

# FY-97 EXECUTIVE BUDGET

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This budget document was prepared for

# **Governor Frank Keating**

by the Office of State Finance, Budget Division, and the  
Deputy Director with the aid of his research staff

Under the direction of the  
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The Office of State Finance would like to thank the Governor's Commission on Government Performance, the Oklahoma Society of Certified Public Accountants, and the many other employees, advisors, private sector business people and citizens who consulted on this document for their contributions

*Special thanks to Julie Dvorak for her beautiful charts and maps*



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This publication, printed by Central Printing, is issued by the Office of State Finance as authorized by Sections 41.33 and 41.34 of Title 62 of the Oklahoma Statutes. Six Hundred (600) copies have been prepared and distributed at a cost of \$4,900.00. Copies have been deposited with the Publications Clearinghouse of the Oklahoma Department of Libraries.

February 5, 1996

It is with great pleasure that I submit to the Legislature and to the people of Oklahoma, for your consideration, this executive budget document. In this, the second year of my administration as your Governor, this document reflects the priorities outlined in my growth agenda for our state, and it is balanced as required by state law.

Last year at this time, I presented a budget that placed emphasis on the need to reduce the tax burden on Oklahoma's taxpayers by reducing the cost of Oklahoma state government and by designing our tax policies to encourage the growth of our economy rather than increase government spending. I outlined significant first steps to implement the necessary changes in state tax policies. Much has been learned since that time, as a result of careful analysis of our state programs, through research conducted by the Governor's Commission on Government Performance, and many other efforts to determine how best to improve the quality of life in Oklahoma.

This budget presents my recommendations to make Oklahoma a rich and prosperous state. I have traveled extensively this year, telling Oklahoma's positive story to the world, and interest in Oklahoma as a corporate site location, a source of abundant resources, and a home, is greater than ever. We have shown the nation that we can pull together and accomplish anything.

I will discuss the progress we have made in the past year and how the proposals outlined in this budget document will be implemented in fiscal 97 in my State of the State presentation. Please consider these recommendations with a vision of Oklahoma's future in mind. These are not quick-fixes, but rather long-term solutions for an Oklahoma that can be a great place to raise a family, earn a living, and get the best education, in a crime-free environment.

Sincerely,

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# **FY-97 Executive Budget**

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### **Executive Summary and Rationale**

A state budget is not just a compilation of projected revenues and expenditures. It reflects public priorities and the condition of the economy; it also has a direct and measurable impact on such fundamental matters as economic growth and prosperity. In that sense, a budget must be viewed from three distinct, yet closely related perspectives: historical trends (where we've been); current conditions (where we are right now, especially in relation to other states), and future projections (where we're headed, with a special emphasis on the impact of expenditures and revenues on economic health.)

When we apply those three criteria to Oklahoma, we reach five inescapable conclusions.

#### **Oklahoma's economic performance has been mediocre over time, with limited prospects for substantial future growth.**

Oklahoma is a state with enormous potential. Our climate, our rich soil, our abundant mineral reserves and our hard working, resourceful people should make us an economic leader. Throughout our history, we have prevailed in good times and bad. In less than a century, we have built a modern state with a promising economic base. Our future can and should be virtually unlimited.

It is therefore perplexing that for more than three decades, Oklahoma's economy has lagged behind that of the United States and most of our

neighboring states. Oklahoma has suffered a per capita personal income gap in relation to the U.S. average, said gap having fluctuated between 15 and 19 percentage points for most of that period. Only during the oil boom of the late 1970s and early 1980s did Oklahoma succeed in closing the gap. Between 1979 and 1983, Oklahoma per capita personal income rose above 90 percent of the national average, reaching a brief high of about 98 percent in 1982 before it began once again to plummet. In 1994, the latest year for which data is available, Oklahoma ranked 45th lowest in the nation, or 6th poorest state in the union. Since 1986, our state's per capita personal income percentage share has hovered in the low 80s -- and there are ominous signs that it is once again declining. According to the latest estimates from the Oklahoma State Econometric Model, maintained by the Oklahoma State University Business and Economic Research Department, Oklahoma's per capita personal income will fall to 79.8% of the national average 1996, the lowest point since 1959, when it stood at 79.6%.

Oklahoma's economy performed reasonably well during 1995 when compared to its own performance in recent times. It grew by an estimated 2.8%, but unfortunately it's rate of growth is also expected to slow slightly from that level this year and next. More importantly however, a state's economic growth rate must be seen in perspective; we are not an island, but one of 50 states within a national economy, and one of a half-dozen states in our region that share many factors in common. As suggested above, growth in our per

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capita personal income level - the best measure of a state's economic health, is not keeping with the rest of the nation.

Unemployment is often cited as a key factor in determining a state's economic health, and Oklahoma's unemployment rate is relatively low. However, employment numbers fail to tell the full story. When our per capita personal income is only four-fifths the national average, and when many areas -- primarily rural -- show dramatically higher unemployment over time, fair observers must temper their economic optimism with reality. Rural Oklahomans earn less than their urban neighbors, which further reduces reasons for optimism. In fact, transfer payments from government now make up fully 25 percent of personal income in rural Oklahoma, up from 18 percent just a few years ago. This is a disturbing trend which says much about job development and growth in a majority of our 77 counties.

One of the most disturbing snapshots depicts the economic relationships between Oklahoma's border counties and the adjoining counties in Texas, Arkansas, Kansas, Colorado, Missouri, and New Mexico. In nearly every case, per capita personal income in the Oklahoma counties is lower than in neighboring counties in these states -- sometimes by as much as 20 percentage points. Yet these counties are generally inhabited by similar peoples, with similar languages and values, who enjoy similar geographies and climates, drink the same water and breathe the same air, face fairly similar costs of living, and live under similar federal government laws and

federal tax systems. The major differential is state government policy.

It became fashionable after the oil bust to blame all of Oklahoma's problems on that economic disaster. While declining oil prices contributed much to economic decline and stagnation, state government's reaction was also less than helpful. From an economy that was already reeling, we extracted even more capital in the form of tax and fee increases. While these may have provided financing to improve some services, the tax and fee increases themselves appear to have exacerbated economic decline.

When viewed in the three perspectives noted above, Oklahoma's economy is NOT healthy.

Over time it has displayed poor growth and, with the exception of the brief oil boom period, relative stagnation.

In snapshot, it compares unfavorably to the rest of the nation and to our neighbors.

And perhaps most ominously, our economy continues to fall behind other states and the national average. We lag well behind neighbors like Texas and Colorado -- states that also suffered intensely during the oil bust -- and even those states that traditionally perform below Oklahoma, like Arkansas, are showing growth rates that put them on track to match and surpass our performance by the end of this decade.

Oklahoma has experienced recent economic growth at a rate of between 2.0 and 2.8 percent per year, with projections for slightly reduced growth in the coming year. Most states already ahead of Oklahoma in per capita personal income are pulling away from us; most behind us are

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gaining. We are in the position of a runner in a distance race who is well back in the pack, who is falling behind the leaders and who hears the closing footsteps of his pursuers.

### **Taxes do have a direct impact on economic growth.**

Taxes, fees and other forms of government revenue have but one justification: to finance necessary government services.

Tax policy -- the form taxes take, the specific placement of the tax burden, the emphasis placed on one tax over another -- has a real and direct impact on prospects for growth in the private sector. Generally speaking, the higher the level of taxes, the lower the growth rate experienced by the state. A recent study conducted by a leading authority on the relationship between taxes and growth cites some 50 different empirical studies which support this conclusion. To cite one compelling result of the study, in the 25 states that had the highest state and local tax burdens between 1965 and 1992, the average rate of growth in income per capita in real terms from 1965 to 1993 was 61 percent. In the 25 states which had the lowest state and local tax burdens over the same period, the growth rate surged to more than 80 percent. That is to say, the relatively low tax states grew nearly one-third faster than the high tax states.

Income taxes have a more immediate and profound impact on economic activity than most other forms of taxation. This is particularly troubling inasmuch as Oklahoma has

significantly increased its reliance on income taxes over time to fund its government operations. Today, Oklahoma's income tax burden as a share of personal income is more than four times what it was in 1960.

Although taxes are not the only factor affecting economic growth, study after study indicates that they are a significant determinant of growth rates over time.

In Oklahoma, our most important taxes are imposed at the margin; they have a depressing impact on new or additional behavior. When a person earns or spends more, taxes on that positive economic activity increase, much like a parachute opening wider and slowing progress. As more tax dollars flow to government, government expands. It is an undeniable axiom that activity conducted by government, which is usually not subject to competitive and market forces, is less efficient than similar activity conducted by the private sector. Hence, expanding government traditionally delivers less economic bang per dollar.

It is widely believed that Oklahoma is a low-tax state. Oklahoma is NOT a low tax state.

When taxes are viewed as a percent of personal income -- the only fair way to compare states -- Oklahoma ranks 17th in overall state taxes, 40th in local taxes and 36th in combined state and local taxation. When fees and miscellaneous revenues are factored in, we are right in the middle: 24th. We are 15th in inheritance taxes and 14th in state and local sales taxes. Our highest marginal income tax rate -- which is the 18th highest in the nation -- kicks in at a low level, penalizing low and middle

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income taxpayers for success. Oklahoma imposes relatively high tax burdens in precisely those areas where taxes have the most immediately negative impact on the economy.

Tax reductions can bring positive economic benefits to a state, regardless of the absolute level of the existing tax burden. Between 1980 and 1993, the median economic growth in the 25 states which raised taxes was 18.61 percent; in the 25 states which lowered taxes, median economic growth was 22.12 percent -- 19 percent higher than in the tax-raising states.

Additional factors at work on the economy include workers' compensation costs and the absence of a Right-to-Work law. Worker's compensation is mandated; hence it is in effect a tax on business. Between 1990 and 1993, Oklahoma's workers' compensation costs rose 16 percent while costs fell nationally by two percent. In our region, most states have recorded decreases in workers' comp costs while Oklahoma's have risen. This does not bode well for economic growth.

Finally, Right-to-Work is a positive economic growth factor for most of our neighbors. Oklahoma lacks a Right-to-Work law.

There are currently 21 states which have Right-to-Work (R/W) laws in place. These states tend to outperform the non R/W states in terms of personal income growth over time. For example, during the period 1989 - 1993, total personal income in R/W states grew 24% faster than in the non R/W states (achieving aggregate growth rates of 27.3% versus 20.74%, respectively). The latest available data - for 2nd Quarter

1995, as compared to 2nd quarter 1994 - indicates that personal income in R/W states grew 21% faster than it did in non R/W states (6.8% growth versus 5.34% growth rates, respectively).

This phenomenon has shown up in per capita personal income measures as well: seven of the top 10 fastest growing states in terms of per capita personal income, 1994 versus 1993, were R/W states. Meanwhile, Oklahoma had the 9th slowest rate of growth in its per capita income level among the 50 states. That kind of anemic growth offers very little hope for a state which is starting out at as the 6th poorest in the nation and wanting to climb out of the cellar.

### **Most states are lowering taxes -- but not Oklahoma.**

Twenty-eight states passed reductions in taxes or fees for FY-96, returning some \$4 billion to the private sector. Among Oklahoma's neighbors, tax-cutters included New Mexico, Kansas, Missouri and Arkansas.

Only eight states recorded tax/fee increases in FY-96: Oklahoma was one of them. Clearly, we are out of step with a national trend.

(It should be noted that our state enacted a small reduction in its unemployment compensation tax as possibly did some other states; the national survey on which these tax increasing and cutting tallies are based exclude modifications in unemployment comp taxes, either up or down, as they are generally considered "off-budget" in various states.)

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Between 1980 and 1992, Oklahoma recorded the 16th highest rate of state and local tax increases as a percent of personal income. Over time, the trend in Oklahoma has been to take an increasingly greater tax bite from the private sector. Our total state taxes, measured as a percent of personal income, are the 17th highest in America.

### **Oklahoma is headed for high-tax status.**

Oklahoma's overall tax burden ranks near the middle. But when that fact is combined with a two-decade upward trend in government revenues -- and the regrettable fact that we were one of only eight states to increase fees or taxes last year -- it is clear that Oklahoma's present course is aimed towards high-tax status.

Between 1960 and 1992, total general government revenues in Oklahoma more than tripled, even when adjusted for inflation. Real taxes more than doubled. Perhaps most disturbingly, government revenues grew as a share of personal income. In 1995 dollars, taxes per person totaled \$914.82 in 1960. By 1992 that figure had risen to \$1,777.93. In addition, our dependency on income taxes -- the taxes with the greatest negative impact on economic growth -- has risen from 21.1 percent of total revenues in 1974 to nearly 36 percent in 1994.

Oklahoma state and local government is taking more from the economy; it is taking that money in the most economically destructive way. This trend flies in the face of widely adopted courses in other states. On the heels of a majority of the states

having just cut their overall tax and fee levels last year, many Governors and Legislatures are convening new legislative sessions this month by announcing plans to reduce taxes further in an effort to improve their states' economies.

As with economic growth trendlines, if we refuse to lower taxes and continue increasing them in a national atmosphere that favors tax reductions, our tax burden will surpass other states and move us ever-higher on the list of high-tax states. High taxes are a disincentive to economic growth and investment. The result of this trend will inevitably be negative, reinforcing the cycle of relatively no/slow growth compounded by excessive taxes, which in turn results in calls for more taxes to fund additional government services.

### **As taxes rise, so does spending.**

It is the nature of government to spend all that it collects. The myth of Oklahoma as a low-tax state has long been coupled with an equally false impression that our government is operated economically. In fact, state spending over time has kept pace with and threatened to outrun the steady long-term upward trend in tax burden.

Of course, as revenues have increased, so has government spending. When measured in 1995 dollars, state and local revenues (and expenditures) have nearly tripled since 1960.

The cost of state and local government as a percentage of personal income in Oklahoma is the 26th highest in America. Perhaps most alarmingly, that cost is the second

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highest in our region, surpassed only by New Mexico.

In summary, Oklahoma faces an economic future that is less than bright, caused by a number of trends that are in part or whole driven by government policy.

Government revenues and expenditures have risen at a steady pace over time. This has siphoned wealth from the private to the public sector, decreasing such engines of economic growth as the availability of investment capital, the attractiveness of our state to new business and personal spending power. The result has been a relatively slow rate of economic growth -- slower than that of our competitors. The result has been an ever-widening gap between personal income in Oklahoma and that of the nation.

This Executive Budget is thus driven by two clear imperatives:

-- Since taxes have a direct impact on economic growth, specific tax reductions can and must help stimulate specific economic activity, increasing wealth and income levels in the private sector;

-- Because the appetite of government is equal to its income, reducing the flow of wealth to government will necessarily and beneficially result in restraint on government spending and a more realistic set of spending priorities.

In short, it can be said that the intent behind this budget recommendation is to downsize state government's income and to upsize the income of Oklahoma's citizens.

The FY-97 Executive Budget seeks to establish priorities that reflect real needs and the prudent management of our state's financial affairs.

### **FY-97 budget priorities:**