisions, and rightly so. What patients ask, and receive, is the right and the ability to go to the doctor of their choice.

As long as teachers insist on having a captive audience and being collectively paid on a standard basis, they will continue to be victimized by their own insecurity. ✪

Retired public educator David W. Kirkpatrick (M.A., Lehigh University) is a senior education fellow at the U.S. Freedom Foundation. For more than a dozen years he served as a top officer or staff member of NEA or AFT affiliates. He is a life member of the NEA.

OCPA Policy Seminar Successful

By Brett A. Magbee

Even in the midst of all the activities related to construction on our new headquarters, the OCPA staff is not neglecting its primary responsibility to educate and inform those who work (or seek to work) in the public policy arena. Policy briefings are an important service provided by OCPA. Experts in key policy areas are gathered at such forums to assist in identifying workable solutions to important and timely issues. Such was the case June 24 when OCPA hosted a special policy seminar at the Cox Convention Center in Oklahoma City for legislators and candidates. Each of the six sessions which filled the day was followed by an opportunity for questions and answers.

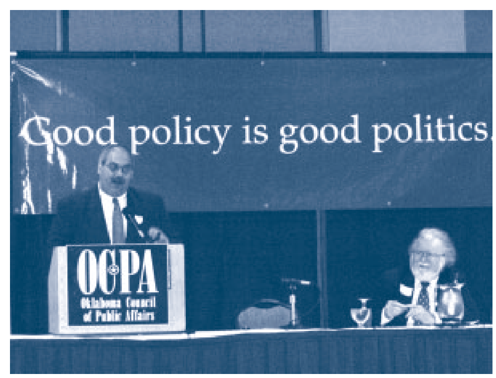
The briefing began at 8:30 a.m. with OCPA president Mark Nichols welcoming attendees to the inaugural seminar. He then introduced Brandon Dutcher, OCPA's vice president for policy, who served as moderator for the seminar. "We believe that ideas which promote free enterprise and limited government are better than ideas which promote high taxes and big government," Dutcher said. "But we're not naïve. We understand that legislators have to operate within the realm of politics and they can't be expected to fall on their swords for every bright idea that conservatives might put forward." But he added that there is solid support for conservative principles in Oklahoma, citing polling data which shows that 69 percent of registered voters in this state identify themselves as conservatives. "We believe that conservatives should run on their ideas, get elected, and then govern as conservatives," Dutcher said. "There's no reason that we have to maintain the status quo in this state."

Dutcher introduced the first topic for discussion: Oklahoma's state budget. Panelists were Steve Anderson, a CPA with the firm Thomas and Anderson; Alison Fraser, director of the Roe Institute for Economic Policy Studies at The Heritage Foundation; and Steve Moore, president of the Club for Growth and a senior fellow at The Cato Institute.

Mr. Anderson, who also spent two years as a budget analyst in the Oklahoma Office of State Finance, summarized the state budget thusly: "It's too big. Waste is everywhere. There's no way to measure success in government. Government accounting is a black hole." He pointed out that there is no net profit that washes out the inefficiencies like in private business. "Government accounting merely tracks

Senate Minority Leader James Williamson (R-Tulsa) discusses health care reform with Nina Owcharenko, health care analyst at the Heritage Foundation.

Cato Institute scholar David Salisbury discusses school choice while Krista Kafer of the Heritage Foundation looks on.



OCPA adjunct scholar Andrew Spiropoulos discusses lawsuit reform. To his left is OCPA adjunct scholar Ronald Moomaw.

Rep. John Nance (R-Bethany) and Nate Webb, chief of staff for Lt. Gov. Mary Fallin, chat with Alison Fraser of the Heritage Foundation.

OCPA's Brandon Dutcher and economists Robert Lawson, Dan Sutter, and Stephen Moore listen to a question from a legislator.

funds through the system," he said. There is no way citizens can measure the efficiency of an agency. While performance measures are often talked about, Anderson said they are fraught with problems because the agencies themselves develop their own performance measures.

Inefficiencies add to the other struggles Oklahoma is burdened with. "When we look at personal income on a per person basis and compare that with the rest of the country, we find that Oklahoma has been lagging traditionally and historically at about 80 to 85 percent of the income level of the rest of the country," Fraser said. "This is a direct result of a lot of Oklahoma's policies." She said Oklahoma has an *income* problem and pointed out that Oklahoma's population has not been keeping up with the rest of the country. The state's tax burden is increasing, leading Fraser to note that Oklahoma not only has an income problem, but a population problem, a tax problem *and* a spending problem. A series of charts prepared by Fraser provided attendees with a snapshot view of Oklahoma's current crisis and clear perspective of what we should be doing as a state to turn it around.

Moore agreed wholeheartedly with Fraser's analysis, and pointed out that California is currently suffering under the very policies that are plaguing other states like Oklahoma. Moore, who has been advising Gov. Arnold Schwarzenegger, said California has a bigger budget deficit than the other 49 states combined. "What has happened in California is that they have literally taxed their way to a depression. You've got this sort of left-wing culture in Sacramento where they treat rich people and business as if they are kind of enemies to the state."

As a result, businesses and people are moving out of the state. "For the first time in the history of the state of California, more people are leaving California than are entering California," Moore said. "People have been driven away by the high taxes and regulation." He also said that Oklahoma has a much more serious problem than a budget deficit – a growth deficit (see page 1).

As with all the topics, specific recommendations were made which could transform the status quo in Oklahoma and provide a good environment for growth and reinvestment.

In another panel, Nina Owcharenko of the Heritage Foundation discussed health care reform, and Krista Kafer of the Heritage Foundation and David Salisbury of the Cato Institute discussed improving education by giving parents more choices.

Steve Moore gave the keynote address at a luncheon entitled "A Pro-Growth Agenda for Oklahoma," which garnered publicity the next day in *The Oklahoman* and the *Journal Record*.

Other topics discussed after lunch included lawsuit reform with OCPA adjunct scholars Andrew Spiropoulos and Ronald Moomaw, and economic freedom and taxes with Stephen Moore, Robert Lawson, and OCPA adjunct scholar Dan Sutter. To complete the day, pollster Pat McFerron of Cole Hargrave Snodgrass & Associates presented detailed polling results which suggest that, indeed, good policy is good politics.

As a result of the seminar, many legislators and future legislators have a better grasp on the issues which impact Oklahomans and things they can do to help our state become a model of free-market ideas in action.

We need your support to continue to make such important forums possible. Please consider making a special summertime contribution to our efforts. Your generosity will be contributing factor to making Oklahoma competitive with other states in our region for businesses, jobs and families. Support our Capitol Freedom Fund effort today! ✪

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QUOTE UNQUOTE

"If you serve a child a rotten hamburger in America, federal, state and local agencies will investigate you, summon you, close you down, whatever. But if you provide a child with a rotten education, nothing happens, except that you're liable to be given more money to do it with."

Ronald Reagan

"The state is the great fiction by which everybody tries to live at the expense of everybody else."

Frédéric Bastiat

"Senator Charles Ford (R-Tulsa) has seen many things during his 38 years in the state Legislature. One thing he has never seen is Democrat legislative leaders abandon their trial lawyer allies – and he doesn't expect them to start now by allowing meaningful lawsuit reform and workers compensation reform legislation to pass the Senate. 'From the viewpoint of the public and the media, there seems to be some momentum on the side of lawsuit reform and workers comp reform happening in the Legislature this year. But I've seen this dog and pony show before, and there is no way the Democrat leadership in the Senate will cross the trial lawyers,' said Ford, a former minority floor leader and the dean of the Oklahoma Legislature. 'In the Senate, the trial lawyers always seem to win in the end.'

Ford said he also has doubts about Governor Brad Henry's recent conversion on the issues of lawsuit reform and workers compensation reform. 'I served with the governor for ten years in the Senate, and his actions here showed he is no friend of lawsuit reform or workers comp reform. While Governor Henry was chairman of the Senate Judiciary Committee, any workers comp or lawsuit reform bill that came his way never seemed to get a committee hearing unless it was approved by the trial bar. It is hard to believe Governor Henry has suddenly seen the light and now supports reform. Of course, the governor can afford to say he's now for reform because he knows the Senate Democrat leadership will do the trial lawyers' dirty work for him and won't let a real reform bill see the light of day,' Ford said. Ford predicted the lawsuit reform and workers compensation reform bills will end up in a House-Senate conference committee where the bills will be gutted or killed."

The text of a press release issued by state Sen. Charles Ford on March 17, 2004 – ten weeks before the end of the legislative session

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