



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

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

State budget looks much like previous ones, just smaller

Budget shrinks again

The Oklahoma state budget for Fiscal Year 2012, while slightly smaller than in previous years, looks much the same as those that came before it. One notable exception is that education received its deepest cuts in years.

This was the first year for Republicans to craft a budget since their takeover of state government, a task made challenging by the continued effects of the economic downturn. While across-the-board cuts were avoided, all but six entities received a reduction in funding. However, the basic functions and

funding priorities of previous budgets are continued into the next fiscal year.

The Governor and legislative leaders said the budget succeeded in shielding core government functions from the steepest cuts while meeting the balanced budget requirement without raising taxes.

Governor Mary Fallin said the budget “makes tough, but realistic spending cuts” and accomplishes the budget goals she laid out at the start of session. Senate Pro Tem Brian Bingman and

House Speaker Kris Steele praised the accord’s commitment to core services and fiscal responsibility.

Although legislative leaders were in unison about the budget agreement, other legislators were less enthusiastic. This year’s budget received the closest vote margin in recent years: 87-53 out of 149 possible votes. By comparison, FY 11 received 108-31 and FY 10 received 132-3.

Closing the gap

The \$6.5 billion budget originally contained a \$500 million shortfall. The gap was closed with appropriation cuts of \$218 million or 3.2 percent. The

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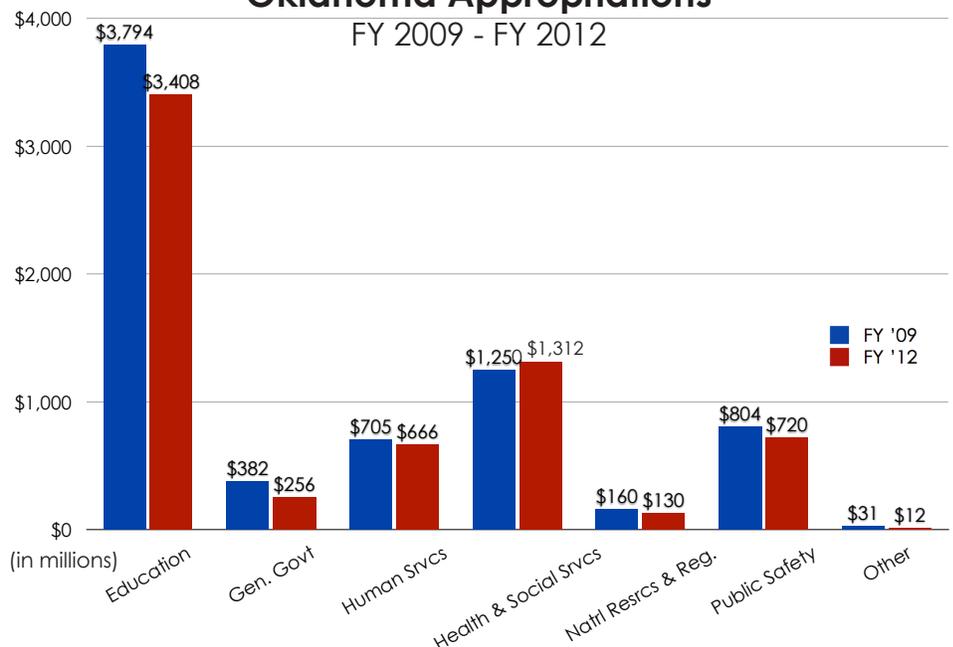
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Oklahoma Appropriations

FY 2009 - FY 2012





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

Let the grading begin

With the Legislature ready to adjourn, performance reviews can now begin in earnest. This historic year has brought notable achievements and a few disappointments. Accompanying the wholesale change in state leadership, significant legislative accomplishments and bold reforms were signed into law.

Landmark pension legislation was enacted that will reduce our unfunded obligations. Considerable improvements were made to our tort, sentencing and parole processes. Additional achievements were scored for schools by eliminating social promotion and aiding the removal of ineffective teachers. Time will tell if other changes such as consolidating technology and several other agency service divisions under one mega-agency will be cost-effective.

While the legislative session began with a promising Executive Budget, one of the bigger disappointments this year is the FY 12 budget agreement. Of course, no single official controls the final product and complaints are the norm. Compromise renders many frustrations, even for budget writers. If budget leaders were left to independently script line items, their plans would be vastly different.

“Let's make sure next session's budget is as bold as this session's efforts at pension, legal and education reform.”

The disappointment stems from the institutional budget process rather than the capable and well-intentioned individuals at the negotiating table. In the rush to get a deal, the “way-we-have-always-done-it” approach takes over, leaving each year's budget in similar proportion to the year before.

The process inevitably becomes little more than fitting together the pieces of a puzzle, matching this year's revenues to last year's expenditures. Thus, the focus is on math rather than outcomes.

This agreement is particularly disappointing because it is the first time in Oklahoma history that a budget has been crafted with complete Republican control and yet it falls short. This was our first real opportunity to rightsize government, implement priority-based budgeting and to prove commitment to public education. Fortunately, it will not be our last opportunity.

Even with large GOP margins in the House and Senate and no veto threat from an opposite party governor, the status quo prevailed again. Except for the larger cuts to education, this is a budget not unlike those signed by our last governor. Nonessential programs continue to siphon taxpayer resources away from core areas critical to our state's success rather than be directed into areas of highest return.

Until policymakers stop trying to be all things to all special interests, our classrooms, roads, bridges and law enforcement will continue to be underfunded. We need budget leaders to commit to:

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Commentary

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- Fund essential functions well and eliminate the rest
- Base spending on results and outcomes rather than history
- Reject the inefficiencies of duplicative agency, social and legal services
- Eliminate unnecessary special project “pass-through” funding
- Monetize non-essential state assets to pay down debt
- Eliminate ineffective tax incentives and exemptions

Perhaps the session got here too quickly for the slate of new leadership to mount a full-fledged attack on the status quo. With our rookie season behind us, let’s make sure next session’s budget is as bold as this session’s efforts at pension, legal and education reform.

Budget

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remainder was filled with a combination of revolving fund transfers, cash sources and remaining federal stimulus funds.

Education gets cut

A general analysis of funding changes between FY 2009 and FY 2012 show education receiving the largest dollar reduction.

In FY 2009, education entities received just less than \$3.8 billion. In FY 2012, appropriations total \$3.4 billion, reflecting a reduction of \$386 million or 10.2 percent from its high. A planned supplemental appropriation of \$21 million was expected to slightly offset the spending cuts to Oklahoma’s schools.

Three-year cuts among education

agencies range from 9.1 percent for Higher Education to 54.5 percent for OETA, including the loss of one-time funds for digital conversion. Common education has absorbed cuts of 10 percent since FY 2009.

Health gets a boost

During the same three-year period, health and social services is the only area of government that has seen spending increases.

Driven by high health care costs, the Health Care Authority has been given a three-year increase of more than \$100 million or 12.7 percent.

Human services shrink

Since the start of the Great Recession, human services agencies have been cut by 5.6 percent, receiving \$705.4 million in FY 2009 and \$666 million in FY 2012. One agency, the Human Rights Commission, has been moved into the Office of the Attorney General.

The Department of Human Services has been reduced by 3.9 percent, while the Office of Juvenile Affairs has been cut by 14.3 percent. The Office of Disability Concerns and the Commission of Indian Affairs have both been cut by about one-fourth.

Public safety & natural resources take cuts

During the next fiscal year, public safety agencies will be spending slightly less than 90 percent of what was appropriated in FY 2009. The Corrections Department’s cuts total 8.6 percent.

Natural resources and regulatory agencies will be operating at a 19 percent reduction during the coming fiscal year compared to three years ago.

General government shoulders reductions

General government agencies have borne the largest percentage reductions within state government during the past three years, with overall cuts in funding of 33.1 percent.

“**...the basic functions and funding priorities of previous budgets are continued into the next fiscal year.**”

Starting in FY 2012, the Office of the Secretary of State will no longer receive appropriated funds and will operate exclusively from money generated by the agency.

The budget of the Department of Transportation, which receives the bulk of its funding from dedicated fuel tax revenue, has been reduced by 48.6 percent. The funds have been substantially replaced with bonding authority.

Three-year reductions in the offices of elected officials range from 22.3 percent to 25.6 percent. In the latest budget, allocations were more diverse: Corporation Commission up 11.7 percent; Attorney General up 8.3 percent; Legislative Service Bureau down 0.2 percent; Labor down 2.7 percent; Lt. Governor down 4 percent; House and Senate down 5 percent; Governor, Insurance and Treasurer down 7 percent; and Auditor down 8.6 percent.



Gross Receipts & General Revenue

A comparison of the Treasurer's May 3 Revenue Report and State Finance's May 9 General Revenue (GR) Fund report shows key differences.

April gross receipts totaled \$1.074 billion, while GR received \$576.8 million — a difference of \$497 million or 46.2 percent. Last month's difference was 52.5 percent.

This is due to variances in the transfer of funds for rebates, remittances and dedicated funding.

In April, the GR Fund received:

- 60.21 percent of personal income tax
- 69.95 percent of corporate income tax
- 45.35 percent of sales tax receipts
- 12.78 percent of gross production tax on natural gas
- 64.71 percent of gross production tax on crude oil
- 33.16 percent of Motor Vehicle tax collections

EDITOR'S NOTE:

Collections from tribal gaming and insurance premium taxes are not available until late in the month.

In April, gaming generated \$10.78 million and insurance premium taxes brought in \$35.7 million.

April revenue shows continued growth

Broad measurement of Oklahoma's economy in April shows growth over the prior year in spite of rising gasoline and diesel fuel prices, State Treasurer Ken Miller said as his office issued its monthly revenue report.

During April, receipts to the State Treasury totaled \$1.074 billion. That is an increase of \$94.23 million or 9.6 percent over April of last year. In the past 12 months, gross collections were \$9.992 billion, an increase of \$579 million or 6.2 percent over the previous 12 months.

"We see promising signs of continued economic growth," Treasurer Miller said. "Income and sales taxes continue to outperform. Income tax collections show strong growth as Oklahoma businesses add jobs and

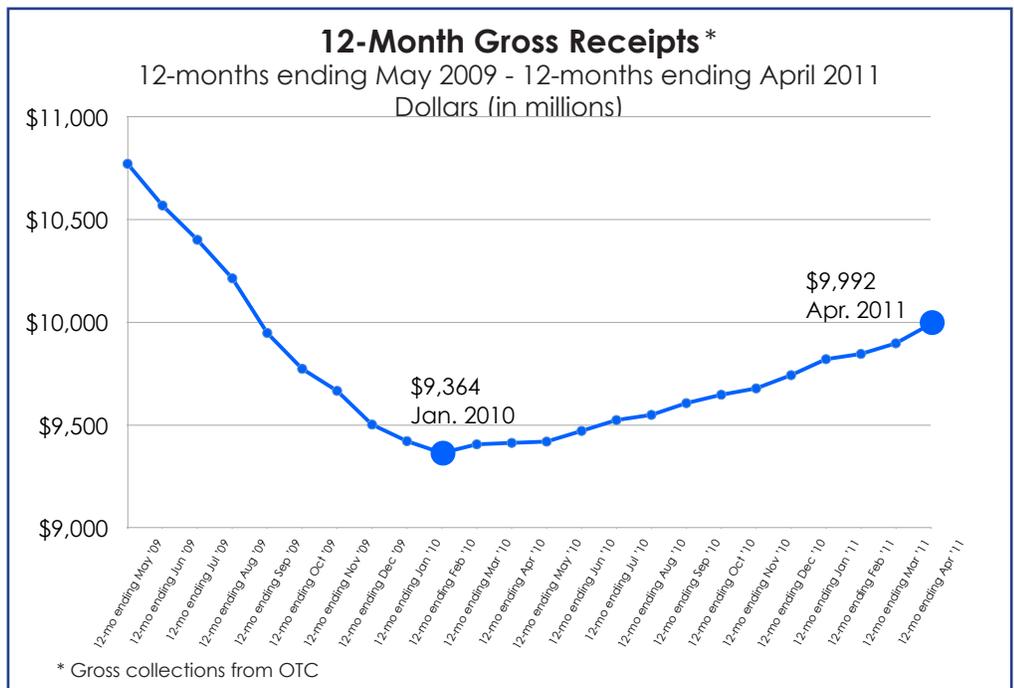
the unemployment rate continues to dip. Sales tax collections continue to be solid, indicating families remain confident in the direction of the state's economy."

Absorbing Higher Fuel Prices

April collections of gasoline taxes are shown as producing \$25.12 million, a reduction of \$0.41 million or 1.6 percent from the previous year. Diesel taxes total \$10.55 million reflecting a \$1.03 million or 10.8 percent increase over April of last year.

The state fuel tax is 16-cents per gallon on gasoline sales and 13-cents per gallon on diesel. According to the U.S. Energy Information Administration, the average price per gallon of gasoline

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Revenue

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in the Oklahoma region was \$3.854 in April compared with \$2.858 the previous April. The average diesel price was \$4.025 per gallon in April compared with \$3.033 in April of last year.

April remittances show Oklahomans purchased 157 million gallons of taxable

gasoline in April compared to almost 160 million gallons the year before. Taxable diesel purchases were more than 81 million gallons in April compared to more than 73 million gallons in April of last year.

“Driving is a necessity for most Oklahomans regardless of the prices at the pump. However, should prices stay high or rise further, drivers would tend to cut back some on miles traveled and

adjust their spending in other areas,” Miller said. “We will continue to be concerned about the effects of higher gas prices on consumer spending and transportation funding since this flat tax is dedicated to road and bridge improvement.”

Except for income and sales taxes, Miller said the other major sources of revenue showed a slight pullback in April.

Economic News Briefs

U.S. Economy

The PPI and CPI last week did not help resolve the debate over the correct measure of the rate of inflation. The CPI is now advancing at a 3.2% annual rate but the core is up only 1.3%. The recent declines in commodity prices are not enough to narrow that gap, but they were a reminder that those prices can be volatile enough to obscure the underlying trend of inflation. Perhaps the best news last week was the big drop in initial claims for unemployment insurance. They had jumped to 478,000 the week before, which was disturbing. The drop back to around 435,000 suggested that jump was a statistical aberration.

The focus this week might be on the housing data, but those looking for signs of life will probably be disappointed. Housing starts increased about 30,000 to a 540,000 annual rate in March, and might stay around that weak level in the April report. Sales of existing single family homes increased slightly in March to a 5.1 million unit rate, and might have slowed somewhat in April. That is the best leading indicator for

housing, and it is still well below a healthy pace.

The 50 forecasters in the Blue Chip survey have not reduced their estimates of GDP growth. The consensus is growth rates above 3% for the remaining three quarters of 2011. And, even the 10 most pessimistic forecasts of inflation see the CPI slowing from a six month rate of 5% now to less than 3% later this year. The consensus forecast for the unemployment rate is 8.5% late this year and 7.9% by the fourth quarter of 2012.

Commodities

Barron's points out the commodity prices excluding oil fell 70% in the 100 years ending in 2002, but since then have reversed that decline. That is due mostly to demand from Asia. China today has 9% of world GDP, but it consumes 53% of the world's cement, 48% of iron ore, 47% of coal, 45% of steel, 45% of lead, 40% of aluminum, 39% of copper, 36% of nickel and 46% of pigs and 37% of eggs. Commodity prices are expected to keep trending higher in future decades.

New Households

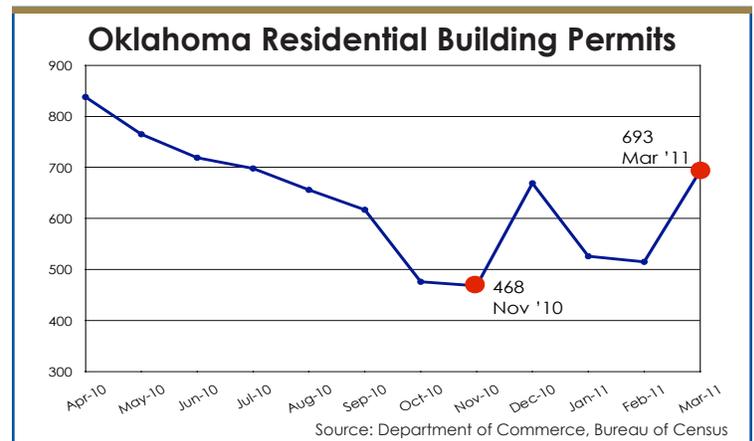
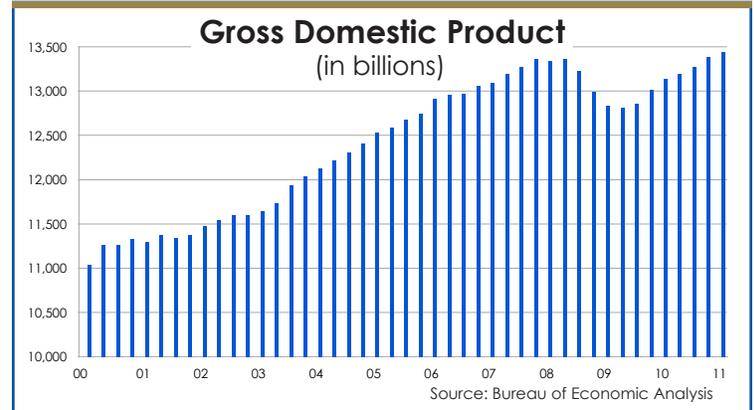
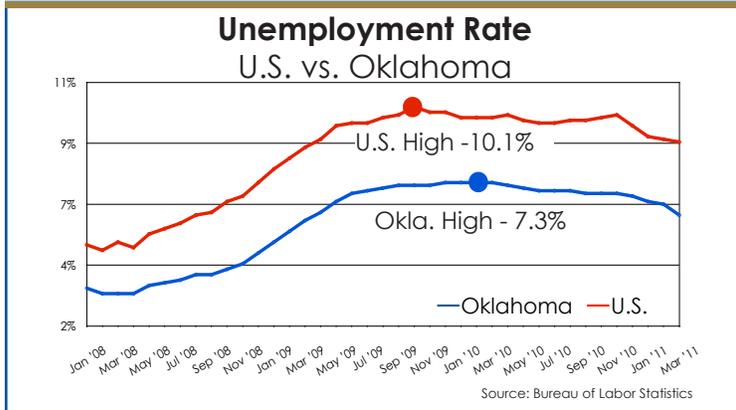
The end of the recession is bringing an increase in household formation, which boosts consumer spending and, eventually, housing. Young people who had been living with parents are starting to move out, forming households, in the parlance of demographers. Nearly 1 million new households will be created this year, up from 357,000 in the year ended March 2010, which was the lowest 12 month total since the data began in 1960. That should boost housing starts to around 650,000 this year and nearly 900,000 next year from 587,000 last year. Household formation has been running at only 40% of the long-term average, so the demographic fundamentals for housing are favorable; it is the economic and psychological components of demand that are still poor.

Divorces also boost household formation and the recession cut divorces per 1000 people to 6.8 from 7.4 before the recession. Divorce lawyers report a 20% increase in customer count in the first quarter.

Reprinted from Baird Fixed Income Commentary, May 16, 2011



Economic Indicators



Interest Rate Forecast

79 Economists

	2Q 2011	3Q 2011	4Q 2011	1Q 2012	2Q 2012
Fed Funds Target	0.25%	0.25%	0.25%	0.50%	1.00%
3-M LIBOR	0.34%	0.35%	0.46%	0.74%	1.25%
Treasury Notes					
2-Year	0.85%	1.00%	1.23%	1.55%	1.90%
10-Year	3.60%	3.75%	3.90%	4.10%	4.23%
Treasury Bonds					
30-Year	4.66%	4.80%	4.92%	5.00%	5.10%
Economic Indicators					
Real GDP	2.9%		3.10%		
Unemployment	8.7%		8.1%		

Source: Median forecasts for key economic indicators as surveyed by Bloomberg April 28.

