

League of Women Voters of Oklahoma Fiscal Policy Restudy

Long Term Planning and the Budget Process

Overview of Oklahoma's State Budget Process

The budget cycle for state operations starts with state agencies developing a detailed outline of financial needs for the next fiscal year. On October 1 each year state agencies are required by law to submit a "Budget Request" detailing their funding needs for the next fiscal year. This "Budget Request" is then reviewed and analyzed by the Office of Management and Enterprise Services (OMES) in light of overall state responsibilities, goals, objectives and total funds available. Legislative staff also review the budget requests. There is no formal process for budget request revisions, but agencies can relay needed changes to their requests by contacting OMES Budget Staff and members of the legislative staff.

Not more than 45 days nor less than 35 days prior to the convening of each regular session of the Legislature, the State Board of Equalization certifies amounts available for appropriation.

A second meeting of the Board is held within five days of the monthly apportionment in February. At these two constitutionally-mandated meetings estimates of revenue to each annually appropriated fund are based on a determination of the revenues to be received by the State under the laws in effect at the time such determination is made. These estimates are based on predictable changes in the economy as well as current law. Should the Legislature enact laws that provide additional revenues or a reduction in revenues to these certified funds, the Board meets to determine the changes in revenue. Only those changes in revenue resulting from changes in law can be considered at the third meeting.

The Governor prepares and submits to the Legislature at the beginning of each annual session a balanced budget based on OMES review of budget requests prepared by state agencies and subsequent recommendations by OMES, cabinet members and policy advisors. Budgeted expenditures cannot exceed the amount available for appropriation as certified by the State Equalization Board unless revenue raising measures are proposed to balance the spending recommendation. The Governor's recommended budget is considered by the State Legislature which makes the final appropriation of funds to the agencies.

A state agency, based upon funds appropriated by the Legislature and other funds available to the agency, then develops a Budget Work Program which outlines in detail planned expenditures for the ensuing fiscal year. Work programs are reviewed by the budget Division of the OMES and the approved work program will serve as a basis for the subsequent allotment of funds. Budget Work Programs can be revised at any time during the fiscal year if justified and if the revision can be accomplished within the various expenditure, full-time-equivalent employee and program expenditure limits.

Red numbers indicate citations to be found in the endnotes after each section of this paper.

Words or phrases in ***bold italics*** are defined in the glossary

During the fiscal year, it is possible that actual revenues are less than the estimates made when agency budgets are prepared. If revenues are not sufficient to cover appropriations, the Director of OMES is required to reduce the budget by the amount of the deficiency.

Budgetary Controls: The legal level of budgetary control is maintained at the line-item level (General Operations, Duties, etc.) identified in appropriation acts. Agency budgets may be modified subject to statutory limits on transfers using the Budget Work Program. The Director of OMES can approve transfers between line-items up to 25%. The Contingency Review Board (a three-member board comprised of the Governor, the President Pro Tempore of the Senate and the Speaker of the House of Representatives) can approve transfers between line-items up to 40%. All transfers are subject to review by the Joint Legislative Committee on Budget and Program Oversight to determine if the transfer tends to effectuate or subvert the intention and objectives of the Legislature. ¹

The Constitutional Reserve Fund (or Rainy Day Fund) may be used to make up for shortfalls in the current budget, used in the budget for the coming year if revenues are forecast to fail, or spent for an emergency. Money flows in to the Rainy Day Fund when revenue is more than estimated. Any General Revenue Fund collections beyond 100% of the estimated amount must be deposited into the Rainy Day Fund (unless it already has the maximum amount specified by the Constitution, 15% of the current revenue estimate for the General Revenue Fund). ²

The Budget Process section of the Oklahoma Policy Institute (OPI) [Online Budget Guide](#) describes the process used to create, implement, and monitor Oklahoma's state budget each fiscal year. The process is a complex combination of politics, laws, and management. Its goal is to create a budget that satisfies the participants in the process, complies with legal limits, and spends no more than the available resources. ³

Issues with OK Budgeting Process

David Blatt, Executive Director of the Oklahoma Policy Institute, states, "Our state tax system is no longer generating the revenue needed to pay for basic public services. There are numerous indicators of a chronic and deepening budget gap, also known as a structural budget deficit. The state's structural budget deficit has multiple causes. Some have to do with economic and demographic [factors] over which state policymakers have little control, but others have been caused or aggravated by policy choices made by state leaders in recent years. While there are specific measures and strategies the state can and should adopt to address each of these components of the structural budget deficit, the broader message is that we need a long-term strategy for getting our revenues back in alignment with what it costs to provide core services for Oklahomans." ⁴

Preston Doerflinger, Director, Office of Management and Enterprise Services (OMES) observes, "However, the figure that the board provides in February is not the only revenue at budget writers' disposal. The Governor and Legislature almost every year use longstanding legal authority granted to them to bring additional revenues into the budget beyond the certified revenue estimate made by the board. As a result, almost every appropriated budget contains additional funds not considered by the board but accessible via actions of the governor and Legislature. . . . The most significant budgeting occurs in private negotiations between the governor's budget staff and a small handful of legislators and legislative budget staff." ⁵

David Blatt suggests three budgeting reforms to help address flaws in Oklahoma's budget process:

- Develop enhanced revenue forecasts for a three-to-ten year period.
- Develop a current services budget - a baseline projection that measures how much it will cost to deliver the same quantity and quality of services to residents it is delivering in the current period budget - rather than assume that agencies can operate with flat funding year after year.
- Adopt PAYGO "pay-as-you-go" policy requiring any program increases or tax cuts be fully offset to achieve budget neutrality.⁶

Former State Treasurer Scott Meacham states, "The budget problems in Oklahoma seem more structural than reflective of the state of our economy The core problem appears to be neither a revenue nor a spending problem but lack of systems that provide for strategic allocation of state resources and structural budget problems that keep state budget makers in constant crisis mode."⁷

Ken Miller, Oklahoma State Treasurer, agrees. "Outside of government, it is well accepted that non-recurring revenues should not be used for ongoing expenditures and that recurring revenue streams should not be cut when current costs exceed them. Yet under the capitol dome, budget drafters are doing just that. . . . Going forward, tax cuts should be revenue neutral."⁸

Tribal contributions to the state budget are collected and distributed in accordance with the "State-Tribal Gaming Act". The Gaming Compliance Unit of the OMES carries out the oversight responsibilities granted to the state under the compact. For the first time ever, in FY 2014, the fees paid to the state by Native American tribes for exclusive gaming rights declined from the previous year.⁹

Governor Mary Fallin reports that "The OMES is implementing a new and improved budgeting system called performance informed budgeting. Performance informed budgeting bases spending on actual outcomes and needs rather than arbitrary, unproven wants. It's done through strategic measurement, metrics and data on program outcomes, rather than our current process which is driven largely by gut feeling, anecdotes and political winds."¹⁰

Gary Jones, State Auditor, has indicated that there is waste in many areas of state government, but that it is not the main cause of the current budget disaster. Jones identified at least two issues that could be examined as they present a problem. One was the issue of lack of equity between and among the salaries being paid by various branches or departments of state government. Another area where he sees inefficiencies is in the preparation of the state budget. The Governor's budget is required by the constitution to be presented before the official information is available for a realistic budget. For example, in 2016, the Governor presented a budget based on a \$900 million shortfall; before the Legislators began their work, this shortfall had grown to \$1.3 billion.

Federal Fund Transparency (2015 interim study H15-061 by Rep Newell)¹¹ examined how federal funds play a role in the overall budget because they usually have actions required or prohibited as a condition of the receipt of the funds. State agencies might depend on such funds for carrying out the core mission of the agency. They could have possible maintenance of effort costs associated with the receipt of these funds.

Tax Cuts and Triggers

In an effort to encourage economic development and growth, Oklahoma's elected leaders have promoted tax cuts as a means of creating a "business friendly" climate in the state.¹² The rationale for such cuts is that when revenue is more than sufficient to fund state needs, a provision to lower tax rates or provide credits for taxpayers or businesses should automatically be triggered on the ground that "government shouldn't hoard their money if it has sufficient revenue to run the state"¹³

While the Oklahoma Legislature had passed laws enabling tax cuts in 2007, it was only in 2014 that the tax trigger was added. At that time both the state Auditor and state Treasurer expressed concerns about the way in which the trigger legislation was written, because of a requirement that the state Board of Equalization compare estimates of revenue rather than actual revenue.

At the 2016 Oklahoma Policy Institute Budget Summit, Mr. Chuck Hoskin, Jr., the Cherokee Nation Secretary of State, made an interesting and emphatic point regarding the understanding of the term "sufficient revenue." He noted that, because of the revenue that the state receives from the Native American entities in the state, we should be the envy of the nation in terms of the quality of our schools and roads. However, these funds have gone instead to pay for a tax cut.¹⁴

This same point has been made with regard to the money received from the state lottery. This money was to be set aside for education. Instead, lottery money has been used as an excuse to cut other revenue streams dedicated to education. Thus far, legislators have not been successful in diverting funds from the Tobacco Settlement Endowment Trust to compensate for budget deficits.¹⁵

An article in Tax Vox notes, "According to the fiscal impact summary prepared by the Oklahoma Tax Commission, the state only has to certify that its estimate of 2016 revenue is greater than its estimate of FY2014 revenue. It is not required to say anything about whether the state can afford the tax cut – or even how big the difference is."¹⁶

How to Increase Revenue

In Oklahoma and in many other states, one of the primary untapped sources of revenue comes from online purchases which are not taxed if the business does not have a brick and mortar store in the state. Online purchases damage Oklahoma's economy in other ways when local stores cannot sell enough to keep open, causing loss of income tax, sales tax and ad valorem tax from them and their former employees. Closely related to this loss of revenue is the fact that software that is downloaded from the Internet is tax free.¹⁷

Although some states attempt to collect taxes on Internet sales, there is some consensus that truly effective Internet sales collection will only come about after federal legislation is passed. Few, if any, states have been successful in recouping the taxes lost because of online sales. This would be an area interested individuals might be able to exercise influence to change the federal legislation.

Other states have managed to maximize or at least reduce the amount of **corporate income tax** lost by insisting on combined corporate income tax reporting, which requires a multi-state corporation to add together the profits of all its subsidiaries, regardless of their location, into one report. Although it is impossible to close all the loopholes, combined corporate income tax reporting makes it less possible for corporations to shirk their public responsibility.¹⁸

Oklahoma and several other states allow taxpayers to keep the state income **tax deduction** claimed on their federal returns when they pay their state income tax. This could be corrected by adding that amount back into their adjusted state income before calculating the state income tax.

Two other means of increasing Oklahoma state revenue have been the source of great controversy:

- Oklahoma is one of the states that has failed to expand Medicaid to include the Affordable Care Act (ACA). A change in this policy would bring millions of dollars into the state's economy and allow many people who are currently uninsured to get insurance. There has been some concern that accepting ACA funds could cost the state money when the federal government no longer reimburses the state for the entire cost of the program. However, proponents of the ACA believe that adopting it would bring in nine dollars for every dollar spent.¹⁹
- Oklahoma recently reduced the personal income tax rate with the belief that this would stimulate the economy and bring greater prosperity. The existence of an ever-increasing budgetary shortfall would cast some doubt on that theory. Legislators from both parties have suggested that the decrease in tax rates should be halted until such time as Oklahoma can actually pay for the support of basic, essential services.

How Other States Budget

The Center on Budget and Policy Priorities report, Policy Futures,²⁰ outlines improved procedures that can help states plan more effectively. This report includes the following information:

- Projecting how much revenue the state can expect to collect beyond the next couple of years enables policymakers to anticipate and respond to predictable changes in revenue. Only 11 states forecast revenue at least four years into the future. Oklahoma is not one of those states.
- A revenue estimate produced by the governor and legislature in partnership – rather than competing revenue estimates – reduces the likelihood of a political fight over the correct revenue number that can derail a more productive policy debate. About half (28) of the states use a consensus revenue estimating process. Oklahoma is not one of those states.
- Knowing the cost of maintaining the current level of services beyond a single year gives policymakers a heads up when major cost increases are coming before it's too late to avoid a fiscal emergency. This information (called a current services budget) also shows if states are in danger of chronically taking in less revenue than needed to meet

obligations (called a structural deficit). Only 5 states and the District of Columbia regularly prepare current services budgets extending beyond one budget year. Oklahoma is not one of those states.

- Any of the above practices would by itself help a state. Even more effective is putting them together and preparing high-quality multi-year revenue forecasts and multi-year expenditure forecasts on a current services basis. This gives the best possible information to set up productive debate on potential policies. Three states – Alaska, New York, and Washington – use both multi-year revenue and multi-year current services budget forecasting, at least for broad categories of spending and revenue. ²¹

The National Association of State Budget Officers (NASBO) provides alternatives to the traditional approach to budgeting. These budget reforms aim to integrate more information into the resource allocation decisions. The emergence of program budgeting reflects a desire to shift the focus of the budget process away from inputs and toward the expected results of government services. Another alternative is known as **zero-based budgeting** (ZBB) where the budget is created without any consideration of past budgets, with all spending requiring justification for each budget cycle. A variety of terms are employed in reference to the use of performance data in budgeting where performance information is incorporated into resource allocation decisions. ²²

NASBO supplies a table showing how each state uses a combination of approaches to develop their budget. In addition to the approaches described above, incremental budgeting (generally requires an explanation or justification only for additions or deletions to current budgeted or base expenditures) and line-item budgeting (focuses on objects or lines of expenditures) are shown on the table. Oklahoma uses incremental budgeting as its primary budget approach. ²³

The Pew Charitable Trusts examined the statutory or constitutional language governing the states' rainy day funds and found that out of the 46 states with rainy day funds, 27 do not clearly express in state law what they are seeking to achieve with them. Only 5 states – Connecticut, Minnesota, Nebraska, Oregon, and Utah – currently require by law regular, periodic evaluations of revenue volatility patterns in order to determine a sufficient maximum or targeted balance for their funds. Pew divided state statutes defining the purpose of rainy day funds into two sets of categories: explicit or implied purposes, and narrow or broad definitions. Oklahoma's Constitutional Reserve Fund is listed as having implied purpose and broad definitions. For states seeking to improve their savings targets for rainy day funds, Pew recommends three best practices to better align targets with goals.

- Explicitly define, in law, the purpose of a rainy day fund.
- Align savings targets with the fund's purpose as well as with the state's tax volatility.
- Determine and clearly express the level of budgetary risk the state seeks to offset. ²⁴

END NOTES LONG-TERM PLANNING (BUDGETING PROCESS)

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5. 2015 Oklahoma Academy Town Hall (OATH) "Priorities – The Government and Taxes we Want" <http://www.okacademy.org/PDFs/2015Research.pdf> pp. 24-25
6. OATH pp. 34-35
7. OATH pp. 40-42
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9. OATH pp. 48-49
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17. Oklahoma Internet Sales Tax <http://www.nolo.com/legal-encyclopedia/oklahoma-internet-sales-tax.html>
18. <http://www.itep.org/pdf/pb24comb.pdf>
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21. "Better State Budget Planning Can Help Build Healthier Economies," Center on Budget and Policy Priorities <http://www.cbpp.org/sites/default/files/atoms/files/10-15-15sfplookingahead.pdf>
22. OATH p. 76

23. OATH pp. 78-79

24. "Why States Save" , PEW Charitable Trusts, December 2015,[http://
www.pewtrusts.org/en/research-and-analysis/reports/2015/12/why-states-save](http://www.pewtrusts.org/en/research-and-analysis/reports/2015/12/why-states-save)