



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

Government subsidies to business studied

Granting tax incentives has always been easier than taking them away. But now, due to budget challenges as the state economy weathers through yet another contraction due to falling oil and gas prices, the focus has tightened on the cost of giving tax exemptions and credits to various industries.

The stated public policy goal of any tax incentive is to provide a benefit to the state that is greater than the cost. However, without established criteria and a structured review process, determining the effectiveness of such incentives is difficult if not impossible to ascertain.

Next session, the Legislature will have the opportunity to make more informed decisions as it will have the first of four annual reports from the latest panel set up to examine tax incentives.

By the end of this year, the Incentive Evaluation Commission (IEC) will issue recommendations on whether to maintain, modify or eliminate nine tax incentives that currently cost the State Treasury some \$110 million each year.

Over the next four years, the IEC will analyze and make recommendations on about 50 incentives with a measurable annual price tag of almost \$475 million.

The total fiscal impact is higher, but 19 of the incentives on the list are thus far unquantified.

At issue for the IEC is whether the plethora of incentives offered by Oklahoma provide a net gain for the state, as a whole, or whether some serve primarily to benefit specific industries and provide little to no broad advantage.

At issue for the Legislature is whether the political will can be mustered to change or eliminate those incentives that are of little or no positive value.

SEE INCENTIVES PAGE 3

Inside

- A way to tell if incentives work – finally! Commentary by Secretary of Finance Preston Doerflinger
- State GDP report shows at least one-year recession
- Economic contraction continues in June
- State unemployment continues rise

Editor

Tim Allen, Deputy Treasurer for Communications and Program Administration

Annual Impact of Tax Incentives to be Studied



Source: OMES



Secretary's Commentary

By Secretary of Finance Preston L. Doerflinger

A way to tell if incentives work – finally!

Those of us who come to government from business are almost always shocked at the lack of tools in place for government to measure its effectiveness.

Government programs get started every year with the best of intentions, but as years go by, little or no time is spent determining whether those programs are effectively achieving stated goals.

Too often, when it comes time to justify the cost or explain what the program has actually done, officials respond with shoulders shrugged. “We don’t measure that,” or “we don’t track that” or “we just do what the statute says” are common refrains when officials get asked to explain if a program works or not.

Tax incentives are a prime example of this dynamic. For decades, Oklahoma and most states never took the time to follow up on the scores of tax credits, deductions, rebates and other tax expenditures policymakers put in place to encourage business activity.

Thankfully, that is changing, and Oklahoma is a leader in the effort.

Building on the dogged work of the late Rep. David Dank, the Legislature

and Gov. Mary Fallin in 2015 put in place Oklahoma’s first-ever tool to regularly measure the effectiveness of its dozens of economic tax incentives.

Like many states, Oklahoma spends hundreds of millions a year on these incentives in order to – hopefully – spur business activity.

“Effective incentives are good for businesses and state tax collections alike. Ineffective incentives, though, are good for one at best and none at worst.”

Therein lies the problem. Until now, that state has just hoped these things worked. Now, for first time, the new Incentive Evaluation Commission will let policymakers truly know if these incentives are worth the cost.

The commission and its independent, third-party evaluator are required to evaluate each tax incentive once every four years. The first



evaluations, which cover more than \$100 million of incentives, will be delivered in December.

Judging by the early progress of the commission and the makeup of the commission itself, the product should be precisely the type of tool Oklahoma has needed to sort out the good incentives from the not-so-good ones.

The commission’s makeup is outstanding because its five voting commissioners are not elected officials, but private citizens.

The Legislature wisely structured the commission in this manner to tamp down the politics that traditionally have dominated incentive discussions. Incentive policy should be data-driven, not political, and the commission is structured to achieve that.

SEE DOERFLINGER PAGE 3



Doerflinger

FROM PAGE 2

The five citizens on the commission are an economic developer, an accountant, an auditor, an economist and even a private investigator. Each of them brings a different, valuable perspective.

I have been particularly impressed with the work of Dr. Cynthia Rogers, a University of Oklahoma economist, and Jim Denton, an Edmond auditor. These two commissioners have been chiefly responsible for development of the criteria that will be used to evaluate each incentive.

Under the evaluation law, each incentive is to be evaluated under criteria specific to that incentive. The law required this because there is no one-size-fits all evaluation method for incentives.

Every incentive has a different

purpose, and should be evaluated with that purpose in mind.

The commission's independent, third-party evaluator is also impressive. Public Financial Management, Inc., is one of the country's leading experts in public sector finances.

It has significant experience evaluating economic incentives. Of particular benefit to Oklahoma is the background of the two men leading the evaluation team working here, Randall Bauer and John Cape. Both are former state budget directors for Democrat and Republican governors, respectively. As former budget directors, they fully understand why policymakers rightfully insist that the cost of all incentives be fully justified.

Finally, Oklahoma is getting much closer to being able to make that justification about its tax incentives. When it does, policymakers will be

better equipped to structure incentives so that the state budget and its economy each see benefits.

Effective incentives are good for businesses and state tax collections alike. Ineffective incentives, though, are good for one at best and none at worst.

When the commission begins making its recommendations, I know the governor will be just as supportive of keeping or expanding those incentives proven to work as she will be of phasing out those incentives that do not justify the cost.

Doerflinger is Gov. Mary Fallin's secretary of finance, administration and information technology and director of the Office of Management and Enterprise Services. In his role as OMES director, he also serves as a nonvoting member of the Incentive Evaluation Commission.

Incentives

FROM PAGE 1

Earlier attempts

Over the years, attempts have been made to examine the effectiveness of tax incentives and lessen their budgetary impact. One example is the Incentive Review Committee, created by the Legislature in 2004.

The nine-member committee, with three members each appointed by the governor, Speaker of the House, and

Senate President Pro Tempore, held public meetings several times a year and issued annual reports for three years.

In its first report, in 2006, the committee listed eight criteria for its evaluations, including that the benefits of the incentive system should not exceed the costs, the program objectives should be clearly identified, and incentives should be targeted to firms where the program will clearly make a difference.

Incentives evaluated by the committee included the Investment/New Jobs Tax Credit, Five-year Manufacturing Ad Valorem Tax Exemption, Tax Increment Financing, Small Business Capital Credit, and the Rural Small Business Capital Credit.

Good intentions notwithstanding, the annual reports received little attention and resulted in no direct changes. The

SEE INCENTIVES PAGE 4

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.



Incentives

FROM PAGE 3

panel was deleted from state law in 2013.

Another effort, but this time's different

Legislation passed in 2015 created the Incentive Evaluation Commission, composed of five voting members and three ex officio non-voting members. The panel was the brainchild of Representative David Dank, R-Oklahoma City, who passed away during the session.

The IEC's five voting members include the past president of the Oklahoma Professional Development Council as chair, an economics professor, two certified public accountants and a private investigator. The non-voting members include two members of the governor's cabinet and a tax commissioner.

Among the key differences between the earlier committee and the IEC is the inclusion of the high-ranking state officials on the panel, albeit as non-voting members.

Staffing is provided by the Office of Management and Enterprise Services (OMES) with assistance from the Commerce Department and Oklahoma Tax Commission.

In addition, a professional consulting firm has been retained to help the panel through its gathering of data and the analysis.

Public Financial Management, Inc. (PFM) is experienced in evaluating tax incentives and includes two team members that are former state budget

directors under both Republican and Democratic governors.

Another key difference from the earlier evaluation attempts is the public attention and transparency of the IEC.

OMES communications staff has provided detailed information to the news media about every meeting, including explanation of each step taken and the schedule of each tax incentive to be examined.

A website, www.iec.ok.gov, containing all of the materials relating to the process will soon be published on the internet.

Finally, according to Preston Doerflinger, cabinet secretary for finance and revenue, the IEC has the full support of Governor Mary Fallin.

In a guest commentary included in this edition of the *Oklahoma Economic Report*, Doerflinger writes, "When the commission begins making its recommendations, I know the governor will be just as supportive of keeping or expanding those incentives proven to work as she will be of phasing out those incentives that do not justify the cost."

Under the microscope in Year One

The incentives to be examined between now and end of the year include:

- Five-year Ad Valorem Tax Exemption – annual impacts, \$67.9 million.
- Credit for Electricity Generated by Zero-Emission Facilities – annual

SEE INCENTIVES PAGE 5

Incentive Evaluation Commission

Voting members:

Lyle Roggow, commission chair. Past president, Oklahoma Professional Economic Development Council (OEDC), current chair, OEDC's Legislative Affairs Committee.

Cynthia Rogers, Ph.D. Economics professor at the University of Oklahoma. Research interests include regional & urban economics, state & local public finance and local economic development.

Carlos Johnson, CPA PLLC. Has more than 40 years of experience in financial institutions, higher education, government, not-for-profit and retail industries.

James Denton, CPA. President and CEO of Arledge & Associates, an Edmond-based accounting firm.

Ron Brown, President and CEO of CSI Group, a full service asset management and recovery agency in Oklahoma City.

Non-voting members:

Preston Doerflinger, Secretary of Finance and Revenue.

Dawn Cash, Oklahoma Tax Commissioner.

Deby Snodgrass, Secretary of Commerce and Tourism.



Incentives

FROM PAGE 4

impact, \$26.6 million.

- Oklahoma Film Enhancement Rebate Act – annual impact, \$5 million.
- Historic Rehabilitation Tax Credit – annual impact, \$4.3 million.
- Aerospace Engineer Tax Credit – annual impact, \$3.4 million.

Will it matter?

All indications are that state leaders are committed to executing a study that will bring clarity to the state's numerous tax exemptions and credits and give an objective analysis of how they are performing.

Once the IEC's report is delivered to the

governor and Legislature, the real work will begin as opponents and proponents of any recommended changes try to influence lawmakers.

Only then will we see if this latest, well-intended effort to get a handle on state tax incentives will be successful.

State GDP report shows at least one-year recession

The downturn in Oklahoma's economy, as measured by gross domestic product (GDP), continued through the first quarter of the 2016 calendar year.

The state GDP report, issued July 27 by the Bureau of Economic Analysis (BEA), shows the Oklahoma economy has contracted for four consecutive

quarter beginning in second quarter of 2015. The report indicates Oklahoma is likely experiencing a recession, as the traditional definition of a recession is at least two consecutive quarters of economic contraction.

Oklahoma ranked 39th among the states for economic change during the

first three months of the calendar year, with GDP down 0.5 percent. It is one of 13 states that experienced negative economic growth during the quarter.

At the bottom of the list is North Dakota, another energy-dependent state, with -11.4 percent change in state GDP. Three states, Arkansas, Oregon, and Washington, topped the list with the biggest growth in GDP during the quarter at 3.9 percent each.

Economic supersectors contributing to the downturn in Oklahoma during the quarter were mining, which includes the oil and gas industry, off by 0.73 percent; durable goods manufacturing, down 0.63 percent; transportation and warehousing, off 0.53 percent; and wholesale trade, down 0.37 percent.

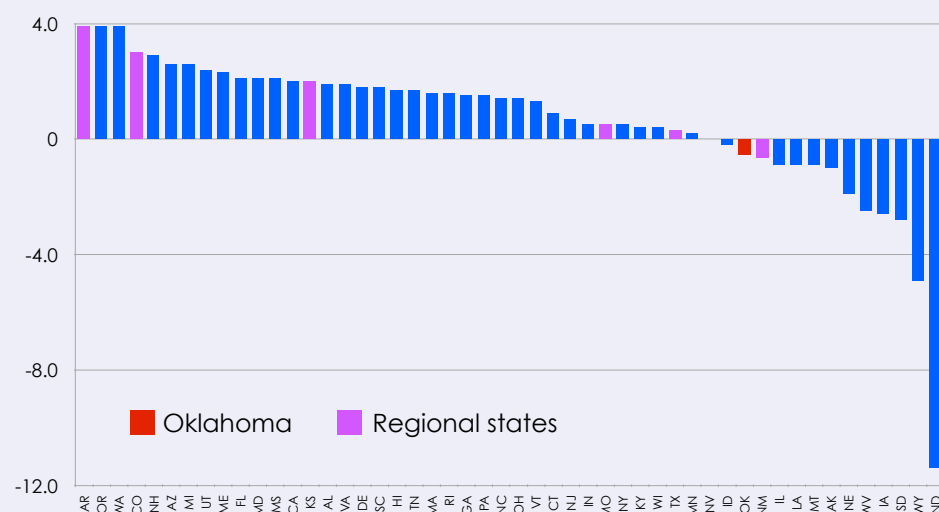
Showing growth was the agriculture supersector, up by 0.83 percent in Oklahoma during the quarter.

On the national level, mining contracted by 11.1 percent, while construction grew by 9 percent during the period.

Updated information, including 2016 second quarter state GDP will be released by the BEA in early December.

State Gross Domestic Product Percentage Change

First Quarter 2016



Source: Bureau of Economic Analysis



Fiscal Year Gross Receipts & General Revenue compared

Gross Receipts to the Treasury during FY-16 totaled \$11.1 billion, compared to \$5.73 billion, or 46.8%, that was allocated to the General Revenue Fund (GRF).

In the month of June, the GRF received 52.8% of the gross. The monthly percentage varied from 29.7% to 52.8% during the fiscal year.

From FY-16 gross receipts, the GRF received:

- Personal income tax: 57%
- Corporate income tax: 49.3%
- Sales tax: 44.2%
- Gross production-Gas: 54%
- Gross production-Oil: 2.2%
- Motor vehicle tax: 29.2%
- Other sources: 43.3%

FY-16 GRF allocations were below the estimate by \$541.3 million or 9.4%. June allocations missed the estimate by \$70.1 million or 12.6%.

Fiscal year insurance premium taxes totaled \$255.47 million, an increase of \$2.5 million, or 1%, from the prior year.

Tribal gaming fees generated \$132 million during FY-16, up by \$3.63 million, or 2.8%, from FY-15.

Gross Receipts to the Treasury show ongoing economic contraction

(Original release date: July 6, 2016)

Oklahoma Gross Receipts to the Treasury continued on a downward trajectory during the month of June and Fiscal Year 2016, as economic data released during the month shows the state entered a recession more than a year ago, said State Treasurer Ken Miller.

Receipts from all major revenue streams – income, sales, gross production, and motor vehicle taxes – are smaller when compared to the same month of the prior year and the previous fiscal year. The monthly bottom line has been less than the same month of the prior year for 14 consecutive months. The 12-month

total has contracted for 14 consecutive months, as well.

The federal Bureau of Economic Analysis issued state gross domestic product (GDP) figures in June showing the Oklahoma economy contracted starting in second quarter of 2015 and continued to do so through the fourth quarter of the year. Recessions are typically defined

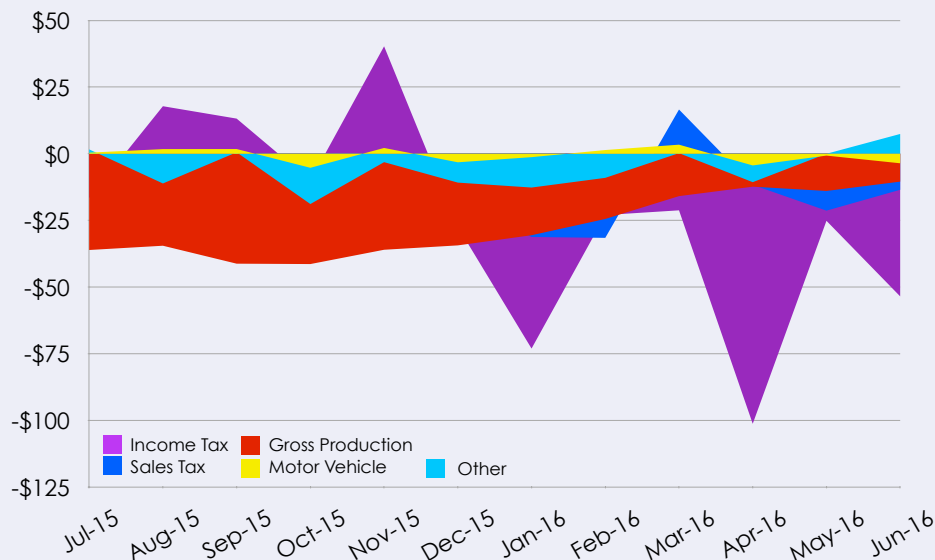
as two consecutive quarters of GDP reduction.

“The latest GDP data show Oklahoma entered a recession starting in spring of last year. We will get new data late this

SEE REVENUE PAGE 7

“There is no indication of any marked recovery at this point.”

Monthly Gross Receipts vs. Prior Year



Dollar change (in millions) from prior year

Source: Office of the State Treasurer



Revenue

FROM PAGE 6

month to show whether the recession continued into first quarter of this year; however, there is no indication of any marked recovery at this point,” Miller said.

Collections from gross production taxes on crude oil and natural gas remain

below prior year numbers, but have risen slightly for two months in a row after hitting a 17-year low in April. June receipts are based on oil prices in April, when the spot price of West Texas Intermediate crude oil was \$40.75 per barrel.

June gross receipts are \$925.7 million,

down by almost \$74 million or 7.4 percent from June 2015. It is the lowest June total in six years.

Fiscal Year 2016 collections are \$11.1 billion, down by more than \$860 million or 7.2 percent from FY-15. It marks the lowest 12-month total in 39 months – since March 2013 – and is down by more than \$980 million or more than 8 percent from the last peak of \$12.1 billion in February 2015.

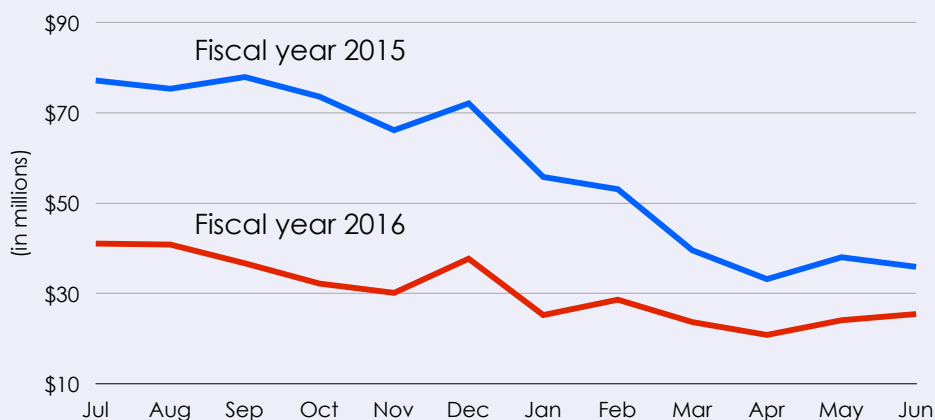
About Gross Receipts to the Treasury

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.

Gross Production Tax Collections

FY-15 – FY-16



Source: Oklahoma Tax Commission

June employment report shows continued rise in jobless rate

Oklahoma’s seasonally-adjusted unemployment rate was set at 4.8 percent in June, up by one-tenth of a percentage point from May, according to the Oklahoma Employment Security Commission (OESC).

During June, statewide employment shrank by 15,062 and unemployment increased by 1,878 from the prior month. Over the year, seasonally-adjusted unemployment grew by 8,850.

The national unemployment rate was unchanged at 4.9 percent in June.

Oklahoma Unemployment Report

June 2016

| OKLAHOMA | Unemp. rate* | Labor force* | Employment* | Unemployment* |
|-----------|--------------|--------------|-------------|---------------|
| June '16 | 4.8% | 1,851,010 | 1,761,337 | 89,673 |
| May '16 | 4.7% | 1,864,194 | 1,776,399 | 87,795 |
| April '16 | 4.5% | 1,871,604 | 1,786,474 | 85,130 |
| Mar '16 | 4.4% | 1,870,152 | 1,788,383 | 81,769 |
| Feb '16 | 4.2% | 1,862,135 | 1,784,329 | 77,806 |
| Jan '16 | 4.1% | 1,853,975 | 1,778,448 | 75,527 |
| June '15 | 4.4% | 1,842,779 | 1,761,956 | 80,823 |

* Data adjusted for seasonal factors

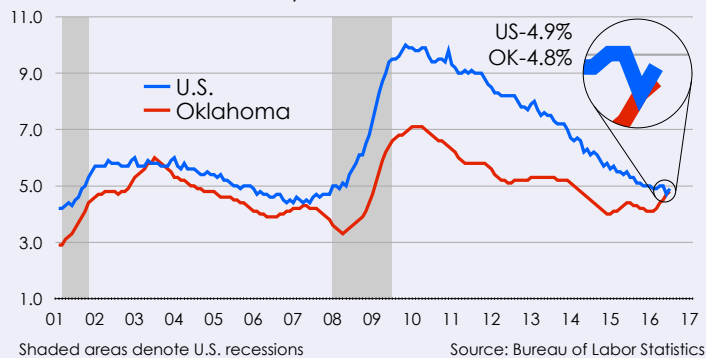
Source: OESC



Economic Indicators

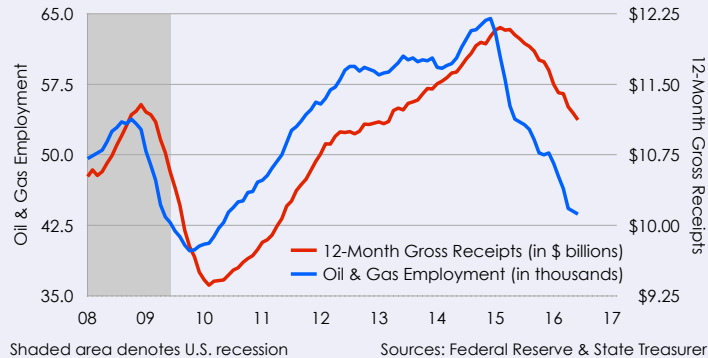
Unemployment Rate

January 2001 – June 2016



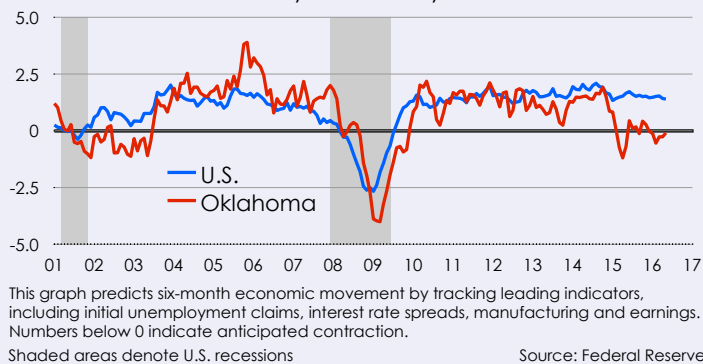
Gross Receipts vs. Oil & Gas Employment

January 2008 – June 2016



Leading Economic Index

January 2001 – May 2016



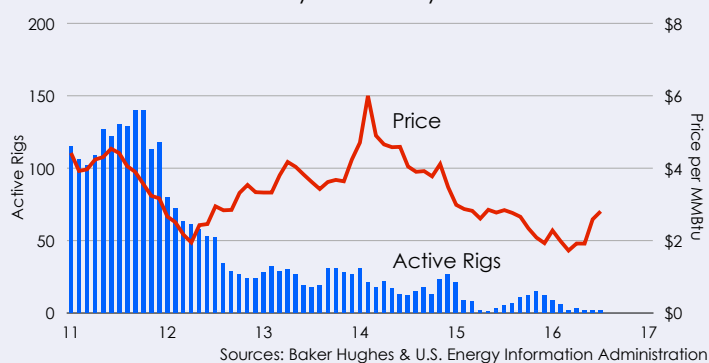
Oklahoma Stock Index

Top capitalized companies
January 2009 – July 2016



Oklahoma Natural Gas Prices & Active Rigs

January 2011 – July 2016



Oklahoma Oil Prices & Active Rigs

January 2011 – July 2016

