



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

Taxing times

At the dawn of a new legislative session, current government expenses once again exceed expected revenues and agencies are lining up with \$2 billion in additional requests. Policymakers and the public are questioning whether Oklahoma taxes too little or too much, if the state has the right mix of taxes, and what the state should or should not be incentivizing through tax policy.

For years, the discussion about Oklahoma's tax structure has focused on eliminating the income tax. Mostly ignored is how to replace the more than one-third of state revenue it generates.

Nine states don't tax personal income. Only one state, Alaska, eliminated the personal income tax, but it did so by depending almost entirely on oil and gas industry taxes. Two no-income-tax states – Florida and Washington – have higher tax burdens than some income-tax-assessing states, including Oklahoma, according to the Tax Foundation. Tax burden is defined as the collective weight of all taxes levied on an individual.

Tax structures, the sources of taxation and their relative weight, reflect states' natural endowments, as well as cultural

and political preferences. For example, the Tax Foundation lists Oklahoma's property tax burden at one-third that of no-income-tax Texas. Oklahoma's personal income tax rate falls near the middle of those states that collect it. Two categories show Oklahoma as an outlier with the fifth highest sales tax rate in the nation and the second lowest property tax collections per capita.

These rankings suggest there could be room to rebalance Oklahoma's taxes, perhaps resulting in a structure that is lower, broader and fairer. But recent

SEE TAXES PAGE 3

Inside

- Guest commentary by Senate President Pro Tempore Brian Bingman
- White House withdraws proposed tax hike for college savings
- America needs tax exempt municipal bonds
- Oklahoma economy expands in 2014
- December unemployment drops to 4.2 percent

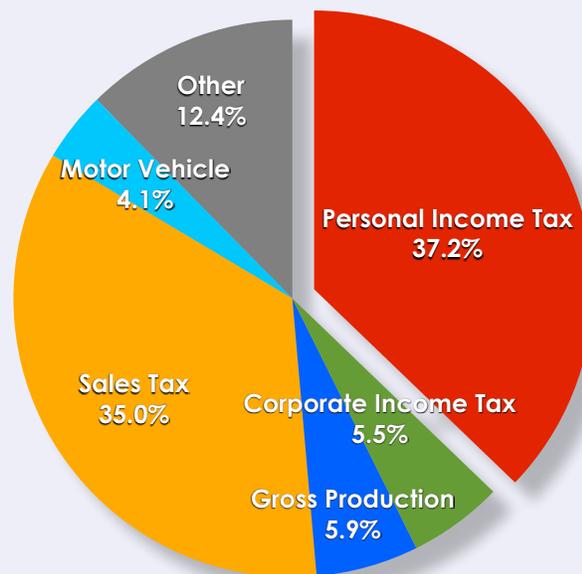
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Composition of Oklahoma General Revenue Fund



Fiscal Year 2014 (in millions)

Personal Income Tax	\$2,084.98
Corporate Income Tax	\$306.54
Gross Production	\$333.20
Sales Tax	\$1,959.40
Motor Vehicle	\$228.00
Other	\$693.40
Total	\$5,605.60

Source: Office of Management and Enterprise Services



Guest Commentary

By Senator President Pro Tem Brian Bingman

Furthering our economic momentum

The past several years have been an extraordinary success story for Oklahoma. Much of our growth and development over this period has been made possible by a Legislature focused on jobs and the economy.

The legislative efforts of recent years have helped our state’s economy become one of the nation’s leaders for job growth and economic development. Unemployment has reached its lowest level since 2008, and we are expected to be one of the nation’s leading job creators this year. Since 2010, we have also been one of the top three states in the country for personal income growth.

Clearly, Oklahoma is headed in the right direction, but we cannot rest on our laurels.

As we approach a new legislative session, the challenge in front of us is to sustain and further our considerable economic momentum. To do so, I believe we should turn our attention to the future, and pursue reforms that will enable prosperity and advancement for many years to come. This begins in the classroom. It’s time for us to build a world-class school system that helps Oklahoma children maximize their tremendous potential.

Employers considering Oklahoma

for relocation or expansion want to be assured our schools are producing students that can meet their needs. Every child in Oklahoma has a right to a first-rate education that will adequately prepare them for the career of their choosing.

Our approach to education should be squarely focused on what is best for our young people, and we will support them in their efforts to succeed. We believe in our hard-working educators and will work with them and Oklahoma parents to strengthen our schools.

“Recent figures have made it clear we will face a challenging budget year. In the coming session, we will need to emphasize fiscal responsibility.”

It is also critical that we protect major legislative achievements that have energized our economy, including our historic reform of Oklahoma’s workers’ compensation system. Our



reform efforts are saving money for employers and protecting injured workers. Workers’ compensation premium levels have decreased by more than 22 percent since our passage of the law. These savings are being reinvested into the economy by companies that are growing and creating jobs.

Recent figures have made it clear we will face a challenging budget year. In the coming session, we will need to emphasize fiscal responsibility. Crafting a more efficient state government that gets the most out of the contributions of Oklahoma taxpayers should always be a priority for us.

I’m confident that our efforts in the coming session will further our status as one of the nation’s leaders in economic growth. We’ve made great progress in recent years, and I look forward to the opportunities and challenges ahead.



Taxes

FROM PAGE 1

history shows that comprehensive tax reform is difficult to achieve. A 2001 study conducted for Governor Frank Keating and legislative leaders suggested that to eliminate the personal income tax, the state would have to expand the state sales tax base by taxing services, and/or create new revenue sources, including a state property tax.

A decade later, another study commissioned by Governor Mary Fallin proposed a 10-year plan to reduce and ultimately end the state’s personal income tax. The task force suggested

offsetting the loss of a “substantial source of revenue” by eliminating credits and exemptions or finding new revenue streams – again proposing a sales tax on services or a state property tax.

The panel listed two options for phasing out the income tax without new revenue: identify upfront spending cuts equal to the revenue reduction, or limit appropriations to 90 percent of certified revenues, with five percent dedicated to an income tax reduction fund to allow spending cuts to be phased-in over time. Comprehensive tax reform has proven illusive, while tax cuts without offsets

have been embraced. Oklahoma’s income tax rate now sits at 5.25 percent and will drop to five percent next January. A trigger waits in the wings to bring it down another 0.15 percentage point contingent on future revenue growth.

Even with Oklahoma income tax rates coming down, some policymakers and advocates are intent on going much further, believing that states taxing income is unacceptable. Oddly, those ideologically against taxing income at the state level seem to be for it at the federal level. Notably, Art Laffer and Grover Norquist both advocate for a flat federal income tax.

Nonetheless, the no-income-tax argument uses competition among the states for jobs as its main selling point. This argument is akin to states using tax incentives to gain competitive advantage. Today, all states would be better off if they had not veered from free market principles and the game had never begun. But, 50 dominoes have already fallen, leaving states with less revenue and little artificial competitive advantage.

Under this no-income-tax race-to-the-bottom scenario, states would continually work to undercut each other’s income tax rates, ultimately leading to no competitive advantage, no income tax revenue, and a less diversified and balanced revenue structure.

Advocates of exempting personal income from taxes can learn from the

SEE TAXES PAGE 4

Income Taxes versus Growth

Regional

	State Income Tax Rates	Per Capita Income Growth 2009-2013
Oklahoma	5.25%	20.1%
Texas	none	17.9
Arkansas	7.00	14.1
Kansas	4.80	13.4
Colorado	4.63	12.3
New Mexico	4.90	11.7
Missouri	6.00	9.8

Oklahoma vs. States with no income tax

	State & Local Tax Burden (Percentage of income)	Per Capita Income Growth 2009-2013
Oklahoma	8.5%	20.1%
Texas	7.5	17.9
Wyoming	6.9	17.2
South Dakota	7.1	16.3
New Hampshire	8.0	14.5
Tennessee	7.6	14.3
Alaska	7.0	13.0
Washington	9.4	11.7
Florida	9.2	11.7
Nevada	8.1	5.6

Note: State income tax figures based on top tax rate as of January 1, 2014.
Sources: Federal Reserve Economic Data, U.S. BEA, The Tax Foundation



Taxes

FROM PAGE 3

Kansas experience. In 2012, Kansas cut its top income tax rate from 6.45 percent to 4.9 percent. With the start of 2015, the tax rate fell to 4.6 percent, and will eventually reach 3.9 percent.

In 2013, faced with plunging revenue collections, Kansas reduced a scheduled sales tax rate decrease to help cushion the impact of the income tax cut. Unable or unwilling to offset reduced revenue with additional budget cuts, the state is now implementing less than ideal fiscal practices to keep government operating. Governor Sam Brownback plans to transfer funds dedicated for highways, sweep various other accounts, raise sin taxes and reduce the state's scheduled payments to the retirement system. Fallout from the Kansas tax cut experiment has also resulted in a downgrade of the state's credit rating.

Still, some are heralding the Kansas tax cut plan as a success, even as Brownback adjusts his position. He was narrowly re-elected in November with less than 50 percent of the vote after campaigning on his tax cut package, but is now distancing himself from the policy.

Recently, Brownback reaffirmed his commitment to eliminating the state income tax, but conceded the tax cut he signed was not the one he wanted. "I proposed a flat tax with a small budget accelerator. What I got from the Legislature was a naked tax cut with none of the pay-fors," he said.

“Oklahoma’s per capita income growth has surpassed that of every non-income-tax state.”

Supporters of Kansas’ tax policy contend that the state’s growing economy is proof the tax changes are achieving their intended effect. But even the economies of states with the highest tax burdens grew as the nation recovered from the recession. And Oklahoma’s per capita income growth has surpassed that of every non-income-tax state over the five-year period ending 2013, including fellow energy producing states Texas and Wyoming. Clearly, a growing economy is attributable to more than just income tax rates, as evidenced by J.P. Morgan Chase’s December

warning that Texas was at risk of slipping into a regional recession due to depressed oil prices.

Tax policy varies in every state, and is more complex than any individual tax. While some philosophically oppose taxing income, the fact is taxes are necessary to provide the services the public demands.

Oklahoma is currently facing a \$300 million budget hole, which is likely to deepen. Many have agreed there are structural budget problems with the way the state appropriates its dollars. The silver lining of the current budget situation may be that it finally forces comprehensive tax reform. But if not, perhaps it will at least discourage additional “naked tax cuts with none of the pay fors.”

White House withdraws proposed tax hike for college savings

At the time of his state of the union address earlier this month, President Obama proposed eliminating the tax exemption on earnings in 529 plan college savings accounts.

The White House said the tax hike would help offset the cost of the President’s proposal to have the government pay for the first two years of college.

Opposition was immediate and strong, not only from members of Congress on both sides of the aisle, but also from state treasurers nationwide, who said such a move would run counter to long-standing public policy to encourage middle class families to responsibly save for educational expenses.

Ten days later, under extreme pressure, the White House announced the proposal was dead.

About Oklahoma’s 529 plans

Oklahoma has two 529 plans, one offered directly to individuals and the other through investment advisors. With combined assets of more than \$750 million in more than 50,000 accounts, Oklahomans have used the program to pay for more than \$267 million in college expenses.

The Oklahoma 529 College Savings Plan and OklahomaDream 529 are the only 529 plans with an Oklahoma income tax deduction of up to \$20,000 per year for contributions to the plan.



America needs tax-exempt municipal bonds

By David Lillard and James McIntire

Congress must maintain the tax-exempt status of municipal bonds in its tax reform discussion this year if we truly want to transform and make critical upgrades to our national infrastructure.

In his 2014 State of the Union address, President Obama proposed capping the tax exemption of municipal bonds for investors, an idea that is still under consideration today.

Other proposals have been made to subject municipal bonds to a surtax, effectively taxing investors on a significant portion of municipal bond interest. But at a time when we should be encouraging investment in infrastructure, these proposals would have devastating consequences on public works projects.

The World Economic Forum ranked the United States 12th in the world in the quality of overall infrastructure in its Global Competitiveness Report — putting us well behind countries like Singapore, United Arab Emirates, the Netherlands and Taiwan. According to the American Society of Civil Engineers, the nation needs to spend \$3.6 trillion by 2020 to meet its critical infrastructure needs.

While today's proposal by Obama for a new Qualified Public Infrastructure Bond (QPIB) may increase infrastructure investment by permitting public-private partnerships to tap into previously unavailable funding sources, the proposal is not a panacea for

infrastructure investment. Traditional tax-exempt municipal bonds remain the primary tool for the financing and construction of schools and other basic infrastructure needs.

State and local governments are responsible for three-quarters of all U.S. public infrastructure projects and for more than 100 years have relied upon tax-exempt municipal bonds to fund these projects. Tax-exempt muni bonds have helped fund approximately \$49.5 billion in infrastructure projects in the state of Washington and \$18.9 billion in Tennessee over the past decade.

Municipal bonds offer investors a strong repayment rate and an attractive tax-exemption for interest earned on their investment. In return, state and local governments receive much-needed funding to finance everything from highways to schools to sewage systems.

If Congress accepts the president's proposal, which would cap the tax exemption at 28 percent of the top 2 percent of income earners, investor interest in funding such projects would plummet, leaving already-stretched state governments to shoulder the burden. Eliminating or reducing the tax exemption in any manner would drive up the cost of borrowing, resulting in fewer projects, fewer jobs and deteriorating infrastructure — an outcome that leaders on both sides of the aisle should agree is unacceptable.

To put this in context, if the tax-exemption limit had been in place from 2003 to 2012, state and local governments would have paid an extra \$173 billion in interest on infrastructure

investments. A June 2013 report by HIS Global Insight suggests this would have negatively impacted 311,000 jobs and \$24 billion in GDP. Moody's suggests that over the next 10 years, a cap on tax exemption would result in a net loss of 78,000 jobs and \$15 billion in infrastructure investment. This is a significant shortfall that Congress is unlikely to cover.

As tax reform is debated in Congress over the coming months, we urge members to consider the impact a change in the tax-exempt status of municipal bonds would have on their communities. Over a century ago, state and federal leaders recognized the importance of this issue and agreed that the income from municipal bonds would never be subjected to a tax — a principle codified by the 16th Amendment. We ask you to stand by that commitment and resist a radical change to an efficient market.

The National Association of State Treasurers adamantly opposes any change to the tax exemption of municipal bonds. With every corner of the nation in need of infrastructure investment, preservation of this effective funding mechanism — one that benefits Americans from all walks of life — is too valuable to risk.

Lillard is Tennessee state treasurer and president of the National Association of State Treasurers. McIntire is Washington state treasurer and senior vice president of the National Association of State Treasurers.

Originally published in The Hill, January 20, 2015.



Gross Receipts & General Revenue compared

The Treasurer's Jan. 7 Gross Receipts to the Treasury report and the Office of Management and Enterprise Services' Jan. 13 General Revenue Fund (GRF) report contain several differences.

December gross receipts totaled \$1.04 billion, while the GRF received \$547.8 million or 52.6% of the total.

The GRF received between 33.1% and 57.1% of monthly gross receipts during the past 12 months.

From December gross receipts, the GRF received:

- Personal income tax: 73.1%
- Corporate income tax: 33.5%
- Sales tax: 45.6%
- Gross production-Gas: 45.3%
- Gross production-Oil: 57%
- Motor vehicle tax: 31.5%
- Other sources: 44%

December GRF allocations topped the estimate by \$18.6 million or 3.5%. Year-to-date revenue exceeds the estimate by \$98.8 million or 3.7%.

For December, insurance premium taxes totaled \$49.73 million.

Tribal gaming fees generated \$10.56 million during the month.

Oklahoma economy expands in 2014

The Oklahoma economy grew at a faster pace in calendar year 2014 than during the prior two years, State Treasurer Ken Miller announced with the release of the state's monthly Gross Receipts to the Treasury Report.

"The calendar year was a good one for Oklahoma's economy with all major sources of revenue finishing the year in the black. The numbers show more of

our people are working and they are expressing confidence through increased consumption," Miller said. "Clearly, the state economy performed well during the past 12 months. However, this new year will likely have its challenges, especially with today's low oil prices," he said.

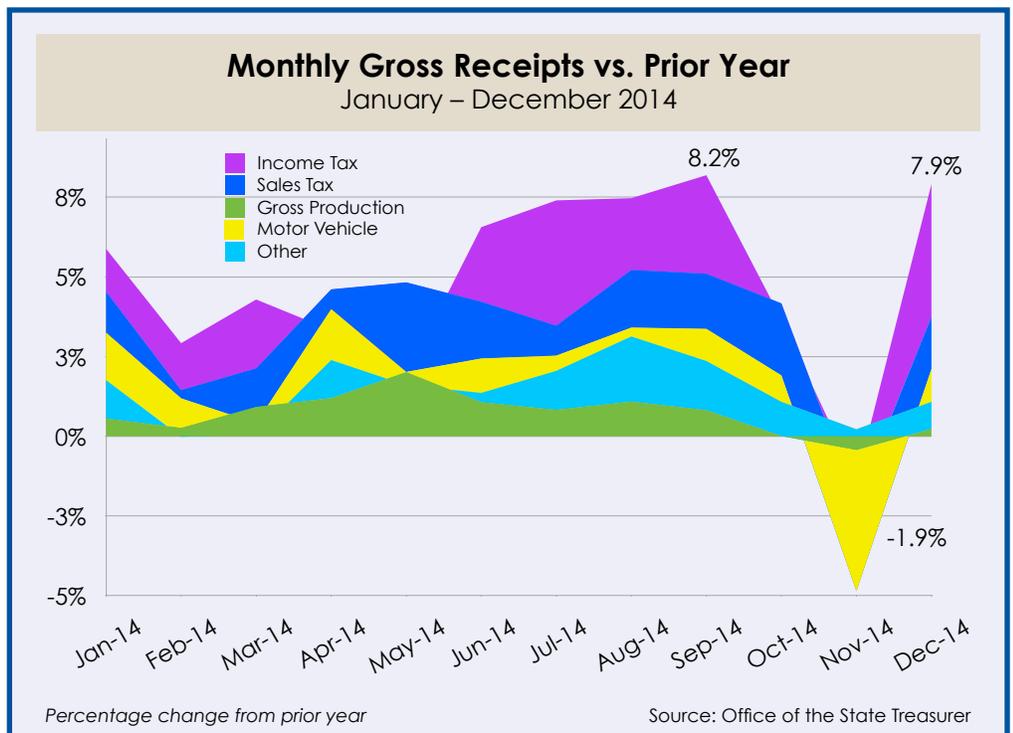
“This new year will likely have its challenges, especially with today's low oil prices.”

The growth in gross receipts during 2014 was 4.9 percent, compared to 3.2 percent in 2013 and 3.8 percent in 2012. In December, an almost 12 percent increase in income tax collections

pushed the bottom line up by just shy of eight percent compared to the same month of the prior year. Total gross receipts in December, at \$1.04 billion, are the largest amount collected during any December in Oklahoma history.

Total monthly gross receipts were less than prior year collections only one time during 2014, and that was due to a reporting correction, not an economic factor. However, corporate income taxes

SEE REVENUE PAGE 7





December unemployment drops to 4.2 percent

Oklahoma’s unemployment rate was set at 4.2 percent in December by the Oklahoma Employment Security Commission, down by two-tenths of one percentage point from November and 1.2 percentage points from the prior year.

Compared to December 2013, the number of those listed as jobless dropped by 23,800 people. The national unemployment rate was 5.6 percent.

State Unemployment Report				
OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
Dec '14	4.2%	1,799,280	1,724,600	74,680
Nov '14	4.4%	1,796,310	1,717,350	78,960
Oct '14	4.5%	1,790,200	1,708,980	81,220
Dec '13	5.4%	1,823,410	1,724,920	98,480

* Data adjusted for seasonal factors Source: OESC

Revenue

FROM PAGE 6

missed the mark five times, finishing the year down by almost seven percent from the prior 12 months.

Sales tax collections indicate a stronger Christmas shopping season than last year. December sales tax collections, reflecting sales between mid-November

and mid-December, were \$15.83 million or 4.3 percent higher than during the same period of 2013. Last December, sales taxes were \$3.5 million or one percent higher than the same period of the prior year.

Oil prices

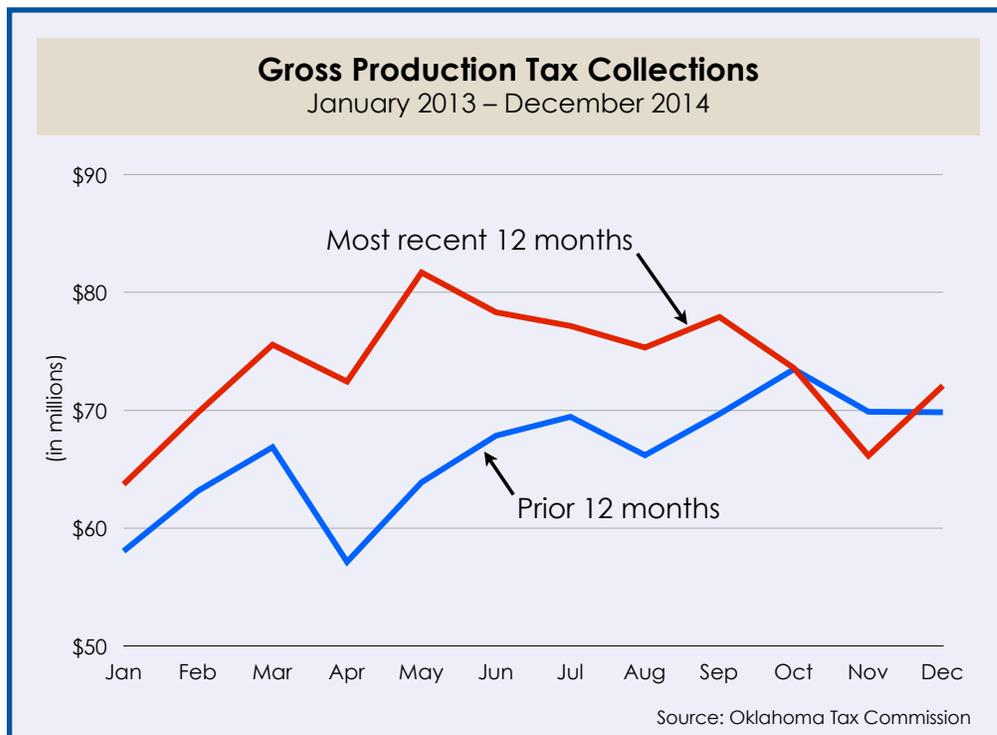
The revenue stream showing the

biggest expansion in 2014 is the gross production tax on oil and natural gas – rising by more than 11 percent during the calendar year. After falling below collections of the same month of the prior year in November – for the first time in 19 months – gross production receipts rose in December, exceeding the prior year by just over three percent.

“It seems somewhat counterintuitive to see rising extraction tax collections during a time of suppressed prices,” Miller said. “However, December receipts reflect oil field activity in October, when the spot price per barrel was \$84.40 for West Texas Intermediate at Cushing. We have yet to feel the impact of the current, lower prices.”

About Gross Receipts to the Treasury

The Treasurer’s Office issues the monthly Gross Receipts to the Treasury report to provide a timely and broad view of the state’s economy. It is released in conjunction with the General Revenue Fund report from the Office of Management and Enterprise Services, which provides information to state agencies for budgetary purposes.

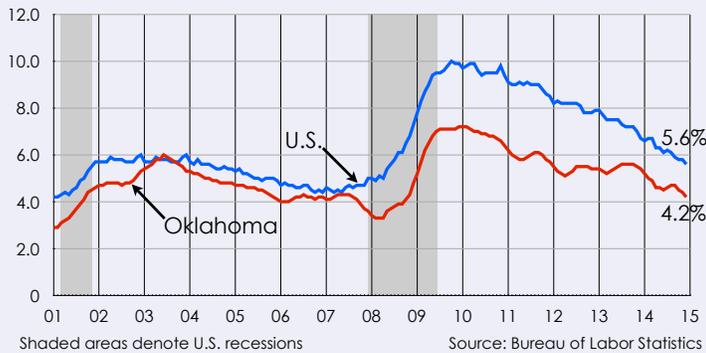




Economic Indicators

Unemployment Rate

January 2001 – December 2014

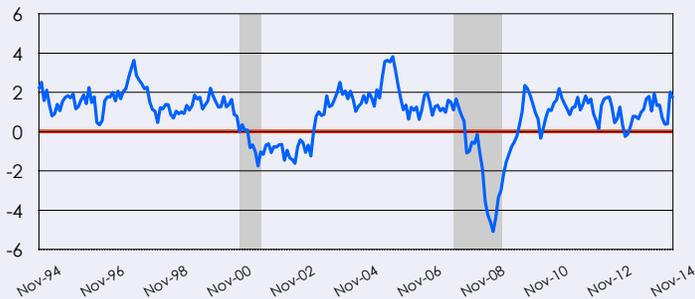


Oklahoma 12-Month Gross Receipts

June 2008 - December 2014
(in billions)



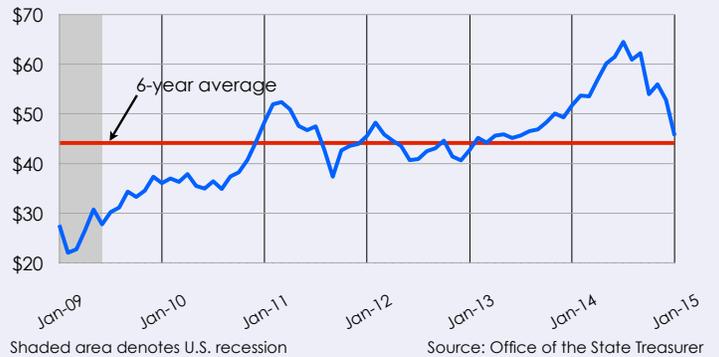
Leading Index for Oklahoma



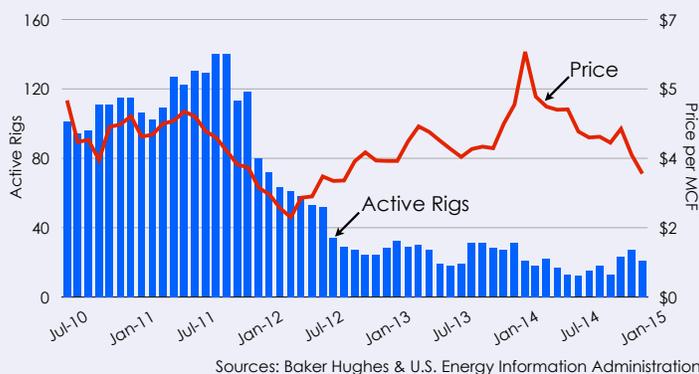
This graph predicts six-month growth by tracking leading indicators of the state economy including initial unemployment claims, interest rate spreads, manufacturing and earnings.

Oklahoma Stock Index

Top 25 capitalized companies



Oklahoma Natural Gas Prices & Active Rigs



Oklahoma Oil Prices & Active Rigs

