



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

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

Better bond balancing

Oklahoma and Washington D.C. are rarely in synch, as demonstrated by the divergent paths of the state's fiscal health compared to the federal government's.

While Congress and the President head toward the fiscal cliff and it's looming cuts and tax increases, Oklahoma policymakers are examining the potential for tax reductions and additional investments in infrastructure.

The national debt is growing at a rapid pace, increasing by about \$6.6 billion per day, and at a rate higher than growth in the national economy. Now topping

\$16 trillion, U.S. debt equals about 107 percent of the nation's gross domestic product.

Oklahoma's state debt, on the other hand, is shrinking. Between January and December of this year, the state's tax-supported debt dropped from \$1,988.6 million to \$1,954.1 million – a decrease of \$34.5 million or 1.7 percent.

Oklahoma's tax-supported debt of \$1.95 billion is a little more than one percent of the state's GDP.

“Repaying Oklahoma's tax-supported debt would take about one penny of every dollar generated by the state economy in a year.”

Repayment of the federal debt would take \$1.07 for every dollar generated by the total U.S. economy in a year.

In Oklahoma, repayment of state government's tax-supported debt would take a little more than

one penny of every dollar generated by

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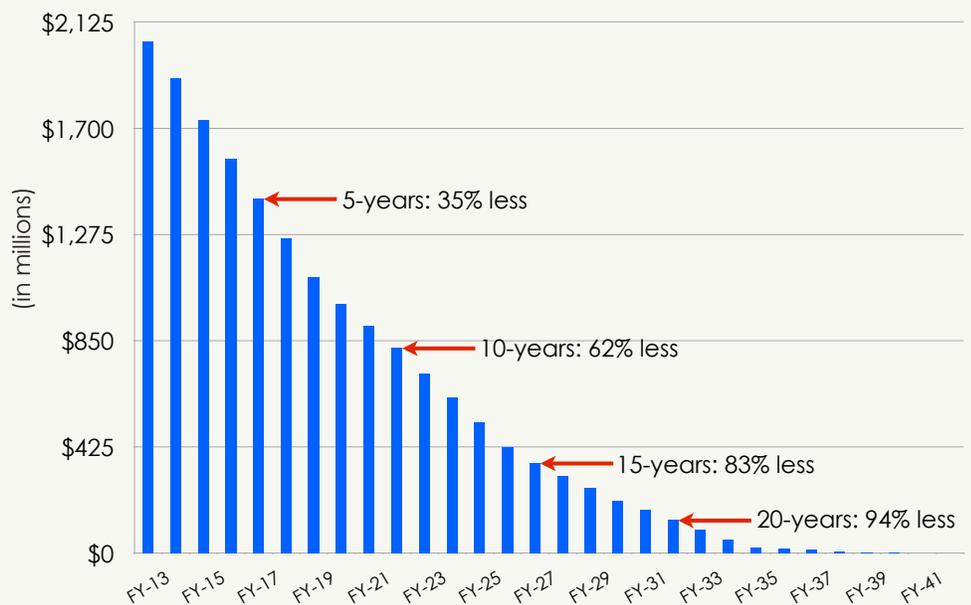
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Oklahoma's shrinking tax-supported debt

Fiscal Years 2013 – 2041



Source: Oklahoma State Bond Advisor's Office



Treasurer's Commentary

By Ken Miller, Ph.D.

In defense of conservatism

If all your friends jumped off a fiscal cliff, would you do it too? The answer from Senator Tom Coburn and Representative Tom Cole is no.

Though staunchly opposed to increasing tax rates, both men recently made national headlines; Coburn for his willingness to increase receipts by eliminating loopholes and preferential

tax treatments and Cole for suggesting Republicans accept a compromise solution ensuring 98-percent of Americans avoid a tax hike.

Grover Norquist claims both positions defy the anti-tax pledge, the revenue-neutral standard for tax policy changes made famous by his Americans for Tax Reform advocacy group.

Until now, ideology-based conservatives like Norquist have defined conservatism by their own terms. Absurdly, yet expectedly,

the conservative credentials of both Coburn and Cole are under fire. Such reality-based conservatives who dare step out, or in it, get branded with the M-word to be thrashed about in the public square clothed in the “moderate” label regardless of the fit.

Norquist lambasted Coburn saying, “he lied his way into office.”

Coburn struck back by defining the difference between cheap and courageous conservatism, stating the former is that of rhetoric, pledges and pandering while the latter is that of truth, action, solutions and sacrifice.

Oklahoma also has ideologically-driven interest groups that seek their own definition of

conservatism.

One such group, the Oklahoma Council of Public Affairs, has upped the ante on the Norquist gold standard where anything short of complete elimination of the state’s largest source of revenue is deemed not conservative.

“Reality-based conservatives get thrashed about in the public square clothed in the ‘moderate’ label regardless of the fit.”



Is it not conservative to be cautious in our approach to needed income tax reduction, to protect the state credit rating, to pay our debts and to ensure sufficient funding for core services with a diversified and dependable revenue structure?

In Oklahoma, those who say cuts in tax rates should be offset by cuts in spending and by broadening the base – ironically the very position heralded as conservative at the federal level – are burnished with the moderate brand.

Perhaps one can find some humor in the dictionary definition of conservative as “moderately cautious.” Its synonyms – reasonable, temperate and judicious – are descriptors that most would normally appreciate. But for us on the right, the term “moderate” is decidedly negative and misdirected at reality-based conservatives who dare question the ideological.

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Commentary

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Even with a consistent record of cutting taxes and spending, this conservative economist was dinged for questioning a study by Arduin, Laffer and Moore and even jabbed in a *Wall Street Journal* editorial for issuing a “bogus” opposing report.

Of course, no such report existed and the editorial was written by Stephen Moore, who along with Laffer was being paid by OCPA for services rendered. Seemingly forgotten was that our policy positions are in alignment much more often than not.

Recently, the *Oklahoman* urged “caution in cutting the income tax without offsets,” siding with the more “moderate

voices.” Their use of the M-word may be correct according to Webster’s.

But in politics such characterization scores a win for the agenda-driven ideologues who seek to redefine conservatism, which begs the question: moderate compared to what?

Ronald Reagan, the deserved standard bearer of conservative principles, would no doubt be attacked in today’s political climate since he failed the revenue-neutral test by signing several tax increases.

The fact that he greatly lowered income tax rates overall and shrunk the highest marginal rate from 70 to 28 percent would not be good enough.

When reminded of this inconvenient fact, Republican Senator Jon Kyl said, “Reagan was in a situation where he had to compromise in order to get some things done.” Gee, with the pending fiscal cliff and three years with no federal budget, I guess we’re not there yet.

Though the 100-percent litmus test currently shows little sign of abatement, with principled statesmen like Coburn reclaiming the real(ist) definition of conservatism, perhaps soon we will be able to focus our energy on the 99-percent where conservatives agree rather than the 1-percent where we do not.

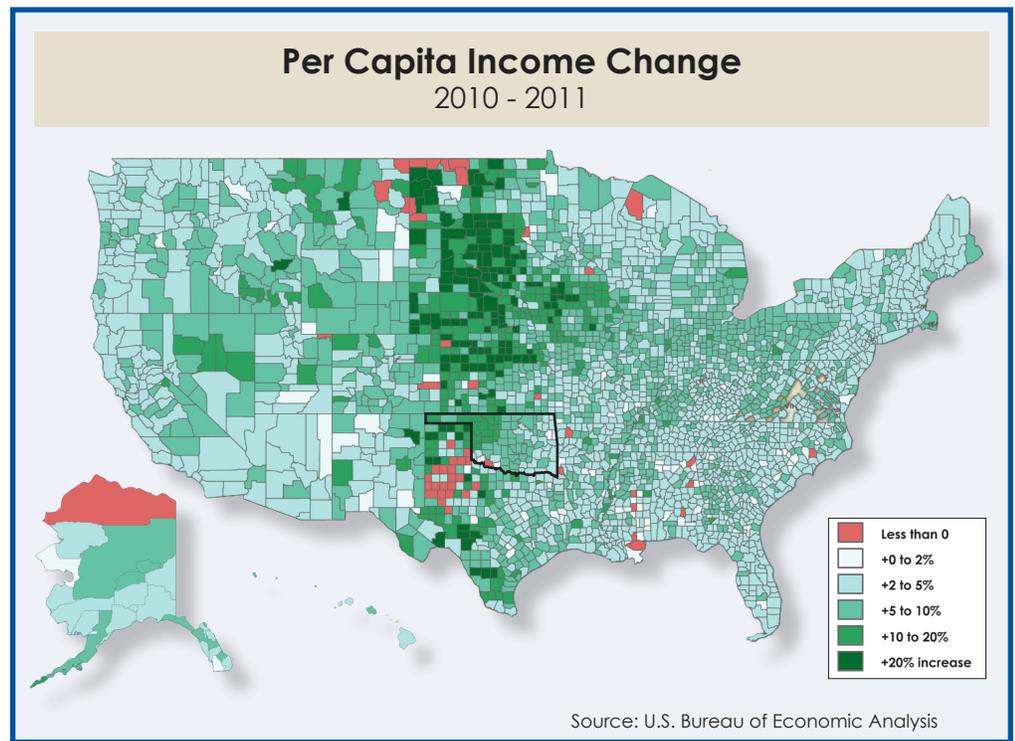
Per capita income rises

Personal incomes increased in every metropolitan area and most counties in the United States last year, according to a report from the U.S. Bureau of Economic Analysis (BEA) released this week.

In the nation’s metropolitan areas, personal income grew an average of 5.2 percent, compared to growth of 3.9 percent in 2010.

The BEA said this is the first time incomes have increased in all 366 metropolitan areas since 2007, prior to the Great Recession.

Income growth in both the Oklahoma City and Tulsa metropolitan areas beat the national average with increases of 7.6 percent from 2010 to 2011.



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Balancing

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the state economy in a year.

The federal government borrows money to pay its ongoing expenses like government worker payroll, public assistance, foreign aid and national defense. In fact, for every dollar the federal government spends, it has to borrow about 40 cents to make ends meet.

In Oklahoma, debt is only incurred for capital improvements – such as roads, bridges and public buildings. The state’s fiscally conservative constitution prohibits debt from being used to fund payroll or other ongoing expenses in Oklahoma state government.

Making payments

Over the past few years, a number of state bond issues were refinanced to take advantage of historically low interest rates. Those refinancing projects resulted in total savings of almost \$11 million in net present savings over the life of the tax-supported loans.

At current repayment rates, Oklahoma’s existing public debt will be reduced by 62 percent within 10 years and will be all but eliminated in less than 25 years.

According to Jim Joseph, Oklahoma’s state bond advisor, the annual payments made to retire the state’s debt, including interest and principle, amount to about four cents of every dollar appropriated by the Legislature from the General Revenue Fund.

At the federal level, there is no debt retirement. The Administration estimates it will take eight percent of total federal spending in the coming year simply to pay the interest on the national debt,

and that is a conservative estimate. The national debt, itself, is projected to keep growing.

Public pensions

Oklahoma’s balance sheet is not without its challenges. The state has historically underfunded and overpromised pension benefits, and just a few years ago Oklahoma ranked among the worst funded states on pension liability per capita.

Reforms enacted over the past two years have improved the funded status of the state’s pension plans, reducing the collective unfunded liability from \$16.2 billion to \$10.8 billion. Investment research firm Morningstar, Inc., ranked Oklahoma as having the second worst-funded public pensions in 2009, with a collective funded ratio of just 57.7 percent. The firm’s 2011 rankings placed Oklahoma 33rd among the 50 states, with a collective funded ratio of 67 percent.

The improvement is notable, but the state falls short of the minimum recommended funded status of 80 percent and the significant liabilities are still a negative to credit ratings agencies. Additionally, new government accounting standards will soon require pension liabilities, which have traditionally been treated differently than other types of debt, be placed on equal footing with other long-term obligations. The new standards may require lower assumptions on investment returns and shorter amortization periods, which in turn would worsen the reported funded status of the plans.

Debt discussion

Historically low interest rates, Oklahoma’s low debt ratio and a long list of expensive infrastructure needs

have policymakers deliberating whether the state should take on additional debt to finance those needs over time.

Bond issues proposed, but not enacted, last session included funds to pay for structural repairs to the State Capitol, finish the American Indian Cultural Center in Oklahoma City and help launch a pop culture museum in Tulsa. Other capital improvement needs brought before lawmakers included a new headquarters for the state Veterans Affairs Department and a new facility required for the state medical examiner’s office to regain its national accreditation.

Joseph has said that Oklahoma could issue as much as \$300 million in new bond debt without it affecting the state’s credit rating. Uncertainty over the impact of changes in federal tax and spending policies, disagreement over spending priorities, and political concerns that Oklahomans wouldn’t distinguish between the state’s borrowing and the federal government’s led to hesitancy among some to further obligate the state and ultimately, inaction. However, Joseph cautions policymakers to consider the cost of deferring needs until they are worse and more expensive.

Other discussions on debt this session may involve how to further improve Oklahoma’s balance sheet. Another idea left on the table last session was to commit a portion of surplus funds or one-time sources of funds to repayment of the state’s debts, including pension liabilities. The state’s decision to take on, or pay off, debt should be a careful one, arrived at after weighing the long-term needs and costs of the state’s priorities. That Oklahoma’s policymakers take the issue of state debt seriously is a good thing; if only Congress felt the same burden.



Q & A with the state bond advisor

Q: How does the state determine what debt is appropriate, and is there any one entity or state official responsible for approval or management of state debt?

There is no formal process in Oklahoma to determine how much tax-backed debt can or should be issued. The State Bond Advisor prepares an annual report that includes detailed information on State debt issuance for each calendar year, including overall gross and net tax-backed debt outstanding.

The Oklahoma Legislature typically identifies and authorizes bond projects and determines how such bonds will be secured. The State Bond Advisor provides general oversight of the management of Oklahoma's debt, with day-to-day administration provided by the issuing entity.

Q: What is your position on responsible use of debt by the state, including the ideal balance or range of debt that the state could carry while still maintaining its favorable credit ratings?

I believe debt is an administrative tool

of government that, if used responsibly, can improve the provision of services to the residents of our state. However, debt is not always the answer to an identified capital need. For example, an agency might be able to set aside a certain amount of money each year to replace needed vehicles or equipment, rather than waiting until the need is urgent and then issuing bonds.

Some major maintenance needs, equipment replacement, and facility upgrades are simply too large to address efficiently with a pay-as-you-go approach. The state needs to be cognizant of the burden created by the over-issuance of bonds and the impact such borrowing may have on our credit ratings.

At this time, Oklahoma's debt levels are not a concern to the rating agency credit analysts and, in fact, additional borrowing could be undertaken without jeopardizing our existing ratings. There are a number of widely recognized debt ratios that demonstrate that Oklahoma has a lower than average debt burden. These can be useful when considering the amount of additional borrowing that

can be issued and efficiently managed.

Q: Should it be a policy goal of the state to be debt-free? Why or why not?

It is not reasonable to expect a governmental entity as large as the State of Oklahoma to be completely free of debt. As noted above, there are certain capital facility and equipment needs that will simply exceed our ability to fund them on a pay-as-you-go basis. Deferring these capital needs because current funding is not available will inevitably lead to inefficient operations and, ultimately, higher replacement costs.

Q: Are Oklahoma's restrictions on incurring state debt stronger or weaker than average?

I believe that Oklahoma has reasonable restrictions on the approval and issuance of debt. Unquestionably, it would be convenient to have standing authority to issue general obligation bonds up to a certain dollar amount. That authority would allow for more consistent funding of the state's essential infrastructure needs.

Meet Jim Joseph

The state bond advisor provides advice and assistance to the executive and legislative branches on matters relating to capital planning, debt issuance and debt management. He also assists issuers in selecting and structuring bonds approved by the Council of Bond Oversight, a five-member board that considers requests for financing from state government entities.

Duties include working with state agencies and institutions of higher education to market and sell bonds and approving related fees and expenses. The advisor also represents the state's interest before bond rating agencies and credit enhancement providers.

James C. Joseph has served as Oklahoma State Bond Advisor for

more than 20 years. His professional experience includes service as a financial advisor, credit analyst and investment banker. A native of Oregon, he received his Bachelor's Degree in Political Science from Oregon State University and his Master's Degree in Public Administration from Syracuse University. Jim and his wife, Wendy, have two sons, Tyler and Riley.



Gross receipts & General Revenue compared

The Treasurer's November 5 Gross Revenue report and the Office of Management and Enterprise Services' November 13 General Revenue Fund (GRF) report contain key differences.

October gross receipts totaled \$913.47 million, while the GRF received \$439 million or 48.1% 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 October gross receipts, the GRF received:

- Personal income tax: 64.6%
- Corporate income tax: 66.3%
- Sales tax: 45.5%
- Gross production-Gas: 23.6%
- Gross production-Oil: None
- Motor vehicle tax: 32.1%
- Other sources: 41.5%

October GRF allocations topped the estimate by \$38.9 million or 9.7 percent. In September, collections were above the estimate by \$19.3 million or 3.7 percent.

For the month, insurance premium taxes totaled \$173,674.

Tribal gaming fees generated \$10.7 million during October.

Revenue up sharply in October in spite of electoral uncertainty

October was another good month for Oklahoma's economy, as measured by the monthly gross receipts to the treasury report issued today by State Treasurer Ken Miller.

In fact, compared to the same month of the prior year, collections rose by nine percent, the highest percentage in eight months.

Miller said the positive October report was driven primarily by personal income tax collections, up by more than 20 percent, and better gross production numbers, which earlier this year had fallen as much as 54 percent below prior

year collections.

"In spite of the uncertainty surrounding the national elections and the impending fiscal cliff, Oklahoma's economy is showing marked improvement," Miller said.

"After leveling off for some six months, revenue collections have resumed their positive trajectory. Last month, we thought we had

turned a corner with extraction taxes and it now appears we have."

October gross production collections, **SEE REVENUE PAGE 7**

“Oklahoma's economy is showing marked improvement.”

Monthly Gross Receipts vs. Prior Year

November 2011 - October 2012
Percentage change



Source: Office of the State Treasurer



State employment and unemployment rise in October

Oklahoma’s seasonally-adjusted unemployment rate rose to 5.3 percent in October, according to the Oklahoma Employment Security Commission. The reason for the hike is that labor force participation increased by more than employment.

In spite of the increase, 6,760 jobs were added in the state during the month. The number of jobless Oklahomans went up by 1,700 from September.

The U.S. jobless rate rose to 7.9 percent for the month.

| OKLAHOMA | Unemp. rate* | Labor force* | Employment* | Unemployment* |
|----------|--------------|--------------|-------------|---------------|
| Oct '12 | 5.3% | 1,821,960 | 1,725,880 | 96,080 |
| Sep '12 | 5.2% | 1,813,490 | 1,719,120 | 94,380 |
| Aug '12 | 5.1% | 1,799,250 | 1,707,850 | 91,400 |
| 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 |
| Oct '11 | 6.3% | 1,779,230 | 1,666,340 | 112,890 |

* data adjusted for seasonal factors

Source: OESC

Revenue

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while still below prior year numbers, were down by a little more than 7 percent from the prior year. If not for the late deposit of \$8.32 million in gross

production collections from October of last year, collections from that source would be down 17.3 percent from the prior year. Even so, that would be a significant improvement from the last several months.

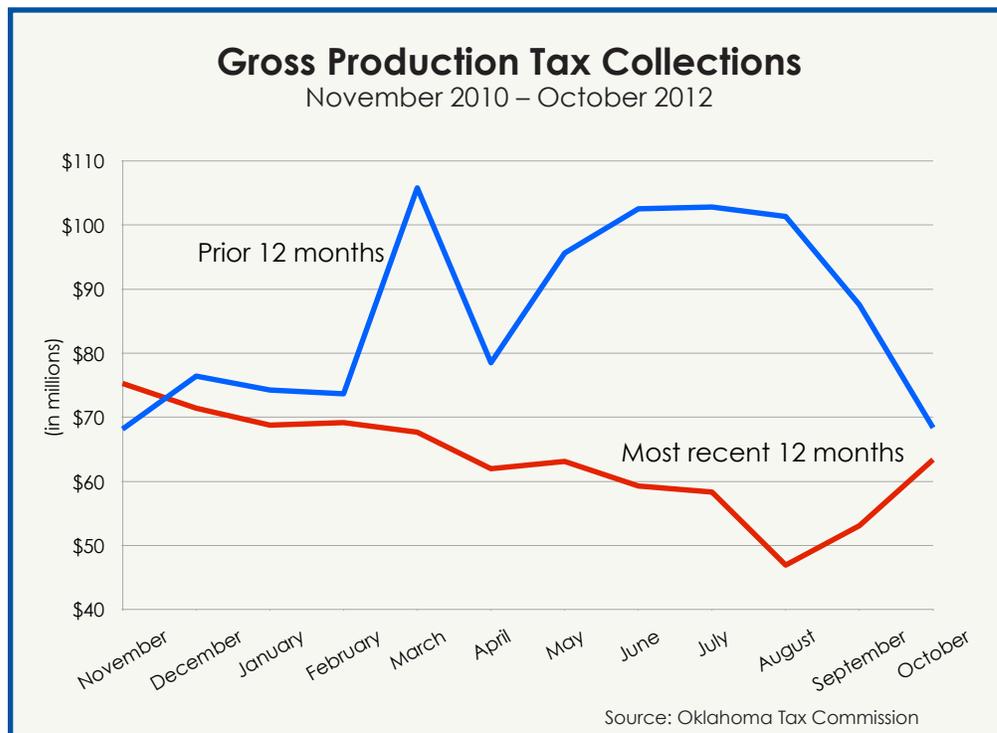
The state’s other major revenue streams – sales and motor vehicle taxes – also grew during October, up four percent and almost 12 percent respectively.

More positive signs

The Business Conditions Index for Oklahoma improved in October. The leading economic indicator rose to 63.3 from 56.6 in September. Numbers above 50 mean growth is expected. The weakest number in the survey, while still in positive territory, is in the area of employment due to some reports of shortages of skilled workers.

Oklahoma’s seasonally-adjusted unemployment rate rose to 5.3 percent in October, according to the Oklahoma Employment Security Commission. The reason for the hike by 0.1 percentage points from September is that labor force participation increased more than employment.

During the month, 6,760 jobs were added in the state and the number of jobless went up by 1,700.

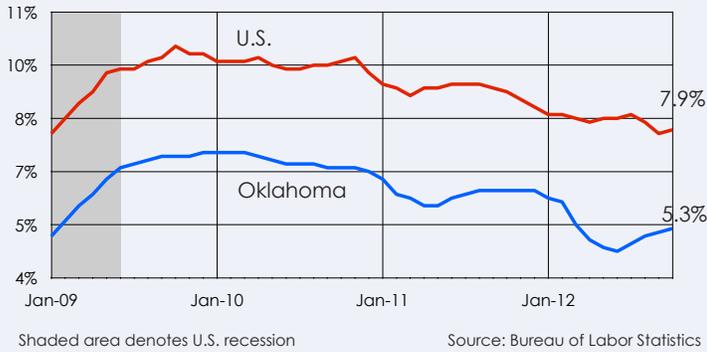




Economic Indicators

Unemployment Rate

January 2009 – October 2012

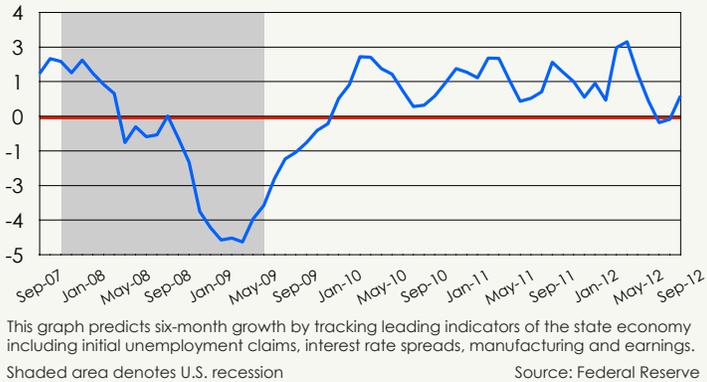


Oklahoma 12-Month Gross Receipts

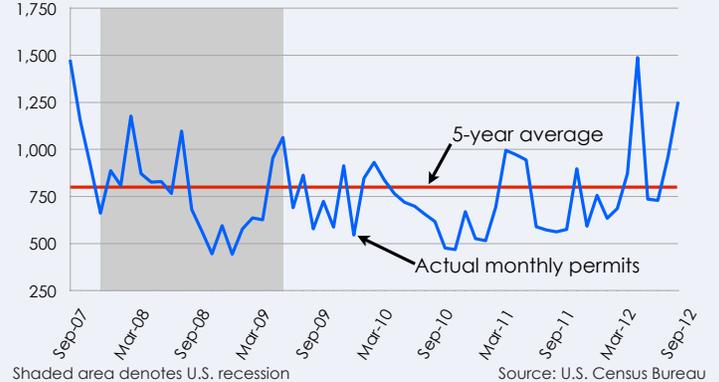
October 2008 - October 2012 (in millions)



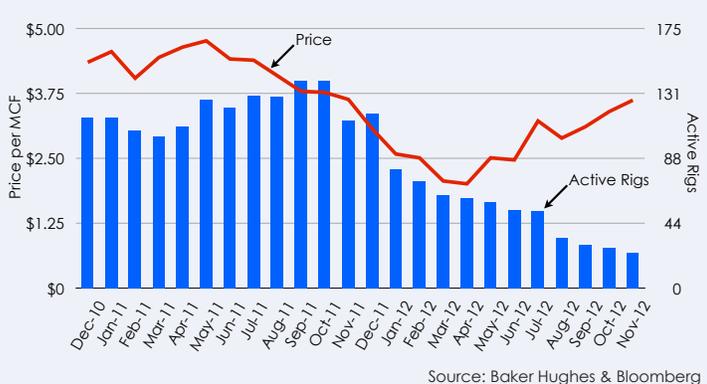
Leading Index for Oklahoma



Oklahoma Residential Building Permits



Oklahoma Natural Gas Prices & Active Rigs



Oklahoma Oil Prices & Active Rigs

