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## Oklahoma Policy Institute

### CLOSING THE BUDGET GAP: OPTIONS FOR A BALANCED APPROACH

by David Blatt, PhD

Oklahoma's huge budget shortfall this year is the result of both falling gas prices and past policy choices that have weakened revenue collections and left less money available for appropriation by lawmakers. Officials projects give lawmakers \$611 million less for next year compared to this year.

The shortfall is only the latest in a prolonged budget crisis since the last recession. This year's budget is already \$680 million smaller than six years ago when adjusted for inflation. Years of budget cuts and flat funding continue to be felt in the form of larger class sizes, uncompetitive salaries for teachers and state employees, understaffed correctional facilities, and long waiting lists for critical services. In addition, many agencies require substantial funding increases next year simply to maintain services at current levels.

In this context, relying on deeper funding cuts to balance the budget would inflict serious harm to Oklahomans' health, safety, and economic well-being. However, state leaders have appropriately indicated that "all options are on the table" in closing the budget gap. Here are 7 feasible and responsible options that deserve serious consideration. The first four options would strengthen the state's fiscal outlook both next year and over the long-term, while the final three would offer one-time solutions to help get us through this rough patch.

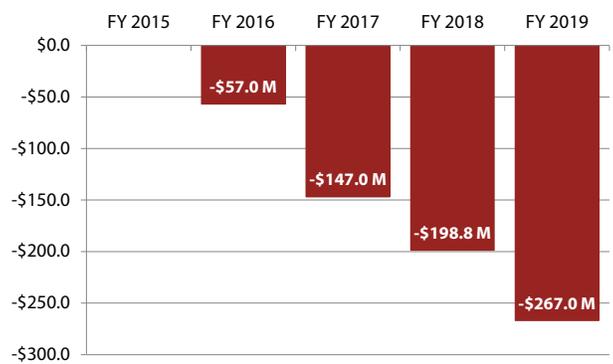
## 1. Cancel the income tax cut

Last year, Oklahoma legislators approved a cut in the top income tax rate from 5.25 to 5.0 percent in 2016, contingent on projected revenue growth. Because of how the legislation was written, the tax cut is now scheduled to take effect next year despite an updated forecast of \$200 million less total tax revenue.

The tax cut is estimated to cost \$57 million in lost revenue in FY 2016 and \$147 million in FY 2017. The median household will receive just \$31, and two-fifths of taxpayers will get nothing at all. Oklahoma has already cut taxes by over \$1 billion over the past decade and tax collections are at a historically low share of the state economy. Legislators should act to cancel or suspend the scheduled tax cut.

**Annual Revenue Loss from 2014 Tax Cuts**

(in \$ millions; assumes rate reductions phase in on 1/1/2016 and 1/1/2018)



## 2. Eliminate the deduction for state income taxes

Oklahoma is one of only six states that allows taxpayers who claim itemized deductions on their federal tax return to also claim the deduction for state income taxes on their state return. This deduction is an unintentional fluke of the law that serves no policy purpose. By eliminating this "double deduction" of state income taxes, the state would gain an estimated \$97 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. A majority of states with a corporate income tax have adopted a reform known as combined corporate reporting that effectively halts this tax avoidance strategy and ensures 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 \$40 - \$80 million.

### 4. 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. According to the Leavitt Group study commissioned by the Governor, accepting federal funds would create net state savings of some \$450 million over a decade by shifting costs 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, support beleaguered rural hospitals and community health centers, and pull the lowest-income Oklahomans out of a “coverage crater” without insurance options.

### 5. Tap the Rainy Day Fund

Oklahoma’s Rainy Day Fund (RDF) currently has a \$535 million balance. Of that amount, up to \$192 million could be appropriated by a simple legislative majority, while an additional \$134 million could be appropriated based upon an emergency declaration by the Governor and a 2/3rds vote of the Legislature. While using the full available amount in FY 2016 would be ill-advised given the chance of a prolonged downturn, the Legislature should tap some of what is available from the RDF to cover a portion of the shortfall.

### 6. Limit the funding increase for transportation

Allocations to the ROADS fund for maintenance and upgrades of roads and bridges is slated for an automatic increase of \$59.7 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. The Legislature should suspend or limit next year’s automatic increase to avoid cuts in other critical areas.

### 7. Carefully use cash reserves and revolving funds

Last year legislators used over \$400 million from cash reserves and agency revolving funds to balance this year’s budget. While this reliance on one-time funds is unsustainable, it will again be necessary to tap these sources to avoid calamitous funding cuts. Revolving funds should be used only where this is clear legal authority to do so and with the active involvement of agency directors.

Oklahoma ROADS Fund Appropriations (in millions)

