With the advent of each legislative session loom many proposals both large and small; some bold and some less so, but all usually accompanied by funding requests.

There will be noble causes found in the thousands of bills filed this session. Surely the road to big government was paved with good intentions. But in Oklahoma, as with any legislative body, the biggest challenge is funding a budget that taxpayers can afford.

Policymakers learned this week there will be a slight increase in funds available for next year’s budget. This news brings pressure from agencies to restore budgets to pre-recession levels. But after several years of crisis budget management, the rosier revenue projection presents another opportunity to reset budget practices, reform the state’s tax code, and make long-term investments.

The budget process has long been in need of improvement, with some fixes more difficult than others. Refinements like reducing the number of dedicated funding streams siphoned to many sources outside of the appropriations process will prove difficult, but stopping dependence on non-recurring funds to pay for recurring expenses should be easier.

With revenues returning to pre-recession levels, weaning the budget from non-recurring funds should not prove as difficult as it would in times of fiscal stress.

**Tighten spending limit**

Another simple improvement to constrain government spending is to cut in half the state’s constitutional spending limit. Put in place in 1985 to limit government spending to no more...
Fixing a broken system

Oklahoma is moving forward with a pro-growth agenda. Industry leaders, local stakeholders, and community banks have modeled common-sense best practices. Governmental leaders have pursued a focused legislative strategy to drive down the cost of doing business and promote a climate that makes Oklahoma attractive to job creators. We have much to be proud of.

Now, it’s time to ask ourselves, “How do we sustain our forward momentum?”

We have to put the brakes on the runaway cost of workers’ compensation insurance. Meaningful, comprehensive workers’ compensation reform is the single most important policy component to a brighter economic future for Oklahoma. The change must be thoughtful, aggressive, and wholesale.

The results of Governor Fallin’s 2012 business climate survey, “Fallin for Business,” are telling. This survey solicited input from nearly 5,000 business leaders statewide. Respondents sent a clear message—the biggest roadblock to job growth in Oklahoma now and in the future is the cost of workers’ compensation insurance.

Oklahoma’s system ranks as one of the most expensive in the nation for employers. One recent study by the Oregon Department of Consumer and Business Services placed Oklahoma’s premium, $2.77 per $100 of payroll, at 147% of the national median. Our costs are the sixth highest among all 50 states.

For comparison, premium rates are $1.19 in Arkansas, $1.60 in Texas, and $1.54 in Kansas. Business professionals across Oklahoma lament that we are simply not competitive with our surrounding states. And they are absolutely right.

We are one of the only states in the nation using a judicial system to resolve workers’ compensation cases. It is a fundamentally adversarial system. We pit employees against employers in a court room. The result has been disastrous for business, for Oklahoma, and most importantly, for injured workers.

Our workers’ compensation system is broken. It doesn’t help injured workers get quality care, get it quickly, and get back on the job site. Rather, we incentivize trial lawyers and a few bad actors to game the judicial system. They drag cases out and drive up the cost of awards. Meanwhile, Oklahoma pays the price.

In recent years, the legislature passed reform measures only to see them undermined by adverse court decisions. We have nibbled around the edges of a system that is, by its nature, resistant to positive change. The frank reality is this—recent reforms have produced a marginal benefit; our business owners say they’ve seen no meaningful change.

“One thing is clear — the status quo is unacceptable.”

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So where do we go from here?
We want to look at successful states like Arkansas, where businesses and employees work together in an administrative system to resolve disputes. We should examine arbitration, explore restrictions on extravagant legal fees, and look at alternatives for responsible employers to self-insure under narrow restrictions and guidelines. All options are on the table.

One thing is clear—the status quo is unacceptable. I am optimistic we will rise to the challenge, and I look forward to working closely with Speaker Shannon, Governor Fallin, and stakeholders across Oklahoma in the coming session on this important issue.

Senator Brian Bingman, R-Sapulpa, is President Pro Tempore of the Oklahoma State Senate.

### Bright bill ideas for Session 2013

- **Tighten spending limit** – Reduce by half the state’s constitutional spending cap. The balanced budget provision currently limits legislative appropriations for any fiscal year to no more than 12% over the previous year’s appropriations, adjusted for inflation.

- **Dedicate surplus funds to debt** – Direct a portion of surplus funds or one-time sources of funds to repayment of the state’s debts, including pension obligations.

- **Maintain assets** – Authorize a responsible bond package for Oklahoma’s long-term capital needs.

- **Modernize pensions** – Adopt a portable pension benefit option for future employees.

Opinions and positions cited in the Oklahoma Economic Report™ are not necessarily those of Oklahoma State Treasurer Ken Miller or his staff, with the exception of the Treasurer’s Commentary, which of course, is the viewpoint of the treasurer.
Eliminating tax-exempt bonds is on the table in Washington

Another potential victim of the fiscal cliff

Taxpayers in Oklahoma save an average of 25 to 30 percent on interest costs by using tax-exempt bonds as a financing tool as opposed to taxable bonds. Because the earnings on the bonds paid to investors are not taxed, lower interest rates are paid.

Those lower interest rates save literally billions of dollars per year in lower taxes. In fact, tax-exempt bonds are the primary mechanism that states, counties, cities and school districts across the country use to finance highways, streets, bridges, water systems, school buildings and buses and many other public infrastructure projects.

This critical tool is now in danger of being eliminated, as Congress and the President are considering plans to either eliminate it or place a cap of 28 percent on the amount of interest bond investors can deduct from their taxable incomes.

While fiscal sanity is sorely needed in Washington, shifting the tax burden from federal taxpayers to state and local taxpayers will not resolve the spending problem our country faces.

The cost savings that state government and its subdivisions are able to realize through tax-exempt bond financing occurs primarily because investors are willing to accept lower interest rates on these bonds in conjunction with the tax benefit.

A rough estimate shows that Oklahoma state government would have to spend an additional $30 million each year if the interest paid on its tax-exempt bonds were to become taxable.

For counties, municipalities and school districts the cost would be much higher. The tax-exempt bonds issued by them are retired using property taxes.

If the tax-exemption is capped or eliminated, interest rates paid to the bondholders would rise and so could property taxes.

Another potential victim of the fiscal cliff occurs primarily because investors are willing to accept lower interest rates on these bonds in conjunction with the tax benefit.

Any attempt to reduce or eliminate the tax exemption on state and local infrastructure financing would have serious repercussions.”

• **Responsible financing** – States, counties, municipalities and school districts can borrow responsibly for capital projects. Bond issuance has remained stable relative to GDP for the past 10 years.

• **Private capital** – Bonds bring private capital to public projects. In an age of constrained federal and state budgets, this is essential. More than 60 percent of bonds are owned by individuals, either directly or through mutual funds. To continue drawing this private investment, states and localities need tax-exempt bonds.

• **Effective System** – The tax-exempt bond market has worked effectively for decades. It’s not a loophole—the tax exemption was considered a fundamental right of states when the country adopted the 16th Amendment which allowed federal income taxes, and the principle that the income should be exempt was enshrined in the very first tax federal income tax code in 1913.

• **Reciprocity** – While the federal government provides a tax exemption on state and local bond interest, the states likewise do not tax the interest on federal bonds.

As the debate continues on how to best avoid the fiscal cliff, Washington politicians should understand that any attempt to reduce or eliminate the tax exemption on state and local infrastructure financing would have serious repercussions.

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Tax-exempt municipal bonds benefit states and localities in the following ways:

• **Local decision-making** – States, counties, municipalities and school districts can build projects based on local priorities and needs assessments.

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Wish list
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revenues exceed 115 percent of previous year’s general revenue fund certified estimate. In other words, once the constitutional reserve fund is full, apply at least a portion of the extra revenues to pay down debt before committing to new spending.

Modernize pensions
Speaking of pensions, the state should offer a portable benefit option to meet the needs of a modern workforce. Adding a 401K-style defined contribution plan, or at least a hybrid version that guarantees a minimum rate of return instead of a set annuity payment, would bring Oklahoma more in line with the private sector, federal government and a growing list of states.

Though perhaps more difficult than the aforementioned wishes, the state also needs to continue reforming its defined benefit systems to reduce costs, gain efficiencies and increase uniformity among the plans.

As are most wish lists near the Christmas season, this legislative session wish list is probably a bit ambitious. But, Oklahomans have been much more nice than naughty and giving them a more fiscally responsible government can’t be nearly as hard as trying to get two front teeth.

Economic briefs

Recent economic data suggest that the economy is ending 2012 on a weak note, but the reasons are not clear.

Most forecasts for fourth quarter GDP growth are in the 1% to 1.5% range. The storms that hit the east coast were one factor depressing output in October-November. Those losses should be temporary.

The $100 bill has overtaken the $1 bill as the most-printed bill in circulation.

In 2011, the auditor for the Federal Housing Authority (FHA) predicted that the mortgage insurance fund would be valued at $9.5 billion in 2012. Instead, that fund is now valued at a negative $13 billion because of significant foreclosure and claim activity predicted in the years ahead.

Yet the agency is still insuring mortgages with down payments as low as 3.5 percent. The problems stem from loans made from 2007 to 2009. But experts say it takes three to five years for problems to fully develop.

A new survey shows that in China the top tenth of households took home 57% of the income in 2010. That is one of the most unequal distributions of income in the world. The survey also shows that households have very little debt. Liabilities amount to less than 5% of assets compared with over 16% in the U.S.

Reprinted from Baird Fixed Income Commentary, December 3, 10 & 17, 2012
November treasury receipts dip slightly

November collections dipped slightly below receipts from the prior year due primarily to continued reduction in gross production tax payments, State Treasurer Ken Miller announced today as he released the gross receipts to the treasury report.

Miller said gross receipts for the month were down by one-half of one percent, or about $3.7 million, compared to November of last year. “In spite of a slight dip in receipts for the month, there’s no reason to believe Oklahoma’s economy is pulling back,” Miller said. “Over the past 12 months, receipts have grown by almost five percent.”

However, the report is somewhat skewed due to two timing issues. An October 2011 gross production payment of $8.32 million was paid late and recorded in November of last year. Without that difference, this month’s total revenue picture would have been higher than the prior year by almost $5 million.

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Revenue
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Income tax collections are down slightly, but the tax commission attributes at least some of the difference to payment deadline variances between 2011 and 2012.

Sales tax collections in November show ongoing positive consumer confidence in Oklahoma with receipts up 8.5 percent from the prior year. Black Friday receipts are not yet reflected in collections as they will not be remitted until December 20.

“While sales tax receipts are still strong this month, we are anxious for Washington to solve the fiscal cliff problem so our consumers will remain confident about the positive direction of our economy,” Miller said.

November gross production receipts are off by more than 25 percent compared to last year. Without the late payment, extraction receipts would be down 16 percent. In general, the negative percentage is getting smaller even though gross production receipts have been lower than the prior year for 12 consecutive months.

More positive signs

The Business Conditions Index for Oklahoma was reduced from October to November, but still indicates growth in the coming months. The leading economic indicator was adjusted to 56.1 in November from 63.3 in October. Numbers above 50 mean growth is expected.

Oklahoma’s 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.

November collections

The revenue report for November sets gross collections at $799.36 million, down $3.66 million or 0.5 percent from November 2011.

Gross income tax collections, a combination of personal and corporate income taxes, generated $225.65 million, a decrease of $15.8 million or 6.5 percent from the previous November.

Personal income tax collections for the month are $220.13 million, down $16.68 million or 7 percent from the prior year. Corporate collections are $5.53 million, up by $885,000 or 19.1 percent.

Sales tax collections, including remittances on behalf of cities and counties, total $348.85 million in November. That is $27.3 million or 8.5 percent above November 2011.

Gross production taxes on oil and natural gas generated $56.25 million in November, a decrease of $19.03 million or 25.3 percent from last November. Compared to October reports, gross production collections are down by $7.13 million or 11.3 percent.

Motor vehicle taxes produced $50.91 million for the month, up by $1.8 million or 3.7 percent from the prior year.

Other collections, consisting of about 60 different sources including taxes on fuel, tobacco, horse race gambling and alcoholic beverages, produced $117.71 million during the month. That is $2.06 million or 1.8 percent more than last November.
Economic Indicators

Unemployment Rate
January 2009 – November 2012

Oklahoma 12-Month Gross Receipts
November 2008 - November 2012
(in millions)

Leading Index for Oklahoma

Oklahoma Residential Building Permits

Oklahoma Natural Gas Prices & Active Rigs

Oklahoma Oil Prices & Active Rigs

Shaded area denotes U.S. recession
Source: Bureau of Labor Statistics

Shaded area denotes U.S. recession
Source: Office of the State Treasurer

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

Shaded area denotes U.S. recession
Source: U.S. Census Bureau

Source: Baker Hughes & Bloomberg

Source: Baker Hughes & Bloomberg