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Oklahoma Economic Report™

News and analysis of Oklahoma's economy

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

It's time to put unused or unnecessary assets to work

Cash in the attic

In his speech, "A Time for Choosing," Ronald Reagan called into question the scope of government. "No government ever voluntarily reduces itself in size," he said. "Government programs, once launched, never disappear. Actually, a government bureau is the nearest thing to eternal life we'll ever see on this earth!"

In that same speech, Reagan also stated that, "Government does nothing as well or as economically as the private sector of the economy."

Recent budget constraints have forced governments to consider what Reagan thought to be implausible: self-imposed reduction, elimination and privatization.

While calls for smaller government have been in vogue for a while, cash-strapped states have become more serious about identifying non-essential functions and state-held assets and exploring how to either convert them into cash or develop partnerships to relieve the state of the full financial burden of maintaining them.

From the federal level to states and cities, governmental entities are re-evaluating their essential functions and determining whether the private sector might find value or opportunity in those services or assets not deemed central to government's mission.

The federal government – the biggest property owner in the nation – has launched a website with links to thousands of excess government-owned properties across the U.S. that are on the market. However, sales have been hampered by a bureaucracy often deemed not worth the time for private investors to navigate.

States have found some success with liquidation. North Carolina's recent budget requires the sale of aircraft, which is expected to generate $1.5 million for the state. Connecticut raised $15 million between 2009 and 2010 from the sale of properties and assets that include a hotel, jailhouse and an armory.

Other states have developed public-private partnerships that retain government ownership of a program or asset but contract out the management or delivery of services. For example, New Jersey's Public Broadcasting System is moving to an independently-financed institution.

> **"No government ever voluntarily reduces itself in size."**
> **– Ronald Reagan**

Illinois, in a ground-breaking arrangement, recently contracted for the private management of its lottery. The agreement is projected to generate $1.1 billion more revenue for the state than was anticipated under public management. Several other states are looking at replacing government-run economic development programs with public-private boards.

Whether it's selling state-owned assets, developing public-private partnerships or turning over a government-provided service to private industry, the success

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Treasurer's Commentary

By Ken Miller, Ph.D.

Zero tolerance

The people of Oklahoma place tremendous trust in their state treasurer. As the state's chief elected financial officer, the treasurer is accountable for safeguarding all of the money collected and spent by state government. The treasurer must make sure that billions of taxpayer dollars are properly deposited, invested and disbursed.

As the person entrusted with that responsibility, I take it very seriously and do my best every day to be worthy of the public trust. Of course, it is essential that the highest standards of professional conduct and ethics be practiced not only by the treasurer, but also by every employee in the office.

Should an employee violate our standards or the infallible trust we have with the citizens of this state, the response will be swift and just.

Zero tolerance will be the norm as long as I am state treasurer.

It is sometimes easy for elected officials to make such strong promises. And with a steady stream of bad actors displayed in the media, it is often easy for the public to dismiss such statements as hollow words. Not so in the state treasurer's office.

Unfortunately, those principles are now being put to the test as just last week we received an allegation of wrongdoing by one key employee within the treasurer's office.

Our response was quick and decisive. Within hours of learning of the allegation and assessing the situation, I personally called the Oklahoma State Bureau of Investigation and the Office of the Attorney General. Simultaneously, our office launched an internal investigation.

> ***"Our solemn duty is to protect the public's money and preserve the public trust."***

Shortly thereafter, the employee in question was placed on administrative leave, our internal investigation was in full swing and the state's law enforcement agencies were actively investigating.

By week's end, evidence uncovered by our internal investigation had been turned over to the proper authorities and I had fired the employee in question.

Since this is an ongoing criminal investigation, law enforcement has requested that details not be made public until their investigation is complete. Rest assured, we will get to the truth and full public disclosure will be made.

Should the findings warrant the filing of criminal charges, our law enforcement agencies will aggressively prosecute any and all violations of the law and the public trust.

In the meantime, our internal investigation proceeds. And we continue to work with the OSBI and attorney general, who are to be commended for their quick and thorough response to this serious matter.

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Commentary

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The treasurer's office will continue to assess systems and procedures to ensure public funds remain secure. We will move forward from this situation better and more secure than ever before.

Our solemn duty is to protect the public's money and preserve the public trust.

It is my sincere hope that because of the swift and decisive actions of all those involved in this situation, the trust our citizens place in the state treasurer's office will grow even stronger – the people of Oklahoma deserve nothing less.

Cash

FROM PAGE 1

of these efforts is often determined by the process established.

The states with the best success at either divestiture or privatization have proceeded thoughtfully, often establishing councils or commissions that include the private sector.

Oklahoma has taken the first step with the creation this session of the "Oklahoma State Government Asset Reduction and Cost Savings Program." The new law requires an annual report detailing state-owned properties, including the most under utilized properties, their value, and their potential for purchase. The first report is scheduled for release prior to the next legislative session.

The current inventory of state-owned real estate lacks information from two major land-owning state entities: the Commissioners of Land Office and higher education. Also missing are relevant details such as the property's condition and level of occupancy.

A full scale review of the state's assets will help officials determine if the state can benefit from shedding excess properties and investing those resources elsewhere. Any review should seek to determine the asset's value to the state and whether it's an inherently governmental function.

After identifying unnecessary or under utilized properties, the private sector and affected communities should be consulted about the best use of the facilities and to gauge the level of interest for private development or use. Lastly, procedures should be examined to identify any bureaucratic obstacles that would unnecessarily deter private industry from being interested.

Converting state-held assets to private ownership could benefit the state and communities alike. The state would receive a much-needed infusion of cash, which could be applied to outstanding debt or invested in better maintenance of state facilities. Buildings or land previously exempt from property taxes would be put back on local tax rolls and private development of the property could create jobs in the community.

States across the nation are more than just rummaging through their attics for things to take to market; the recession has spurred assessment of government's true obligations.

Asset monetization is a logical opener to a discussion that should continue even in an improved economy.

Larger Rainy Day Fund deposit expected

After years of collections to the General Revenue Fund failing to meet official estimates, the Office of State Finance (OSF) reports a deposit is expected to be made next month to the Constitutional Reserve Fund, commonly called the Rainy Day Fund.

Deposits to the fund are made when General Revenue collections are more than 100 percent of the official estimate set by the State Board of Equalization.

In February, it was estimated the Rainy Day Fund would receive a deposit of $71.1 million. But now OSF Director Preston Doerflinger says the deposit at the end of the Fiscal Year 2011 could easily be more than double that amount.

Prior to the Great Recession, the fund contained $596.6 million. Lawmakers tapped the fund to help make up for revenue lost during the economic downturn. It currently contains $2.03.

It's a fact

Acres Owned by State Government:

- **744,000 owned by the Commissioners of Land Office**
- **380,000 combined acreage of all other state-owned property***

*Excludes higher education institutions
Source: Department of Central Services

Allocation to the General Revenue Fund

A comparison of the Treasurer's June 2 Revenue Report and State Finance's June 13 General Revenue (GR) Fund report shows key differences.

May gross receipts totaled $812.14 million, while GR received $414.68 million or 51.06 percent.

Last month's difference was 46.2 percent. This is due to variances in the transfer of funds for rebates, remittances and dedicated funding.

In May, the GR Fund received:

- 63.15 percent of personal income tax
- 22.70 percent of corporate income tax
- 45.67 percent of sales tax receipts
- 65.74 percent of gross production tax on natural gas
- 37.62 percent of gross production tax on crude oil
- 32.91 percent of motor vehicle tax collections

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

In May, insurance premium taxes generated $848,000 and gaming brought in $10.41 million.

Twelve-month collections mark recovery milestone

Using gross state revenue collections as a guide, the Oklahoma economy has recovered more than one-third of the activity lost during the Great Recession.

12-month collections peaked at $12.283 billion in December 2008 and hit a trough of $9.364 billion in February 2010. Since then, collections have gradually increased.

Milestone Reached

Twelve-month receipts ending in May are $10.071 billion, marking the first time since August 2009 that the 12-month total has topped $10 billion.

"Oklahoma's economy has made great strides in the past year," Miller said. "We see improving health in virtually every economic sector measured by revenue collections."

From the trough in February of last year, 12-month gross receipts have recovered 37 percent of the revenue that was lost during the more than one-year plunge in collections.

> ***"Absent a significant external event, there is no indication the Oklahoma economy will experience a 'double-dip'. . ."***

"Our revenues fell sharply once the Great Recession took hold," Miller said.

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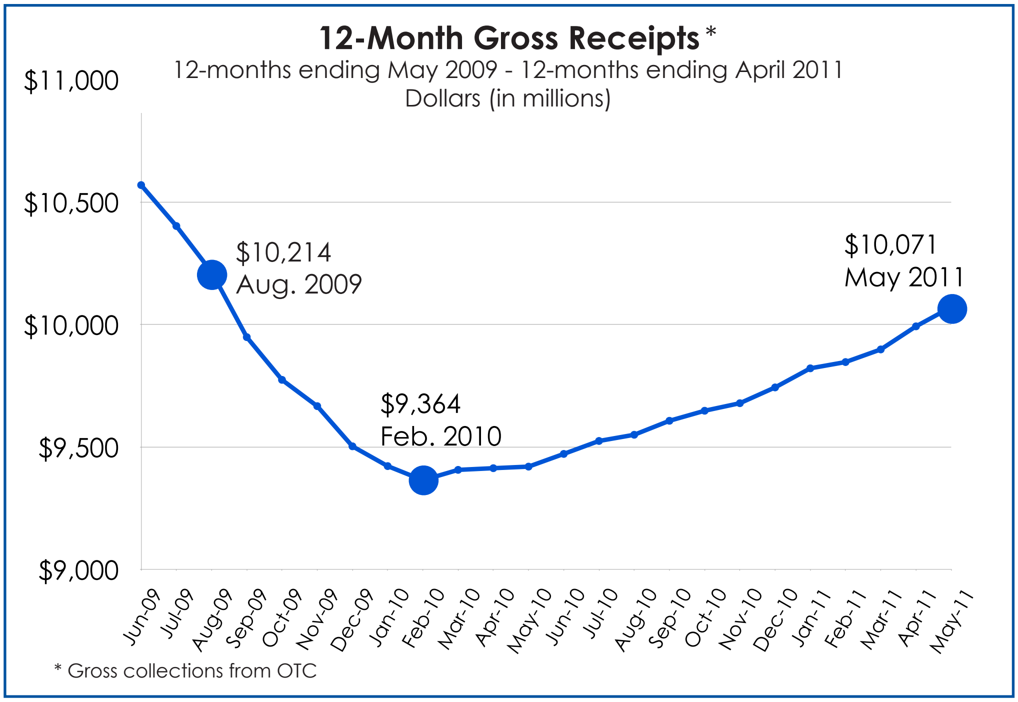

Milestone

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"Now 15 months into the expansion phase of the business cycle, we are seeing continued signs of steady recovery."

Economists were divided on the shape of the eventual recovery. Some predicted an L-shaped business cycle, where economic growth would be flat for an extended period. Others predicted the typical V-shaped recovery, indicating a steep decline in the economy followed by a steep increase. Oklahoma numbers indicate a hybrid of the two with a steep decline and slow incline.

"Absent a significant external event, there is no indication the Oklahoma economy will experience a "double-dip" or W-shaped recovery but will continue on its current expansionary path," Miller said.

Capital markets snapshot

Total net borrowing in the U.S. capital markets grew at only a 2.2% annual rate last quarter, and almost all of that growth was federal government borrowing.

In contrast, during the five years 2003-2007, that growth rate averaged 8.8% and virtually all of the growth was private sector borrowing—by households and business.

In 2010, net private sector borrowing was -$225 billion. Private sector borrowing was running at an annual rate of $165 billion last quarter, the first positive annual rate since 2008.

Households continued to retire debt last quarter. The amount of mortgage debt outstanding has now declined for 12 consecutive quarters.

In the first quarter of this year, that debt continued to decline at an annual rate of more than $400 billion. There has been no similar collapse in borrowing in the U.S. since the great depression.

While the private sector was retiring debt, the federal government has been creating lots of it. Federal borrowing increased from an annual rate of $235 billion in 2007 to almost $1.6 trillion last year. Even with that explosion in federal borrowing, total borrowing in the capital markets today is more than $1 trillion less than in 2006-2007.

> ***"There has been no similar collapse in borrowing in the U.S. since the great depression."***

The collapse in private sector borrowing has more than made room for the increase in Treasury borrowing. This helps explain why the huge increases in the federal deficit have not pushed bond yields sharply higher.

Purchases by the Federal Reserve also were a major factor helping the markets absorb the Treasury debt. The onset of the Fed's QE2 purchases coincided with a sharp falloff in demand from foreign investors.

Weak demand for credit in the private sector of the economy remains one of the key fundamentals of this recovery cycle.

Since, historically, strength or weakness in private sector borrowing has been the primary driver of market yields, it is not surprising that yields have remained low even with record federal deficits.

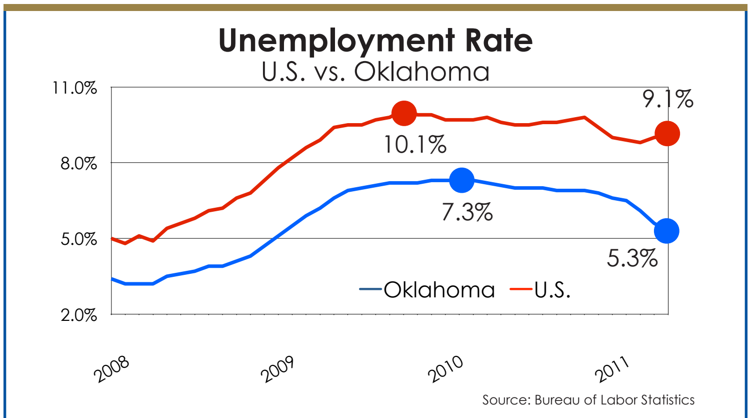
How long in this cycle private sector borrowing remains weak probably depends on the housing sector. Housing is usually a big user of borrowed money, up to $1 trillion per year as recently as 2006. Borrowing by businesses is beginning to increase slowly but the amount of mortgage debt outstanding is still declining.

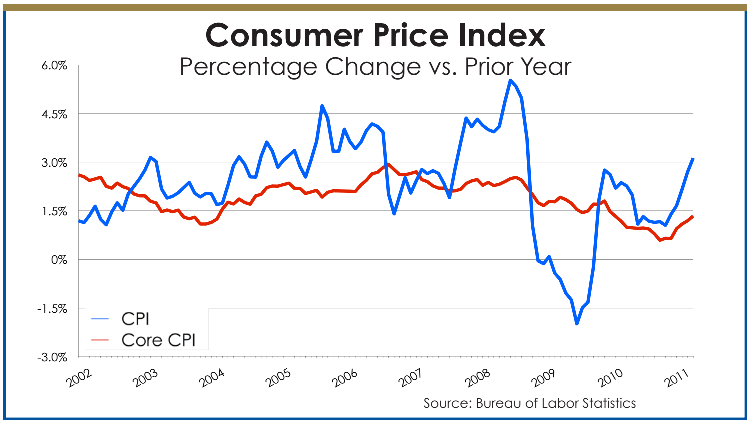
Rents are rising because many would-be home buyers or people who lost homes are now looking to rent. Because rent makes up 40% of the CPI, that inflation index could continue to rise relatively rapidly.

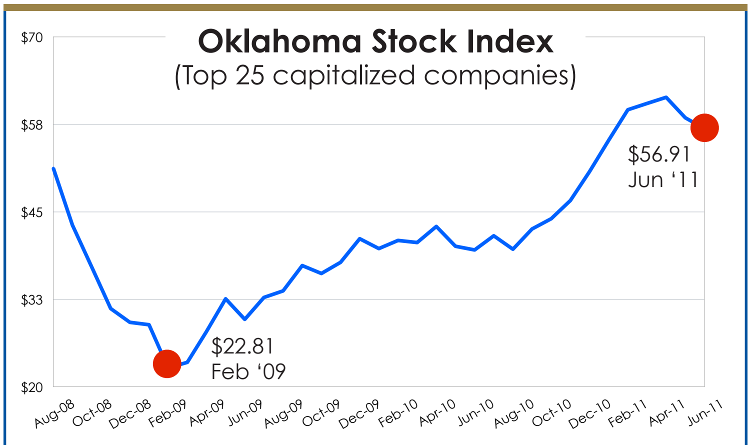
Apartment rents rose 5% in the last twelve months and landlords now have considerable pricing power. If rents keep rising, core inflation figures will not look as contained as they have to date.

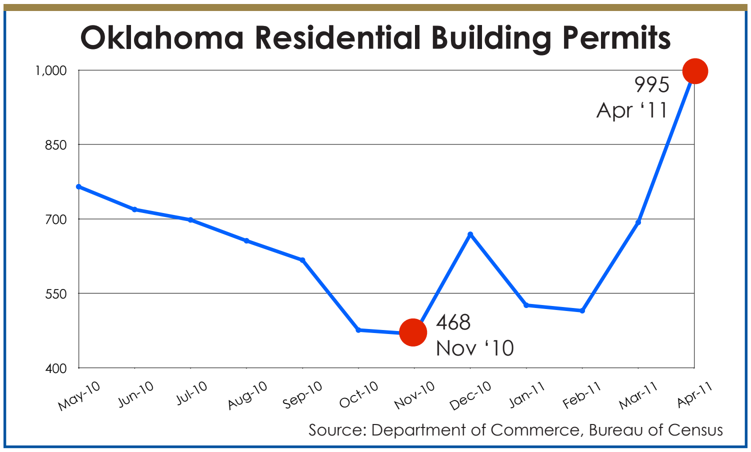
Reprinted from Baird Fixed Income Commentary, June 13 and 20, 2011

Economic Indicators









Interest Rate Forecast

75 Economists

	2Q 2011	3Q 2011	4Q 2011	1Q 2012	2Q 2012	3Q 2012
Fed Funds Target	0.25%	0.25%	0.25%	0.50%	0.75%	1.25%
3-M LIBOR	0.31%	0.35%	0.45%	0.75%	1.09%	1.45%
Treasury Notes						
2-Year	0.76%	0.90%	1.20%	1.50%	1.75%	2.10%
10-Year	3.50%	3.65%	3.80%	4.00%	4.10%	4.27%
Treasury Bonds						
30-Year	4.50%	4.65%	4.80%	4.90%	5.00%	5.09%
Economic Indicators	**2011**		**2012**			
Real GDP	2.7%		3.10%			
Unemployment	8.7%		8.1%			

Source: Median forecasts for key economic indicators as surveyed by Bloomberg June 6 - 11.