



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

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

Rightsizing in action

One upside of the budget cuts of the past several years is that agencies have been forced to find efficiencies and cost-savings. But just because revenues are now improving doesn't mean agencies should stop looking for ways to perform better.

Many agencies have found ways to do more with less, responsibly managing through budget reductions by realigning functions to better concentrate on core services.

Like other agencies that have outsourced non-core services, the treasurer's

office has contracted with the attorney general's office to provide legal services instead of employing a staff attorney; prior to the mandate, the treasury began using the Office of State Finance (OSF) for information technology support; and OSF has been asked to perform agency purchasing, payables and receivables support starting next fiscal year. The office has eliminated its fleet vehicles in favor of using the centralized motor pool.

The outdated perception that an agency's worth is measured by its size and scope is partly to blame for reluctance

to downsize. Agency growth can be constructive if it results in overall streamlining for the state. However, growth for the sake of empire-building and mission-creep is

destructive.

At a time when some agencies are trying

“A mission-centric approach is emerging that will reshape government for the better.”

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Personal income growth leaps

Personal income in Oklahoma grew faster than the national average last year, according to figures released Wednesday, March 28, by the U.S. Bureau of Economic Analysis.

Fueled by the energy sector, Oklahoma's per capita personal income growth was third highest in the nation at 5.3 percent, rising from \$35,389 in 2010 to \$37,277 in 2011.

Total personal income in Oklahoma was up 6.2 percent in 2011 at \$141 billion, the fourth-highest change in the nation.

Nationally, per capita personal income grew by 4.3 percent and total personal income was up by 5.1 percent.

In spite of the strong growth in the past year, Oklahoma's ranking of per capita personal income is 34th among the states at 89 percent of the national average.

Oklahoma is in a group of energy-rich states that grew the fastest, along with North Dakota, Wyoming, Texas, Louisiana and West Virginia.



Treasurer's Commentary By Ken Miller, Ph.D.



Invisible handcuffs

In my undergraduate economics courses, I always start the semester by introducing students to Adam Smith and his invisible hand doctrine, which proclaims self-interest a fundamental component of free market capitalism.

The doctrine suggests that self-interest guides individuals to unknowingly work toward the common good while intending only to pursue their own gain.

Perhaps Smith's defining work, *The Wealth of Nations*, can be summed in one famous phrase from the book:

"It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own self interest. We address ourselves not to their humanity, but to their self-love, and never speak to them of our own necessities, but their own advantages."

In Hollywood speak, it sounds a lot like Gordon Gecko's "greed is good" speech and even makes sense after we replace "brewer" with "candlestick maker" for relevancy at a Christian university.

That introduction leads to a lecture on how the primary economic

actors – the households, firms and governments – seek to maximize satisfaction, profit, and quality of life, respectively.

Eventually, we discuss tax and spend policies elected leaders can use to influence fluctuations in the business cycle.

“The forces of inaction, politics, ambition and special interests are again hard at work.”

Some students think the invisible hand doctrine should also apply to the democratic process and fiscal policymakers – theorizing that self-interested politicians would work to increase the quality of life for all to ensure they earn the majority vote in the next election.

Other students ask how the country's finances could be such a mess if the invisible hand doctrine also applies to the democratic process. Their answers typically include partisanship, special interests, personal ambition, ignorance and apathy, all of which act as invisible handcuffs.

Exhibit A is Congress' three-year failure to produce a budget, its chief constitutional duty. The students' answers are on target. Inaction due to partisanship, and the other political ills listed above, do lie at the heart of most of Washington's problems. Beneficiaries of the current state of affairs have become quite adept at resisting change so the win-lose ratio isn't altered.

Unfortunately, inaction is not confined to the District of Columbia. The power of the status quo also can be seen at our state capitol.

Now halfway into Oklahoma's legislative session, the democratic process is well underway. The forces of inaction, politics, ambition and special interests are again hard at work.

True statesmen work even harder to ensure the common good prevails. Good public policy is more difficult than good politics. Comprehensive

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Commentary

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tax reform is harder than simply cutting taxes. Efficient prioritization of spending is more difficult than merely writing a

balanced budget. Economic vitality is tougher to create than political viability. Such is true for anything worth achieving.

It has been often said that our government was designed to make

it difficult to accomplish anything of significance, and frankly, our government does that very well.

Reform that benefits the common good can be difficult and politically costly to achieve; but not impossible.

In action

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to expand, the Treasurer's Office is shrinking its footprint. In just five years, the office will have cut staffing by 31 positions for a 40 percent reduction in force.

A more efficient layout increased usable workspace by 32 percent in the treasury's Capitol offices, eliminating the need for leased space and saving the agency more than \$25,000 each year.

A sharper focus on treasury mission has created some efficiencies, while others resulted from technological advances that automated time-intensive processes.

While each agency is unique, all can benefit from defining the core mission of the public service provided. Anything not central to that mission should be eliminated so agencies can instead deliver the best service possible.

A mission-centric approach is emerging in Oklahoma that will reshape government for the better.

Limited resources have led many agencies to shed administrative functions that are more cost-effectively met through a centralized support office.

Agencies that once employed entire departments for purchasing, payroll processing and information technology

are now using services provided by OSF, soon to be renamed the Office of Management and Enterprise Services.

Adjusting to the loss of autonomy has been challenging, but the shift is permitting agencies to focus on core functions, enabling purchasing, payables and technology support to come from specialists in those areas.

Sixty-five agencies voluntarily contract with OSF for support with human resources and/or payroll services.

A recent report on information technology consolidation shows savings are far exceeding expectations: \$4.3 million in savings for the current fiscal year and estimated savings of \$172 million over seven years.

The state has made a great start, but more efficiencies can be gained. Maybe government can't operate just like a business, but it can continue to adopt some business sense.

If the pieces of government were arranged according to function instead of territory, a more streamlined model would naturally emerge.

For example, private companies don't have lawyers working in each

department giving inconsistent advice; instead, they outsource or have one legal division. Governor Mitt Romney consolidated Massachusetts' legal services under the attorney general's office; a similar effort was defeated in Oklahoma in 2010.

Further realignment of Oklahoma financial functions can still be achieved. Even the federal government centralizes bill paying and debt oversight under the U.S. Treasury.

By streamlining government according to function and embracing technological advances, less time can be spent processing paperwork and more time spent on delivering something of public value.

Change comes slowly, and even slower when government is involved. But Oklahoma is on the right track in evaluating how to streamline bureaucracy while protecting or enhancing its public services.

A return of revenue should not equate to a return to "the way it's always been done." Instead, Oklahoma can build on its successes by taking a critical and business-minded approach to organizing Oklahoma's government to meet modern-day needs.



February by the numbers: Gross receipts vs. General Revenue Fund

A comparison of the Treasurer's March 5 Gross Revenue Report and State Finance's March 13 General Revenue Fund (GRF) report illustrates fundamental differences.

February gross receipts totaled \$809.9 million, while the GRF received \$283.4 million or 35% of the total. Last month, the GRF received 56.5% of the gross.

The GRF received between 35% and 58% of monthly gross receipts during the past 12 months, highlighting the value of using total collections rather than the GRF subset to gauge state economic performance.

From gross receipts in February, the GRF received:

- Personal income tax: 14.3%
- Corporate income tax: 16.8%
- Sales tax: 45.1%
- Gross production-Gas: 78.2%
- Gross production-Oil: 77.4%
- Motor vehicle tax: 32.7%
- Other sources: 25.3%

GRF collections for the month topped the official estimate by \$43.1 million or 17.9 percent.

Insurance premium taxes totaled \$18.7 million in February.

Tribal gaming fees generated \$8.3 million during the month.

Miller says low natural gas prices still a concern

February continues 24-month revenue streak

Oklahoma is celebrating its second anniversary of revenue growth out of the Great Recession, State Treasurer Ken Miller said as he released the February gross receipts report.

The state economy shows signs of improving health in all areas measured by state revenue collections, especially income taxes, he said.

“In the past 12 months, all major sources of revenue are higher than the previous 12 month period,” Miller said.

“However, the state income tax is by far the strongest performer. It is up by more than 14 percent over the period, while all other areas are up by less than 10 percent.”

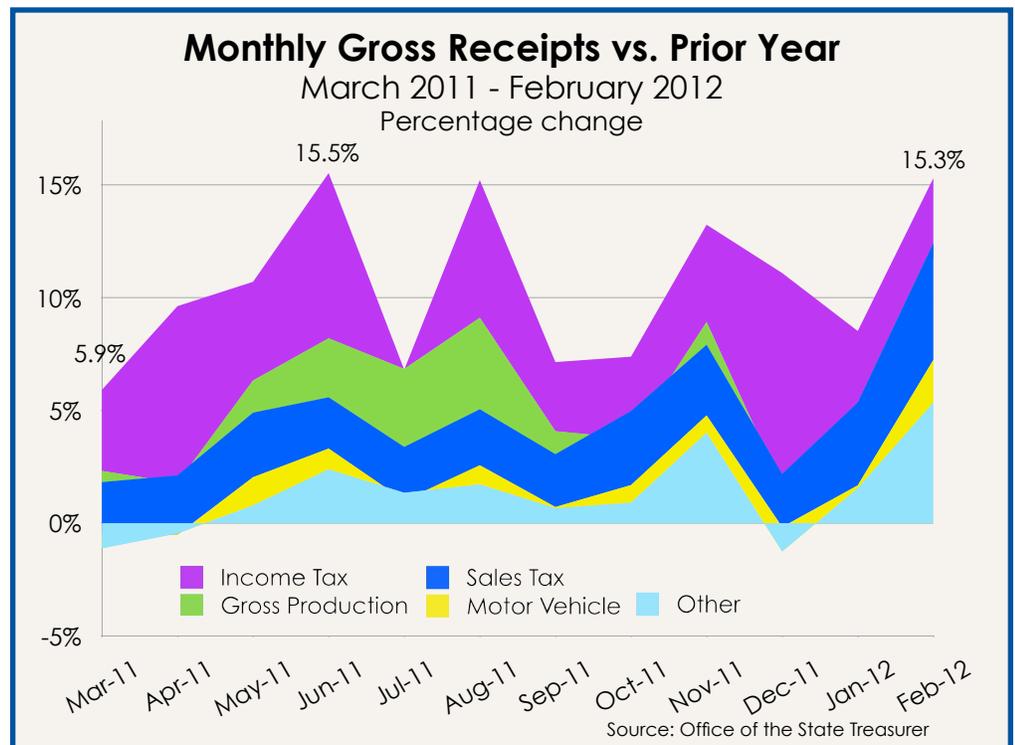
Even so, Miller said recent signs point to decreasing revenue generated by natural gas production.

“... the state income tax is by far the strongest performer.”

“We continue to see the impact of low natural gas prices,” he said.

“For a third consecutive month, gross production collections are down

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Revenue

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compared to the prior year. In five of the past 12 months, gross production has dropped below the prior year.”

The spot price of natural gas reached a 52-week low in March, having dropped more than 47 percent in the past year. On March 29, the price closed at \$2.00 per thousand cubic feet at the Henry Hub in Louisiana.

However, on the broad scale, Miller said total revenue collections – a reflection of the performance of Oklahoma’s economy – continue robust growth.

“In the past two years, monthly receipts have been up over the prior year. In each of the past 12 months, collections are up by more than 10 percent six times and more than 15 percent three times, including in February,” he said.

It has been three years and two months since state collections began showing the impact of the recession. Collections began rising exactly two years ago. Miller said 12-month collections are now more than \$1.5 billion or 78.3 percent higher than at the low point.

“Barring any unforeseen occurrences, Oklahoma is on track to recover revenues lost during the recession before the end of the year,” Miller said.

Pension reforms taking hold

Legislative reforms enacted last session have cut the unfunded liability of Oklahoma’s public pensions by more than \$5.5 billion. The reforms take future cost-of-living adjustments out of pension obligation assumptions and help more accurately project when each plan’s full obligations will be met.

Data recently presented to the State

Pension Commission show the collective funded ratio of Oklahoma’s public pension plans improved from 55.5 percent to 66.7 percent based on the new liability calculations. The industry considers systems to be actuarially sound at 80-percent funded status.

The state’s seven pension plans also

have new projections for when each will reach fully funded status. The largest and worst-funded of the plans, the Teachers Retirement System, previously could not predict a time frame for when all obligations could be met. The plan, which is on a 30-year amortization schedule, is now expected to reach fully-funded status within 22 years if contribution rates and returns remain as projected.

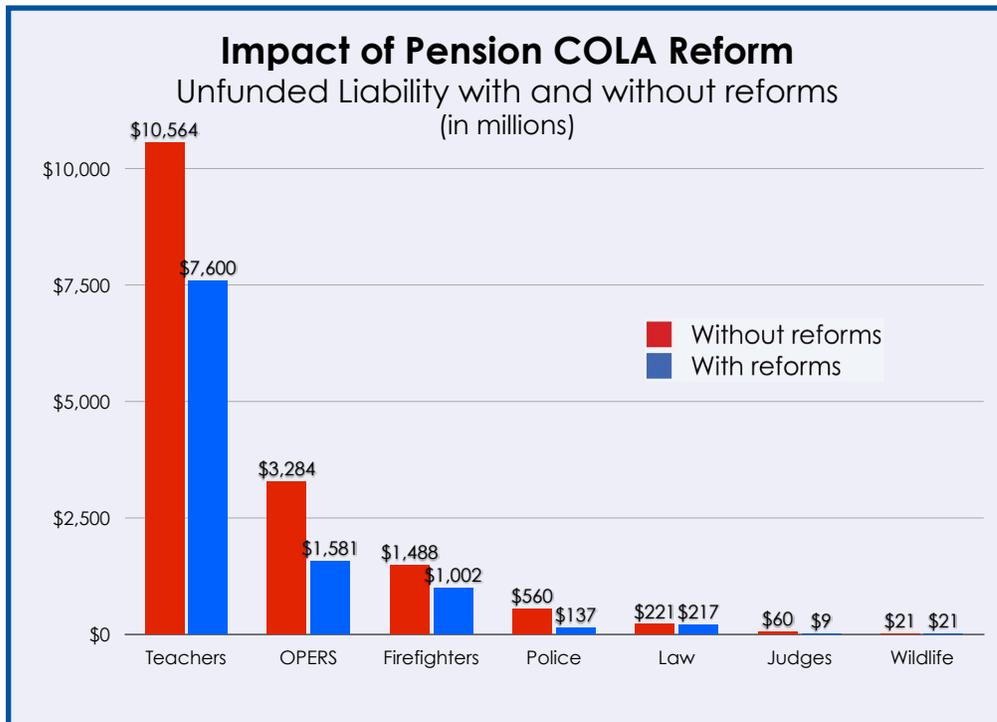
The second largest plan – the Public Employee Retirements System – is scheduled to meet all its obligations within 16 years.

The revised projections assume that recent reforms will not be relaxed and unfunded COLAs will not be resumed.

Fiscal status improvement is based solely on the elimination of unfunded COLAs.

Reforms affecting new entrants will further improve solvency, including longer vesting periods.

Additional reforms are necessary to ensure the long-term stability of the funds, but the reforms passed last year are having a measurable impact.





Student loan debt demonstrates need for college savings

Sometime last year, outstanding student loan debt topped \$1 trillion (\$1,000,000,000,000), according to the Consumer Financial Protection Bureau (CFPB). That is roughly 16 percent higher than an estimate earlier this year by the Federal Reserve Bank of New York.

“The cost of college is a barrier for many families and is increasing every year.”

The announcement last week by the CFPB comes as efforts ramp up to save Oklahoma’s college savings tax deduction from elimination.

Earlier this month, the Oklahoma College Savings Plan Board of Trustees voted unanimously to urge the governor and lawmakers to maintain the incentive, which allows families to deduct from their state taxable income contributions to the Oklahoma 529 College Savings Plan up to \$20,000 per year.

In its resolution, adopted March 8, the college savings panel listed reasons why Oklahomans should be encouraged to save for the costs of higher education:

- The cost of college is a barrier for many families and is increasing every year
- Only 22.7 percent of Oklahomans

over the age of 25 have completed a college degree

- Oklahoma lags behind both the national and regional average of college graduates
- The only border state with a lower percentage of college graduates is Arkansas
- The unemployment rate in 2010 for those with a bachelor’s degree was half that of high school-only graduates
- Lifetime earnings of those with a college degree surpass those with no post-secondary education by \$1 million.

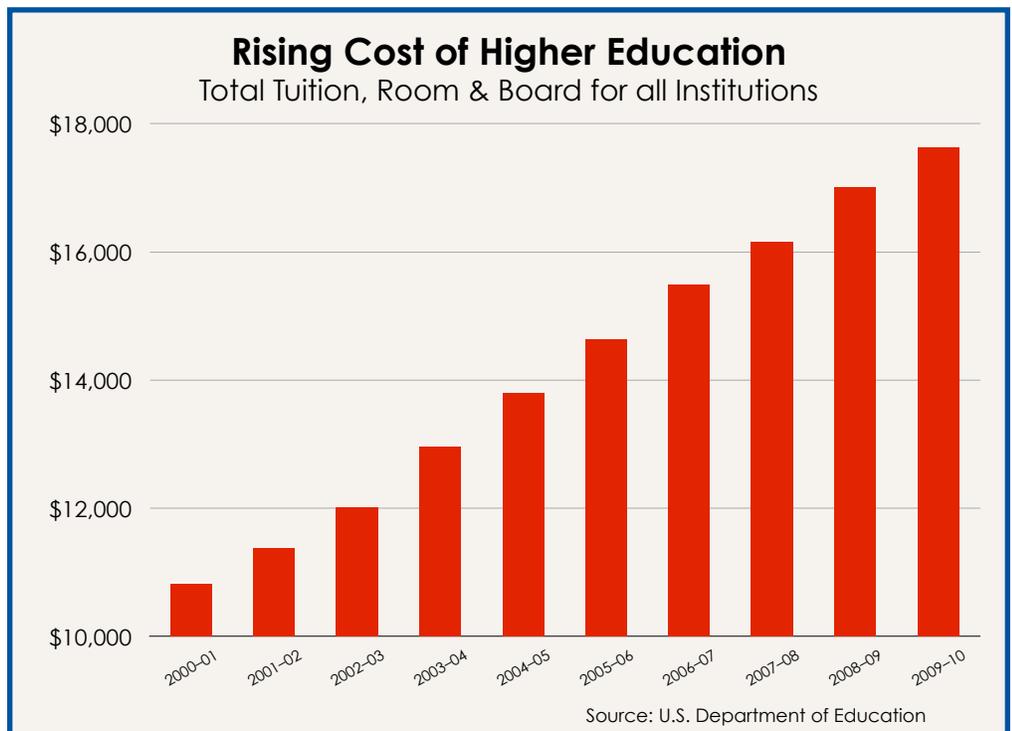
In a question-and-answer segment published in the *Oklahoman* on March 20, Treasurer Ken Miller talked about

the impact of the state tax deduction.

“Nearly 10,000 Oklahoma taxpayers annually claim the deduction, keeping on average an extra \$242 of their hard-earned money each year,” he said.

Miller also said he expects support for the deduction will increase in the coming weeks.

“I believe support for continuing the deduction will grow as lawmakers hear from the Oklahoma families who are seeing their loved ones benefit from earning a college degree paid for with money invested in the plan,” he said. “Families have used the plan to pay for more than \$152 million of higher education costs.”





Falling natural gas prices trigger concern

A supply glut is driving natural gas prices to drastically low levels. On Thursday, March 29, prices at the Henry Hub in Louisiana reached \$2.00 per thousand cubic feet (mcf).

The low prices have state tax authorities keeping an eye on collections from the gross production tax. Currently assessed at seven percent, the rate would drop to

four percent should the average monthly price fall below \$2.10/mcf.

If the average price were to drop to that level, the lower tax rate would become effective three months later with collections at the reduced assessment remitted some three months after that.

Should the average natural gas price

drop below \$1.75/mcf for a month, the gross production tax rate would be cut again, this time to one percent.

The fiscal year 2013 budget estimate is based on natural gas at \$3.64/mcf.

Gas prices are a leading economic indicator in Oklahoma because one-third of the economy can be tied to the energy industry.

Federal issues to watch

Several issues are pending either in Congress or with various federal agencies that could have an impact on the Sooner State.

Growing government

Interest on the debt now accounts for 6.2 percent of federal spending, and could reach one-third of the budget by 2045, according to the CBO. Federal spending now equals 23.5 percent of current dollar GDP.

Taxation of Municipal Bonds

President Obama has proposed a cap on some tax deductions and tax exemptions, including interest on state and local bonds. If enacted, investors would likely demand higher interest rates to make up for the new tax, and that would have a direct and negative impact on state and local governments.

Money Market Mutual Funds

Changes proposed by the Securities and Exchange Commission (SEC) to money market mutual funds (MMMFs) could eliminate or curtail state and local governments' ability to invest in these products. SEC-proposed changes

could also make it difficult to market municipal securities used to raise capital for vital infrastructure projects. The possibility of changing the fixed net asset value (NAV) to a floating net asset value is also of concern. The NAV is the fundamental feature of money market funds. Such a change would eliminate the market for such products and force investors, including state and local governments, to divest their MMMF holdings.

Municipal Securities Market

The SEC is considering proposing repeal of the Tower Amendment, which would have a chilling effect on the municipal securities industry. The Tower Amendment restricts the SEC from directly or indirectly requiring municipal securities issuers to file documents with it before the securities are sold.

Volcker Rule

The Volcker Rule was added to the Dodd-Frank Act to generally prohibit two activities of banking entities: (a) proprietary trading of any security, derivative, and certain other financial instruments; and (b) ownership interest, sponsorship, or having certain

relationships with a hedge fund or private equity fund. Several federal agencies have proposed implementation of the Volcker Rule, which, as proposed, includes a narrow "government obligations" exemption from proprietary trading.

Oklahoma jobless rate drops

Oklahoma's unemployment rate dropped to 6.0 percent in February according to preliminary figures released March 30 by the Federal Bureau of Labor Statistics.

February's rate is 0.1 percentage point less than the rate of 6.1 percent in February 2011.

The figures show Oklahoma total employment is 21,040 higher than in February of last year.

The number of unemployed was set at 106,570 in February, down by 530 from the same month last year.



Economic Indicators

