



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

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

Demystifying the General Revenue Fund

It's no surprise that state finances are a mystery to most people outside of government; what is surprising is how mysterious it remains to many of those on the inside. With so many different taxes and fees and even more special funds and formulas, a complete picture of what the state collects and spends is understandably elusive.

Decades of legislative actions have resulted in just half of the money collected by the state being deposited into the General Revenue Fund (GRF), the main funding source for state government.

Some of the collections that never make it into the GRF are paid as refunds and the rest is transferred to several dozen special funds and uses for such worthy purposes as transportation and education. Another

example is footnote 29 from the tax commission's allocation spreadsheet relating to the Alcoholic Beverage Tax, in which "any amount over the 2/3

of 97% from FY 10 goes to the Okla. Viticulture and Enology Center up to \$350,000 each fiscal year."

Such carve outs ensure ongoing funding without legislative appropriations.

The amount that is remitted to the GRF, while significant, does

not tell the whole story of how much taxpayer money is used to provide

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“ State government collects twice as much money as is placed into General Revenue.”

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Staff

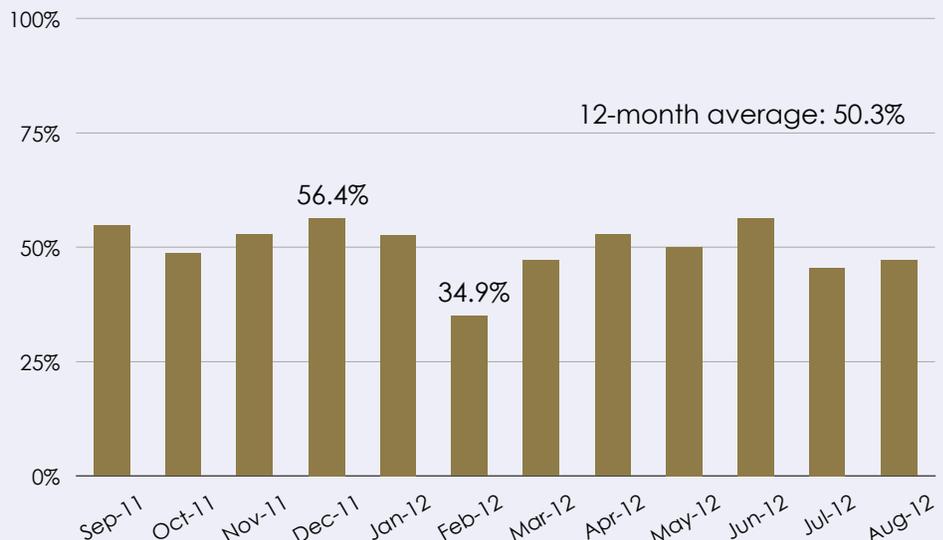
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Percentage of Gross Receipts to General Revenue Fund

September 2011 - August 2012



Source: Office of the State Treasurer



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

Theoretically speaking, of course

Most have heard the famous Churchill comment that “democracy is the worst form of government except for all the others that have been tried.” Fewer know where he points the finger, which is evidenced by his statement that “the best argument against democracy is a five-minute conversation with the average voter.”

Today, far fewer would point to the median voter as the problem. In fact, many would say that they are being completely ignored.

With the increasing polarization of both political parties, Washington is seemingly in a permanent stalemate and the current elected class is fearful that any compromise may cost them their jobs.

Such pandering has resulted in Congress failing to accomplish its primary constitutional duty: passing a budget.

Even at the state and local levels, there are politicians who seem to be more concerned with job security

than job responsibilities, as can often be seen from the power of the status quo and the tell-them-what-they-want-to-hear approach to public policy.

It is no wonder the citizens of our great republic have all but given up on politicians.

We have a public that loves the

“Few would point to the median voter as the problem.”

American system of democracy, but dislikes anyone connected to it . . . except, of course, their own representative. Which begs an interesting question: how can the system be broken if each

current officeholder is deemed worthy of support and how is it supposed to work in the first place?

Two theories of representative democracy prevail: the trustee and delegate theories.

The trustee theory is a model whereby voters entrust their representatives with sufficient autonomy to act in favor of the greater common interest, recognizing the problems associated with time and information that often hinder the ability of constituents to



take informed positions on complex problems.

Under the delegate theory the voters grant no such autonomy, expecting their representative to act on the preferences of the majority regardless of their own opinions.

James Madison held strongly to the delegate theory. John Stuart Mill, the social contract theorist who helped shape the U.S. constitution, extensively argued for the trustee theory believing that a better informed representative had not only the right, but the responsibility to use his own judgment and opinions when representing the voters.

There are reasonable arguments for both theories. A look back at recent congressional decisions shows both in action.

Expansion of entitlement benefits has generally had popular support while the bank and auto bailouts did not.

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Commentary

FROM PAGE 2

The great debt challenges facing the nation and the needed tax, spending and pension reforms in our state cannot be solved without meaningful and honest interaction between the public and those representing them.

In this respect, the trustee and delegate theories don't have to be mutually exclusive.

When leaders work to shape public opinion, not just respond to it, the people are sovereign and the argument

for democracy is strong.

With all due respect to Churchill, democracy is the best form of government because of its people, not in spite of them.

GASB pension reporting changes coming

Recently approved changes in accounting and financial reporting requirements for government pension plans are causing confusion and concern among state and local governments.

This June, two new accounting standards were approved by the Governmental Accounting Standards Board (GASB), an independent financial accounting foundation

whose goal is to establish standards that provide greater accountability in public-sector financial reporting.

The new standards detailed in GASB Statements 67 and 68 are intended to improve the information reported by states and local governments for public pension plans and allow for better comparability of pension information across governments.

One of the concerns raised by states and local governments is that the new standards don't reflect for differences

in various state laws regarding responsibility for future pension benefits.

For example, the new standards require local governments like municipalities or counties to report a portion of the state's pension liability in their financial statements.

Some states do share the cost and liability of pension plans with sub-levels of government. However, other states, like

Oklahoma, have state-sponsored plans that have historically accepted all of the legal liability for public pension obligations.

While municipalities, counties and schools may participate in Oklahoma's public pension plans, they have never before been required to calculate and report any portion of the liability on their financial statements.

There is concern that inclusion of this liability will give the appearance that a government is financially weaker

compared with financial statements that did not include this data.

GASB acknowledges in accompanying documents that the actual financial situation of the governments will not change regardless of what is reported. They contend the inclusion of the shared liability on reports will more clearly portray the government's financial status because the pension liability will be placed on an equal footing with other long-term obligations.

It is important to note that the new standards relate only to how pension costs and obligations are measured and reported, not how they are funded.

GASB was deliberate in affirming an accounting based approach, having determined the matter of pension funding as a policy decision for elected officials.

GASB's new guidelines will also change how governments calculate their total pension liability to better reflect the present cost of deferred benefits.

The new changes will go into effect between fiscal years 2014 and 2015.

“... the changes will better reflect the present cost of deferred benefits.”

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Demystifying

FROM PAGE 1

public services and fuel government operations.

Allocations from gross revenue sources can be quite complex. The Tax Commission compiles all of the details into a meticulous Apportionment of Statutory Revenues spreadsheet that contains 67 lines, 16 columns and 29 finely-detailed footnotes.

Oklahoma's two biggest sources of revenue are personal income taxes and sales taxes, but the total of those collections is much larger than what is appropriated by the Legislature from General Revenue.

Income Taxes

Gross personal income tax collections during Fiscal Year 2012 were \$3.31 billion, with \$2.04 billion, or 61.8 percent, deposited into the GRF.

Refunds and payments to Oklahoma businesses in the Quality Jobs Program come right off the top.

To make it more confusing, during some months money is transferred to the corporate income tax fund to cover for deficits due to payment of refunds to Oklahoma businesses. That money is repaid in subsequent months.

From the remainder of personal income tax collections, 85.66 percent goes to the GRF, 5 percent to the Teachers Retirement System, 8.34 percent to the Education Reform Revolving Fund and 1 percent to the Ad Valorem Reimbursement Fund.

In addition, from the portion of the income tax placed in the GRF, a total of \$297.4 million is taken in monthly, one-twelfth increments with \$292.4 million for the Rebuild Oklahoma Access and Driver Safety (ROADS) Fund, \$2 million for the Oklahoma Tourism and Passenger Fund and \$3 million for the Public Transit Revolving Fund.

Sales Taxes

During the last fiscal year, gross sales tax collections were \$4.04 billion with only \$1.83 billion, or 45.3 percent, placed into General Revenue.

The biggest deduction from sales tax is the amount collected by the state on behalf of cities and counties. The tax commission acts as a collections agent for the political subdivisions on about 46 percent of gross sales tax collections.

After the cities and counties are paid and refunds are made, 83.61 percent of the remainder goes to the GRF, 5 percent to Teachers Retirement, 10.46 percent to the Education Reform Revolving Fund, 0.56 percent to the Oklahoma Tourism

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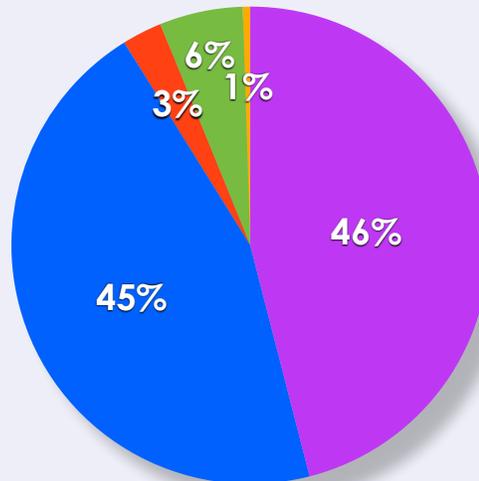
Dividing the Dollars

Sales Tax Allocation

- Cities/Counties
- General Revenue
- Teachers Retirement
- Education Fund
- Tourism

Sub-allocations:

- 0.56% - Capital Improvements Fund
- 0.31% - Revolving Fund
- 0.06% - Historical Society Capital Fund

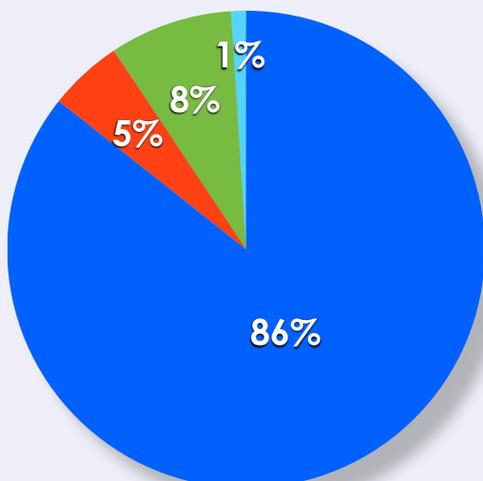


Personal Income Tax Allocation

- General Revenue
- Teachers Retirement
- Education Fund
- Ad Valorem Fund

Additional Subtractions:

- Refunds
- Transfers to Corporate
- \$292.4 million - ROADS Fund
- \$2 million - Tourism
- \$3 million - Public Trans



Source: Oklahoma Tax Commission



Demystifying

FROM PAGE 4

Capital Improvement Revolving Fund, 0.31 percent to the Oklahoma Tourism Revolving Fund and 0.06 percent to the Oklahoma Historical Society Capital Fund.

The tax commission also assesses a fee on sales tax collections for cities and counties, which is placed in its revolving fund.

The Rest

Personal income tax and sales tax allocations are the largest sources of state funding, but they aren't the most labyrinthine of the earmarks from some six dozen taxes and fees as they are distributed to special funds.

Of the 67 tax and fee categories listed on the apportionment spreadsheet, 31 provide no money to General Revenue.

The 16-cent per gallon tax on gasoline and 13-cent per gallon tax on diesel are among the largest of those funds.

Money collected from those taxes is sent to transportation-related funds with the State Transportation Fund receiving just less than two-thirds.

Much smaller percentages of the fuel taxes are assigned to cities and towns, county bridges, county highways, the High Priority Bridge Fund and the Statewide Circuit Engineering District Revolving Fund.

Footnotes specify calculations used to send fuel tax money to the Oklahoma Aeronautics Revolving Fund, Corporation Commission Storage Tank Regulation Revolving Fund, Oklahoma Turnpike Authority and others.

Perhaps the most convoluted allocation is motor vehicle collections. The tax commission's apportionment spreadsheet contains eight footnotes and specifies 11 different funds for motor vehicle collections.

Motor vehicle allocations range from 36.2 percent for school districts, to 29.84 percent for General Revenue,

to 0.03 percent for the Wildlife Conservation Fund.

The footnotes specify specific dollar amounts be allocated to various funds, including \$4 of each license renewal fee to the Trauma Care Assistance Revolving Fund and "monies in excess of \$1,216,000 from permit and overweight truck permit fees shall be apportioned to the Weigh Station Improvement Revolving Fund."

Some might think of state finances as a Rube Goldberg machine, and that might be true. A review of the state's apportionment schedule brings to mind the quote often misattributed to Otto von Bismarck that "those who enjoy laws and sausages should see neither being made." The past decade's shift toward more transparency has helped reveal a product cobbled together over decades by necessity, creativity and bureaucracy. However, the sausage-makers might now decide that the allocation of Oklahoma's tax revenue is unnecessarily complex and find a way to demystify it for all.

Miller elected to national leadership posts

Long considered an example of effective and efficient management, Oklahoma's state treasury now has a formal position of leadership among the nation's state treasurers.

In September, during the 2012 annual conference of the National Association of State Treasurers (NAST) in Anchorage, Treasurer Ken Miller was elected by his peers to a position on the NAST Executive Committee and the NAST Foundation Board of Directors.

Miller's responsibilities on both panels will begin in January 2013.

As the southern region vice president on the executive committee, Miller is one of eight members who will provide leadership to the association of the nation's state treasurers.

The executive committee works with the association's president to provide policy direction. It also acts on urgent matters until they can be addressed by the full membership.

As one of seven members of the NAST Foundation Board, Miller will work with corporate affiliates of the 501(c)(3) devoted to professional development for state treasury operations.

State Treasurer's staff receives ethics training

Employees of the Office of the State Treasurer have received training in Oklahoma ethics rules.

In September, all Treasury employees attended a two-hour seminar presented by Lee Slater, former election board secretary and renowned ethics law expert.

Treasurer Ken Miller has made the ethics training mandatory for all of his staff.



Comparing August gross receipts and the General Revenue Fund

Comparison of the Treasurer's September 6 Gross Revenue report and State Finance's September 11 General Revenue Fund (GRF) report illustrates key differences.

August gross receipts totaled \$819.6 million, while the GRF received \$386.4 million or 47.2% of the total.

The percentage of monthly gross revenue going to the GRF varied from 34.9% to 56.4% during the past 12 months.

From August gross receipts, the GRF received:

- Personal income tax: 63.2%
- Corporate income tax: 49.1%
- Sales tax: 45.6%
- Gross production-Gas: 1.1%
- Gross production-Oil: None
- Motor vehicle tax: 30.2%
- Other sources: 49.5%

August GRF allocations fell below the official estimate by \$17 million or 4.2 percent. In July, collections topped the estimate by \$20 million or 5.4 percent.

For the month, insurance premium taxes totaled \$6.2 million.

Tribal gaming fees generated \$10.7 million during August.

Oil and gas again pull collections into negative territory

For the third time in the past six months, collections to the Oklahoma Treasury fell below prior year receipts in August, State Treasurer Ken Miller announced as he released the

monthly gross receipts to the treasury report.

As with the two prior negative months, markedly lower gross production tax collections are the cause, Miller said.

“Spending by businesses and consumers continues to be strong,” Miller said. “Unfortunately, the growth in that area is insufficient to keep the

overall trend from dipping into negative territory again.”

Gross collections for August are 2.8 percent below August of last year.

Collections on oil and natural gas production are 53.7 percent lower for the month, while sales tax collections are up by 10.4 percent.

Gross production collections have been lower than the prior year for nine consecutive months, which Miller said

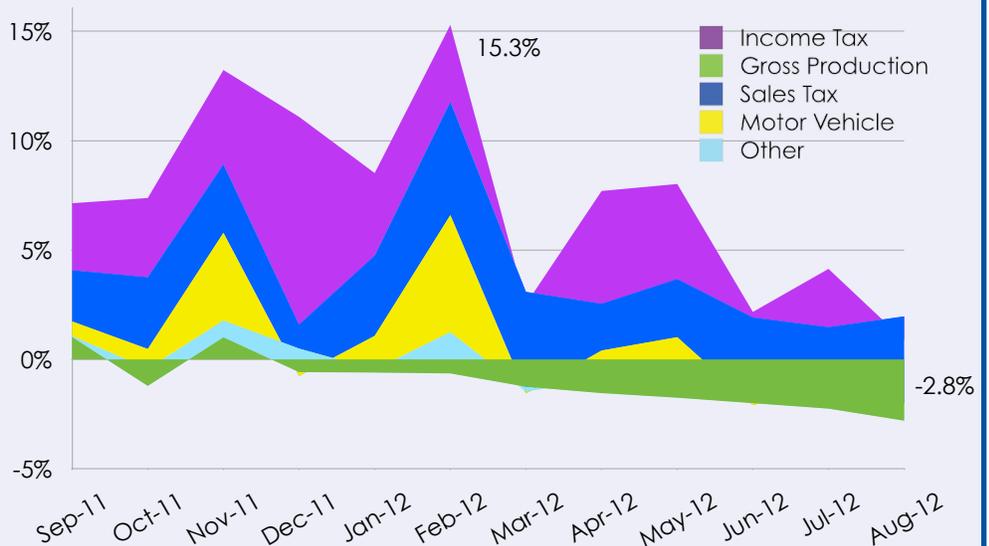
presents a somewhat skewed picture of the Oklahoma economy.

SEE REVENUE PAGE 7

“I remain confident in the ability of Oklahomans to manage through any obstacles that may come our way.”

Monthly Gross Receipts vs. Prior Year

September 2011 - August 2012
Percentage change



Source: Office of the State Treasurer



Revenue

FROM PAGE 6

“Low unemployment continues to strengthen personal income which in turn continues to boost purchases, but weak gross production collections drag down an otherwise healthy report,” he said.

August personal income tax collections are also lower than the prior year for a second time in three months. As with June collections, the downturn is in withholding taxes remitted by businesses for hourly and salaried employees. Also as with June, withholding remittances for August are 6.2 percent lower than the prior year.

However, Oklahoma Tax Commission officials believe the drop in withholding taxes is an anomaly due to remittance deadlines set by the Internal Revenue Service.

Mixed signals

Leading economic indicators are sending mixed signals. Oklahoma’s Business Conditions Index was in positive territory at 53.6 in August, compared to 52.7 in July. The state’s consumer confidence index was listed at a relatively weak 42.3, even though it rose from July’s rate of 37.5.

“These numbers are a bit of head scratcher,” Miller said. “Typically good retail numbers coincide with better consumer confidence data, but we are seeing conflicting measures this month. Sales reports appear to indicate higher confidence than is measured by the survey.”

Oklahoma’s low unemployment rate of 5.1 percent in August compares to a national rate of 8.1 percent and shows the state’s relatively positive

position. The Oklahoma City metro area continues to top the list of lowest jobless rates among large U.S. cities with the July rate set at 4.7 percent.

Miller said state treasury officials will be paying close attention to overall collections in the coming months.

“For 10 of the past 12 months, we’ve seen the drop off in gross production collections accelerate while sales and income collections have kept growing,” he said. “But because of the large impact of the energy industry on the state economy, it’s important to keep an eye out for spillover effects that may be

attributable to weakness in oil and gas collections.”

Miller said consumers today appear to be more uncertain about the future due to the state’s drought, concerns with Washington’s inability to manage federal fiscal issues, the impending elections and a weakened China and Europe.

“I remain confident in the ability of Oklahomans to manage through any obstacles that may come our way,” he said. “It’s the external economic, political and fiscal issues beyond our control that can give one pause.”

State unemployment rises in August

The Oklahoma unemployment rate rose by 0.2 percentage points for a second consecutive month to 5.1 percent in August, according to the Oklahoma Employment Security Commission (OESC).

Oklahoma’s rate in August compares to 4.9 percent in July and 6.3 percent in August 2011.

The U.S. unemployment rate in August

was set at 8.1 percent by the Bureau of Labor Statistics.

In spite of the state’s higher unemployment rate, Lynn Gray, chief economist for OESC, said there is a silver lining in the report.

Gray said the monthly survey indicates the state’s labor force included people resuming a search for work after being jobless for an extended period.

OKLAHOMA	State Unemployment			
	Unemp. rate*	Labor force*	Employment*	Unemployment*
Aug '12	5.1%	1,798,940	1,707,750	91,190
Jul '12	4.9%	1,795,720	1,707,300	88,420
Jun '12	4.7%	1,794,260	1,709,300	84,960
May '12	4.8%	1,791,380	1,706,070	85,320
Apr '12	5.0%	1,789,150	1,699,870	89,280
Mar '12	5.4%	1,787,380	1,690,470	96,910
Aug '11	6.3%	1,769,890	1,658,410	111,480

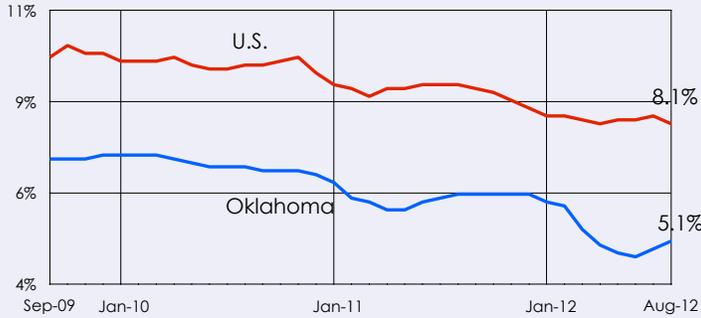
* data adjusted for seasonal factors Source: OESC



Economic Indicators

Unemployment Rate

September 2009 – August 2012



Source: Bureau of Labor Statistics

Oklahoma 12-Month Gross Receipts

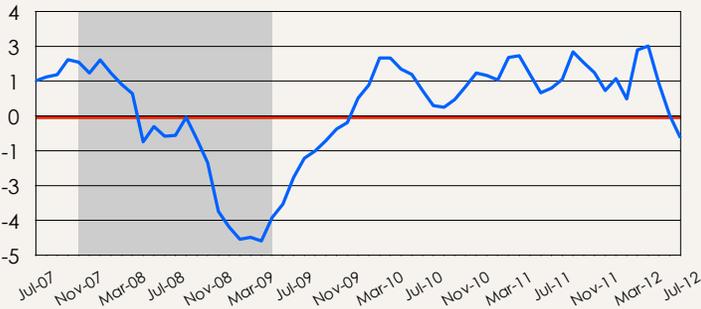
September 2008 - August 2012
(in millions)



Shaded area denotes U.S. recession

Source: Office of the State Treasurer

Leading Index for Oklahoma

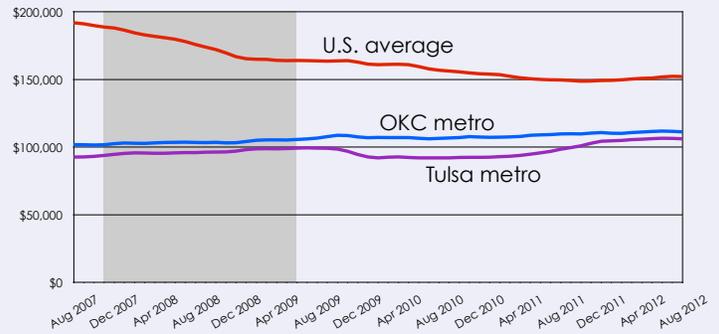


This graph predicts six-month growth by tracking leading indicators of the state economy including initial unemployment claims, interest rate spreads, manufacturing and earnings. Shaded area denotes U.S. recession

Source: Federal Reserve

Real Estate Prices

August 2007 – August 2012



Shaded area denotes U.S. recession

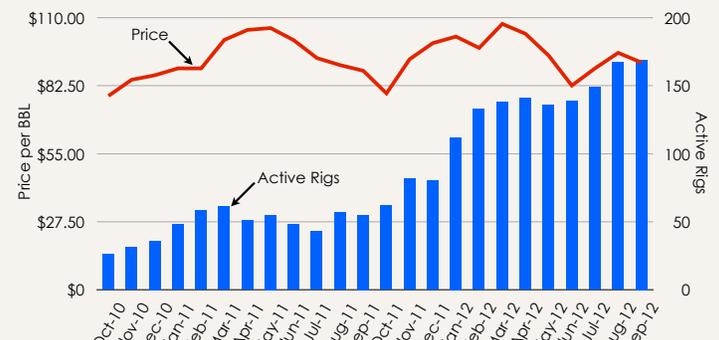
Source: Zillow Home Value Index

Oklahoma Natural Gas Prices & Active Rigs



Source: Baker Hughes & Bloomberg

Oklahoma Oil Prices & Active Rigs



Source: Baker Hughes & Bloomberg