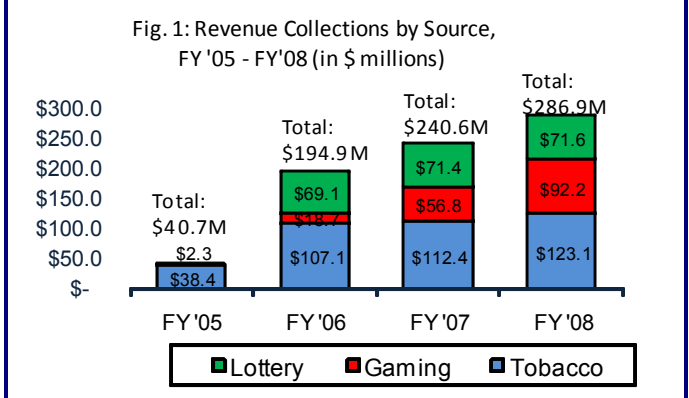


Lottery, Gaming and Tobacco Measures Generated \$287 Million in FY '08

In 2004, Oklahoma voters approved a series of measures intended to raise new revenues for education and health care through a state lottery (SQ 705 and 706), gaming compacts (SQ 712), and increased tobacco taxes (SQ 713). During the most recently completed budget year, Oklahoma collected \$286.9 million from these three revenue sources.

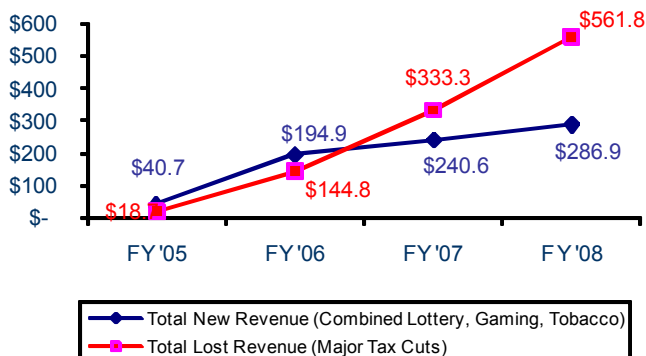
The state collected \$123.1 million from increased tobacco taxes, \$92.2 million from gaming at tribal casinos and racetracks, and \$71.6 million from the state lottery in FY '08. Revenues from the lottery and gaming are dedicated for education, while revenues from the tobacco tax increase are earmarked for health care projects. Since their approval four years ago, the three new revenue sources have generated a total of \$763.1 million in new funding for education and health care.

- The \$286.9 million in collections from the three sources in FY '08 represents an increase of \$46 million, or 19 percent, from FY '07.
- Three-quarters of the total FY '08 increase, or \$35 million, resulted from an increase in tribal gaming revenues subject to the model compact approved in SQ 712. Gaming revenues grew 62 percent in FY '08 and are five times greater than two years previously.
- Tobacco revenues from the increased tobacco taxes approved in SQ 713 were up \$11 million, or 9.5 percent, in FY '08.
- Lottery net proceeds in FY '08, at \$71.6 million, were essentially flat compared to the \$71.4 in net proceeds generated in FY '07 under the terms of SQ 705 and SQ 706.



While the new revenues generated by the so-called "sin taxes" approved by voters in 2004 have boosted funding for education and health care, these gains have been more than offset by the revenue impact of tax cuts approved by the Legislature in recent years. As can be seen in Fig. 2, the major tax cuts adopted between 2004 and 2006 had an estimated revenue loss of \$562 million in FY '08, which is just under twice the amount of the revenue gain from the lottery, gaming and tobacco. Based on the allocation of revenues by agency in the FY '08 budget, we calculate that *in the absence of both the new revenue sources and the tax cuts*, the education agencies funded by the lottery and gaming (Common Education, Higher Education and Career Tech) would have been appropriated some \$127 million more than they actually received (Table 1). By contrast, the combination of the tobacco tax increase and tax cuts led to a net funding increase for health care agencies supported by the tobacco tax (Oklahoma Health Care Authority and Health Department).

Fig. 2: Estimated Revenue Impact of New Revenue Measures Compared to Major Tax Cuts, FY '05 - FY '08 (in \$ millions)



New revenues do not include tribal tobacco tax proceeds. Revenue losses are Oklahoma Tax Commission projections

Table 1: Impact of New Revenue Sources compared to Impact of Tax Cuts, by Agency, FY '08 Budget

Agency	FY '08 Funding from New Revenue Sources	FY '08 Lost Funding due to tax cuts	Net Impact
Common Education*	\$ 117.4	\$ 210.5	\$ (93.1)
Higher Education	\$ 45.2	\$ 71.4	\$ (26.2)
Career Tech	\$ 4.5	\$ 12.5	\$ (8.0)
OHCA	\$ 91.3	\$ 63.3	\$ 28.0
Health	\$ 15.2	\$ 6.1	\$ 9.1
Mental Health	\$ 5.0	\$ 17.2	\$ (12.3)
Corrections		\$ 37.0	\$ (37.0)
DHS		\$ 44.1	\$ (44.1)
Other Agencies**	\$ 11.6	\$ 71.7	\$ (60.2)

*Teachers Retirement System included in Common Ed

**Funding from new revenue sources are for comprehensive cancer center and OSU-COM. Assumes that additional revenues to GR Fund and HB 1017 Fund in the absence of tax cuts would have been allocated in same proportions as actual revenues

SQ 705 and SQ 706: The Oklahoma Education Lottery

In 2004, Oklahoma voters approved three revenue-raising measures that offered the promise of additional state funding for key public services. These fact sheets explore the outcome of these new revenue sources four years later.

The Oklahoma Education Lottery was created by passage of SQ 705 and SQ 706 in 2004. Under the terms of these two measures, at least 30 percent of gross revenue during the first two years of the lottery and 35 percent of gross revenue thereafter would be dedicated as net proceeds to the Oklahoma Education Lottery Trust Fund for appropriations. The distribution of lottery net proceeds was specified as follows:

K – 12 funding, including early childhood programs	45%
Higher Education Tuition Assistance	
Capital projects (all levels of education)	
Technology improvement (all levels of education)	45%
Endowed Chair Professorships for Higher Education	
School for the Deaf and Blind	
School Consolidation Fund	5%
Teacher's Retirement Fund	5%

The Lottery Trust Fund is a certified fund, meaning that the Legislature can appropriate up to 95 percent of estimated collections for the upcoming fiscal year. If collections exceed the appropriated amount, the surplus is rolled over and is available to be appropriated in subsequent years. If lottery revenues come in the below appropriated amount, agencies must either absorb the difference or the Legislature must identify additional funds.

Table 1 presents the revenue and expenditure history of the lottery for its first three years of operation, along with projections for FY '09. Total revenue in the lottery's first year, FY '06, was \$205.4 million and grew modestly, by 5 percent, to \$216.3 million in FY '07, with the addition of Powerball. However, revenues flattened in FY '08 and are projected to decline slightly (-3.0 percent) in FY '09. New revenue from Powerball and, more recently, Hot Lotto, has been offset by declining revenue from instant scratch-off games.

Net proceeds from lottery revenues to the Oklahoma Education Lottery Trust Fund totaled \$69.0 million in FY '06, \$71.4 million in FY '07 and \$78.4 million in FY '08 (which included carryover funds). Revenues in FY '07 fell considerably below the certified estimate, creating a shortfall of \$46.3 million in appropriations to the agencies and programs supported by lottery funds. The Legislature ap-

propriated \$69.3 million in lottery funds in the current budget (FY '09).

Lottery net proceeds are allocated between several agencies as set out by the statutes. As can be seen from Table 1, lottery funds have been dedicated by the Legislature to different education-related purposes in different years. These have included a mix of capital and operating costs, as well as both on-going and one-time expenditures. For the most part, lottery revenues have been blended with other revenues to support programs, rather than being dedicated to any distinct, ongoing and identifiable purpose.

Over the past two years, the Lottery Commission has proposed amending the lottery statutes to eliminate or reduce the mandated profit percentage ensuring a fixed amount (35 percent) as net proceeds. This change is intended to allow for higher payouts, which the Commission contends is needed to boost lottery sales and help the lottery meet its funding goals for education. The Commission was unsuccessful in efforts to bring about legislative changes in 2008 but remains actively committed to this goal during the 2009 session.

TABLE 1: Education Lottery Trust Fund Revenues and Appropriations

	FY'06 Actual	FY'07 Actual	FY'08 Actual	FY'09 Budgeted
LOTTERY REVENUES				
Total Revenues	\$ 205.4	\$ 215.2	\$ 214.4	\$ 208.1
Share of net proceeds/profit	33.6%	33.2%	33.4%	35.0%
Actual Net Proceeds	\$ 69.0	\$ 71.4	\$ 71.6	\$ 72.8
Available Prior-Year Carryover	\$ -	\$ -	\$ 6.8	\$ -
Total Lottery Net Proceeds	\$ 69.0	\$ 71.4	\$ 78.4	\$ 72.8
APPROPRIATIONS OF LOTTERY FUNDS				
General operating	\$ 28.0		\$ 39.9	\$ 31.2
Teacher pay/raise		\$ 53.0		
Consolidation	\$ 3.1	\$ 5.9	\$ 4.4	\$ 3.5
OTRS	\$ 3.1	\$ 5.9	\$ 4.4	\$ 3.5
Total Lottery Funds for Common Education	\$ 34.2	\$ 64.8	\$ 48.7	\$ 38.2
Construction, renovations or repairs	\$ 23.0	\$ 33.0	\$ 35.4	\$ 27.3
General operating		\$ 13.7		
Scholarships	\$ 5.0			
Total Lottery Funds for Higher Education	\$ 28.0	\$ 46.7	\$ 35.4	\$ 27.3
General operating and construction		\$ 6.0	\$ 4.5	\$ 3.8
Total Lottery Funds for Career Tech		\$ 6.0	\$ 4.5	\$ 3.8
Lottery Funds for Dept of Rehab Services		\$ 0.3		
Total Appropriations	\$ 62.2	\$ 117.8	\$ 88.6	\$ 69.3
Surplus/Shortfall	\$ 6.8	\$ (46.4)	\$ (10.2)	\$ 3.5

SQ 712: State-Tribal Gaming Act

In 2004, Oklahoma voters approved three revenue-raising measures that offered the promise of additional state funding for key public services. These fact sheets explore the outcome of these new revenue sources four years later.

SQ 712, which Oklahoma voters approved in the fall of 2004, had two principal components:

- It authorized a set number of gaming terminals at each of three racetracks (Remington Park, Blue Ribbon Downs and Will Rogers), and authorized or prohibited specific categories of games;
- It set up a model compact between the state and Native American tribes to regulate tribal gaming operations. Under the compact, tribes were authorized to operate specified games in return for making exclusivity payments to the state.

The measure provides for the state to receive a share of gaming revenues generated by the compacting tribes and race-

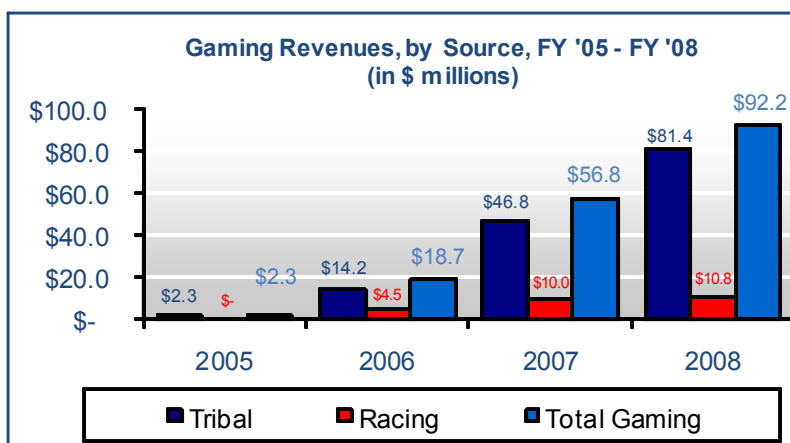
tracks. The state's share of adjusted gross revenues begins at 4 percent of tribal games subject to the compact (10 percent for card games), and at 10 percent of revenues from racetrack gaming. The state share rises if revenues from particular tribes and racetracks exceed certain thresholds.

After an initial \$250,000 is allocated to the Department of Mental Health and Substance Abuse Services for gambling education and treatment, 100 percent of gaming revenues are allocated to the 1017 Education Reform Fund, which can be appropriated only to the Department of Common Education. Until FY '09, 12 percent of gaming revenues were allocated to the Oklahoma Higher Education Learning Access Program (OHLAP) Trust Fund for scholarships.

The Office of State Finance originally projected \$71.8 million in annual state revenues from gaming at the time of SQ 712 in

2004. Actual collections initially fell substantially below the estimate, as both tribal casinos and racetracks only gradually installed revenue-generating games. State revenues from gaming grew from \$2.3 million in FY '05 to \$18.7 million in FY '06, \$56.8 million in FY '07, and \$92.2 million in FY '08. The Legislature appropriated \$89.0 million in gaming revenues in the FY '09 budget; actual collections are likely to come in above this amount.

Of the \$92.2 million collected in FY '08, \$81.4 million (88 percent) came from tribal gaming and \$10.0 million (12 percent) from the racetracks. These revenues can be further broken down as follows:



- Over 60 percent of the \$81.4 million in tribal gaming revenues in FY '08 came from three tribes – the Chickasha (\$21.5 million), Choctaw (\$18.0 million) and Cherokee Nation (\$11.5 million). Five tribes—the Citizen Pottawotami, Miami Nation, Muscogee (Creek), Osage and Tonkawa—contributed

between \$2 million and \$5 million. In total, 28 tribes paid exclusivity fees to the state under the compact.

- Revenue from *electronic games* made up over eighty percent of tribal gaming revenues and grew 96 percent between FY '07 and FY '08. *Card games* made up the remaining 12 percent of gaming revenue and grew by 13 percent in FY '08
- About 70 percent of racetrack gaming revenue is from machines at Remington Park, 25 percent from Will Rogers Downs and 5 percent from Blue Ribbon Downs.

SQ 713: Tobacco Tax Increase

In 2004, Oklahoma voters approved three revenue-raising measures that offered the promise of additional state funding for key public services. These fact sheets explore the outcome of these new revenue sources four years later.

SQ 713 increased the excise tax on cigarettes and other tobacco products, while eliminating the state and local sales tax on these products.

The amount of the tax increase approved by SQ 713 differed for tribal and non-tribal retailers. For non-tribal retailers, the cigarette tax was increased by 80 cents per pack of cigarettes to \$1.03 per pack, with an offsetting elimination of twenty-five cents per pack in state and local sales taxes. For tribal retailers, the situation was more complicated, with retailers subject to one of six different rates depending on their geographic location and status of their compact with the state. The tribal tax rate ranges from a maximum of 85.75 cents per pack for a tribe that has negotiated a revised compact with the state, to a minimum of 5.75 cents for tribes under a "proximity exemption". Taxes were also increased on other tobacco products.

A total of **seven health care projects** were targeted for support from new revenues generated by the tobacco tax increases, as follows:

- Oklahoma Health Care Authority for Medicaid provider payments and services for developmentally disabled children (40.06 percent);
- Health Employee and Economy Improvement Act Fund to assist low-income employees buy into employer or public health insurance coverage (33.49 percent).
 - Through FY '08, this fund had collected \$128 million, far more than what was expended on the Insure Oklahoma premium assistance program. In 2008, the Legislature transferred \$108.2 million out of the fund to cover general operating expenses of the Medicaid program;
- Trauma Care Assistance Fund to support emergency trauma care (11.39 percent);
- Comprehensive Cancer Center Debt Service Fund for bond payments on a new OU cancer center (4.69 percent);
- OSU College of Medicine Fund for telemedicine and indigent care (4.69 percent);
- Department of Mental Health and Substance Abuse Services for adolescent substance abuse centers and services (4.01 percent);
- Tobacco Prevention and Cessation Fund for anti-tobacco efforts (1.00 percent)

- Breast and Cervical Cancer Treatment Fund to fund Medicaid coverage of cancer treatment (0.67 percent).

In total, projections were for the tobacco tax increases to generate an additional \$150 million annually in new revenue for health care projects. As can be seen from the Table, the tobacco tax increase has generated a considerable amount of additional funding for health care projects but has fallen well short of projections. The tax increase, which took effect mid-way through FY '05 (Jan. 1, 2005) initially generated an additional \$38.4 million in FY '05 before rising to \$107.1 million in FY '06, \$112.4 million in FY '07, and \$123.1 million in FY '08.

Net revenue collections from *non-tribal retailers* came in at \$103.5 million in FY '08, exactly in line with the state's original revenue projections. By contrast, *tribal* tax collections for health care projects totaled just \$19.6 million in FY '08. This represents a slight increase from previous years, but is far short of the \$45.8 million projected from tribal sales in the run-up to SQ 713.

Most of the shortfall in actual tobacco tax collections projections is a result of a shift within tribal tobacco sales to retailers selling cigarettes with the lowest-tax proximity exception rate. During the first two years that the new tax rates were in effect, a full two-thirds (67.5 percent) of all tribal cigarette sales were made under the 5.75 cent exception rate. As a result of a variety of measures aimed at curtailing tribal retailers from purchasing and reselling cigarettes stamped with the lowest rate, the prevalence of the exception rate has declined. During FY '08, just under half (46.9 percent) of tribal cigarettes were sold with the 5.75 cent exception rate. The state has now negotiated a new "unity rate" of 51.5 cents per pack with the Comanche, Kaw and Ote-Missouri nations which took effect July 1, 2008 and which may further cut into sales at the lowest exception rate. Still, only 19.8 percent of tribal cigarette sales in FY '08 were made under the new compacts which impose the highest tax rate of 85.75 cents per pack.

Since passage of SQ 713, total cigarette sales have declined in Oklahoma. In FY '08, a total of 313.7 million cigarette stamps were sold, a 12.1 percent decrease compared to FY '03, the last full year under the old tax rate. Cigarette sales in FY '08 grew by 2.1 percent compared to the previous year.

Allocation of Increased Revenue from Cigarette and Tobacco Products

	2005 Total	2006 Total	2007 Total	2008 Total
Oklahoma Health Care Authority	\$ 15,395,095	\$ 43,302,211	\$ 45,015,862	\$ 49,311,280
Health Employee and Economy Improvement Act Fund	\$ 12,873,394	\$ 36,209,940	\$ 37,642,694	\$ 41,224,132
Trauma Care Assistance Fund	\$ 4,376,965	\$ 11,311,167	\$ 12,798,389	\$ 14,019,643
Comprehensive Cancer Center Debt Service Fund	\$ 1,803,145	\$ 5,071,903	\$ 5,272,565	\$ 5,775,567
OSU-COM Fund	\$ 1,803,145	\$ 5,071,903	\$ 5,272,565	\$ 5,775,567
Dept. of Mental Health and Substance Abuse Services	\$ 1,545,646	\$ 4,348,341	\$ 4,520,093	\$ 4,950,773
Tobacco Prevention and Cessation Fund	\$ 385,031	\$ 1,083,126	\$ 1,125,937	\$ 1,233,274
Breast and Cervical Cancer Treatment Fund	\$ 256,890	\$ 722,453	\$ 751,131	\$ 822,835
TOTAL HEALTH CARE PROJECTS	\$ 38,439,311	\$ 107,121,044	\$ 112,399,235	\$ 123,113,072
Amounts do not include rebates to replace lost sales tax revenues or tribal trust allocations				

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