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FILLING THE BUDGET HOLE: OPTIONS FOR A BALANCED APPROACH

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Executive Summary

The Board of Equalization has certified that legislators will have \$188 million less for next year's budget compared to this year. In her FY 2015 Executive Budget, Governor Fallin proposed an overall cut of 1.9 percent across all of state government and cuts of 5 percent to most agency budgets.

The prospect of a new round of budget cuts is of grave concern for two main reasons:

- The state has never fully recovered from the prolonged budget crisis that accompanied the recession of 2009-10. This year's budget is \$638 million, or 8.2 percent, smaller than the budget of five years ago when adjusted for inflation. Years of budget cuts and mostly flat funding continue to be felt across state government in the form of larger class sizes, understaffed prisons, increasingly uncompetitive salaries, and long waiting lists for critical services;
- Many agencies require substantial funding increases next year simply to maintain services at current levels.

In short, our state agencies and public schools cannot absorb budget cuts simply by tightening their belts and squeezing out greater efficiencies. Further cuts would inflict serious harm to the public institutions on which our health, safety, and economic well-being depend.

However, responding to budget shortfalls by imposing deeper budget cuts is not an inevitable outcome. Policymakers have the choice of adopting a balanced approach to filling the budget hole that includes new revenues. Among the feasible options to bolster state revenues that should be on the table are the following:

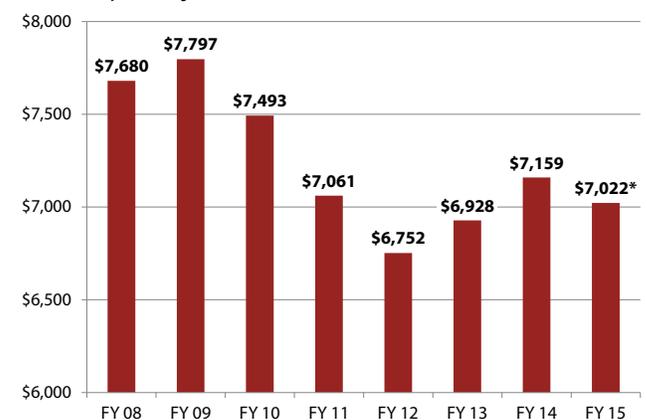
1. CURB THE TAX BREAK FOR HORIZONTAL OIL AND GAS PRODUCTION

Oklahoma taxes production from horizontal wells at just 1 percent for 48 months, compared to 7 percent for traditional production. As an ever-increasing share of oil and gas production shifts to horizontal drilling, the cost of the tax break has reached \$250million. A recent study concluded, that Oklahoma's 48-month exemption "goes way beyond encouraging innovation and reducing investment costs and exempts wells that oil and gas producers would drill and develop without the exemption."

Policymakers should eliminate the tax break for horizontal drilling and establish a 7 percent rate for all production. This would allow energy companies to continue to operate profitably while ensuring adequate funding for the public services that the energy industry and others depend on.

Oklahoma's appropriations budget remains significantly below pre-recession years

2014 dollars adjusted using the Consumer Price Index, in millions



* Proposed in Governor Fallin's FY 2015 Executive Budget

2. ELIMINATE THE “DOUBLE DEDUCTION” OF STATE INCOME TAXES

Oklahoma is one of only six states that allow taxpayers who claim itemized deductions to deduct state income tax on state tax returns. This deduction is an unintentional fluke of the law that serves no policy purpose. By eliminating this “double deduction” of state income tax, the state would gain an estimated \$101 million in additional revenue. Only taxpayers who itemize their deductions, which tend to be higher-income households, would be affected.

3. ADOPT COMBINED CORPORATE REPORTING

Some multi-state corporations shift income between parent and subsidiary companies as a way to minimize their state tax liability. More than half of all state with a corporate income tax have adopted a reform known as combined corporate reporting as a way to put an end to this tax avoidance strategy and ensure that multi-state corporations pay their fair share of taxes, just like local businesses. By adopting combined reporting, Oklahoma could boost corporate tax collections by an estimated 10 -20 percent, or some \$50 - \$100 million.

4. ENHANCE TAX COLLECTION FROM ONLINE SALES

States are hampered in their ability to require some retailers to collect and remit taxes owed on online sales. With the growth of e-Commerce, this situation puts local Main Street retailers at a competitive disadvantage and leads to substantial lost revenue for state and local governments. While waiting on federal action, Oklahoma could follow the lead of ten states that have adopted so-called “Amazon laws” to help boost tax collections from more online businesses based outside of Oklahoma.

5. TAP THE RAINY DAY FUND

Oklahoma’s Rainy Day Fund currently has a \$537 million balance. Up to \$162.1 million of that amount may be appropriated to help balance the budget and avert cuts that could cause serious damage to the state economy and to Oklahoma families and businesses.

6. MAINTAIN TRANSPORTATION FUNDING AT CURRENT LEVELS

Allocations to the ROADS fund for maintenance and upgrades of roads and bridges is slated for an automatic increase of \$56.7 million next year. While investments in transportation are unquestionably important, it doesn’t make sense to allow this increase while slashing support for other vital services, such as schools, health care, and public safety. The legislature can decide to suspend or limit the automatic increase scheduled for FY 2015 to avoid cuts in other critical areas.

7. ACCEPT FEDERAL FUNDS TO EXPAND HEALTH COVERAGE

Between now and 2016, the federal government will assume 100 percent of the cost of providing health insurance to adults with incomes below 138 percent of the poverty level who are not currently eligible for Medicaid. Expanding coverage would create savings for the state budget by shifting payment of services that are currently paid for with state funds to the federal government. It would also provide a major economic boost to the state, help businesses by creating a healthier workforce, and avoid leaving the lowest-income Oklahomans in a “coverage crater” without insurance options.

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