In the past five years, the effective tax rate on Oklahoma crude oil and natural gas gross production has been cut in half.

The effective rate – the average tax rate paid on all crude oil production in Oklahoma – fell from 6.38 percent in FY-12 to a low of 3.02 percent in FY-16. Through February, the effective rate for FY-17 has been 3.29 percent.

For natural gas production, the effective tax rate was 6.08 percent in FY-12. That had fallen to 3.38 percent by FY-16, and is set at 3.5 percent thus far in FY-17.

Gross production rates

The state has four different gross production tax rates that are assessed based on the type of well, the amount of time it has been in production, and the date on which production began.

For horizontal wells that began producing before July 1, 2015, the tax rate is 1 percent for the first 48 months. After that, the rate rises to 7 percent.

For deep wells, those more than 15,000 feet in depth and in production before July 1, 2015, the rate is 4 percent for the first 48 months. The rate becomes 7 percent after that.

Wells that meet neither of those qualifications or that were in

**SEE GROSS TAX PAGE 3**
Grappling with a billion dollar budget shortfall appears to be the new normal in Oklahoma. For a third consecutive year, certified revenues are about a billion less than the prior year, and for a second year in a row mid-year cuts have been ordered. But this new normal requires much more than business as usual.

Last week a junior legislator shared with me a conversation with a senior one where he was warned against voting for any new revenue “if he ever wanted to run for Congress.” Unfortunately, such thinking is nothing new. For too long politicians have been more concerned with the next election rather than the next generation. They repeat tired rhetoric about reining in waste and inefficiency as the panacea for all that ails, while ignoring the failure to adequately provide core services or make the spending cuts they say are necessary.

For now, perhaps pivoting away from Governor Fallin’s revenue proposals is the better political move – and to be sure many have run for the hills – but doing so without offering solutions does nothing to correct the budgetary challenges that just resulted in the state’s first credit downgrade in 30 years.

Certainly, I’ve called out bad policy when I believed it to be so, but today I applaud the governor for taking the road less traveled and thank her for accepting not only the responsibility of leadership, but also its burden.

The first step in recovery is admitting a problem, yet it would be hard for any Republican officeholder to acknowledge revenue issues. Even so, that realization is dawning on a growing number.

For those who remain reticent to admit by word that the state has a revenue problem, I have a revelation: Actions speak louder than words.

Yes, spending inefficiencies exist and should be addressed, but the ones still on the table are politically difficult and the will to address them currently lacking. Governor Fallin and I worked to reduce the $100 million annual administrative costs to our pension systems through consolidation, but failed to gain support in the Legislature. Others have tried to lessen the administrative expense of having over 500 school districts, but last session could not get the education committee to support consolidating even the failing dependent districts in the metro areas.

The realization is drawn from years of appropriation bills that included hundreds of millions in nonrecurring revenue, in good times and bad, which falsely propped up budgets and exacerbated the current situation. So, for those who remain reticent to admit by word that the state has a revenue problem, I have a revelation: Actions speak louder than words.

Soon, action will be taken to address the short-term problem, the FY-18 budget. Hopefully, the long-term structurally deficiencies will also receive attention. Governor Fallin has proposed several bold solutions. Now, 

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Commentary
FROM PAGE 2

it is time for others to help shoulder the burden. Outright rejection is not sufficient. I, too, don’t like all that has been proposed, but one thing is certain: agree or disagree, she is leading.

To date, the governor’s proposals are short on followers. Her revenue measures have not been embraced by the Legislature, but neither have cuts big enough to balance the budget. It’s time to ask the hard questions: Is it unreasonable for the fuel tax to be set at the regional average or to increase cigarette taxes to deter teen smoking? Should our antiquated tax code reflect a modern economy and at least tax the retail services as do our neighboring states?

Our people and businesses need a tax system that retains the profit incentive to propel the economy and incomes, but they also require one that properly educates, protects and transports a healthy populace and workforce.

As our history shows, statesmen who put the needs of their constituents above personal aspirations do step up in times of crisis. Hopefully, they will again form a governing majority to set our state on a sustainable path and let the political chips fall where they may.

Gross Tax
FROM PAGE 1

production prior to the start of the deep and horizontal incentive rates enacted in 1994, the tax rate is 7 percent.

For all wells that have come online since July 1, 2015, the gross production tax rate is 2 percent for the first 36 months of production. The rate becomes 7 percent for any production after the first three years.

Why the effective rate decrease?

The energy industry downturn that began in mid-2014 had a significant negative impact on gross production collections as prices and production levels dropped, but it had little to no effect on the effective tax rates.

The key driver of the falling gross production effective tax rate has been the normalization of horizontal wells.

When originally enacted in 1994, the 1 percent horizontal rate was offered as an incentive to encourage what was at the time a new and relatively expensive method of drilling.

For many years, few horizontal wells were drilled, but as the process was

SEE GROSS TAX PAGE 4
refined, it became the predominate drilling method – accounting for more than 90 percent of new wells by 2015, according to weekly rig count reports from Baker Hughes.

The impact of the 1 percent incentive rate will decline during the next three years and will be gone in 2020 – four years after implementation of the 2 percent rate.

As a result, the effective tax rate is expected to marginally increase.

**Effect of the 2 percent rate**

When the 1 percent horizontal and 4 percent deep well incentive rates were facing sunset, rather than let them expire and revert to a 7 percent rate for all production, the Legislature enacted a new 2 percent rate effective at the start of FY-16.

The new rate applies to the first three years on all new wells before rising to 7 percent for the remainder of the well’s life. The tax commission reports the majority of traditional horizontal wells experience a 70 percent decline in output after the first 12 to 18 months of production.

A tax commission analysis of monthly remittances from the 2 percent rate shows a steady rise in collections.

During FY-16, the new rate yielded $11.8 million from oil and gas production. During the first eight months of FY-17, through February, the 2 percent rate has generated $40 million in total collections.

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Gross Tax
FROM PAGE 4

The analysis also shows that if the new rate had not been enacted and had instead reverted to 7 percent across-the-board on all new production, FY-16 collections would have been higher by $29.5 million.

For FY-17 collections through February, the difference would have been almost $100 million. The analysis assumes production volumes would have remained unchanged under the different tax rate. Principles of supply and demand suggest production would decline due to a higher tax rate’s impact on profit margins.

The supply-driven contraction in the energy industry is showing early indications of ending. Gross collections in March improved by more than 100 percent compared to March 2016. While it is positive news, collections during the spring of last year were among the lowest totals since before the turn of the century.

As recovery continues, revenues will rise, but effective rates will likely remain lower than before the downturn.

Year-to-date General Revenue short of estimate

With four months remaining in the fiscal year, allocations to the General Revenue Fund (GRF) are within two percent of the estimate, according to the Office of Management and Enterprise Services (OMES).

The GRF, as reported by OMES, is the state’s main operating account and receives slightly less than 50 percent of Gross Receipts to the Treasury.

FY-17 GRF allocations total $3.1 billion through February and are $64.9 million, or 2 percent, less than the estimate.

Less than anticipated sales tax collections are the main reason for the missed estimate. Year-to-date allocations are $1.2 billion, below the estimate by $81.7 million, or 6.3 percent.

Net income tax, a combination of individual income and corporate income collections are ahead of the estimate by $27.6 million, or 2.3 percent.

Gross production taxes on crude oil and natural gas, at $94.6 million, top the estimate through February by $10.8 million, or 12.9 percent.

Motor vehicle collections, at $130 million, are shy of the estimate by $5.7 million, or 4.2 percent.

Other sources accounted for $473.6 million to the GRF. This is less than the estimate by $16 million, or 3.3 percent.
February Gross Receipts &
General Revenue compared

February Gross Receipts to the Treasury totalled $759.5 million, while the General Revenue Fund (GRF), as reported by the Office of Management and Enterprise Services, received $248 million, or 32.7%, of the total.

The GRF received between 32.7% and 52.8% of monthly gross receipts during the past 12 months.

From February gross receipts, the GRF received:
- Individual income tax: 9.6%
- Corporate income tax: None
- Sales tax: 43.5%
- Gross production-Gas: 71.3%
- Gross production-Oil: 10.5%
- Motor vehicle tax: 27.4%
- Other sources: 51.5%

February GRF allocations are above the estimate by $18.9 million, or 8.3%. Year-to-date GRF revenue trails the estimate by $64.9 million, or 2.7%.

February insurance premium taxes totaled $9.7 million, a decrease of $2.5 million, or 20.6%, from the prior year.

Tribal gaming fees generated $9.8 million during the month, up by $339,846, or 3.6%, from February 2016.

February Gross Receipts to the Treasury show slight improvement over prior year

(Original release date: March 7, 2017.)

Gross Receipts to the Treasury in February were slightly higher than those in the same month of last year. It marked a second month of positive growth following 20 months of contraction, State Treasurer Ken Miller announced today.

February also marked the first increase in sales tax collections since March of last year and only the fourth month of positive sales tax numbers in the past two years.

At $759.5 million, total February Gross Receipts to the Treasury expanded by $1 million, or 0.1 percent, compared to February of 2016.

“State budget problems and missed estimates notwithstanding, indications from gross receipts and other measurements show a marginally improving Oklahoma economy,” Miller said. “The revitalized economic activity might take some time to filter down into the state budget, but we have good reasons to remain cautiously optimistic.”

State Finance Secretary Preston

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### Monthly Gross Receipts vs. Prior Year

<table>
<thead>
<tr>
<th>Month</th>
<th>February-16</th>
<th>February-17</th>
<th>Variance from Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>PRELIMINARY</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income Tax</td>
<td>246.68</td>
<td>238.08</td>
<td>-8.60</td>
</tr>
<tr>
<td>Gross Production</td>
<td>26.64</td>
<td>37.90</td>
<td>9.27</td>
</tr>
<tr>
<td>Sales Tax (1)</td>
<td>321.63</td>
<td>323.86</td>
<td>2.23</td>
</tr>
<tr>
<td>Motor Vehicle</td>
<td>28.64</td>
<td>37.90</td>
<td>9.27</td>
</tr>
<tr>
<td>Other Sources (2)</td>
<td>101.44</td>
<td>106.16</td>
<td>4.71</td>
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<tr>
<td>TOTAL REVENUE</td>
<td>758.48</td>
<td>759.50</td>
<td>1.02</td>
</tr>
</tbody>
</table>

Dollar change (in millions) from prior year

Source: Office of the State Treasurer

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Revenue
FROM PAGE 6

Doerflinger has declared a revenue failure for the remainder of the current fiscal year due to projections of General Revenue Fund (GRF) allocations falling further below appropriated levels.

In addition, the state Board of Equalization has certified an almost $900 million reduction in estimated revenue for Fiscal Year 2018.

The GRF, the state’s primary funding source, is a subset of Gross Receipts to the Treasury and growth in total collections don’t necessarily directly result in GRF increases.

About Gross Receipts

Since March 2011, the Treasurer’s Office has issued the monthly Gross Receipts to the Treasury report, which provides a timely and broad view of the state’s macro economy.

It is provided 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 slightly 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.

Oklahoma unemployment set at 4.6 percent in February

Oklahoma’s seasonally-adjusted unemployment rate shrank by one-tenth of one percentage point in February and was set at 4.6 percent, one-tenth of one percentage point below the U.S. jobless rate, figures released by the Oklahoma Employment Security Commission show.

It is the second consecutive month the state unemployment rate has been below that of the nation and followed eight straight months in which the Oklahoma rate was higher.

<table>
<thead>
<tr>
<th>Month</th>
<th>Unemp. rate*</th>
<th>Labor force*</th>
<th>Employment*</th>
<th>Unemployment*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feb '17</td>
<td>4.6%</td>
<td>1,834,199</td>
<td>1,749,828</td>
<td>84,371</td>
</tr>
<tr>
<td>Jan '17</td>
<td>4.7%</td>
<td>1,827,615</td>
<td>1,742,286</td>
<td>85,329</td>
</tr>
<tr>
<td>Dec '16</td>
<td>4.8%</td>
<td>1,823,830</td>
<td>1,735,518</td>
<td>88,312</td>
</tr>
<tr>
<td>Nov '16</td>
<td>4.9%</td>
<td>1,823,846</td>
<td>1,734,685</td>
<td>89,161</td>
</tr>
<tr>
<td>Oct '16</td>
<td>4.9%</td>
<td>1,823,784</td>
<td>1,733,794</td>
<td>90,000</td>
</tr>
<tr>
<td>Feb '16</td>
<td>4.8%</td>
<td>1,834,371</td>
<td>1,747,067</td>
<td>87,304</td>
</tr>
<tr>
<td>United States</td>
<td>4.7%</td>
<td>160,056,000</td>
<td>152,528,000</td>
<td>7,526,000</td>
</tr>
</tbody>
</table>

* Data adjusted for seasonal factors

Source: OESC
Economic Indicators

**Unemployment Rate**
January 1980 – February 2017

- U.S.: 4.7%
- Oklahoma: 4.6%

Shaded areas denote U.S. recessions
Source: Bureau of Labor Statistics

**Gross Receipts vs. Oil & Gas Employment**
January 2008 – February 2017

- 12-Month Gross Receipts (in $ billions)
- Oil & Gas Employment (in thousands)

Shaded area denotes U.S. recession
Sources: Bureau of Labor Statistics & State Treasurer

**Leading Economic Index**

Numbers above 0 indicate anticipated growth.
Shaded areas denote U.S. recessions
Source: Federal Reserve

**Oklahoma Stock Index**
Top capitalized companies
January 2009 – March 2017

Avg. = $42.82
$45.03

Shaded area denotes U.S. recession
Source: Office of the State Treasurer

**Oklahoma Natural Gas Prices & Active Rigs**
January 2011 – March 2017

Sources: Baker Hughes & U.S. Energy Information Administration

**Oklahoma Oil Prices & Active Rigs**
January 2011 – March 2017

Sources: Baker Hughes & U.S. Energy Information Administration