

Securing Oklahoma's Fiscal Future:

Designing Revenue Policy For Today's Needs and Tomorrow's Challenges

**Presentation to the
House Revenue & Taxation Committee**

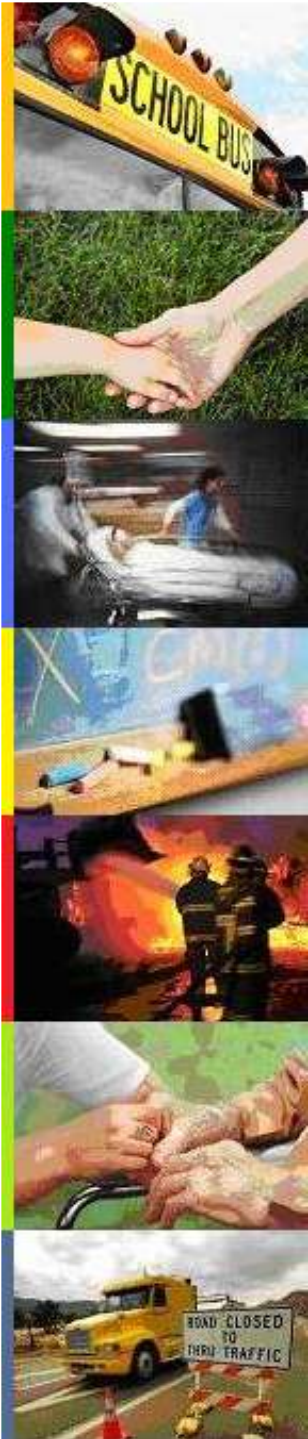
September 27, 2007

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■■ www.CBPP.org



Oklahoma's Path to Prosperity

Question:

Should we enact further tax cuts? If so, which taxes should we cut?

Context:

To answer the question, we need to know:

- ***What are our goals as a State?***
- ***What public structures do we need to meet these goals?***
- ***What level of funding is needed to be maintain these structures?***

Oklahoma's Path to Prosperity

Defining our Common Goals

1) EDUCATION

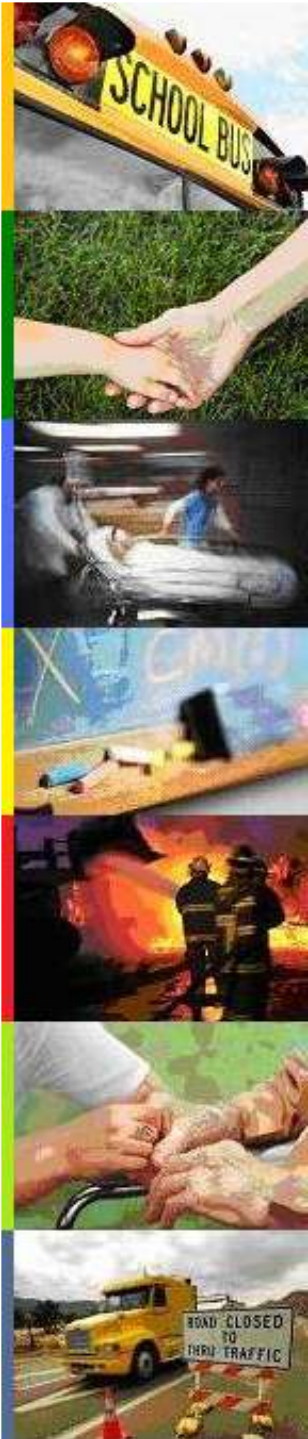
- Ensure that all children receive a **quality education** and that **affordable and accessible higher education** is available to all who are eligible.

2) HEALTH & SOCIAL SERVICES

- Ensure that vulnerable individuals and families have **basic needs**, including food, shelter, medical care and protection from violence.

3) TRANSPORTATION & INFRASTRUCTURE

- Ensure that physical infrastructure allows for the **safe** and well-functioning movement of goods and people



Common Goals

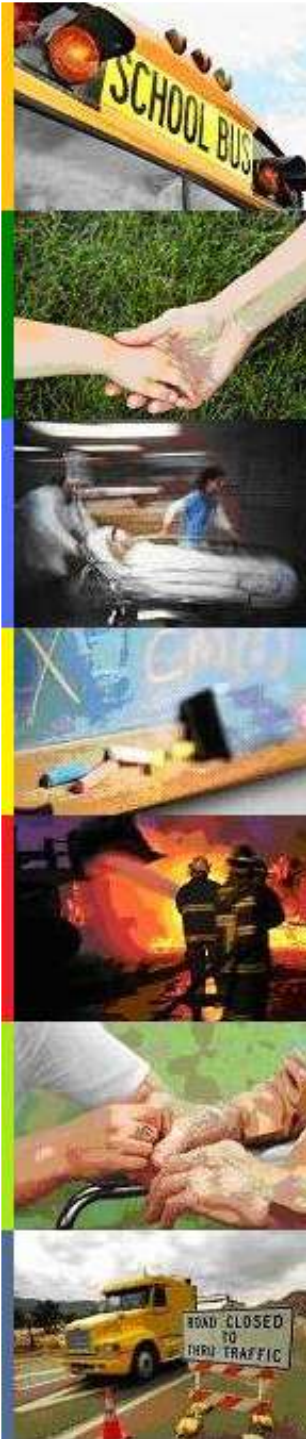
Defining our Common Goals

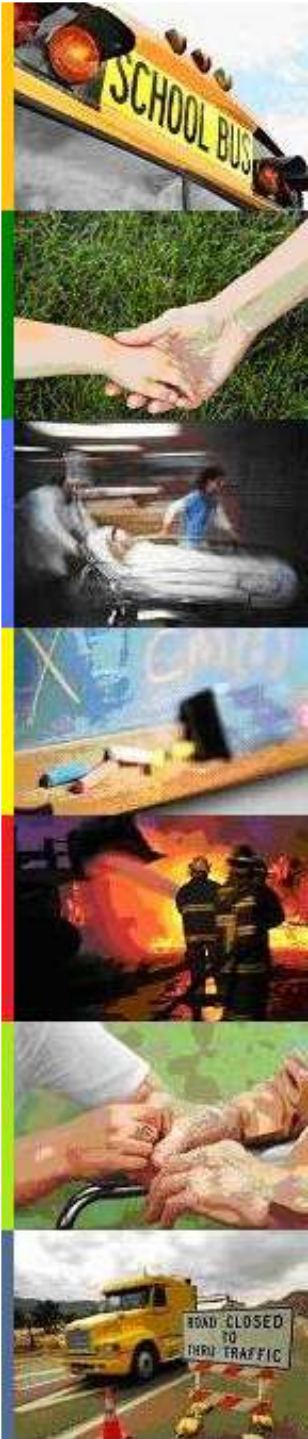
4) PUBLIC SAFETY

- Ensure that families, neighborhoods and communities are **protected** from threats to their physical safety and well-being.

5) REGULATION & CONSUMER PROTECTION

- Ensure that businesses can operate fairly and safely





Leadership :: Stewardship

What do we expect from our elected leaders ?

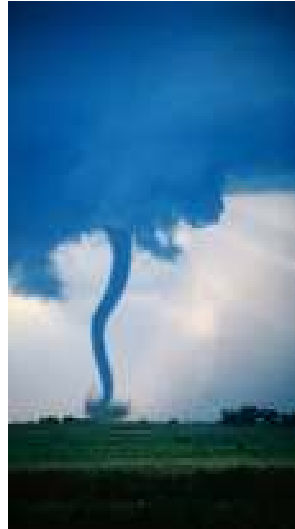
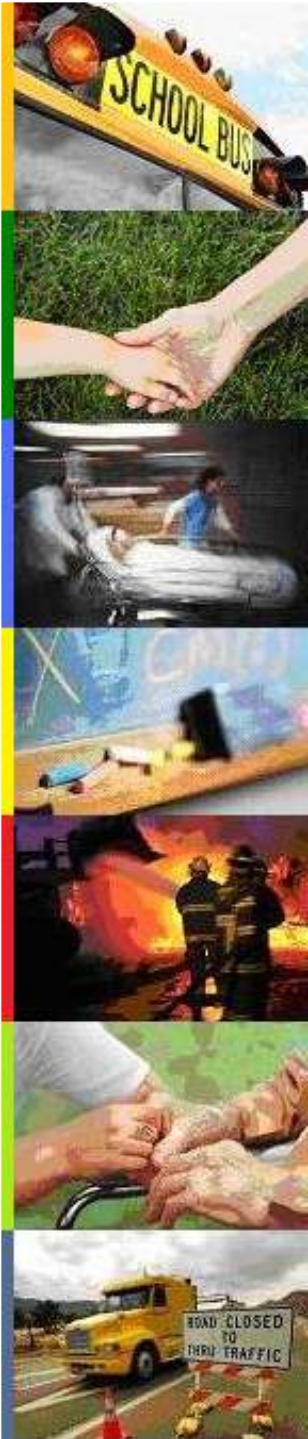
- **Productive collaboration between citizens, business and government.**
- **Long term planning: vital public services will continue to be delivered, and we'll hand our children a legacy of an effective, prosperous, fiscally sound Oklahoma.**



Leadership :: Stewardship

What do we expect from our elected leaders ?

- **Provide responsible stewardship of taxpayer dollars and uphold the democratic principles of accountability and responsibility.**

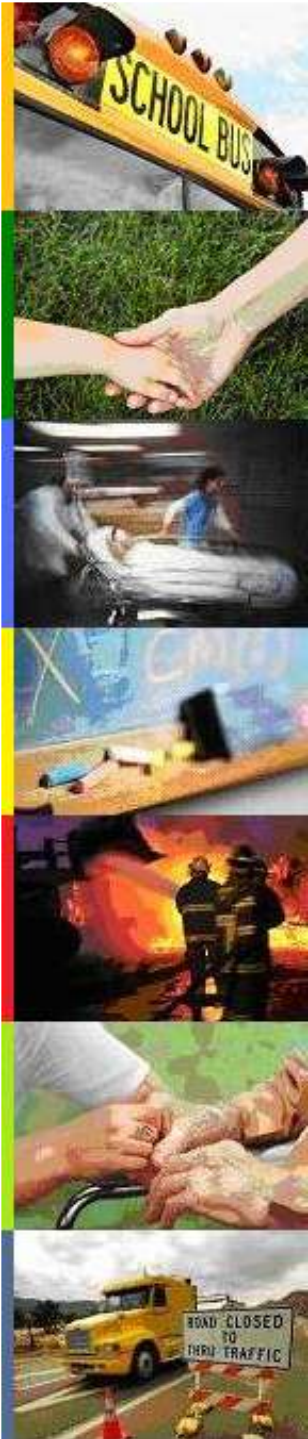


Public Investment

Has Oklahoma Met its Goals?

There are areas where Oklahoma performs excellently and where we have made great strides in recent years

- ❑ Career tech system
- ❑ OHLAP program
- ❑ Parks system
- ❑ Early childhood education
- ❑ Nationally certified teachers
- ❑ Bio-Medical research

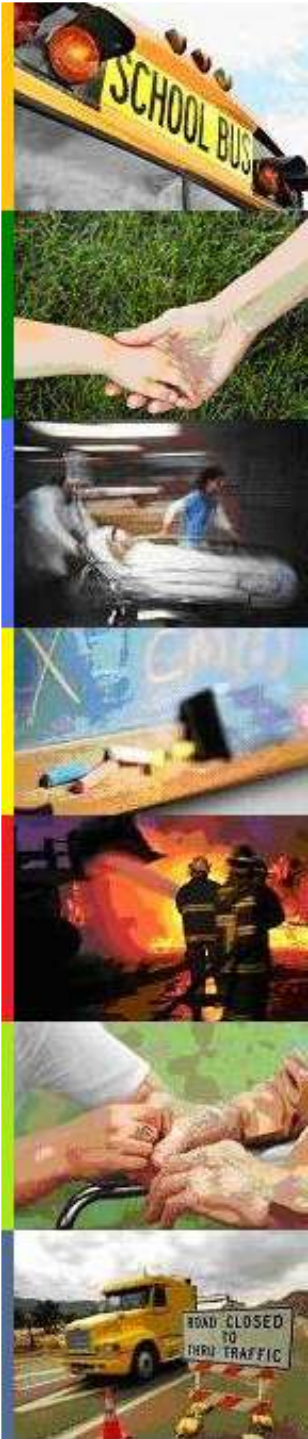


Public Investment

Has Oklahoma Met its Goals?

1) EDUCATION

- ▣ **Student Test Scores** below expectations
- ▣ **Teacher Pay** among nation's lowest
- ▣ **College Graduation Rates** trailing the national average

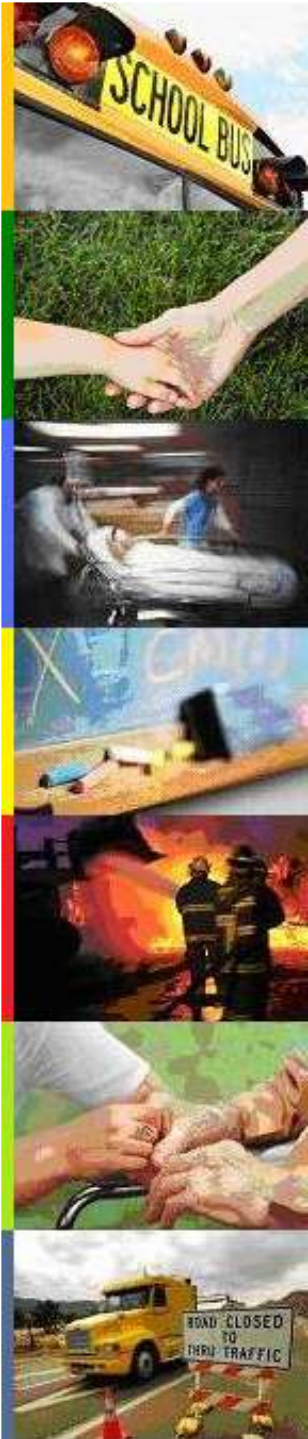
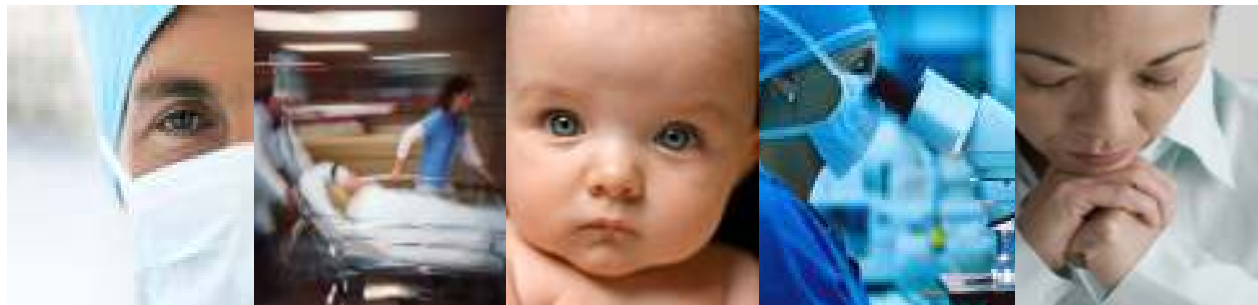


Public Investment

Has Oklahoma Met its Goals?

2) HEALTH CARE & SOCIAL SERVICES

- ❑ Overall poverty and child poverty remains high
- ❑ Health Status of residents is poor
- ❑ Minority and Rural Health disparities
- ❑ Drug Abuse & Addiction
- ❑ Child Abuse and Neglect
- ❑ Domestic Violence

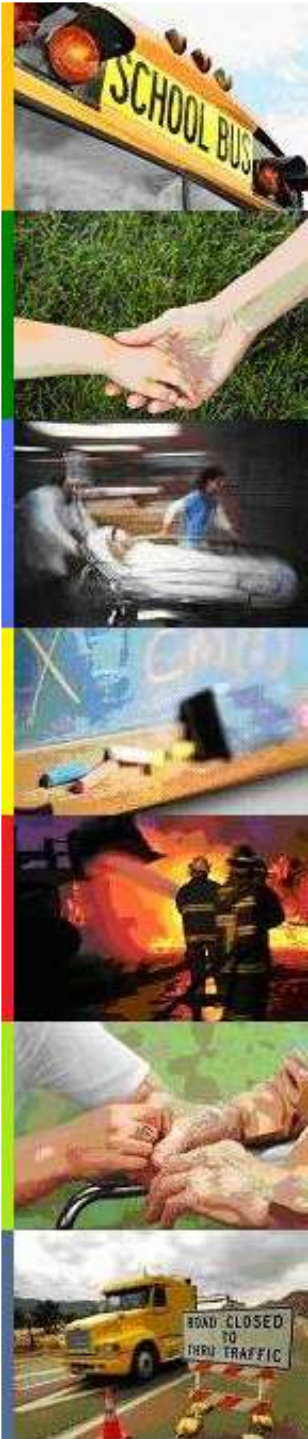


Public Investment

Has Oklahoma Met its Goals?

3) TRANSPORTATION & INFRASTRUCTURE

- ▣ Roads deficient
- ▣ Bridges crumbling
- ▣ Water & Wastewater Systems failing

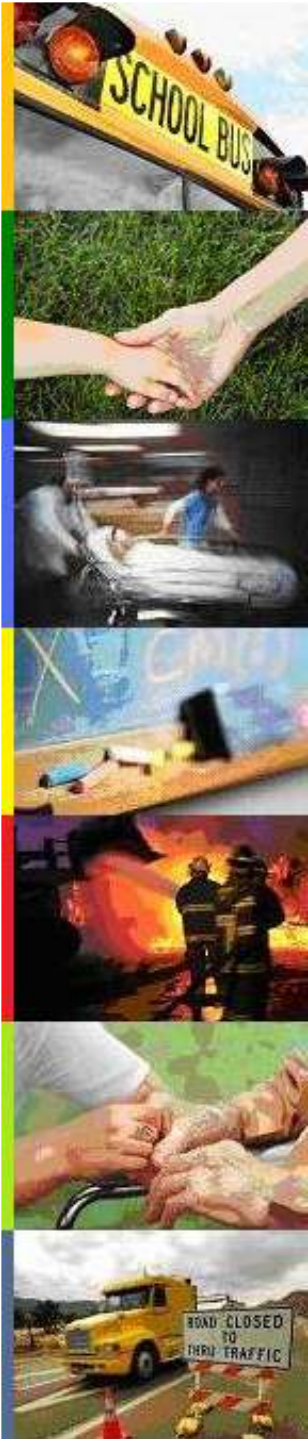


Public Investment

Has Oklahoma Met its Goals?

4) PUBLIC SAFETY

- ▣ Crime Rates high
- ▣ Prisons overcrowded
- ▣ Homeland Security concerns

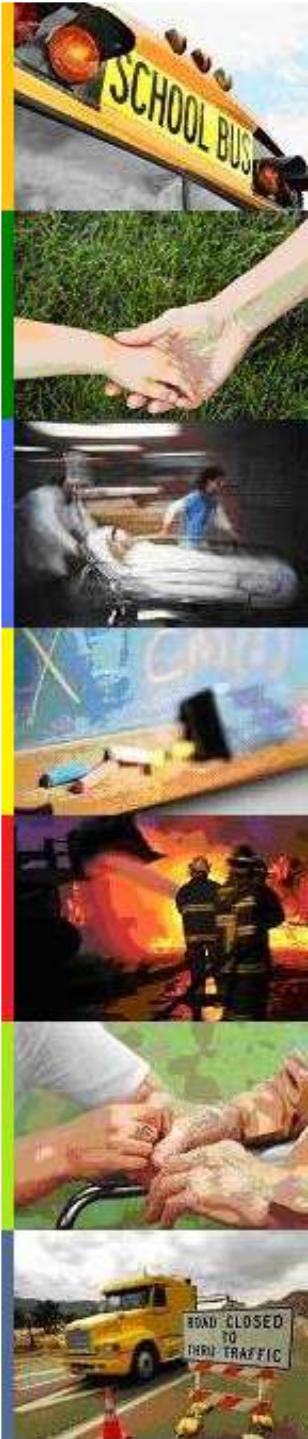


Public Investment

Has Oklahoma Met its Goals?

5) REGULATION & CONSUMER PROTECTION

- ▣ Nursing Home and Child Care Inspection needs
- ▣ Animal safety concerns
- ▣ Consumer fraud and abuse



Public Investment

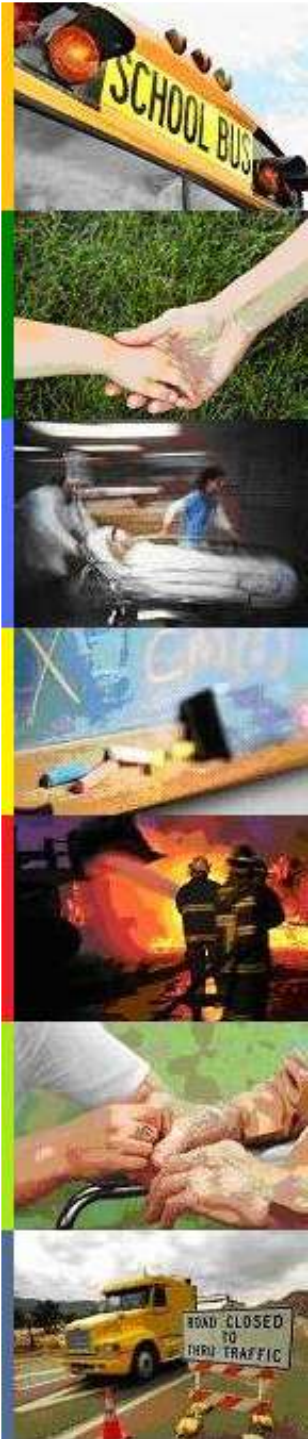
How much do we invest to meet our goals?

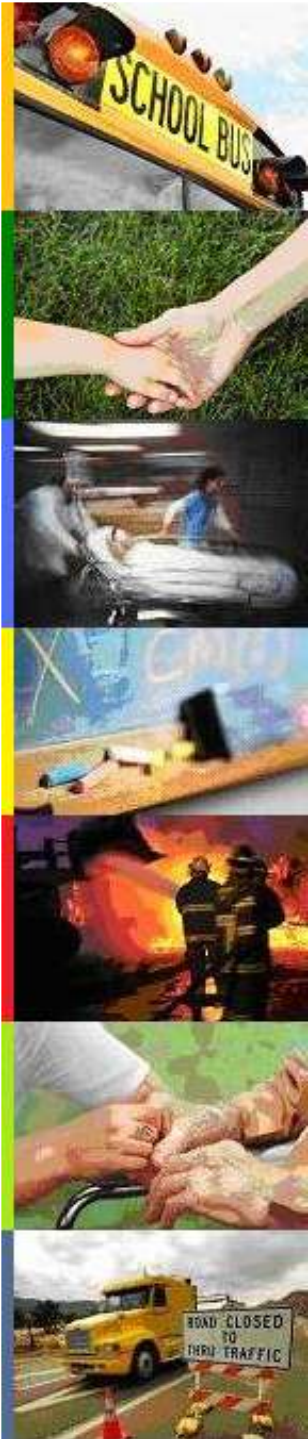
Oklahoma ranks **LAST in per capita state and local government spending**

- **OKLAHOMA :: \$5,152** per capita direct general expenditures
 - **NATIONAL AVERAGE :: \$6,481** per capita direct general expenditures
-
-

Oklahoma's public workers are **49th in average annual earnings**

- **OKLAHOMA :: \$33,513**
average annual salary
- **NATIONAL AVERAGE :: \$45,239**
average annual salary





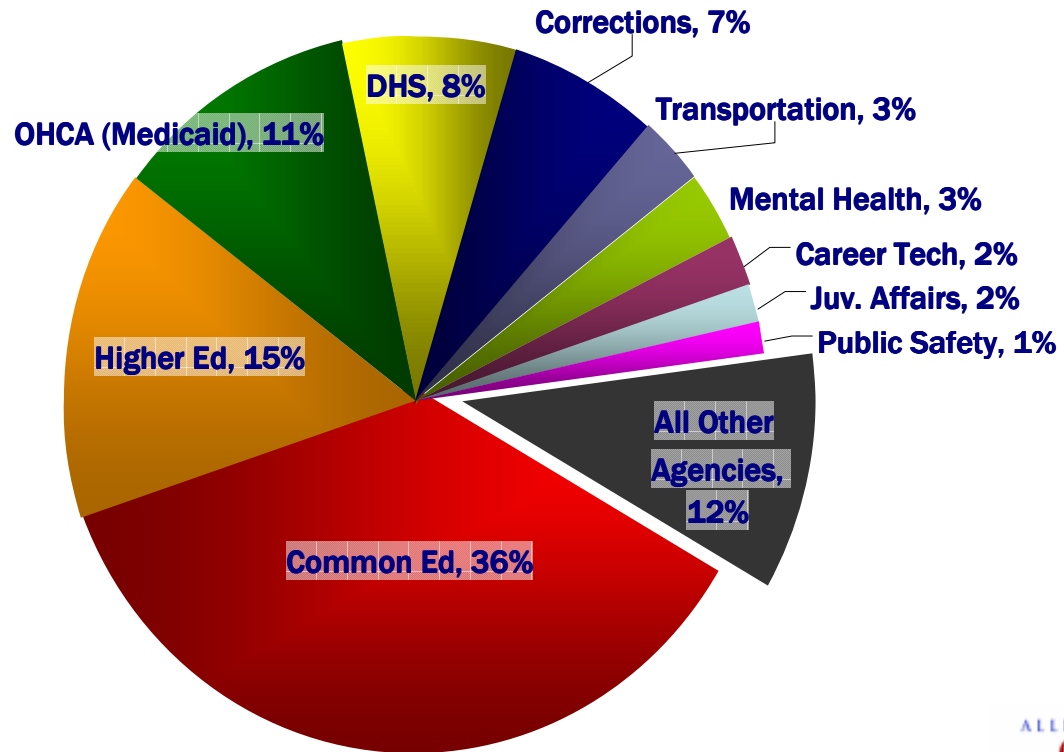
Public Investment

How much do we invest to meet our goals?

FY '08 State Appropriations

10 Largest Agencies: \$6.2 billion (88%)

All Other Agencies (75 agencies): \$803 million (12%)



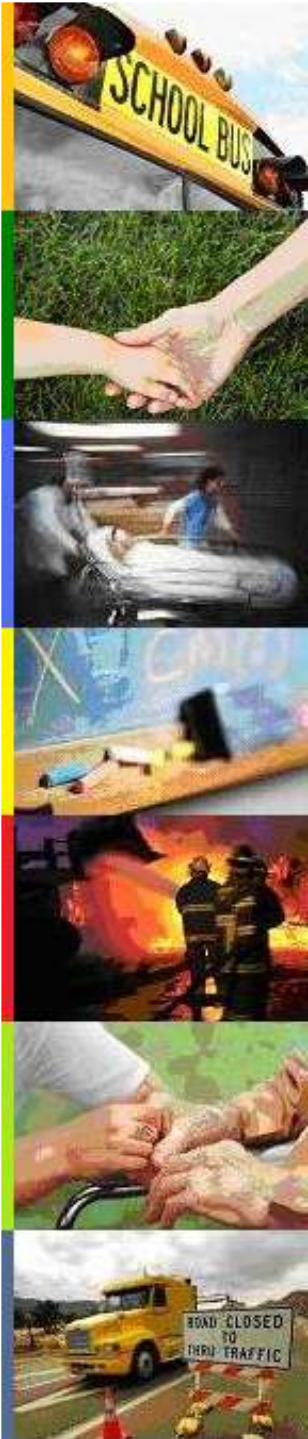
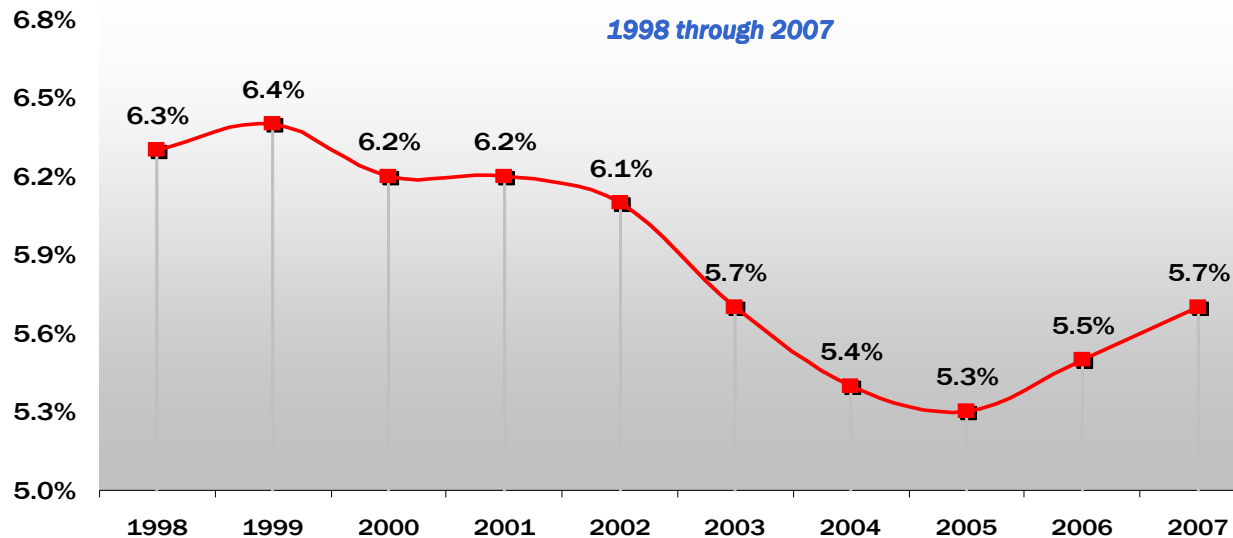
Public Investment

How much do we invest to meet our goals?

State spending has been growing less rapidly over time than the state economy

- From FY '02 – FY '07, state personal income grew at an annual average rate of 4.7%, compared to 3.8% average annual growth in state appropriations.
- The state budget is below its historical average as a share of personal income - even with the rebound in state spending after 2005.

State Spending as a Share of Personal Income



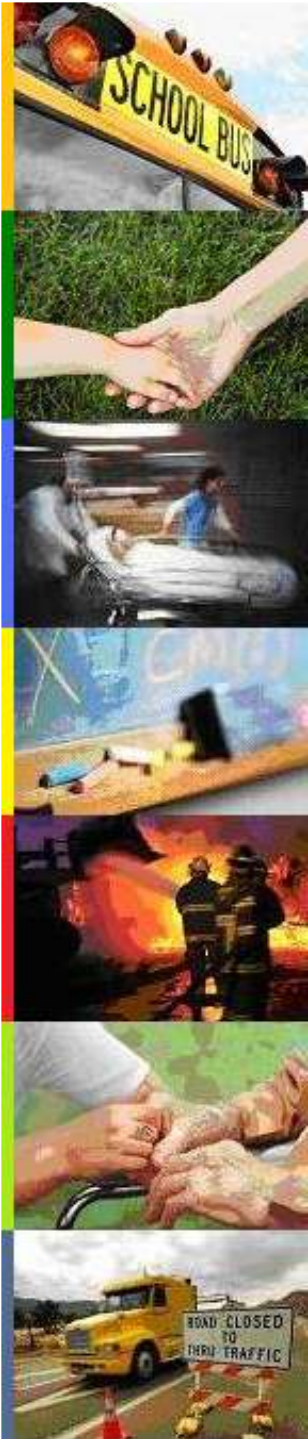
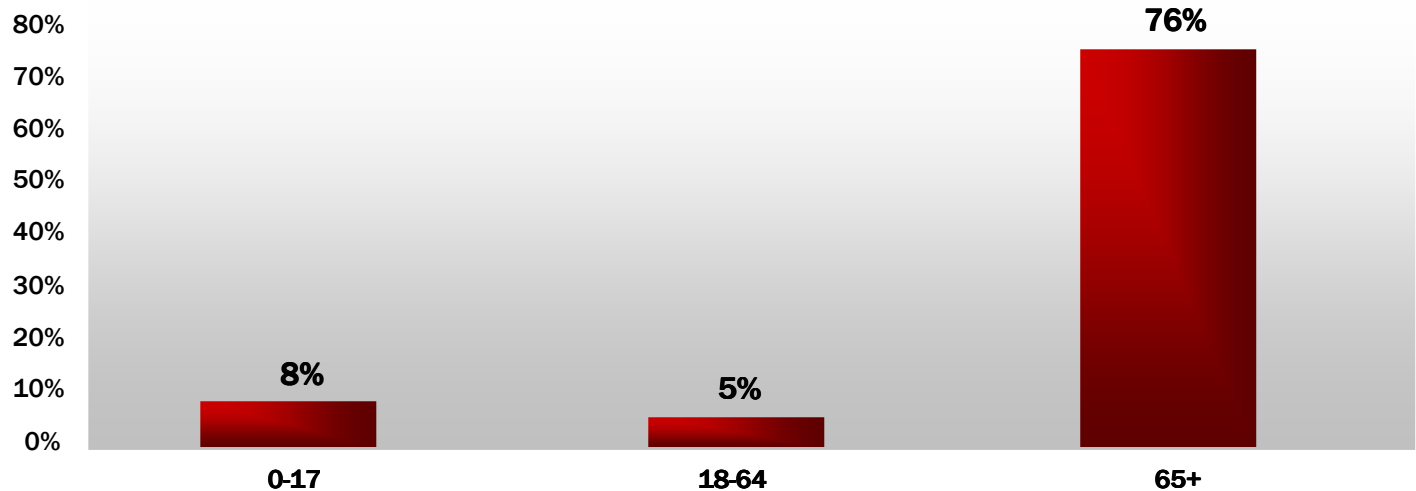
Budgetary Pressures

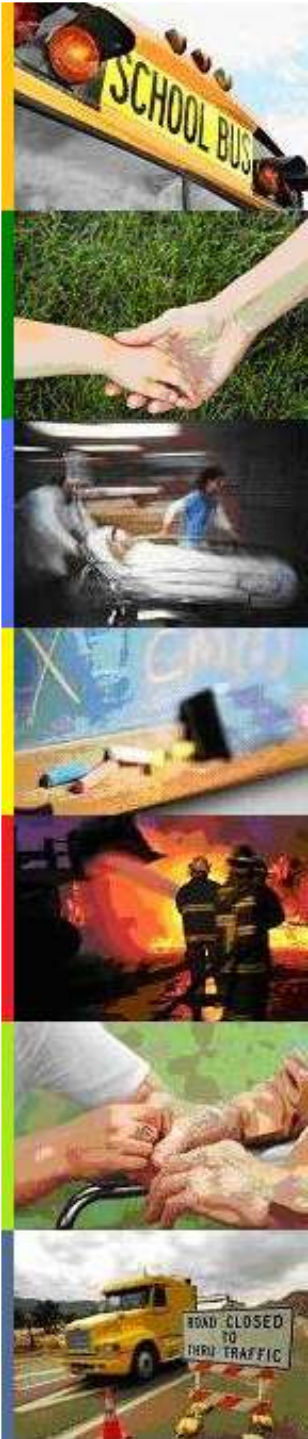
Growing Budgetary Demands Ahead

OKLAHOMA'S POPULATION IS RAPIDLY AGING

- A slowly increasing working-age population will need to support an ever-expanding senior population
- Implications for state budgets in the areas of health care (especially long-term care), social services, corrections (aging inmate population)

Oklahoma Projected Population Growth, 2005-2025,
by Age Category





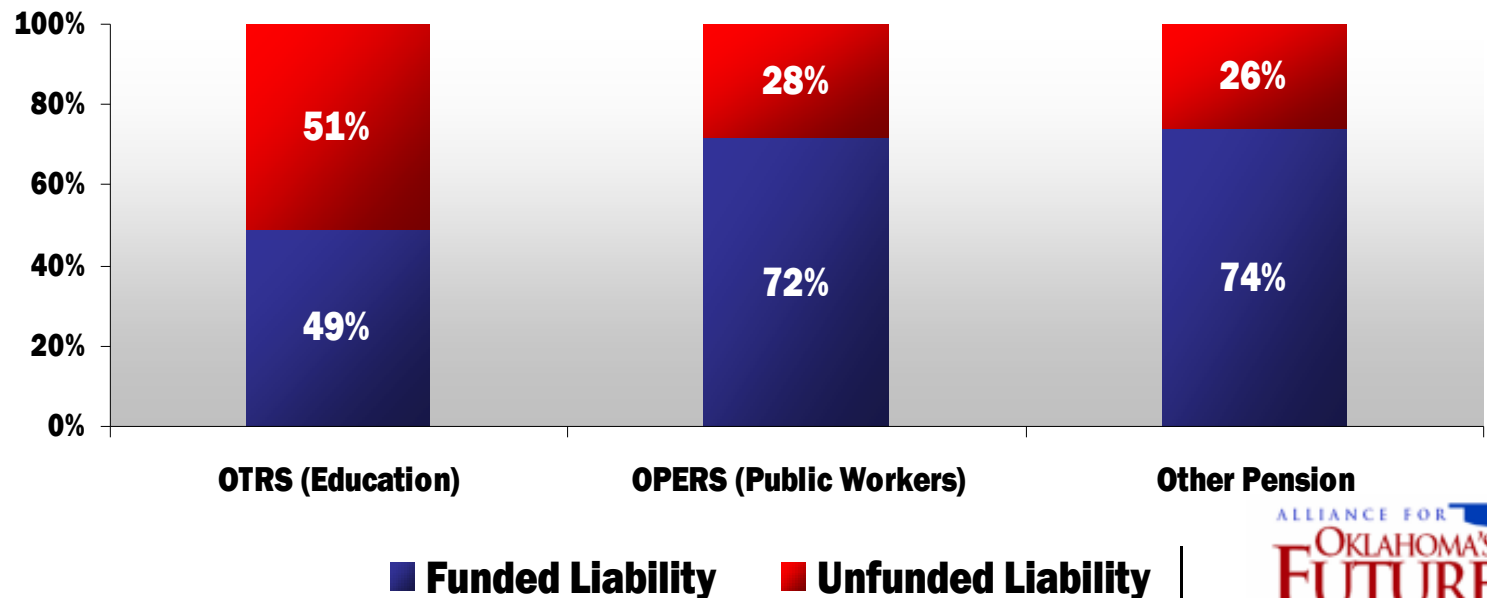
Budgetary Pressures

Growing Budgetary Demands Ahead

UNFUNDED PENSION OBLIGATIONS

- Oklahoma's retirement systems currently have over \$10 billion in unfunded liabilities. The largest system, OTRS, is the third worst funded retirement system in the nation.

Oklahoma Pension System
Asset to Liability Ratio

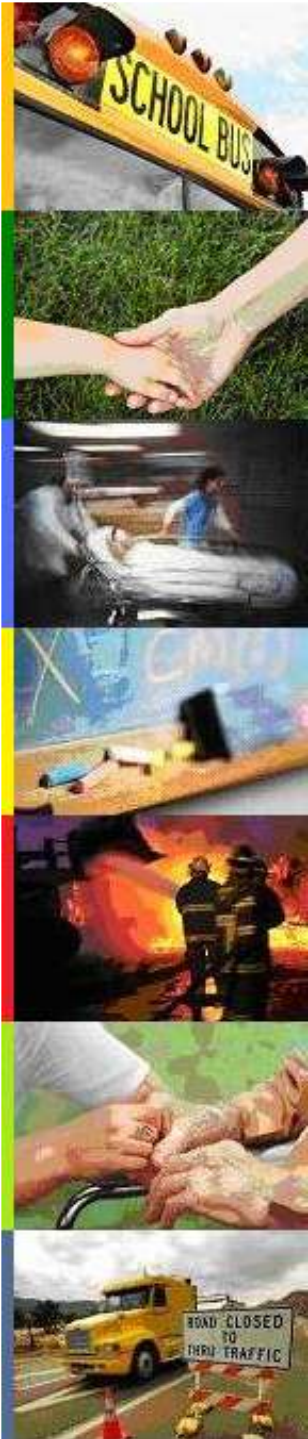


Budgetary Pressures

Growing Budgetary Demands Ahead

TRANSPORTATION NEEDS

- Roads and Bridges

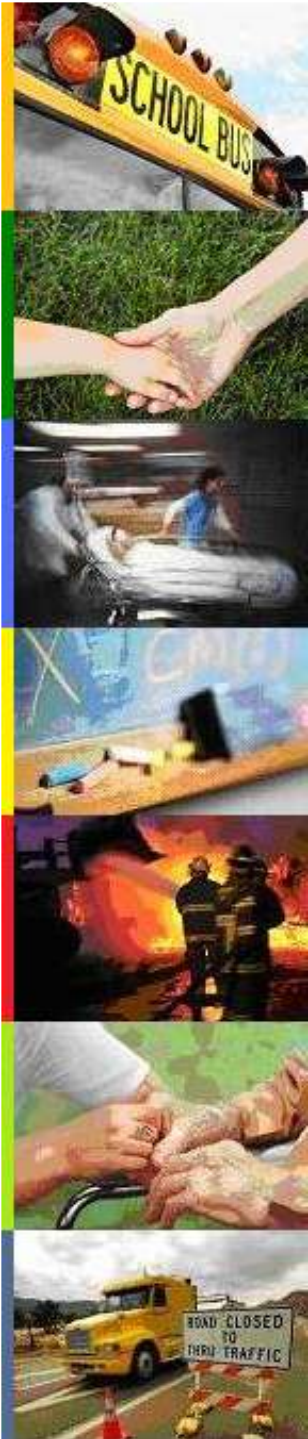


Budgetary Pressures

Growing Budgetary Demands Ahead

CORRECTIONS NEEDS

- **Prison Beds and Corrections Officers**

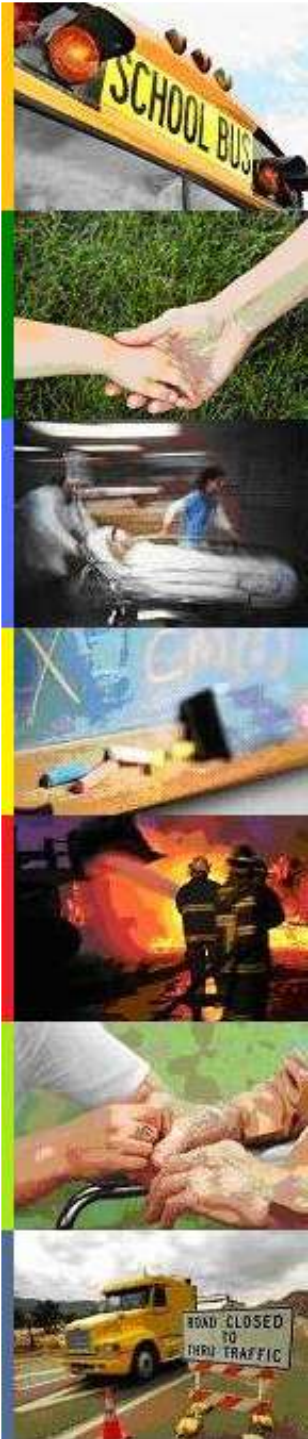


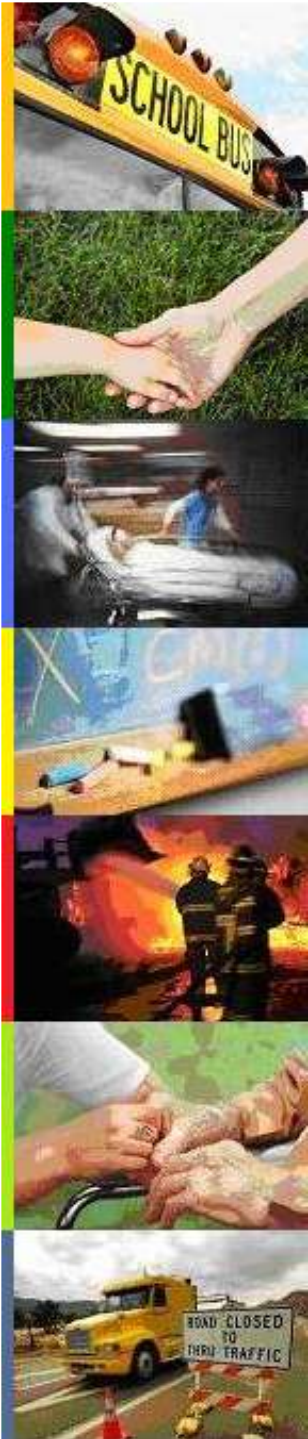
Budgetary Pressures

Growing Budgetary Demands Ahead

FEDERAL GOVERNMENT PUTTING PRESSURE ON STATES

- The impact is already being felt in states:
 - Unfunded mandates (NCLB, IDEA, Real ID)
 - Declining Medicaid assistance
 - Frozen block grant allocations
 - Growing federal debt





Fiscal Policy: ADEQUACY

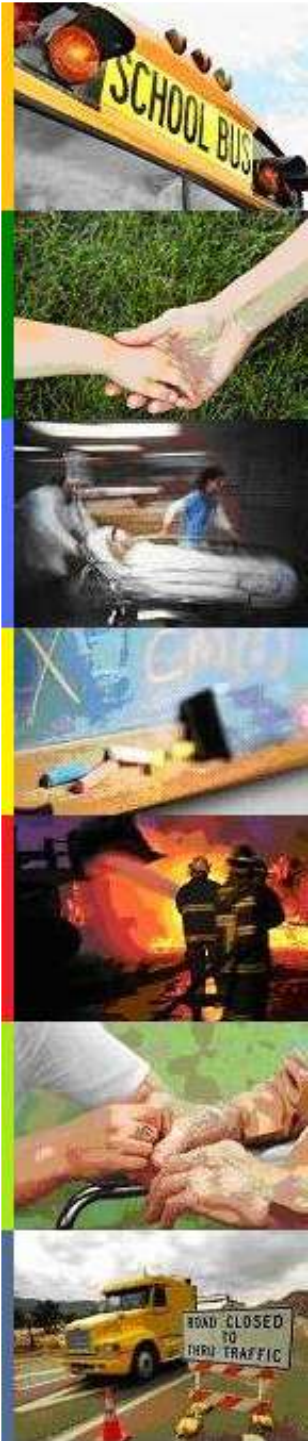
Is our Tax Policy ADEQUATE for our Needs?

OKLAHOMA IS A LOW TAX STATE

- Oklahomans pay among the least amount of state and local taxes in the nation, either per capita (45th) or a share of state personal income (43rd)
- Less than a dime of every dollar earned by Oklahomans goes to pay for state and local services

	State & Local Taxes as a % of Income	State & Local Taxes per Capita
National Average	10.0%	\$3,698
Oklahoma	9.4%	\$2,843
Where Oklahoma RANKS	43rd	45th

Source: U.S. Department of Commerce, Bureau of Economic Analysis, 2005

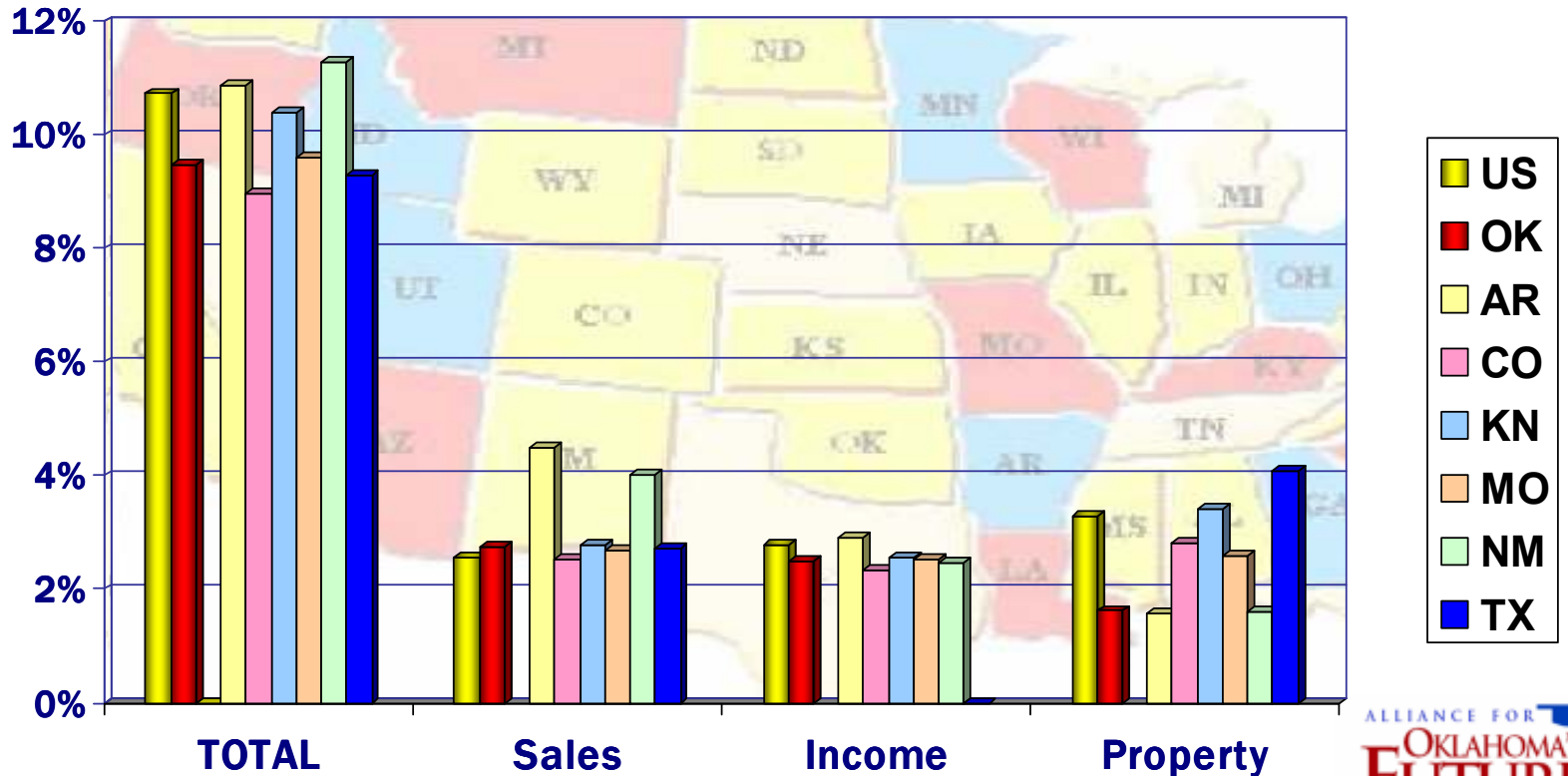


Fiscal Policy: ADEQUACY

Is our Tax Policy ADEQUATE for our Needs?

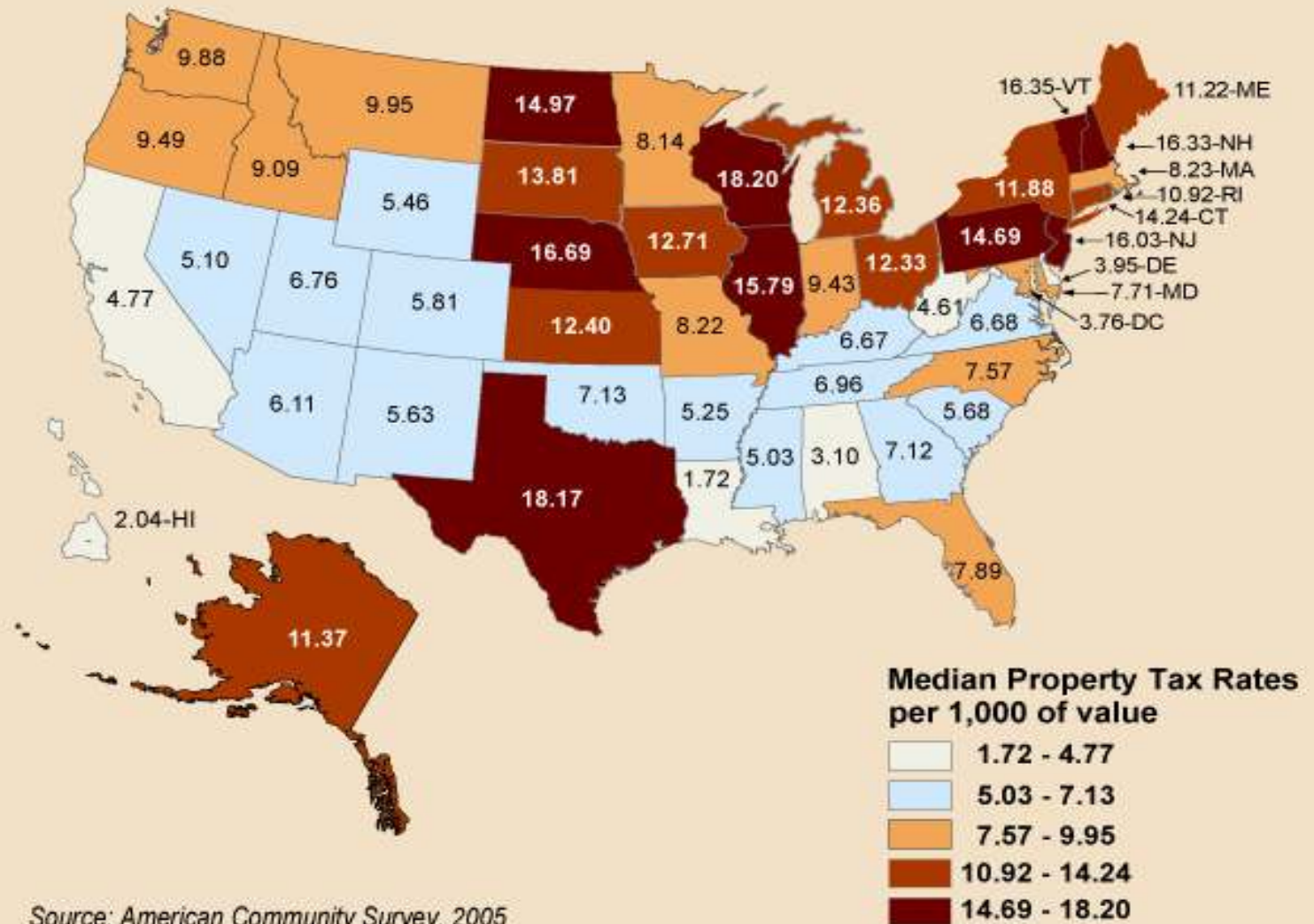
Oklahomans' taxes are similar to or lower than its neighboring states – both overall and on each of the major taxes

State and Local Taxes as a Percent of Personal Income, 2005

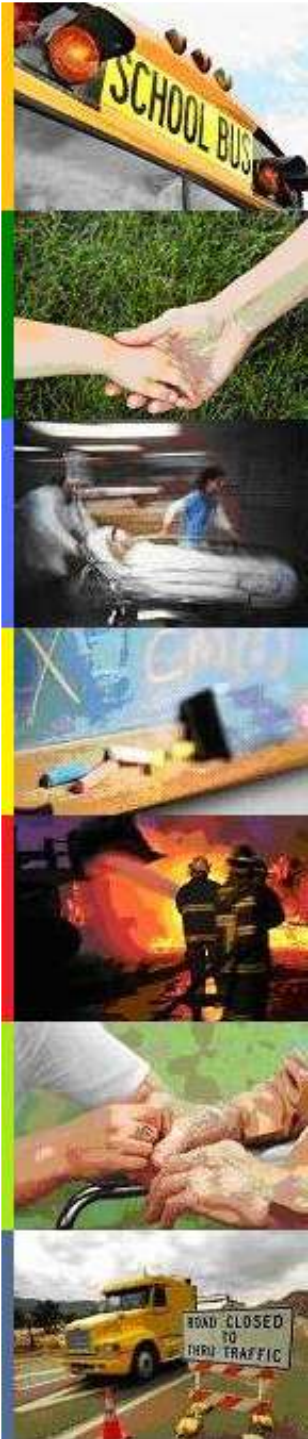


Fiscal Policy: ADEQUACY

Median Real Estate Tax Rates per 1,000 of Value



Source: American Community Survey, 2005

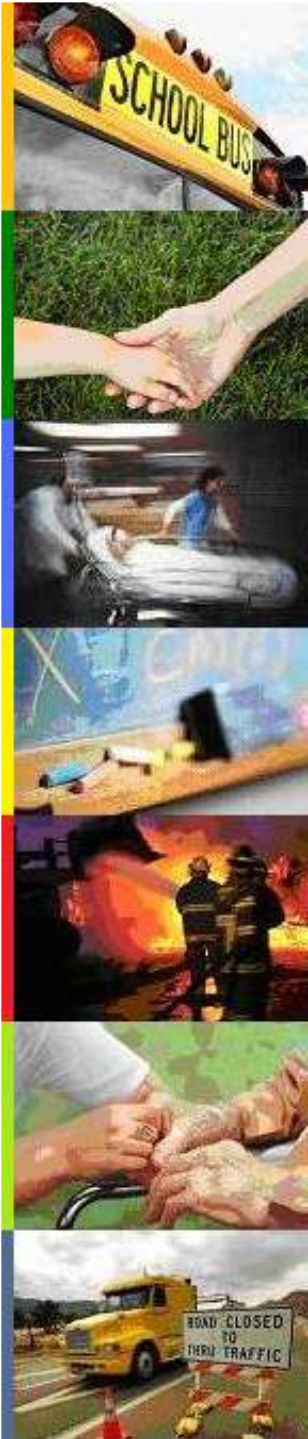


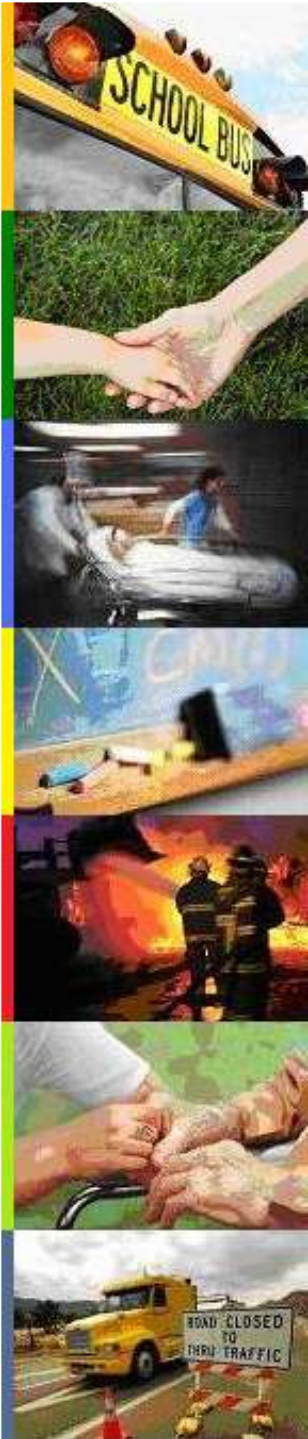
Fiscal Policy: ADEQUACY

Is our Tax Policy ADEQUATE for our Needs?

State and local tax systems are not well designed to keep pace with economic and social change

- Goods are taxed, services are not
- E-commerce
- Internet tax moratorium





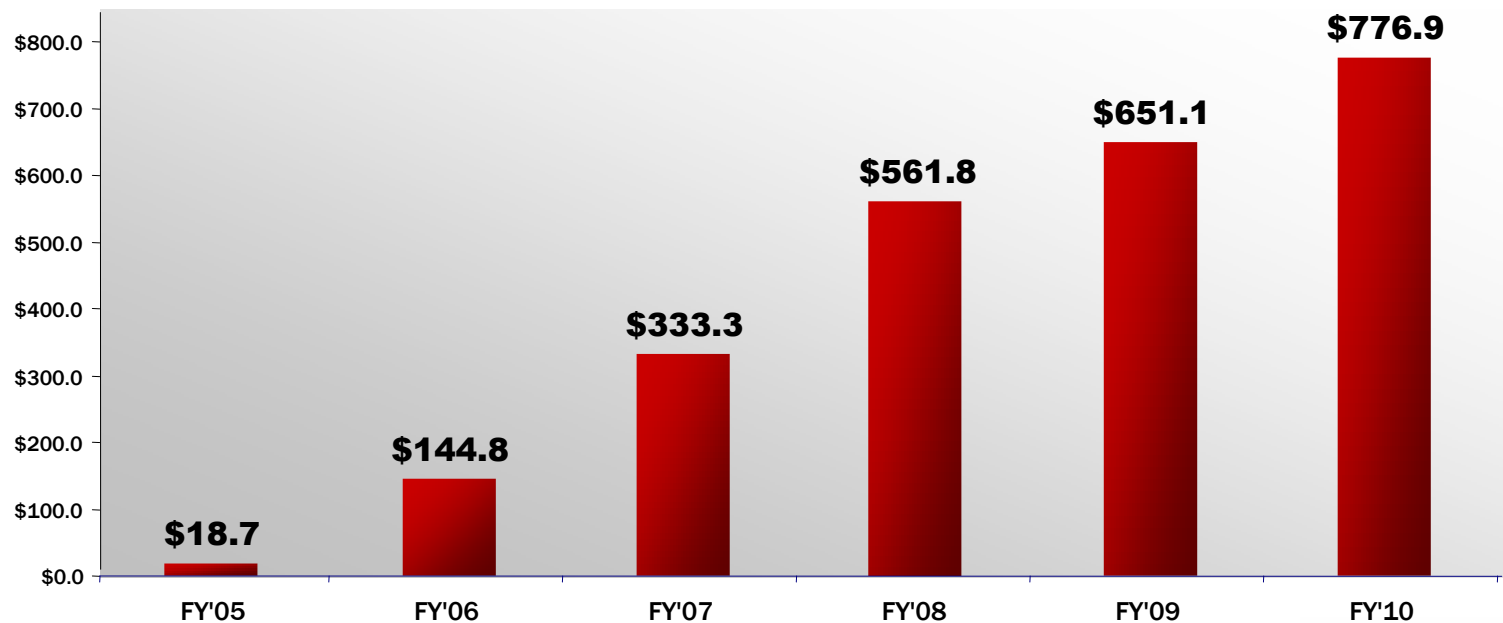
Fiscal Policy: ADEQUACY

Is our Tax Policy ADEQUATE for our Needs?

- Recent tax cuts will permanently hinder Oklahoma's ability to meet future needs

Lost Revenues from Select Tax Cuts, 2004-06

FY'05 through FY'10 (in \$ millions)



source: Oklahoma Tax Commission

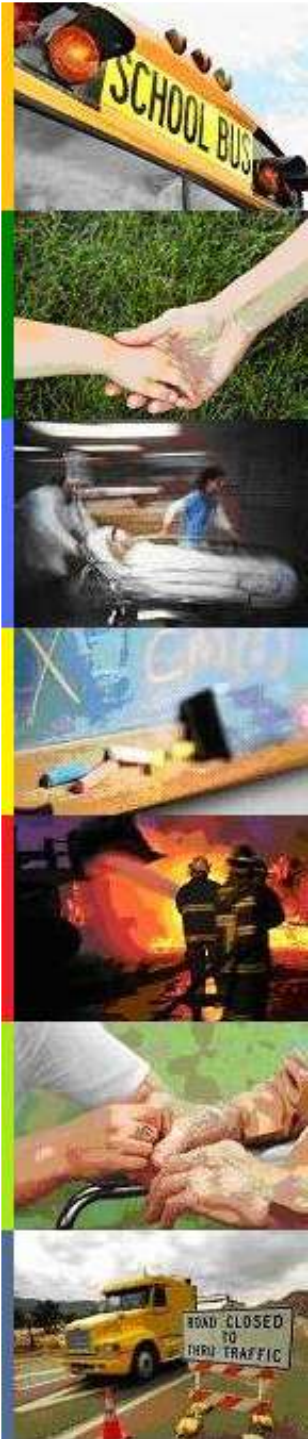
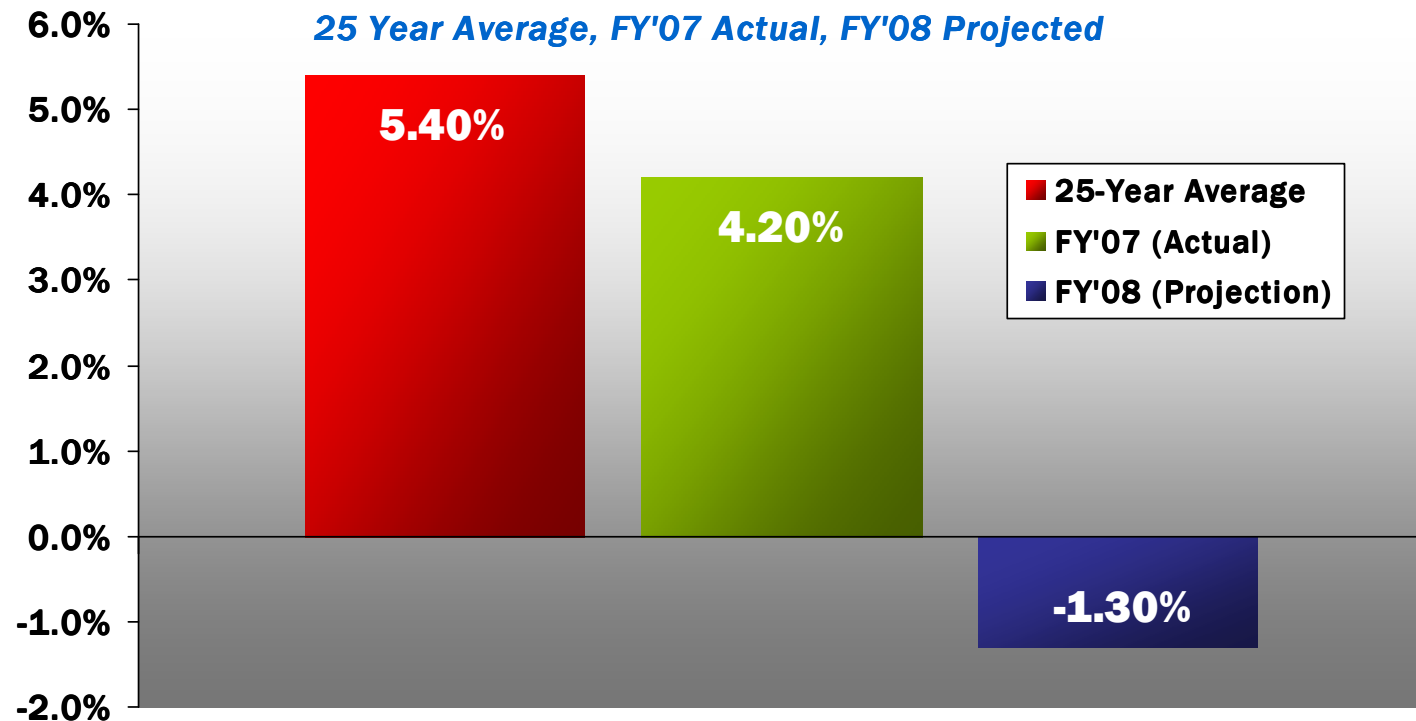
Fiscal Policy: IMPACT

IMPACT :: Oklahoma Faces Inadequate Resources to Meet our Goals

- State revenue growth is already slowing, even while the economy is faring well

Comparison of General Revenue Growth

25 Year Average, FY'07 Actual, FY'08 Projected



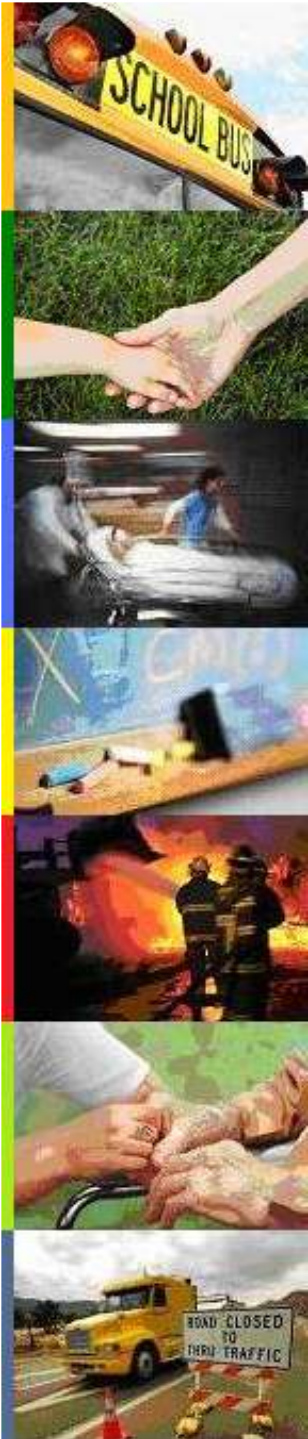
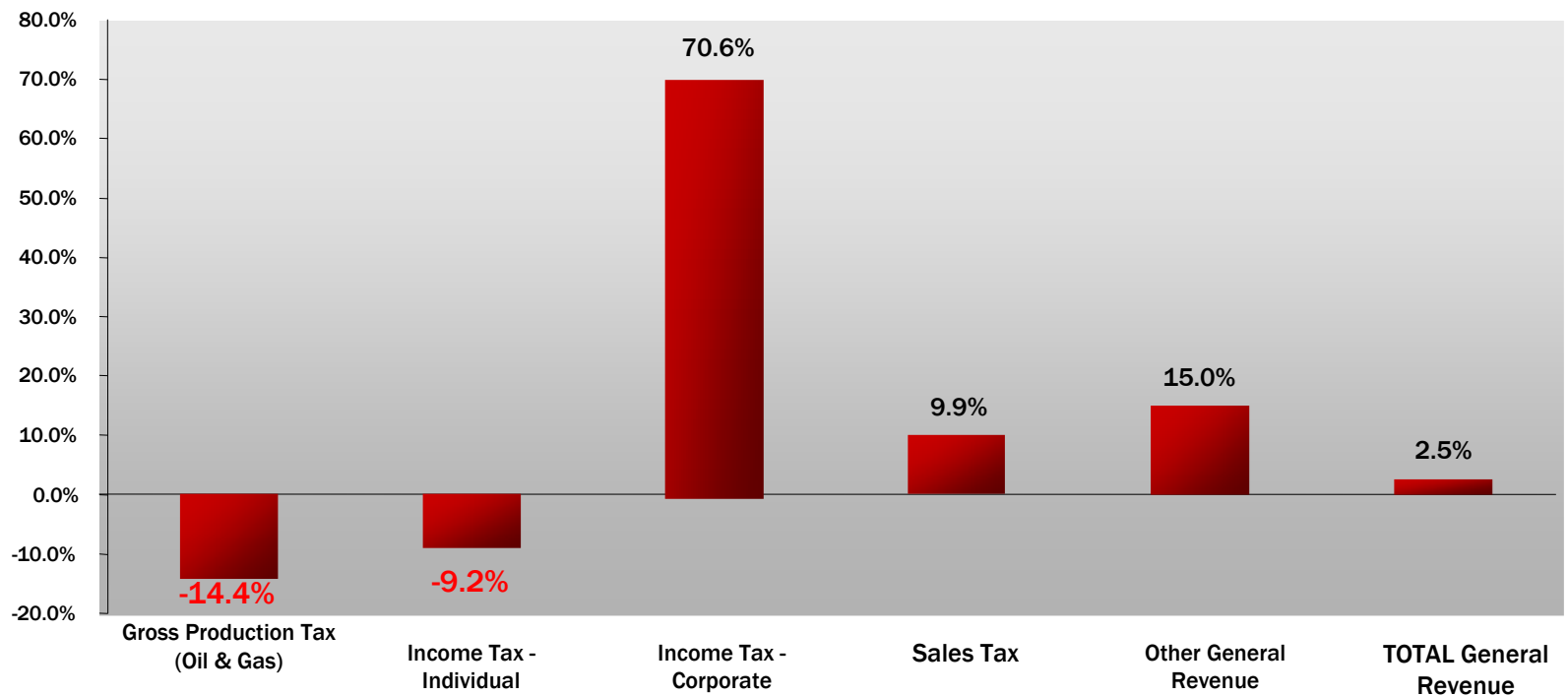
Fiscal Policy: IMPACT

IMPACT :: Oklahoma Faces Inadequate Resources to Meet our Goals

- **Current revenue growth derives primarily from the corporate income taxes – which is highly vulnerable to an economic slowdown**

Change in General Revenue Collections by Tax

FY'06 actual to FY'08 projected (February 2007 certification)



Fiscal Policy: IMPACT

IMPACT :: Oklahoma Faces Inadequate Resources to Meet our Goals

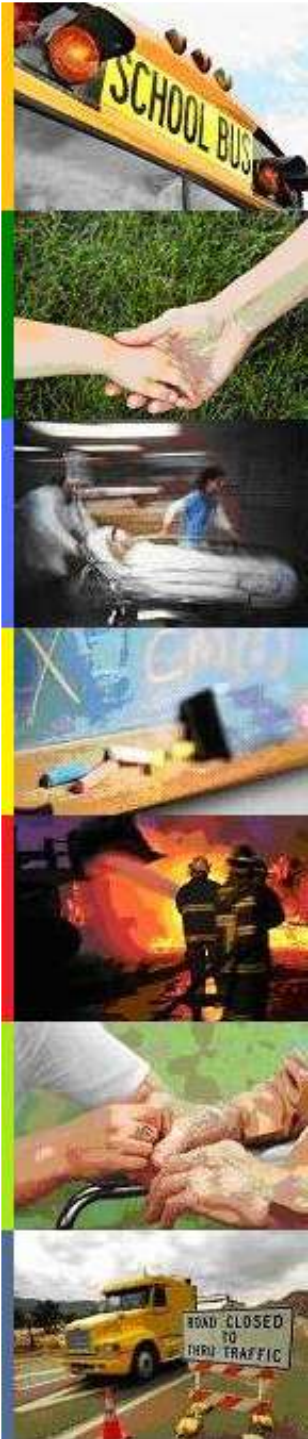
Recent Legislatures have earmarked a growing share of tax revenues to specific spending priorities:

- \$17 million or \$50 million annually in new growth revenue to the ROADS fund for transportation needs;
- Increasing contributions to fund OTRS;
- Automatic allocation of certified revenues for OHLAP scholarship payments



BUT IT'S A ZERO-SUM GAME ::

The more you fund “off the top”, the less that’s left for everything else

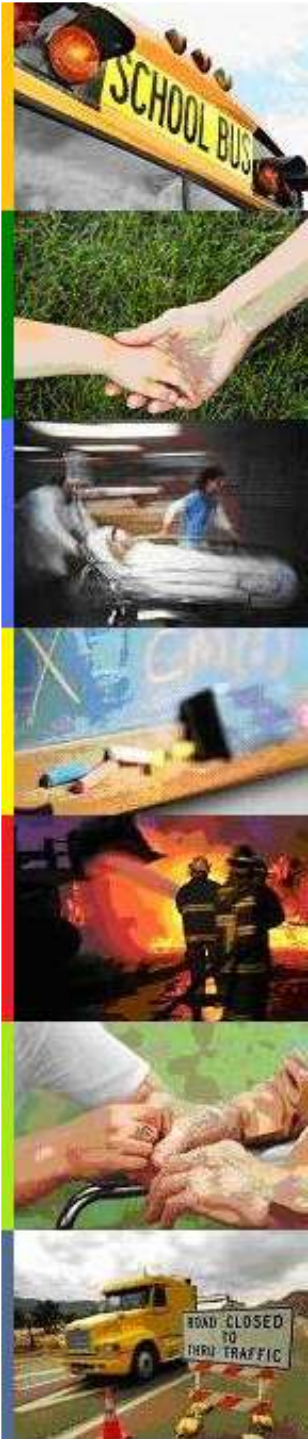


Fiscal Policy: IMPACT

IMPACT :: Oklahoma Faces Inadequate Resources to Meet our Goals

Revenues already bumping up against spending obligations

- Slowdown in revenue growth led to less money for ROADS fund in FY'08
- Annual Corrections shortfalls (\$30 - \$40 million)
- Annual shortfall in Ad Valorem reimbursement fund for manufacturing exemption (\$20 million)
- No increases for state aid formula
- No funding for fixed costs of agencies
- Growing backlog of critical capital improvements

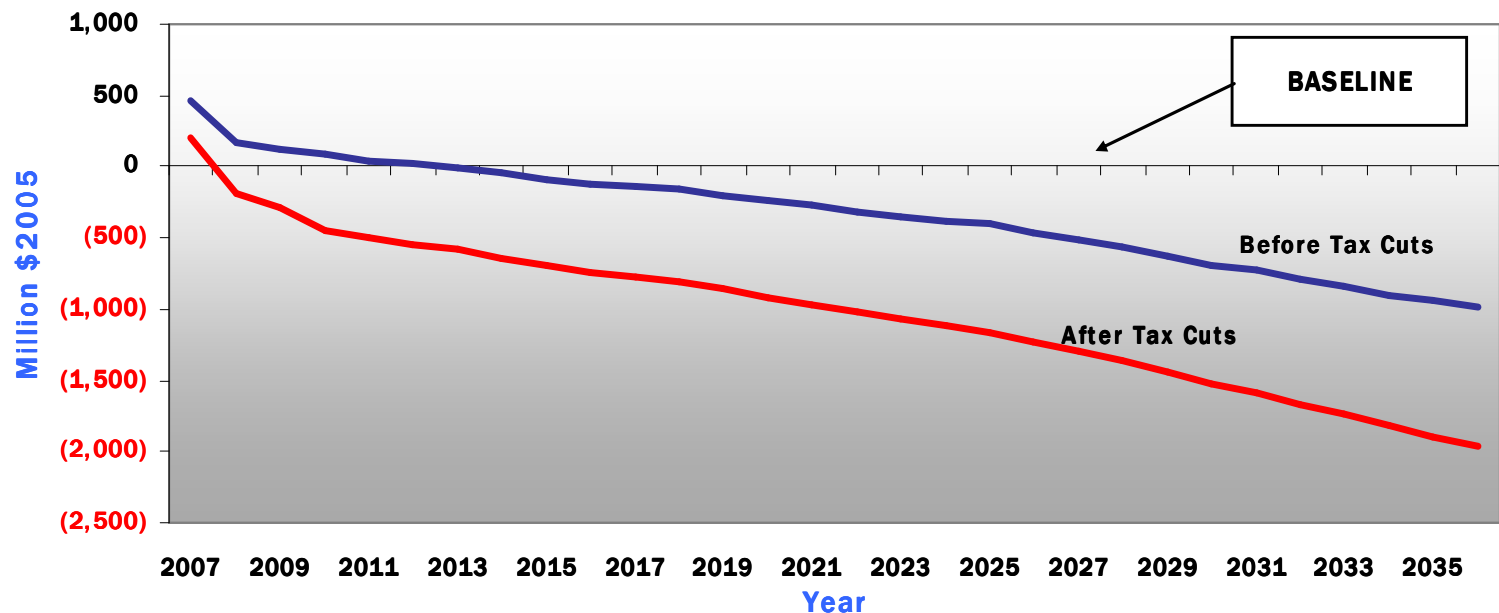


Fiscal Policy: IMPACT

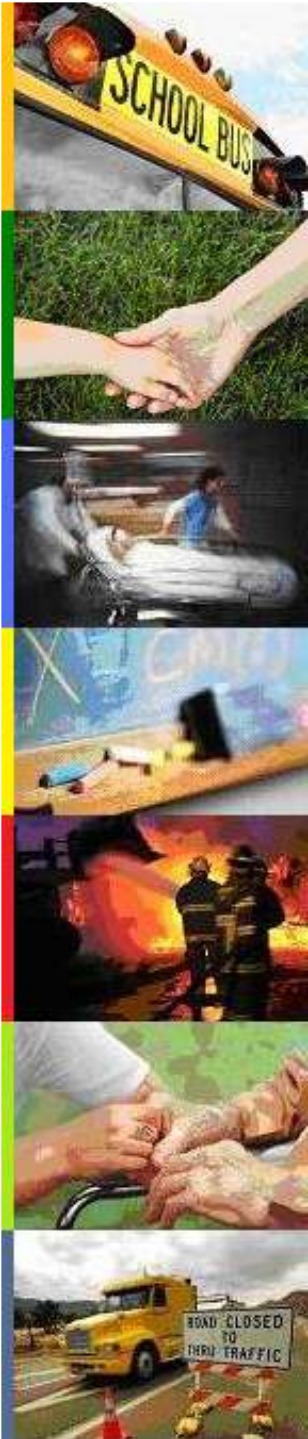
IMPACT :: Oklahoma Faces Inadequate Resources to Meet our Goals STRUCTURAL DEFICITS

A situation where "normal growth of revenues is insufficient to finance the normal growth of expenditures year after year"

Projected Annual Budget Surpluses and Deficits
Before and After 2004-2006 Tax Cuts (2007 to 2035)



source: Dr. Kent W. Olson, Professor of Economics, OSU)

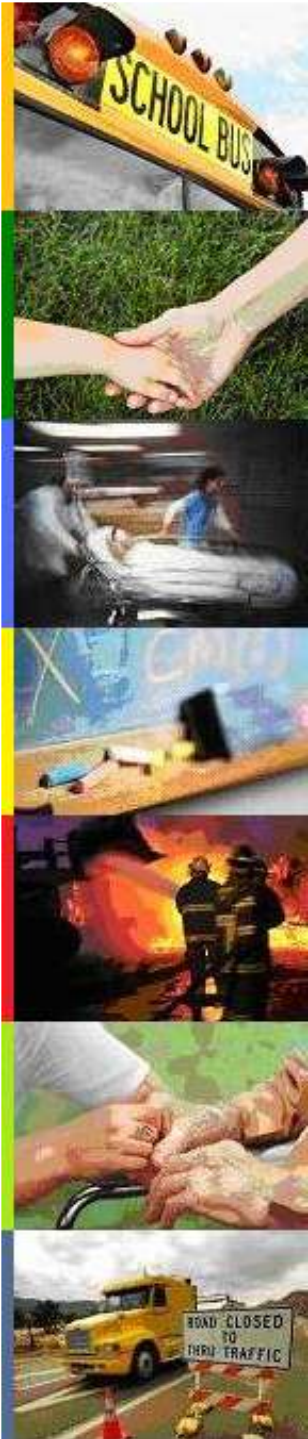


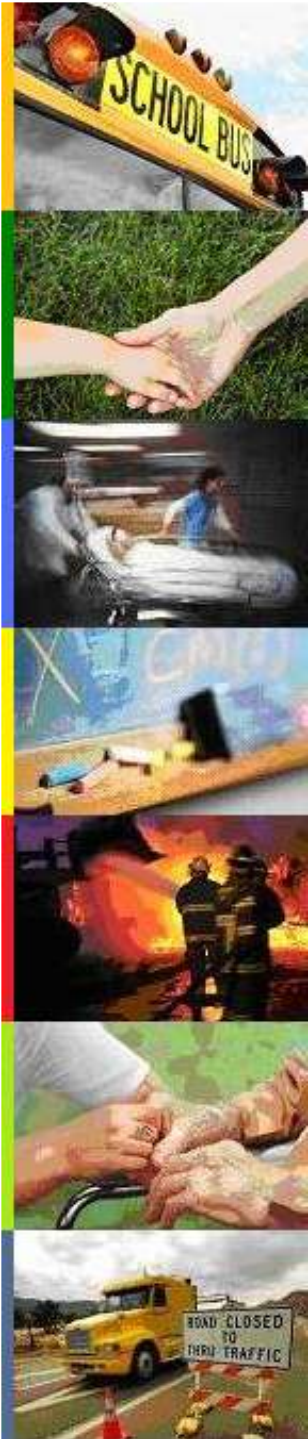
Fiscal Policy: IMPACT

IMPACT :: Oklahoma Faces Inadequate Resources to Meet our Goals

State Question 640

- As a result of SQ 640, the Legislature is unable to raise taxes to respond to budget shortfalls triggered by economic downturns.
- The only available options are to spend down the Rainy Day Fund and to cut services.





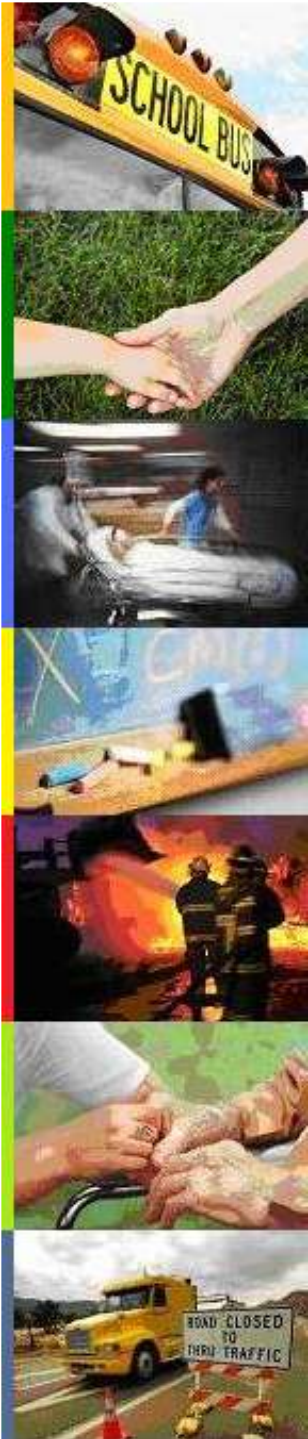
Fiscal Policy: IMPACT

IMPACT :: Oklahoma Faces Inadequate Resources to Meet our Goals

STRUCTURAL DEFICITS

CONDITION: Revenues \neq State Obligations

RESULT: continuous erosion of our public structures - our schools, hospitals, roads, law enforcement, safety inspections, courts, etc.



Principles for Revenue Decisions

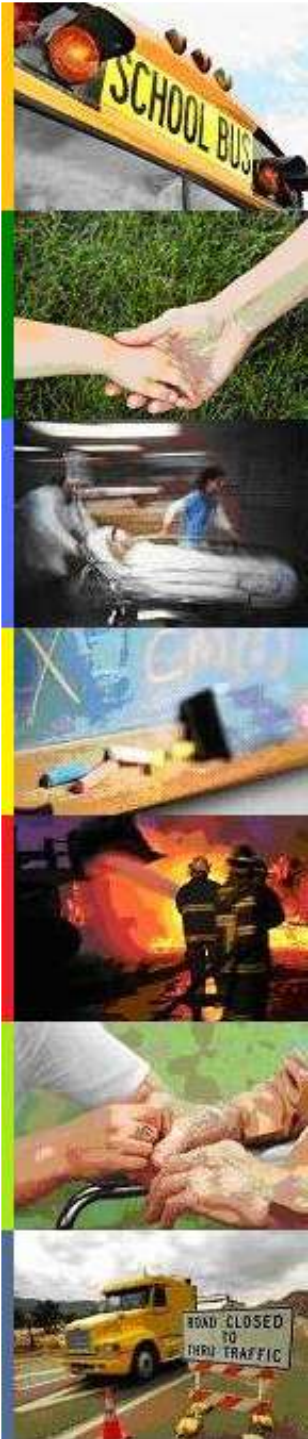
1. Take a breather from further tax cuts



I think we ought to have a **moratorium** on tax reductions right now. We're **bumping the limits** and I think we certainly don't need to proceed down that path.... I think what people really want is **excellence**

-David Boren

Associated Press, Sept. 17, 2007

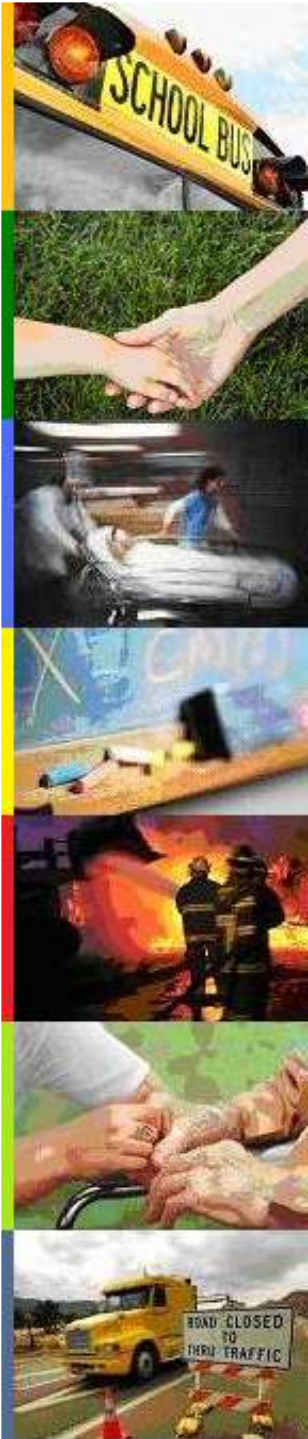


Principles for Revenue Decisions

2. Regular, Long-Term Budget Forecasts

- SB 368 - forecasting legislation



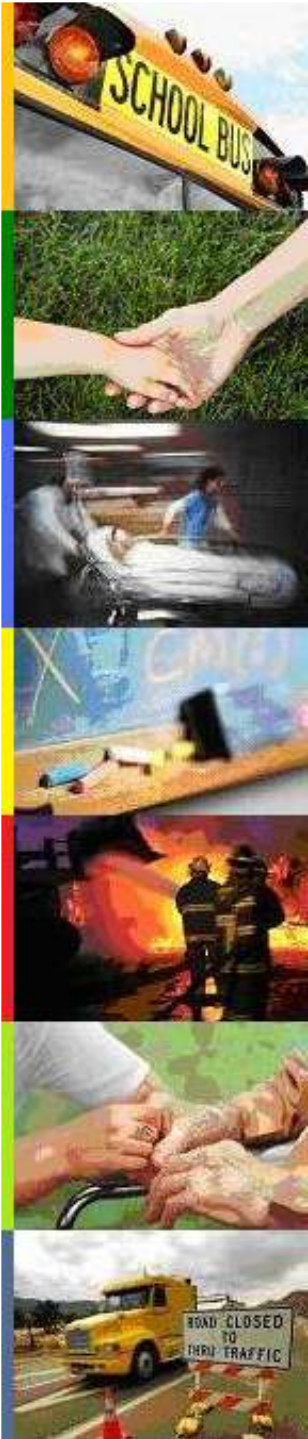


Principles for Revenue Decisions

3. Modernize the Tax System

- Broaden the sales tax base
- Combined reporting
- Review incentives and exemptions

Let's get people thinking and talking about our options

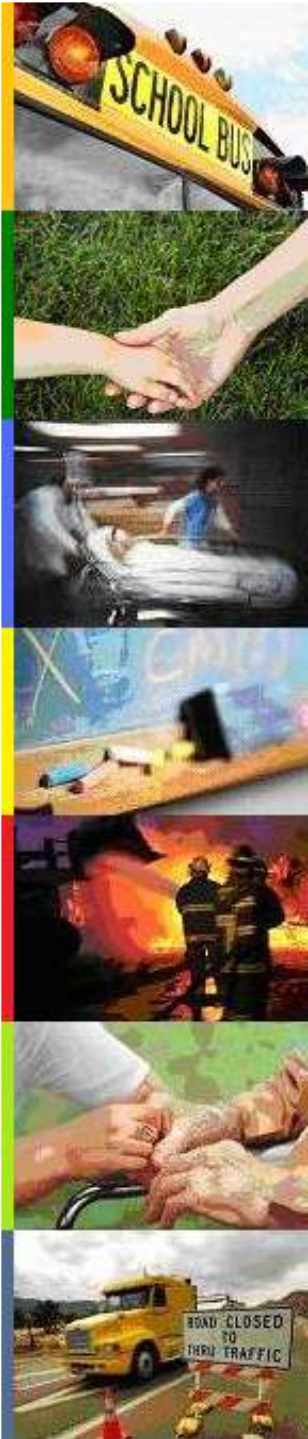


Principles for Revenue Decisions

4. Preserve a Balanced Tax Structure

- Prevents over-reliance on any single revenue stream
- Income tax is most dynamic tax source
- Non-income tax states face even worse immediate challenges and structural deficits





Public Spending as Investment

Are Tax Cuts an Effective Tool for **ECONOMIC GROWTH?**

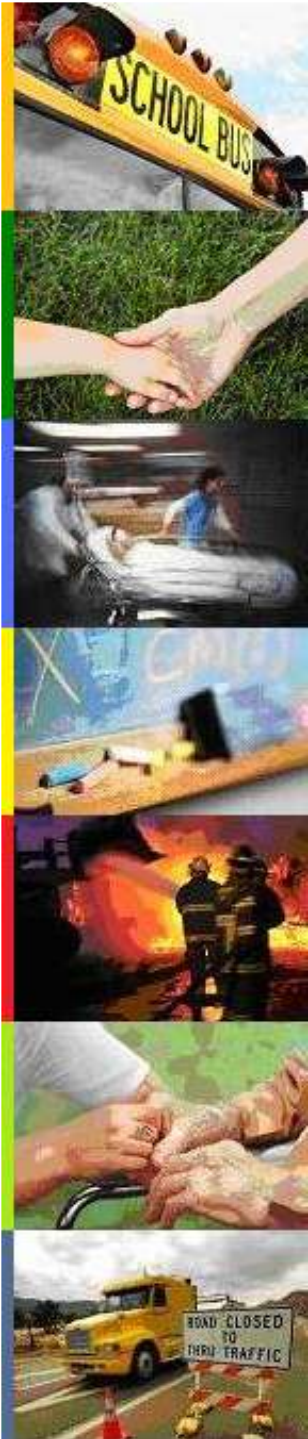
INVESTMENTS – A Proven Solution

- Extensive economic development literature establishes that investment decisions are driven more by the presence of a well-trained, productive workforce and strong public infrastructure than by state and local tax rates.



Rank of Relevant Factors in Location Decisions	
1	Labor Productivity
2	Skilled Labor Supply
3	Labor Costs
4	Distance to Major Market/Access
5	Crime Rates/Safety
6	Highway Access
7	Quality Health Care Facilities
8	Red Tape – Regulatory Climate
9	Public Schools
10	Corporate Tax Rate

Source: Louisiana Business Image Survey



Public Spending as Investment

Are Tax Cuts an Effective Tool for **ECONOMIC GROWTH**?

CEO's on State Taxes



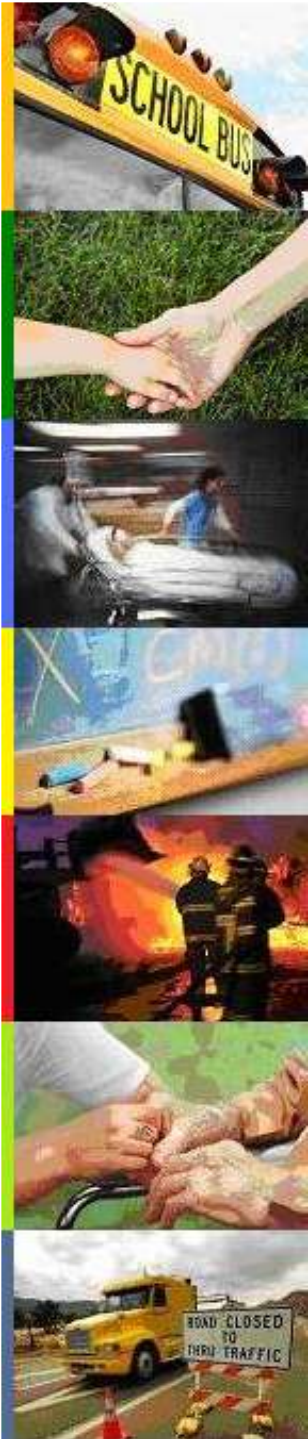
- **“As a businessman, I never made an investment decision based on the tax code...[I]f you are giving away money I will take it. If you want to give me inducements for something I am going to do anyway, I will take it. But good business people do not do things because of inducements, they do it because they can see that they are going to be able to earn the cost of capital out of their own intelligence and organization of resources.”**

Paul O'Neill, former Bush Treasury Secretary and Alco CEO

- **Any company that makes a decision as to where they are going to be based on the tax rate is a company won't be around very long. If you're down to that incremental margin you don't have a business.”**

Michael Bloomberg

- **In the wake of the merger between Bartlesville-based Phillips Petroleum and Houston-based Conoco Inc., Phillips CEO Jim Mulva commented that the lack of personal income tax in Texas had “absolutely no impact” on the decision to locate the new headquarters in Houston.**

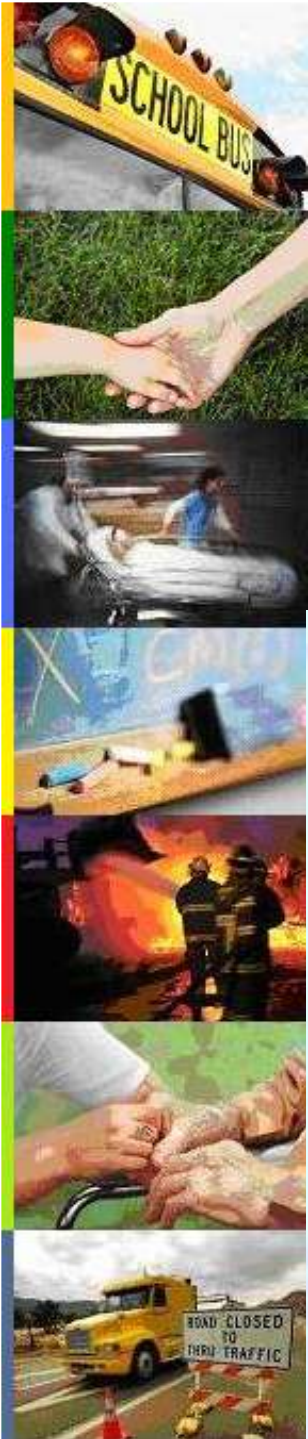


Public Spending as Investment

Are Tax Cuts an Effective Tool for **ECONOMIC GROWTH**?

- **President George W. Bush's former Chief Economic Adviser and Harvard Economics Professor Gregory Mankiw** called any economist who claimed that **tax cuts pay for themselves in new tax revenues that follow economic growth** a **"snake oil salesman trying to sell a miracle cure"**.
- **A 2006 Treasury Department analysis** found that **even under the most positive economic scenario federal tax cuts would not offset more than ten per cent of their long term costs"**



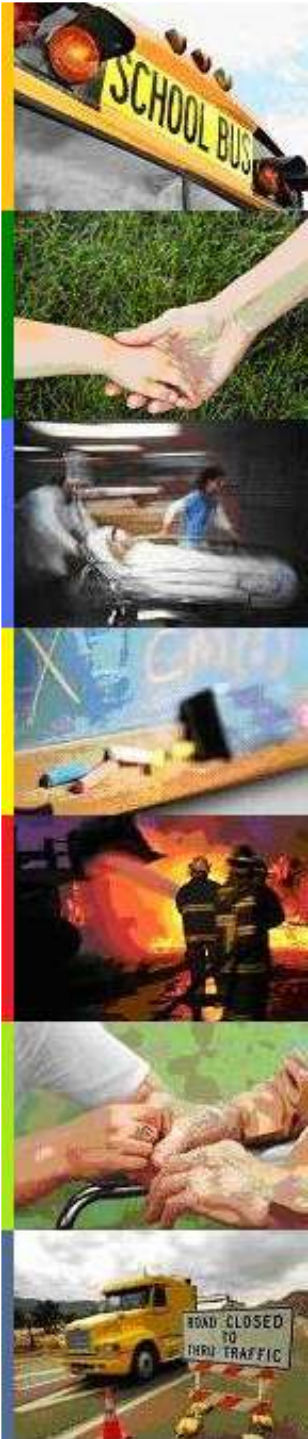


Public Spending as Investment

Are Tax Cuts an Effective Tool for ECONOMIC GROWTH?

A 2004 review by Dr. Robert Lynch of hundreds of economic and econometric studies found ❑

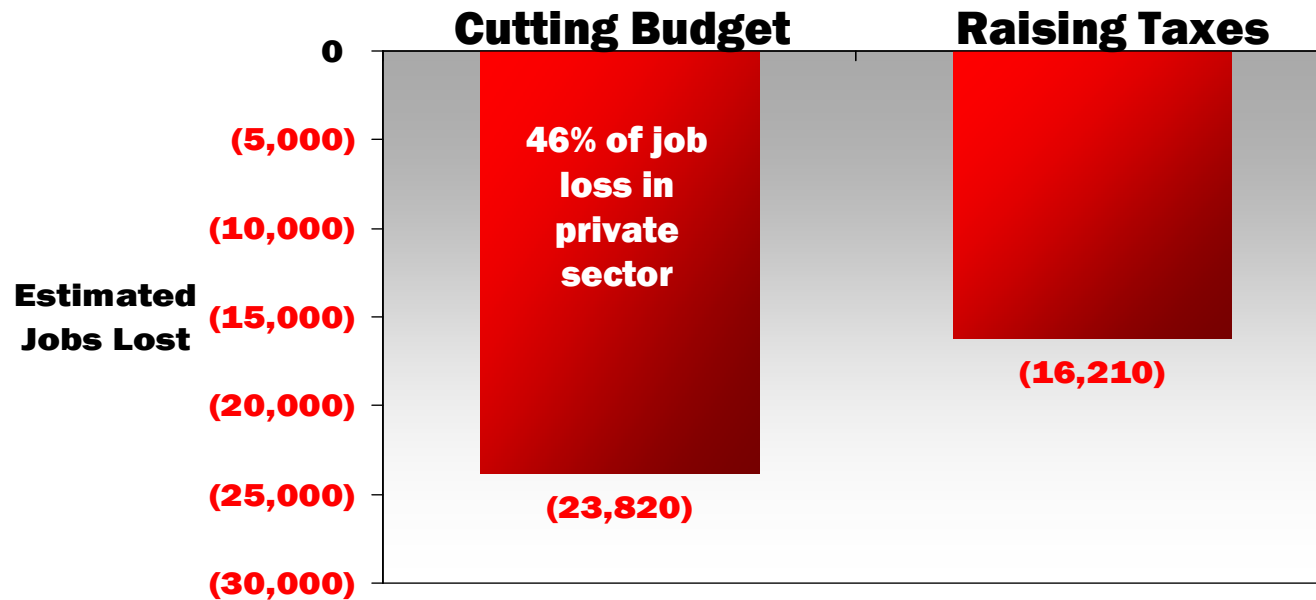
- **"state and local taxes, at their current low levels, may be largely **irrelevant** to business investment decisions."**
- **"any jobs that might be gained by cutting taxes can be more than offset by the jobs lost as a result of cuts in public services."**



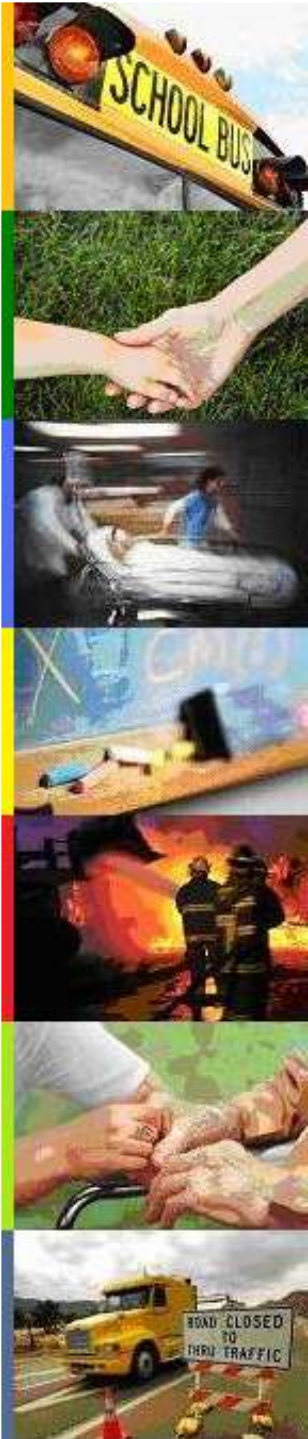
Principles for Revenue Decisions

Are Tax Cuts an Effective Tool for **ECONOMIC GROWTH?**

**W. E. Upjohn Institute for Employment Research Analysis ::
Cutting Budget Results in Steeper Job Losses
than Raising Taxes**



Study estimated impact of balancing the budget in Michigan in 2003 with a \$935 M budget cut or \$935 M income tax increase

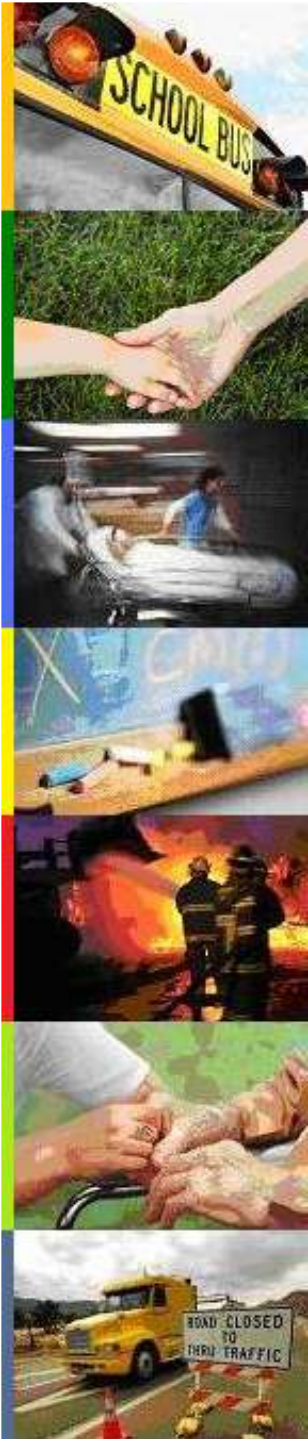


Paying Our Fair Share

Is Oklahoma's Tax System EQUITABLE?

Progressivity versus Regressivity



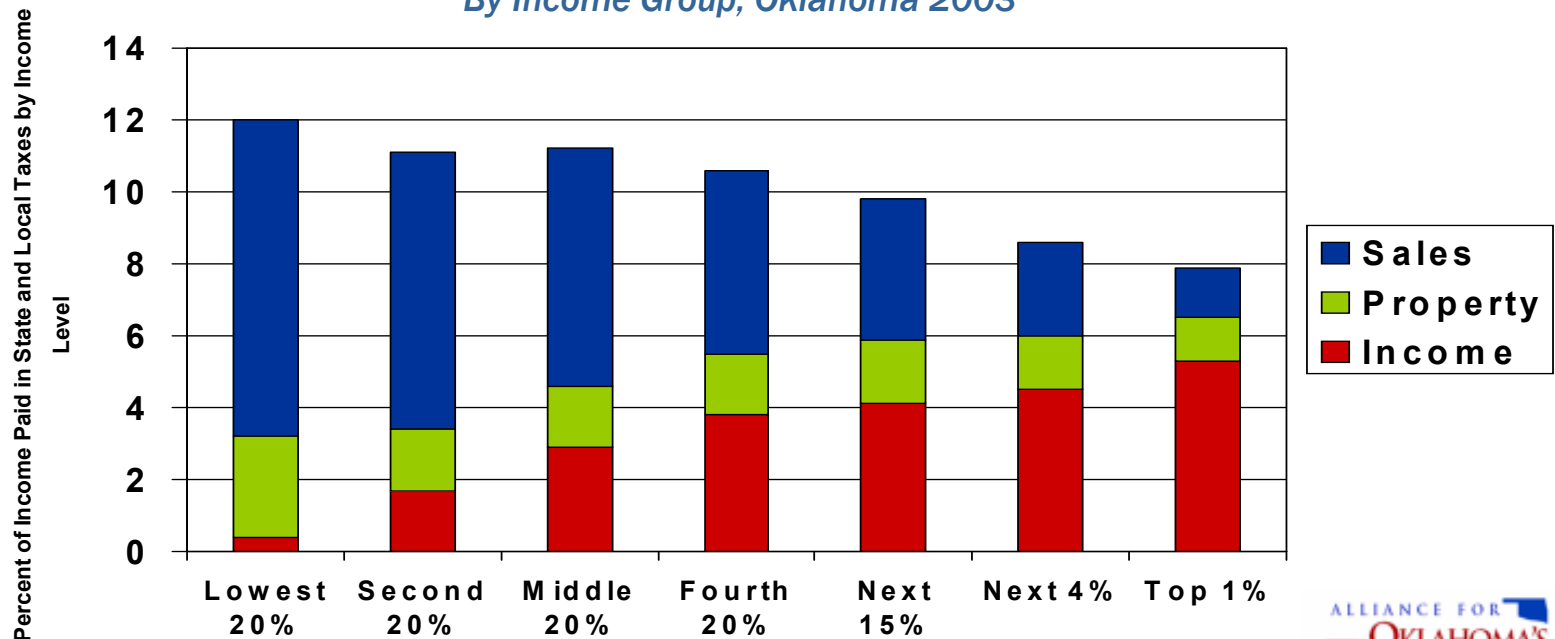


Paying Our Fair Share

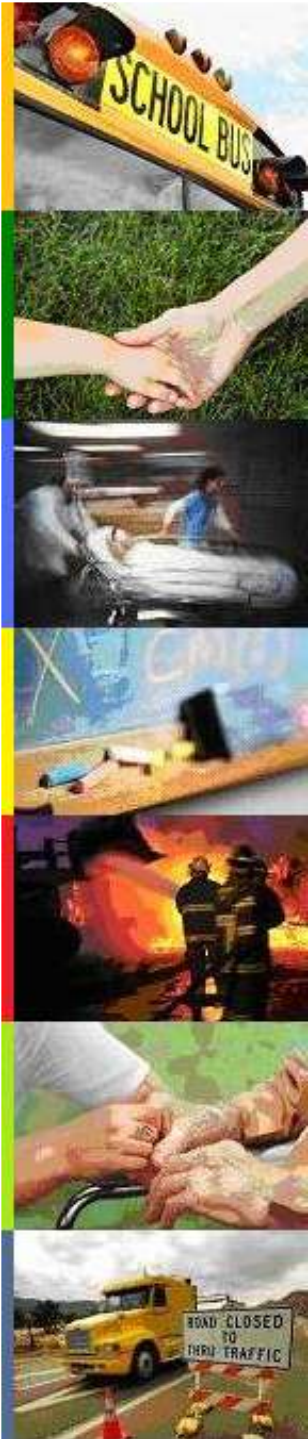
Is Oklahoma's Tax System **EQUITABLE?**

- **Low- and moderate-income Oklahomans pay a considerably greater share of their income in state and local taxes than do upper-income Oklahomans.**
- **The progressive effects of the state income tax are more than offset by the regressive effect of sales and property taxes.**

Percentage of household income paid in state and local taxes
By Income Group, Oklahoma 2003



Source: Institute for Taxation and Economic Policy, 2003

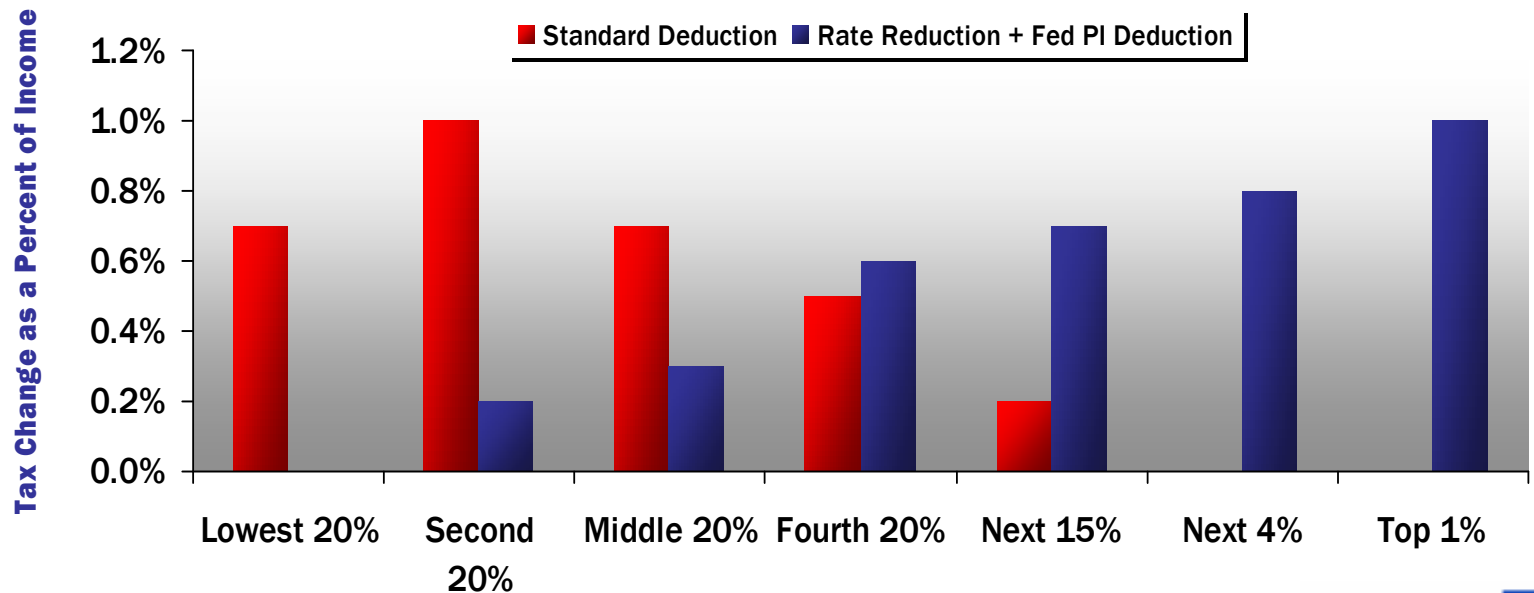


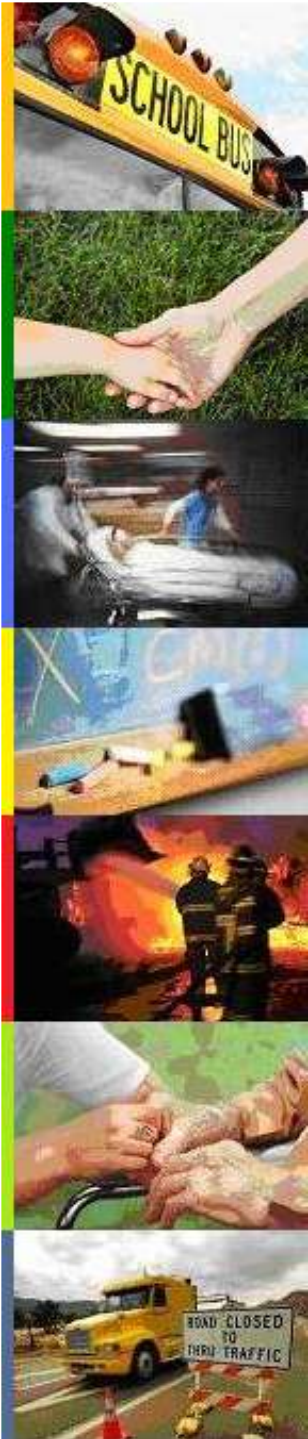
Paying Our Fair Share

Is Oklahoma's Tax System **EQUITABLE**?

Impact of recent policy decisions to the Oklahoma tax system

How Taxes are Cut (or Raised) Has a Profound Implications for Equity





Paying Our Fair Share

Is Oklahoma's Tax System EQUITABLE?

SOLUTIONS :: Suggestions for making the tax system **MORE EQUITABLE**

- Increase state EITC
- Index sales tax relief credit
- Increase personal exemptions
- Stretch the income tax brackets
- Add a new top bracket



Conclusions

The first step in climbing out of a hole is to **STOP** digging

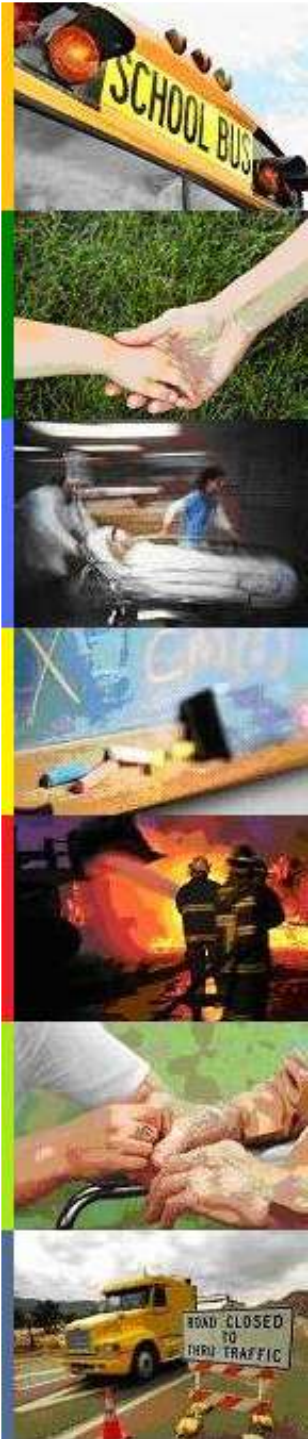


Conclusions

Plan for the Future :: 5 Keys

- Use Long-Term Forecasts
- Compare Goals and Needs to Revenues
- Balance Revenue Streams to Protect Against Economic Downturns
- Expect Everyone to Pay their Fair Share
- Invest for Economic Growth





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Texas :: A Model?

Is Texas a Model to Follow?

INDICATORS	OK	TX
Overall Asset and Opportunity Score (CFED)	C	F
Children Without Health Insurance - Rank	43	51
Per pupil spending - Rank	43	45
8 th grade students scoring below basic levels	43%	47%
Home Ownership Rates – Rank	17	44
Affordability of Homes – Rank	1	4

