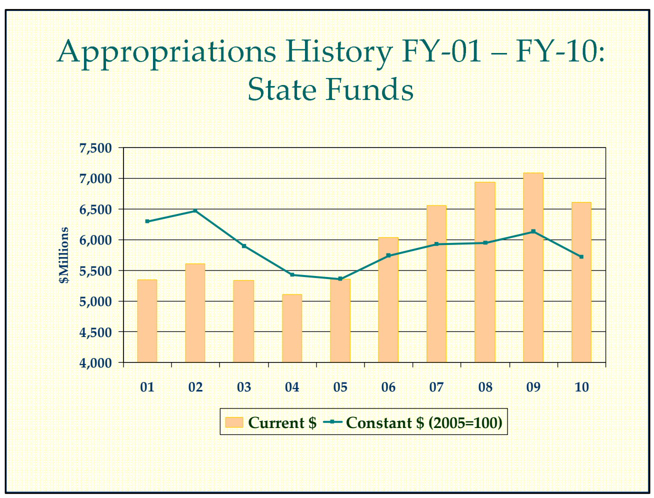
FY-10 Appropriations Overview

As the 52nd Oklahoma Legislature convened, it faced the unenviable task of constructing a state government budget in a year of economic volatility when the nation sank into the most severe recession in seventy years. At the heart of any state legislature's responsibilities is the obligation, through the use of taxation and appropriation, to formulate a budget that meets critical core services in the areas of education, health, public safety, and transportation. This challenge is more complicated in the State of Oklahoma, as the Legislature must balance the state budget in accordance with a constitutional mandate and must adhere to certain voter approved provisions, including State Question 640 which limits the Legislature's ability to raise revenue. For these reasons, and in a time when state revenue falls significantly short of estimates made a year in advance, the Legislature must make difficult fiscal policy decisions which inevitably affect the delivery of public services.

In February of 2009, the State Board of Equalization certified $6.456 billion as available for appropriation in the 2009 Legislative Session, a certified appropriations authority of $612.5 million or 8.7% below the $7.068 billion appropriated in the 2008 Legislative Session. A worldwide reduction in demand, a dramatic decline in energy prices and a consequent decrease in gross production tax collections were major factors contributing to the cutback in appropriations authority. The Legislature was confronted with the challenge of balancing the FY-10 budget with $612.5 million less to appropriate than for FY-09. Moreover, the Legislature had to develop a strategic plan that addressed over $500 million in increased operating expenses originally created in the FY-09 budget.



Further complicating development of the budget were the appropriation and subsequent formulation of rules and regulations governing the American Renewal and Reinvestment Act (ARRA) federal stimulus funds, designed primarily to offset imminent FY-10 state budget decreases in the areas of education and Medicaid related programs. The Governor's application for such funds was submitted in late June with final federal approval occurring in July, thus making it difficult for legislators to decisively establish FY-10 appropriation parameters before the end of session.

For Oklahoma, the federal stimulus package of approximately $2.6 billion included $1.2 billion to be employed over a two-year span that encompasses part of FY-09, all of FY-10, and part of FY-11. The FY-10 budget agreement included the use of slightly more than half of the $1.2 billion for Common and Higher Education and through the enhanced Federal Medical Assistance Percentage (FMAP). The Education Subcommittee allocated $236,776,019 in stimulus funds while the Public Health and Human Services Subcommittees designated $404,271,860 for the FY-10 state budget. The education component does not include approximately $300 million that Oklahoma school districts received directly from the federal government. In addition, more than $460 million was directly provided to the Oklahoma Department of Transportation to expedite road projects included in the agency's construction plan.

A primary goal of the this year's Legislature was its commitment to preserve previously enacted tax cuts for all Oklahoma families and to continue to recognize the sacrifices our veterans have made to our state and the nation. To meet these obligations, the Legislature employed several innovative tactics when crafting the FY-10 state budget.

Since 2005, historically significant tax cuts have been enacted. Some of the reductions were effective immediately including a sales tax holiday occurring each August to assist parents with school year purchases. Other reductions have occurred incrementally as the top marginal individual income tax rate decreased from 6.65% in 2005 to the current rate of 5.5%. Coinciding with the rate reduction, the standard deduction has increased to the federal amount, allowing Oklahoma families to retain more of their income. Additional major tax cuts include increases in the amount of tax liability exempt from the franchise tax, affecting primarily small businesses and a phase out of the death tax by 2010.

A key budget tactic designed to enhance and preserve revenues for the state totaling more than $100 million was contained in **SB 318**. The bill requires the internet listing of delinquent taxpayers owing more than $25,000, and expands other internet delinquent account collections procedures. Bill provisions also prevent the 2009 federal stimulus package from having a negative impact on state FY-10 certified revenue. As an example, federal stimulus regulations allow for accelerated expensing of assets purchased by businesses in one year, but **SB 318** requires assets to be expensed over a five-year timeframe for Oklahoma returns, thus blunting an impact on FY-10 state revenues. Oklahomans may take advantage of the bonus depreciation allowance on federal returns.

Even under unprecedented budget constraints, the Legislature passed one major tax reduction during this session, honoring Oklahomans currently serving in the United States military. **SB 881** exempts all active military payments from state income tax beginning July 1, 2010, making Oklahoma one of only 16 states with an active-duty military tax break.

Despite the continuing economic recession and the resultant declining revenue trends, the House of Representatives concluded a budget agreement in May with the State Senate and the Office of the Governor to "preserve the core services of state government."
The agreement:

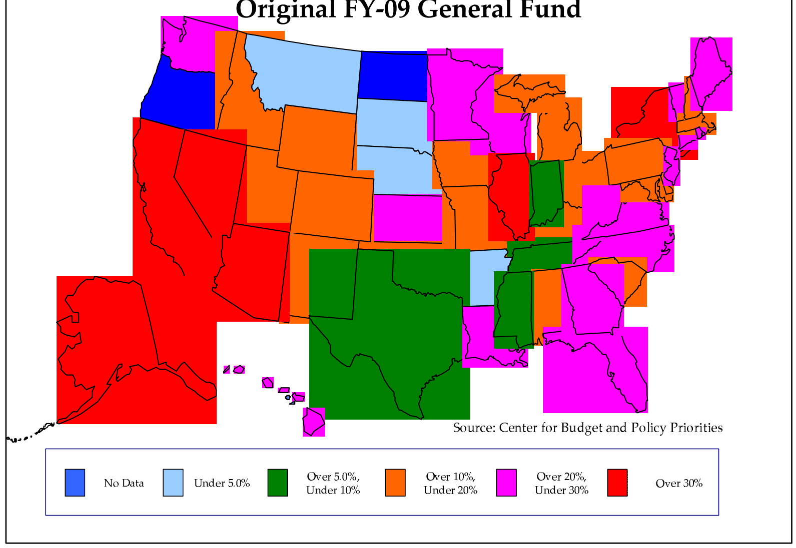
- Provides a virtually standstill budget from that of FY-09 in the critical areas of education, health, transportation, and public safety;

- Honors previous financial commitments made to the state retirement systems in an attempt to reduce unfunded liabilities given stringent budget constraints;

- Limits the remainder of state government to appropriation reductions no greater than 7% and in many cases a much smaller reduction; and

- Protects the Constitutional Reserve "Rainy Day" Fund in order to preserve these funds in case the state's financial status worsens.

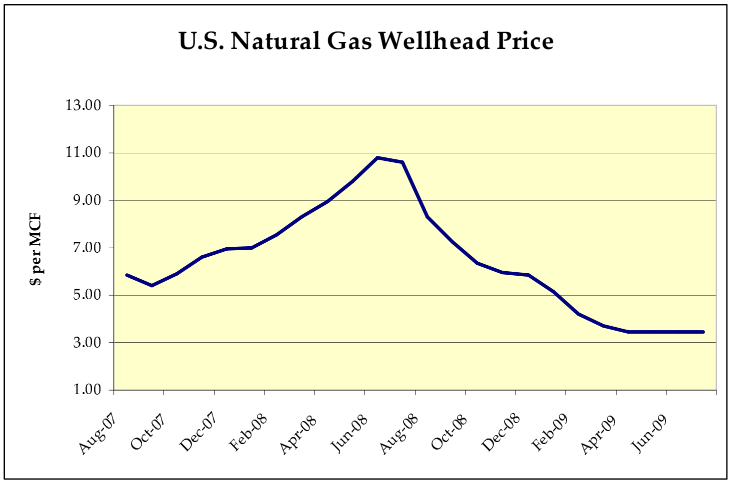
The Oklahoma Legislature's determined effort to maintain core public services while preserving previously enacted tax cuts is underscored by recent surveys conducted by the National Conference of State Legislators (NCSL) in which eleven states resorted to tax increases, one-half of the states realized reduced spending and at least eight states tapped reserve funds to close FY-10 budget gaps. Nearly two-thirds of the states already project a budget gap in FY-11.



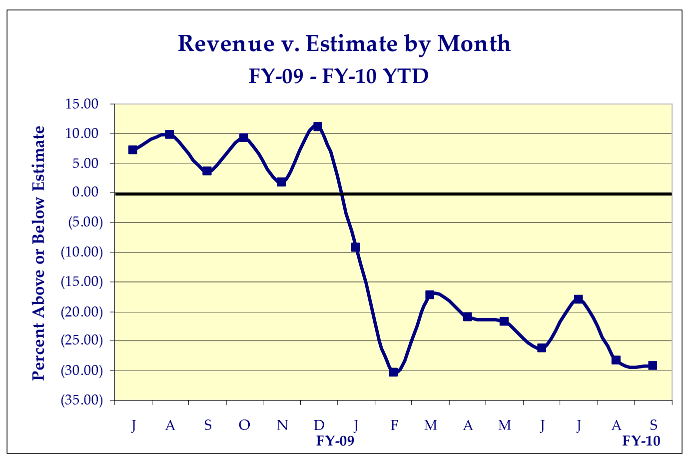
Projected FY-10 Budget Gaps Compared to Original FY-09 General Fund

Since the end of the 2009 regular session, the continuing economic recession and the resultant declining revenue trends continue to test the current budget, as revealed by the first quarter revenue reports issued by the State Treasurer and the subsequent five-percent reduction in monthly General Revenue Fund (GRF) allocations to state agencies.

As with other energy producing states, Oklahoma has been negatively affected by dismal natural gas prices, a reminder that despite efforts to diversify the economy, the state's economic health remains closely linked to that of the energy sector. Resultant cutbacks in drilling activity and investment lead to higher unemployment, reduced consumer spending and decreased income tax collections. The short-term revenue outlook is not expected to improve until economic events result in higher natural gas prices.



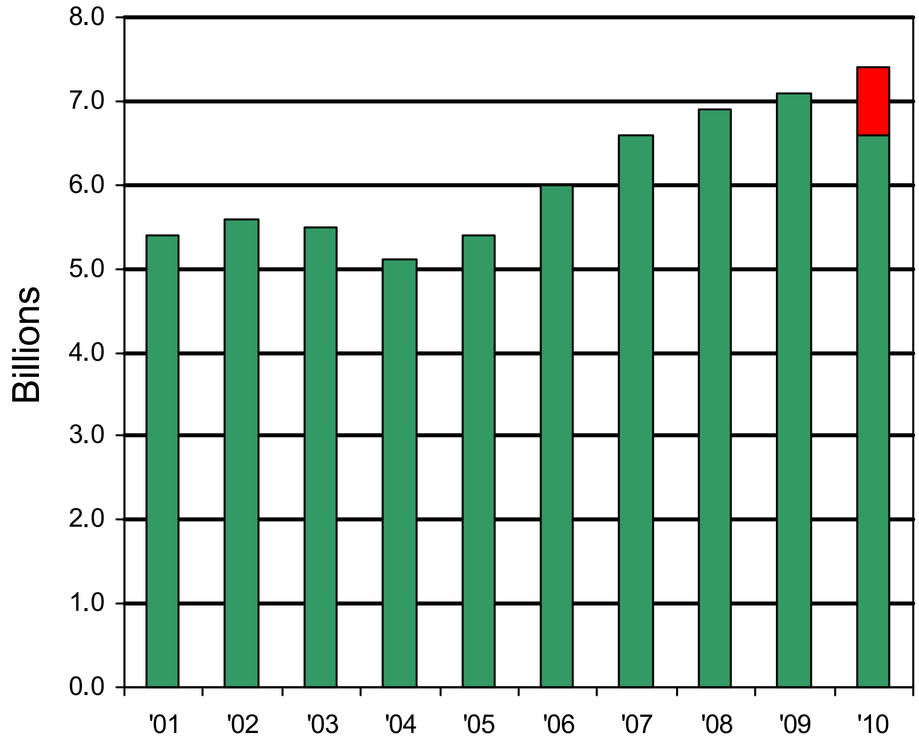
Clearly, the effects of the national recession and the resulting rise in unemployment to post-war highs has significantly increased the demand for government services, including Medicaid, food stamps and unemployment benefits and will, at the same time, exacerbate declining state revenue trends and increase government expenditures on such services in the months ahead. The unknown variable affecting the current FY-10 state budget and the construction of the FY-11 budget is the depth and duration of the current economic downturn and the prospects and timing of a sustainable recovery.



As Legislators evaluate options for an appropriate response to declining revenues, the budget outlook for FY-11 should be taken into consideration so as not to deplete cash reserves or remaining federal stimulus funds any more than is fiscally prudent. At present, the FY-11 revenue outlook appears bleak and the Legislature will not have access to the over $290 million in prior year GRF cash or the $98.7 million in Special Cash that was available when constructing the FY-10 state budget. With the severe reduction in available cash and the certainty of a decrease in FY-11 certified appropriations authority, the reduction of agency budgets for the balance of FY-10 will allow time for adjustment in expectation of additional budget cuts and will blunt the need for extreme reductions as the FY-11 budget takes form.

Ten Year Appropriation History

Total Appropriation Level



FY-01	$5,350,656,390	FY-06	$6,038,003,816
FY-02	$5,611,514,760	FY-07	$6,554,329,152
FY-03	$5,532,095,223	FY-08	$6,932,106,070
FY-04	$5,106,597,024	FY-09	$7,089,333,227
FY-05	$5,358,101,676	FY-10	$6,574,296,466

*** Total Appropriations with Federal Stimulus $7,215,344,345**

Notes:

1. These figures include appropriations, pension systems, capital and special projects. Figures exclude Rainy Day Fund spillover transfers and supplemental appropriations.

2. Totals also include the Tobacco Settlement Fund, the Common Education Technology Revolving Fund, the Education Reform Revolving Fund, the Higher Education Scholarship Revolving Fund and the Higher Education Capital Revolving Fund.