Enactment of increased taxes for the first time in Oklahoma under the provisions of State Question 640, requiring a 75-percent majority for passage in each house of the Legislature, is drawing positive words from Moody’s Investors Service, one of the big three bond rating agencies.

On April 9, Moody’s issued the following Issuer Comment:

Oklahoma overcomes political gridlock and passes revenue bill for first time in decades, a credit positive

On March 29, Oklahoma (Aa2 negative) Governor Mary Fallin signed a series of revenue increases into law, the first time in nearly three decades that the state was able to surpass the 75% legislative supermajority required for a tax increase.

The revenue package raises approximately $523 million in fiscal year 2019, signifying that under certain fiscal and political circumstances — in this instance, the threat of a teacher strike — the state can reach consensus to implement a solution to its fiscal challenges.

Moody’s: State Fund Balances Continue to Decline

The matching of new expenditures with new revenues demonstrates fiscal responsibility, but a moderate structural deficit persists.

Source: Oklahoma Comprehensive Annual Financial Reports, Moody’s Investors Service
An historic event, but work remains

The historical significance of what has happened in the past month at the State Capitol cannot be overstated. For the first time in Oklahoma history, taxes have been raised within the constraints of State Question 640 and under Republican leadership.

The provision of State Question 640, requiring a 75-percent majority in each house of the Legislature, presents a very high bar. Proponents of the requirement, approved by voters in 1992 following multiple years of tax increases, intended to force the Legislature to seek alternative solutions to funding issues before hiking taxes.

In subsequent years, recurring revenues dwindled due to a combination of tax cuts, incentives and economic downturns, forcing efficiencies and funding cuts throughout state government. During the last state recession, attitudes about the need for additional revenue began to change.

In the past year, several votes were taken in the Legislature to raise new revenue, but the 75-percent requirement could not be met. Disagreements over which revenue sources to tap, and to what degree, stymied those efforts. Motivation to break through a partisan impasse was supplied by tens of thousands of teachers, students, and state employees threatening to march on the Capitol Building.

"Motivation to break through a partisan impasse was supplied by tens of thousands of teacher, students and state employees threatening to march on the Capitol Building."

The result was passage of HB 1010XX. Even though the standoff continues, the mere specter of the march accomplished what the STEP UP business coalition could not.

Increasing recurring revenue to pay for a like amount in new spending commitments to support education is positive for several reasons, but it does not solve the structural budget deficit nor address other pressing needs and reforms.

The problems faced by the state are easily demonstrated and public education funding is but one of them. A relative comparison of spending by the states on core...
services – public education, public safety, public health, and public transportation – shows Oklahoma has lagged behind most states, even when adjusted for cost-of-living.

Once the dust settles from the current teacher walkout, perhaps it would be wise to take a step back and examine Oklahoma’s entire tax structure to lay the groundwork for a comprehensive reform effort. Rather than a hodgepodge of passable measures, Oklahoma’s tax structure should be strategically built around our modern economy and designed to adequately fund core services while encouraging entrepreneurial activity, productivity and growth.

The governor, speaker, pro tem, and supermajority of legislators are to be commended for their efforts. So too are all the citizens for their strength of conviction and persistence—and clever signs. It has been the greatest show of representative democracy in action that I have witnessed at the Capitol. When the crowds dissipate and normalcy returns, let us not forget what can be achieved with a spirit of compromise and cooperation. Much work remains.

Moody’s

failed attempts by the legislature to raise new revenues or otherwise achieve structural budget balance in recent years.

The ability to raise new revenues is especially hard in Oklahoma, limited by a 1992 state constitutional amendment that requires a three-quarters majority in each legislative chamber or majority popular approval via referendum for all new taxes. Until now, that hurdle has proven insurmountable.

Since the energy downturn of 2014, the state has relied on reserves and other one-time revenues and expenditure cuts to close the annual budget, despite considerable bipartisan agreement that further cuts are undesirable.

After two special sessions tasked with raising new revenues to plug a $215 million hole last year, the legislature resigned itself to across the board cuts. Simultaneously, the state’s general fund balance continues to decline.

The enacted revenue measures include new taxes of $1-per-pack on cigarettes, three cents per gallon on gasoline, six cents per gallon on diesel and an increase in the gross production tax on oil from 2% to 5%.

A separate measure capped itemized deductions on state income tax returns at $17,000. A number of these measures had failed to garner support only a few months ago.

Most of the new revenues will be used for $470 million in new expenditures — mainly raises for state employees, including an average pay hike of $6,100 for teachers. Teacher demands for a $10,000 raise and the threat of a walkout were the primary political impetuses behind the package.

Although the strike is ongoing — supporters contend that education still remains underfunded and are seeking the repeal of an income tax deduction on capital gains — mounting political and fiscal pressures surrounding the funding of teachers and education were sufficient to generate a large enough coalition to overcome the high constitutional requirements.

The matching of new expenditures with new revenues demonstrates fiscal responsibility, but a moderate structural deficit persists. Oklahoma has been operating with a structural

SEE MOODY’S PAGE 4
deficit after the decline in oil prices shrank one of the state’s most important revenue sources.

About $50 million of the new recurring revenues remains undedicated in the budget, helping to reduce a projected gap which is still more than $100 million.

While this represents a substantial improvement — Oklahoma’s structural deficit has declined from above $1.3 billion — the persistence of the deficit remains a credit weakness.

There is still potential for further progress due to additional revenue measures currently under consideration by the legislature — including two awaiting the governor’s signature that will generate an additional $44 million in fiscal year 2019 — and recent rapid growth in state revenues.

Receipts have grown by 13.2% and outpaced estimates by 3.5% in fiscal 2018 year-to-date, owing to a rebound in economic activity – particularly in the oil and gas sector – and very strong income tax receipts.

Officials, however, have urged caution in overinterpreting the positive results since the economy has yet to fully recover and changes to the law have also contributed to the revenue boost.

Furthermore, success at directly addressing the fiscal imbalance has so far remained limited and it is unclear if there is yet sufficient political will to fully close the budget gap.

### New Revenue and Expenditures Approved by the Legislature and Signed by the Governor
(as of April 9, 2018)

<table>
<thead>
<tr>
<th>New Revenue</th>
<th>New Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>HB 1010XX</strong></td>
<td><strong>HB 1023XX</strong></td>
</tr>
<tr>
<td>• $1.00 per pack cigarettes</td>
<td>• Teacher pay raise $353.0 million</td>
</tr>
<tr>
<td>• $1.00 per pack little cigars</td>
<td></td>
</tr>
<tr>
<td>• 3 cents per gallon gasoline</td>
<td><strong>HB 1024XX</strong></td>
</tr>
<tr>
<td>* 6 cents per gallon diesel</td>
<td>• State employee pay raise $63.7 million</td>
</tr>
<tr>
<td>• 5% Gross Production Tax</td>
<td><strong>HB 1026XX</strong></td>
</tr>
<tr>
<td>first 36 months Crude Oil $99.4 million</td>
<td>• School support staff raise $52.0 million</td>
</tr>
<tr>
<td>Natural Gas $71.1 million</td>
<td></td>
</tr>
<tr>
<td>• $5 per night lodging tax (Repealed by HB 1012XX)</td>
<td><strong>NOTE</strong>: HB 3705 – State Education appropriation of $2.9 billion including additional education funding of $33 million for textbooks, $17 million in state aid, and $24.7 million for health benefits.</td>
</tr>
<tr>
<td><strong>HB 1011XX</strong></td>
<td>Sources: Oklahoma Tax Commission (for revenue), Legislative fiscal staff (for expenditures)</td>
</tr>
<tr>
<td>• Caps itemized income tax deductions at $17,000, excluding medical expenses and charitable donations $94.0 million</td>
<td>Note: Totals may not sum due to rounding.</td>
</tr>
<tr>
<td><strong>Total new recurring revenue for FY-19</strong> $568.7 million</td>
<td></td>
</tr>
</tbody>
</table>
March Gross Receipts to the Treasury show continued growth

March Gross Receipts to the Treasury grew by 7.4 percent compared to the same month of the prior year as gross collections have now shown growth for 12 consecutive months, State Treasurer Ken Miller announced on April 3.

For the first time since February 2017, monthly individual income tax collections failed to top receipts from the prior year, dipping by $6.6 million, or 2.2 percent. However, the tax commission attributes the difference to the timing of income tax withholding deadlines with one less payment required this March compared to a year ago.

Miller said he sees no cause for concern in the revenue report.

“The state’s economic fundamentals continue to appear strong,” he said.

“Growth persists with most major revenue sources; unemployment...”

SEE REVENUE PAGE 6
Revenue
FROM PAGE 5

remains low, and commodity prices continue to show strength.”

March gross receipts show increases in collections from sales and gross production taxes.

In addition to individual income taxes, corporate income taxes are also down for the month, as has frequently been the case. Total receipts for March are up by $67.9 million.

Collections from the past 12 months compared to the previous period show growth in every major revenue stream. Total 12-month collections are up by more than $1 billion, or 9.5 percent.

New revenue collections
The tax commission attributes $33.6 million in March to new revenue resulting from legislation enacted during 2017.

The additional revenue comes primarily from changes in sales tax exemptions and gross production tax incentives.

The new revenue accounts for 3.4 percent of March gross receipts. Out of $7.8 billion in gross collections since last August, $206.2 million, or 2.7 percent, has resulted from law changes from last year.

Other indicators
The Oklahoma Business Conditions Index has topped growth neutral for eight consecutive months.

The March index was set at 62.4, up from 60.5 in February. Numbers above 50 indicate anticipated economic growth during the next three to six months.

March collections
March gross collections total $982.9 million, up $67.9 million, or 7.4 percent, from March 2017.

Gross income tax collections, a combination of individual and corporate income taxes, generated $323.5 million, a decrease of $11.1 million, or 3.3 percent, from the previous March.

Individual income tax collections for the month are $299.9 million, down by $6.6 million, or 2.2 percent, from the prior year. Corporate collections are $23.6 million, a decrease of $4.5 million, or 16 percent.

Sales tax collections, including remittances on behalf of cities and counties, total $368.9 million in March. That is $33.7 million, or 10 percent, more than March 2017.

Gross production taxes on oil and natural gas generated $72.8 million in March, an increase of $24.9 million, or 52 percent, from last March. Compared to February reports, gross production collections are up by $6 million, or 9 percent.

Motor vehicle taxes produced $74.3 million, up by $6 million, or 8.8 percent, from the same month of 2017.

Other collections, consisting of about 60 different sources including use taxes, along with taxes on fuel,
**Revenue**

**FROM PAGE 6**

Tobacco, and alcoholic beverages, produced $143.4 million during the month. That is $14.4 million, or 11.2 percent, more than last March.

**Twelve month collections**

Gross revenue totals $11.8 billion from the past 12 months. That is $1.02 billion, or 9.5 percent, more than collections from the previous 12 months.

Gross income taxes generated $4.1 billion for the period, reflecting an increase of $234.1 million, or 6 percent, from the prior 12 months.

Individual income tax collections total $3.7 billion, up by $203.1 million, or 5.8 percent, from the prior 12 months. Corporate collections are $415.3 million for the period, an increase of $30.9 million, or 8.1 percent, over the previous period.

Sales taxes for the 12 months generated $4.5 billion, an increase of $375 million, or 9 percent, from the prior period.

Oil and gas gross production tax collections brought in $618.7 million during the 12 months, up by $227.2 million, or 58 percent, from the previous period.

Motor vehicle collections total $765.4 million for the period. This is an increase of $22.2 million, or 3 percent, from the trailing period.

Other sources generated $1.7 billion, up by $164.2 million, or 10.5 percent, from the previous year.

**About Gross Receipts to the Treasury**

The Office of the State Treasurer has issued the monthly Gross Receipts to the Treasury report since March 2011 to provide a timely and broad view of the state’s macro economy.

It is released in conjunction with the General Revenue Fund allocation report from the Office of Management and Enterprise Services, which provides important information to state agencies for budgetary planning purposes.

The General Revenue Fund receives less than half of the state’s gross receipts with the remainder paid in rebates and refunds, remitted to cities and counties, and placed into off-the-top earmarks to other state funds.

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**State jobless rate unchanged for six consecutive months**

At 4.1 percent, Oklahoma’s seasonally-adjusted unemployment rate in February remained unchanged since September of last year, according to figures released by the Oklahoma Employment Security Commission.

State jobless numbers improved by five-tenths of a percentage point over the year.

The U.S. jobless rate was also set at 4.1 percent in February, equal to Oklahoma’s rate for a fifth consecutive month.

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**Oklahoma Unemployment Report**

**February 2018**

<table>
<thead>
<tr>
<th>February 2018</th>
<th>Unemp. rate*</th>
<th>Labor force*</th>
<th>Employment*</th>
<th>Unemployment*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oklahoma</td>
<td>4.1%</td>
<td>1,845,167</td>
<td>1,770,033</td>
<td>75,134</td>
</tr>
<tr>
<td>United States</td>
<td>4.1%</td>
<td>161,921,000</td>
<td>155,215,000</td>
<td>6,706,000</td>
</tr>
<tr>
<td>OKLAHOMA</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jan ’18</td>
<td>4.1%</td>
<td>1,842,471</td>
<td>1,766,250</td>
<td>76,221</td>
</tr>
<tr>
<td>Dec ’17</td>
<td>4.1%</td>
<td>1,841,801</td>
<td>1,765,566</td>
<td>76,235</td>
</tr>
<tr>
<td>Nov ’17</td>
<td>4.1%</td>
<td>1,842,189</td>
<td>1,766,036</td>
<td>76,153</td>
</tr>
<tr>
<td>Oct ’17</td>
<td>4.1%</td>
<td>1,842,332</td>
<td>1,766,262</td>
<td>76,070</td>
</tr>
<tr>
<td>Sept ’17</td>
<td>4.1%</td>
<td>1,840,852</td>
<td>1,764,595</td>
<td>76,257</td>
</tr>
<tr>
<td>Feb ’17</td>
<td>4.6%</td>
<td>1,825,759</td>
<td>1,742,574</td>
<td>83,185</td>
</tr>
</tbody>
</table>

* Data adjusted for seasonal factors

Source: OESC
Economic Indicators

Unemployment Rate
January 1980 – February 2018

Gross Receipts vs. Oil & Gas Employment
January 2008 – March 2018

Leading Economic Index
January 2001 – January 2018

Oklahoma Stock Index
Top capitalized state companies
January 2009 – March 2018

Oklahoma Natural Gas Prices & Active Rigs
January 2011 – March 2018

Oklahoma Oil Prices & Active Rigs
January 2011 – March 2018