Recovery Underway, Receipts Confirm

Broad revenue receipts confirm Oklahoma’s economic recovery is well underway, however, global unrest threatens to interrupt the trend, State Treasurer Ken Miller announced this week as he reported on gross receipts to the Oklahoma Treasury.

Preliminary reports from the State Treasurer’s Office show total collections for February were $702.54 million. That is $25.56 million or 3.8 percent above February 2010.

For the past 12 months, collections total $9.846 billion, which is $482.37 million or 5.2 percent higher than the previous 12-month period. During that period, collections have exceeded the prior year each month ranging from a high of 9.3 percent in January to a low of 0.7 percent in April.

Miller said virtually all areas of Oklahoma’s economy are showing improvement.

“Our analysis of all major sources of revenue deposited into the treasury show we are traveling up the expansion side of the business cycle,” Miller said. “We expect, however, to see some anomalies from month-to-month in different categories. For example, motor vehicle collections are slightly below levels recorded last February, following a substantially higher January.”

Total income tax collections, a combination of personal and corporate income tax, are $207.13 million in February. That compares to $200.84 million the previous February, an increase of $6.29 million or 3.1 percent.

SEE RECOVERY PAGE 4
Treasurer’s Commentary
By Ken Miller, Ph.D

Rightsizing Matters

Thanks to the enor-mously ir-responsible
spending spree in Washington, there is considerable discourse surround-
ing the issue of government size.

While historically there have been inexhaustible amounts of political rhetoric on both sides of the “size matters” debate, today vote-seekers everywhere are pledging to reduce the size of government. Which begs a couple of seldom asked questions: How does one measure the size of government and what size should it be?

Universally, government size is measured by the share of an economy’s production going to government consumption. At the sub-federal level, that means state and local spending as a percentage of gross state product (GSP).

Thus, there are two sides of the equation. One can reduce the size of government by cutting spending, growing the economy, or both.

So what about the appropriate size? For some, being for smaller government is always good politics. For others it is an ideological question.

But if the goal is increasing quality of life, then it is an economic question with merit.

Government size and economic output are expected by many to have a negative association. Although public spending does displace private investment, it can also promote private sector productivity.

“In Oklahoma, public sector size is a problem secondary to our lack of prioritization and fiscal discipline.”

Some base level of spending on safety, infrastructure and education provides the very foundation for a functioning free market economy. Therefore, policymakers must consider both the positive and negative effects while seeking the government spending level that maximizes economic output.

Latest numbers show that among the 50 states, government size ranges from 16 to 31 percent with an average just under 22 percent. Government size in Oklahoma currently stands near 19 percent. Like most states, our public share has ticked up slightly as our economy has contracted.

For the political realist who understands the total dollar outlays by government will not likely be reduced due to population and inflation growth, the dialogue has changed to “rightsizing government.”

Unfortunately, this terminology is ambiguous and provides some of the same political benefits but without the risk of a quantifiable measuring stick.

Rightsizing might mean reducing the public share of GSP through cuts or economic growth. Or it could mean better prioritization and efficiency. Regardless, rightsizing is a laudable goal.

Although our state has gained efficiencies, tremendous waste elimination opportunities still exist.

In Oklahoma, public sector size is a problem secondary to our lack of prioritization and fiscal discipline. Nonessential programs have been funded to the detriment of core areas critical to future success.

Today, we must fund core functions but also pay for decades of irresponsible behavior that created our massive unfunded pension obligation.

Finding the appropriate size of government presents a difficult and fundamental dilemma.

SEE RIGHTSIZE PAGE 4
Pension Funding is Looming Crisis

By Regina Birchum,
Deputy Treasurer for Policy & Chief of Staff

The alarm has been sounding for so long on the need for pension reform that it has become little more than white noise to those in government. It seems the pitch has finally pierced through, but as many are discovering, inattentiveness has come at considerable cost.

Oklahoma has more than $16 billion in unfunded liabilities among the state’s seven pension plans. And while Oklahoma isn’t lacking in company – only one state in the nation can boast of fully funding its public pensions – Oklahoma ranks among the worst funded states on pension liability per capita.

Our unfunded liability equals more than eight percent of our Gross State Product, with approximately $4,500 of pension debt per citizen.

The problem isn’t just a matter of the state holding expensive debt; there is the risk of damaging the state’s currently strong credit rating, resulting in higher interest costs. Moody’s Investors Service has already begun revamping its credit rating system to include states’ unfunded pensions. Fitch Ratings recently announced it also would be re-evaluating states’ unfunded pension liabilities as a reason to downgrade bond rating assessments.

All agree the state’s pension systems are underfunded. It’s the discord on solutions that have until now paralyzed reform efforts.

This year 24 states are considering significant changes to public employee pension systems and the opposition has been fierce. Across the nation, retired and current public employees are understandably worried that the issuance of state financial reports to provide better data, analysis and transparency. The Treasurer’s Office will report on total revenues collected, while State Finance will report on the portion of collections deposited to the General Revenue Fund for allocation to state agencies.

Analysis of overall revenue collections, or “Gross Receipts to the Treasury,” will utilize a complete data set to more accurately gauge state economic performance, since viewing only the General Revenue Fund data subset can understate or exaggerate underlying conditions.

While the State Finance report on General Revenue Fund allocations provides information important to state agencies for budgetary planning purposes, it is our hope to provide a timely and less obstructed view of our macro economy. Our Gross Receipts Report will be made early each month with a follow-up comparison to the General Revenue Fund report in our Oklahoma Economic Report.

I hope you find our newsletter of value to you and your business. We are just getting started so let us know your ideas to make our report even better.

Warm regards,
Recovery

FROM PAGE 1

Total income tax collections exclude refunds paid and statutory transfers. The General Revenue Fund includes net income tax deposits.

“Income collections is a case where examination of gross collections better reflects true economic activity in Oklahoma,” Miller said.

According to the Office of State Finance, the February deposit to the General Revenue Fund from income tax collections was $27.7 million and reflected a 141 percent increase from the prior year. The General Revenue number excluded more than $146 million paid in tax refunds, reflecting only 81.44 percent of the remaining personal income tax collections and 77.5 percent of corporate collections.

“Our employment picture is getting brighter; the unemployment rate is dropping and incomes are rising, but not by as much as would appear to be indicated by the General Revenue figure,” Miller said.

Sales tax collections, including those collected on behalf of counties and municipalities, are $284.27 million in February. Compared to prior year collections of $262.06 million, this reflects an increase of $22.21 million or 8.5 percent.

On average, 46 percent of sales tax collections are remitted to the state’s cities and counties each month. In February, $131.21 million was remitted to counties and municipalities.

Gross production taxes on oil and natural gas yielded $73.66 million in February. This compares to $71.45 million the previous year and is $2.21 million or 3.1 percent higher.

Motor vehicle taxes for the month totaled $41.39 million, compared to $46.28 million the previous year. This is a reduction of $4.89 million or 10.6 percent.

Other revenue sources, reflecting gross collections from the Oklahoma Tax Commission from approximately 60 different sources including alcoholic beverage, franchise, tobacco and use taxes, total $96.09 million in February. This is $250,000 or 0.3 percent less than the previous February.

Twelve-month income tax collections are 2 percent lower than the previous 12 months. Sales tax collections are up 7 percent over the trailing 12-month period. Gross production taxes are showing a 29.2 percent increase from the previous one-year period. Motor vehicle taxes are up 9.6 percent and other sources show an increase of 3.4 percent.

Collections for the past 12 months show the economic recovery has taken hold with improvements in all major tax categories except income tax, Miller said.

“Income tax collections are viewed as lagging indicators of economic activity,” he explained. “One of the last areas to recover from a recession is employment and income tax collections help us measure that activity.”

Rightsize

FROM PAGE 2

When government is too small, it cannot provide basic enforcement of property rights and personal safety or the infrastructure necessary to facilitate markets.

On the other hand, a government so large that it excessively engages in wealth transfer and regulation to the detriment of the profit incentive will thwart economic prosperity.

Rightsizing does matter. It deserves much more than rhetoric; it demands immediate action and lasting commitment.

Briefly

Tobacco Settlement Fund

The constitutionally-created Oklahoma Tobacco Settlement Endowment Trust Fund currently contains $495 million with another deposit expected next month. Since its inception in 2001, more than $81 million has been certified to help improve Oklahomans’ health.
Pensions

FROM PAGE 3

benefits they’ve been depending on might not continue. Yet, policymakers realize maintaining the status quo is not feasible.

The private sector has already made painful but necessary adjustments to keep business afloat. Multinational corporations like General Motors had to restructure, due in part to the burden of unrealistic employee benefits that were out of line with its global counterparts.

Airlines and automotive manufacturing are just two examples of industries where workers had to decide between a job with reduced pay and benefits or no job at all. The lesson to the public sector is that no one wins if the pension system fails.

At its core, the pension funding issue is one of basic math. The state can’t keep mandating benefit increases without paying for them and it can’t keep putting off difficult decisions.

The current structure of the state’s public pension plans is unsustainable; now government must find a way to honor the promises made to existing workers while finding a funding solution that is fair to both public employees and taxpayers. Policymakers must recognize promises made must be promises kept. Public workers must understand our pension systems are on a path to insolvency and changes must be made.

Advancing needed reforms may be politically charged, but with the fiscal health of our state at risk, now is the time to stop studying and take action.

Economic News Briefs

Global Events

The earthquake in Japan is expected to have a significant effect on national trade balances due to the interruption of global supply and demand.

The catastrophe is also expected to reduce the demand for Treasuries in that country, and could even force some selling of Treasuries by some banks and insurance companies. Japanese investors owned $880 billion of Treasuries at year-end, versus $1.16 trillion owned by China. There will certainly be more sales of Japanese bonds as the government finances rebuilding.

Barron’s/ Reprinted from Baird Fixed Income Commentary, March 14, 2011

Turmoil in the Middle East is hurting stocks because higher gas prices act like a tax on consumers and are a drag on the economy. It might be helping bonds because it strengthens the safety bid for Treasuries. Good foreign demand helped the 10- and 30-year auctions last week.

Foreign participation in these auctions will become even more crucial later this year when Fed purchases of notes and bonds are scaled back by approximately $60 billion per month.

In a roundabout fashion, higher oil prices can be bullish for Treasuries because much of the “tax” on consumers that is collected by oil exporting nations gets invested in the dollar markets. For the U.S. economy, it is equivalent to saving rather than spending some of those “tax revenues”.

For the bond market, it increases foreign demand, mostly for Treasuries. To be sure, the oil exporters can invest anywhere around the world. But, whenever conditions in the rest of the world become more unsettled, U.S. Treasuries appear to capture a greater share of the proceeds of the global petroleum “tax”.

GDP Forecast

The 50 forecasters for the Blue Chip now government must find a way to honor the promises made to existing workers while finding a funding solution that is fair to both public employees and taxpayers. Policymakers must recognize promises made must be promises kept. Public workers must understand our pension systems are on a path to insolvency and changes must be made. By working together, common-sense solutions that benefit all can be found.

Advancing needed reforms may be politically charged, but with the fiscal health of our state at risk, now is the time to stop studying and take action.

Economic Indicators expect the economy to grow at a 3.4% rate this year, but they have reduced slightly their forecast for consumption spending due to higher gas prices. They expect real consumer spending to grow at a 3.1-3.2% rate. The 10 most optimistic forecasts for GDP have growth at 4.2% and unemployment dropping to 8.4%. The 10 least optimistic have GDP growth at 2.6% and no further decline in the unemployment rate. Inflation adjusted disposable income hit a new high in January.

Household Debt

The most exceptional aspect of the 2008-10 recession/ recovery has been the collapse in borrowing and lending in the private sector of the economy. In 2007, borrowing by households and businesses was running at a $2.2 trillion annual rate. By the end of 2009, that borrowing was declining at a $900 billion rate, a swing of more than $3 trillion. It has recovered only very slightly since the lows of 2009.

Reprinted from Baird Fixed Income Commentary, March 14, 2011
Economic Indicators

Consumer Confidence

Residential Building Permits

Unemployment Rate
U.S. vs. Oklahoma

Oklahoma Stock Index
(top 25 capitalized companies)

Interest Rate Forecast

US GDP Price Index

Source: Median forecasts for key economic indicators as surveyed by Bloomberg March 4-11.