Perhaps Oklahomans know better than most that the only thing constant in life is change. We joke that if you don’t like the weather, just wait a minute. And, of course, our anchor industry is subject to much price volatility.

In June, West Texas Intermediate crude oil topped $140 per barrel, drilling was on the rise and jobs were expanding. Seven months later, the same oil could be had for less than $50 per barrel, drilling activity was dropping and layoffs were becoming commonplace.

And in Oklahoma, government leaders are staring down a projected budget hole of more than $600 million caused, in large part, by the price decline.

The challenge today for oil company leaders is endurance and profitability. For government leaders, it’s conservation. For oilfield workers, it’s survival.

One can be excused for feeling a sense of déjà vu because we have been here before. It’s not another historic bust, but to some it may feel that way. Still the question on many minds is how long will this last and how do we endure and emerge stronger on the other side?

Ripple effects

As prices have fallen, and thus the profit margin on a barrel of oil, domestic companies have pulled back by reducing new well drilling and by shedding employees.

The number of exploration and development wells are shrinking at an accelerating rate. Since mid-November, the U.S. rig count has dropped by 619, a reduction of 32 percent. In Oklahoma, February’s rig count was 26 percent lower than in November, with 54 fewer wells being drilled.

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With every challenge comes an opportunity and, as one of my favorite sayings goes, “setbacks are opportunities for comebacks.” Fifty dollar a barrel oil prices and a $611 million budget shortfall certainly qualify as challenges, even setbacks, but they are ones that we can overcome. This year we have a tremendous opportunity to carefully rethink how we put together the state’s budget and to address cyclical and structural imbalances that threaten the stability of state finances.

It is important to keep this shortfall in context. This is not the first or the largest budget shortfall the state of Oklahoma has had in recent memory. In 2010, during the national recession, we had a billion dollar shortfall. The sky did not fall. In 2011, when I took office, I inherited a $500 million shortfall. At the time, we had very few tools to work with to close that budget gap. The state was broke; we had only $2.03 in our savings account. The economy was stagnant; tens of thousands of Oklahomans were without work.

Today we are in a much better position to deal with a budget hole. We have a strong economy, one of the lowest unemployment rates in the nation, and more than $535 million in our Rainy Day savings account. Thanks to strong economic growth, we are much better equipped to deal with this year’s shortfall. Because of that growth, we can balance the budget while still preserving the core functions of government.

“These are all things we can do to balance the budget in the coming fiscal year. As I said before, however, we need to take a longer view and use this year’s budget as an opportunity to correct structural imbalances in our budget system.”

There are several tools in our toolbox we know we can use to make up for the shortfall, including:
- Cutting some agency appropriations
- Redirecting some amount of the Rainy Day Fund to core government services like education
- Redirecting some portion of the $1.7 billion dollars in agency revolving funds to the general revenue fund
- And seriously evaluating the value of ALL of Oklahoma’s tax credits and economic incentives.
Governor

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currently sitting on over 900 million unencumbered revolving fund dollars.

The great irony of this year’s budget shortfall is this: as our economy has grown, the state is now collecting more total tax revenue than ever (which you can see in Chart A). However, because of off-the-top spending, the percentage of total tax receipts that make their way into the General Revenue Fund is decreasing (as you can see in Chart B). In 2007, the Legislature appropriated 55 cents of every dollar taken in by the government. Last year, that declined to 47 cents.

That means that lawmakers today have fewer total dollars to appropriate than in the past, despite the state collecting significantly more money. That is a decline that will continue if we do not fix the problem. My budget office’s projections show the percentage of the total revenue that lawmakers can appropriate will shrink to less than 44 cents of every dollar by 2017.

The ability to minimize cuts to government services is going to hinge on how great an effort we make to fix these structural problems in our budget. That means this year’s legislative session should not just be about closing a $600 million budget hole. Our goal should be to address the recurring problems that continue to reduce our legislators’ ability to direct state dollars to public priorities.

That can be done through an earnest, thoughtful evaluation of revolving funds and tax credits and a commitment to performance informed, data-driven budgeting.

This legislative session surely represents a challenge. But it also represents an opportunity to permanently improve the financial situation of the state of Oklahoma. I encourage lawmakers to seize that opportunity.

Read more about Governor Fallin’s budget proposals at http://www.ok.gov/governor/State_of_the_State_Address.html

Opinions and positions cited in the Oklahoma Economic Report are not necessarily those of Oklahoma State Treasurer Ken Miller or his staff, with the exception of the Treasurer’s Commentary, which of course, is the viewpoint of the treasurer.
Crude
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For every planned well that is not drilled, Continental Resources estimates the loss of 120 direct and indirect jobs. By those estimates, the job losses since just before Thanksgiving would be more than 74,000 nationwide. In Oklahoma, the losses would total almost 6,500.

Energy companies across the board are slashing capital expenditures, primarily the budgets for drilling new wells. As of February, domestic producers had announced $41 billion in capital expenditures reductions for 2015.

Service and supply companies have recently announced planned job reductions, including 9,000 at Schlumberger, 8,000 at Weatherford, 7,000 at Baker Hughes, and 2,000 at Helmerich & Payne.

The effects are also beginning to be felt in Oklahoma government coffers as total gross production tax collections for oil and natural gas in February dropped by $16.7 million or 24 percent compared to the prior year. February unemployment figures won’t be released until Mar. 27.

International players

Saudi Arabia and its influence in OPEC, the Organization of Petroleum Exporting Countries, is being given the most blame for the current low prices; while others say Russia shares culpability.

OPEC is pumping cheap oil into the world market to counter the challenge from U.S. producers, who have increased production in the past few years due to technological improvements to allow extraction from shale formations. Saudi oil is cheap to extract and it has vast reserves, enough so that it can withstand an extended period of low prices.

According to industry experts, the Saudi’s are also working to keep prices low to gain advantage over Iran, its main regional adversary both religiously and politically. Saudi Arabia, predominately Sunni Muslim, opposes Iran, with its dominant Shia Muslim sect, in its support of Syria’s President Assad. Also, Iran’s economy is hurting from Western sanctions and desperately needs higher oil prices and the Saudi’s have no intention of helping.

At the same time, Russia has increased production to all-time highs to protect its market share.

Remnants of the past

Industry leaders are predicting prices will begin to rebound later this year, but aren’t saying exactly when. After falling below $50 per barrel in January, prices rose to the mid-50s in February. But some say the situation would be much better, if not for a 40-year-old executive order issued by Richard Nixon during the oil embargo of the 1970s.

The order bans the export of crude oil, while permitting export of refined petroleum products. Currently, there aren’t enough refineries to produce all of the crude oil the U.S. is producing, and so it sits in barrels waiting.

Industry executives are urging the current administration to lift the order, noting the “scarcity mentality” that originally led to the export restrictions no longer exists.

Unquestionably, the energy sector will recover, just as Oklahoma’s weather always does.

For companies, state governments and workers, the question is how long before that happens. Any policy change that could accelerate that timeline would benefit all.

U.S. Rig Count in Rapid Decline

U.S. rig count has declined by 619 rigs, or 32%, since mid-November. One rig laydown equals the loss of 120 direct and indirect jobs.*

Source: * Continental Resources jobs estimate; rig counts Baker Hughes.
Low oil prices help budget hole grow to $611.3 million

In December, concerns were raised when state officials estimated the Legislature’s expenditure authority would be $298 million less for FY-16 than for the prior year.

The impact of falling oil prices, the overuse of one-time funds during the previous year, and the effects of an income tax rate reduction were shown as the primary causes.

But then came the final revenue estimate in February and budget writers found themselves wishing for the good old days of December.

With oil prices continuing to tumble and projections of future prices getting smaller, along with spillover effects in employment and reduced business and consumer spending across the state, the final estimate of expenditure authority for FY-16 was certified to be $611.3 million less than during the current fiscal year – a drop of 8.8 percent.

In FY-15, the Legislature spent $7.21 billion. The spending authority for FY-16, as certified by the State Board of Equalization on February 17, is set at $6.6 billion.

For FY-15, oil prices were expected to be $76.32 per barrel. The final estimate for FY-16 uses an oil price of $57.55 per barrel, a drop of 24.6 percent.

The biggest impact of the downturn is seen in the General Revenue Fund with personal income tax collections down by 5.8 percent, and corporate income taxes down by 33.4 percent from the prior fiscal year estimate.

College savings improvement bill passes U.S. House

On Wednesday, February 25, the U.S. House of Representatives passed HR529, sponsored by Reps. Lynn Jenkins, R-Kansas, and Ron Kind, D-Wisconsin, by a vote of 401-20.

The bill contains three provisions to improve plans for families saving for college. First, it clarifies that computer technology and equipment are a qualified higher education expense. Second, it removes distribution aggregation requirements, eliminating an unnecessary paperwork burden. Finally, it permits account owners to redeposit refunds from colleges back into a 529 account without taxes or penalties.

Immediately after passage, the National Association of State Treasurers released the following statement.

“If there is one issue that can bridge the partisan divide in Washington today, it is college affordability.

“Our economic prosperity as a country is dependent upon making higher education more accessible for all Americans. The more college tuition and student loan debt continues to rise, the more we must do to protect families from carrying this burden.

“We applaud the House of Representatives for their aggressive action in passing H.R. 529 and encourage the quick passage of the Senate’s companion bill S. 335, so American families from across the economic spectrum can benefit from these changes to college savings plans.”
Gross Receipts & General Revenue compared


January gross receipts totaled $1.13 billion, while the GRF received $605.7 million or 53.4% of the total.

The GRF received between 33.1% and 54.5% of monthly gross receipts during the past 12 months.

From January gross receipts, the GRF received:
- Personal income tax: 66%
- Corporate income tax: 58.6%
- Sales tax: 45.7%
- Gross production-Gas: 35.4%
- Gross production-Oil: 64.1%
- Motor vehicle tax: 27.2%
- Other sources: 51.8%

January GRF allocations were below the estimate by $56 million or 8.5%. Year-to-date revenue exceeds the estimate by $42.8 million or 1.3%.

For January, insurance premium taxes totaled $17,440.

Tribal gaming fees generated $11.4 million during the month.

Gross Receipts to the Treasury grow in January

Picture tempered by drop in gross production, other collections

Oklahoma’s economy, as reflected in monthly Gross Receipts to the Treasury, showed continued expansion in January, said State Treasurer Ken Miller.

Miller said two components of gross receipts entered new territory during the first month of 2015 with record highs set for sales tax collections and total gross receipts in a January.

“Total receipts last month brought in more than in any other January,” he said. “Also, Oklahomans spent at record levels during the past month, due, in part, to increased purchasing power from lower gasoline prices.”

In spite of the strong bottom line, three components of gross receipts fell short of prior year collections.

Gross production taxes on oil and

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Monthly Gross Receipts vs. Prior Year

Percentage change from prior year

Source: Office of the State Treasurer
Revenue
FROM PAGE 6

natural gas dropped by almost $8 million, or more than 12 percent, compared to the prior year. Personal income tax collections were down by about $3 million or just less than one percent from last January, and motor vehicle collections slipped below the prior year by $2.4 million or 3.4 percent.

“As expected, less money is coming in from gross production,” Miller said. “January collections reflect oil field activity from November, when prices were dropping steeply. In the past 21 months, gross production collections have dipped below the same month of the prior year only two times, both within the last three months.”

Gross receipts from the past 12 months total $12.08 billion and are $571 million or five percent higher than during the prior 12 months.

Other Indicators

Oklahoma’s December unemployment rate is set at 4.2 percent. That compares to a national rate of 5.6 percent.

The January Business Conditions Index for Oklahoma points to continued growth in the state economy during the next three to six months, but at a slower pace than what was indicated in December. The January survey shows Oklahoma with a rating of 52, compared to December’s rate of 54. Numbers above 50 indicate anticipated economic expansion.

January collections

The revenue report for January shows gross collections at $1.13 billion, up $65.57 million or 6.1 percent from January 2014.

Gross income tax collections, a combination of personal and corporate income taxes, generated $450.15 million, an increase of $34.98 million or 8.4 percent from the previous January.

Personal income tax collections for the month are $374.18 million, down $3.02 million or 0.8 percent from the prior year. Corporate collections are $75.96 million, an increase of $38 or 100.1 percent. Wide variances in monthly corporate collections are not uncommon.

Sales tax collections, including remittances on behalf of cities and counties, total $405.84 million in January. That is $27.51 million or 7.3 percent above January 2014.

Gross production taxes on oil and natural gas generated $55.8 million in January, a decrease of $7.92 million or 12.4 percent from last January. Compared to December reports, gross production collections are down by $16.28 million or 22.6 percent.

Motor vehicle taxes produced $68.51 million, down by $2.38 million or 3.4 percent from the prior year.

Other collections, consisting of about 60 different sources including taxes on fuel, tobacco, and alcoholic beverages, produced $153.9 million during the month. That is $13.38 million or 9.5 percent more than last January.

About Gross Receipts to the Treasury

The Treasurer’s Office issues the monthly Gross Receipts to the Treasury report, which provides a timely and broad view of the state’s 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.
Economic Indicators

Unemployment Rate
January 2001 – January 2015

Oklahoma 12-Month Gross Receipts
July 2008 - January 2015
(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. Shaded area denotes U.S. recessions. Source: Federal Reserve

Oklahoma Stock Index
Top 25 capitalized companies

Oklahoma Natural Gas Prices & Active Rigs
Sources: Baker Hughes & U.S. Energy Information Administration

Oklahoma Oil Prices & Active Rigs
Sources: Baker Hughes & U.S. Energy Information Administration

Notes:
1. Economic Indicators
2. Unemployment Rate
3. Oklahoma 12-Month Gross Receipts
4. Leading Index for Oklahoma
5. Oklahoma Stock Index
6. Oklahoma Natural Gas Prices & Active Rigs
7. Oklahoma Oil Prices & Active Rigs

Sources:
- Bureau of Labor Statistics
- Office of the State Treasurer
- Federal Reserve
- U.S. Energy Information Administration