



# Oklahoma Economic Report™

News and analysis of Oklahoma's economy

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

## Budget busters

Thanks to Washington, uncertainty is the rule as states begin drafting budgets for the next fiscal year. With states receiving from 20 to nearly 50 percent of revenue from the federal government, the only certainty is that all possible responses to the fiscal crisis in D.C. will greatly impact the states.

The biggest federal issue with local impact is also the most daunting: Medicaid. According to the National Association of State Budget Officers (NASBO), for fiscal years 2011 and 2012, state budgets grew by about 3.5 percent while Medicaid is projected to grow by 3.9 percent this fiscal year.

If the pace continues, Medicaid costs will begin to crowd out other budget priorities. Already, Medicaid has become the largest spending category in state budgets, surpassing spending on K-12 education.

In the latest Fiscal Survey of the States report issued by the National Governor's Association and NASBO, 21 states anticipate that general fund revenues for fiscal year

2013 will be lower than 2008's pre-recessionary levels. But even states with rebounding revenues are understandably proceeding with caution, rebuilding emergency funds and foregoing new program spending initiatives.

The recession and its slow recovery have been challenging for the states, but it has also highlighted

**“The recession and its slow recovery have highlighted long-term structural fiscal problems.”**

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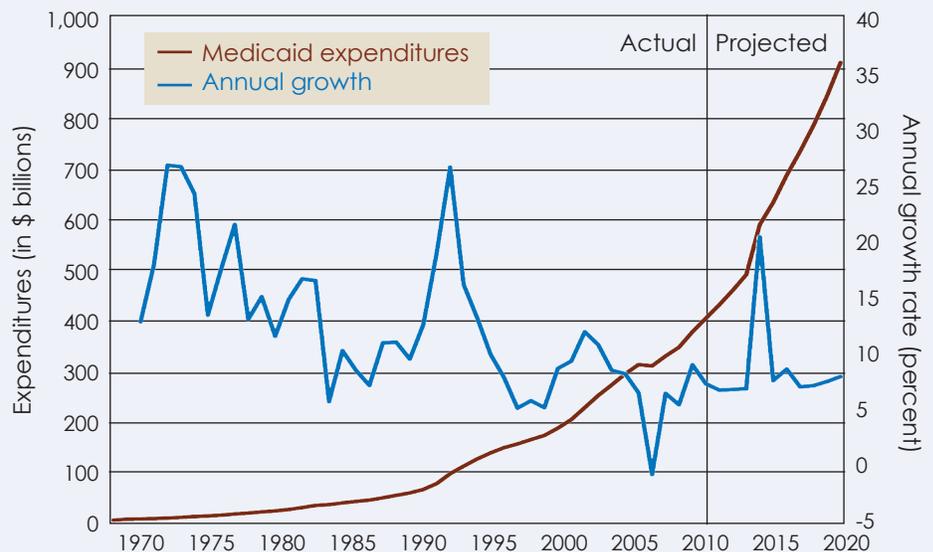
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### Medicaid Spending Has Grown Dramatically



Source: Centers for Medicare and Medicaid Services



## Speaker of the House Commentary

By Representative T. W. Shannon



### Fighting the addiction

An addiction to spending by Congress has created a national debt so staggering - \$16 trillion and counting – that most people can't even comprehend it.

That debt is owed by each American family, spent on their behalf by Washington, D.C. politicians who can't seem to shake their addiction to spending.

Like all addicts, the politicians rationalize their spending addiction.

They convince themselves that government is the solution to every problem, feeding their addiction with more and more spending, fueled by more and more debt.

This addiction is not only a threat to our country, but it threatens our state as well.

Today, more than 40 percent of our annual state budget is based on federal tax dollars. This is like depending on your parents to help

you pay the bills each year when they have no money in the bank and maxed out credit cards.

In the event of a fiscal emergency, Oklahoma must be prepared to maintain vital core services.

We simply can't depend on a dysfunctional federal government to meet our financial needs forever.

That's why I introduced House Bill 1917, which will require all state agencies to create a contingency plan

to prepare for a 25 percent drop in federal funds.

Agencies also will be required to rank federal funding grants by importance and in terms of federal strings attached.

For example, federal funds make up only eight percent of our education budget, but with that eight percent comes a whole host of expensive mandates. We need to fully

**“Our federal government has a serious spending addiction, and it doesn't look like it will be seeking help any time soon.”**

understand not just how many federal dollars are coming in, but also what we are required to do to get those dollars.

We must also address the issue of pension reform to ready our state for the times ahead. Like many states, our current pension system is unsustainable and projected unfunded liabilities are estimated at roughly \$11 billion. As lawmakers, we must figure out a way to make good on the promises made with our current state employees and create a system for new employees that is competitive with the private sector and limits debt taken on by the taxpayer.

Our federal government has a serious spending addiction, and it doesn't look like it will be seeking help any time soon. That means it is up to us to plan for when the federal government hits rock bottom.

After all, the first thing necessary to treat an addiction is to admit there is a problem.



## Budget busters

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long-term structural fiscal problems such as the sustainability of current public employee health and pension benefits.

It's not a matter of waiting out the storm; even the rosier of economic outlooks can't negate the fiscal turmoil awaiting states that fail to implement structural reforms.

The Report of the State Budget Crisis Task Force, which states its goal as to "inform the public of the gravity of the issues and the consequences of continuing to postpone actions to achieve structural balance," recently identified several major threats to states' fiscal sustainability. Growth in Medicaid spending and diminishing federal funds ranked as most pressing, followed by underfunded retirement promises.

While the costs of Medicaid and public pensions have been problematic for years, the anticipated wave of retirees from the baby boom generation may push the systems to their tipping points. The Social Security Administration projects the growth rate of the elderly population will more than double in each of the next two decades, dramatically increasing those eligible for Medicaid as well as the number of public employees who will begin collecting retirement and other benefits promised to them.

Since the program's inception, the cost of Medicaid has increased at "a significantly faster pace than the U.S. economy," according to the Centers for Medicare and Medicaid Services (CMS). And while much of the growth

in cost is due to expanded eligibility, the CMS notes that per-enrollee costs for the program have also increased significantly faster than per capita GDP.

Health care reforms, as implemented under the federal Affordable Care Act (ACA), are not expected to ease states' Medicaid costs, even for those who accept the expansion and the federal government's promise to pick up at least 90 percent of the tab.

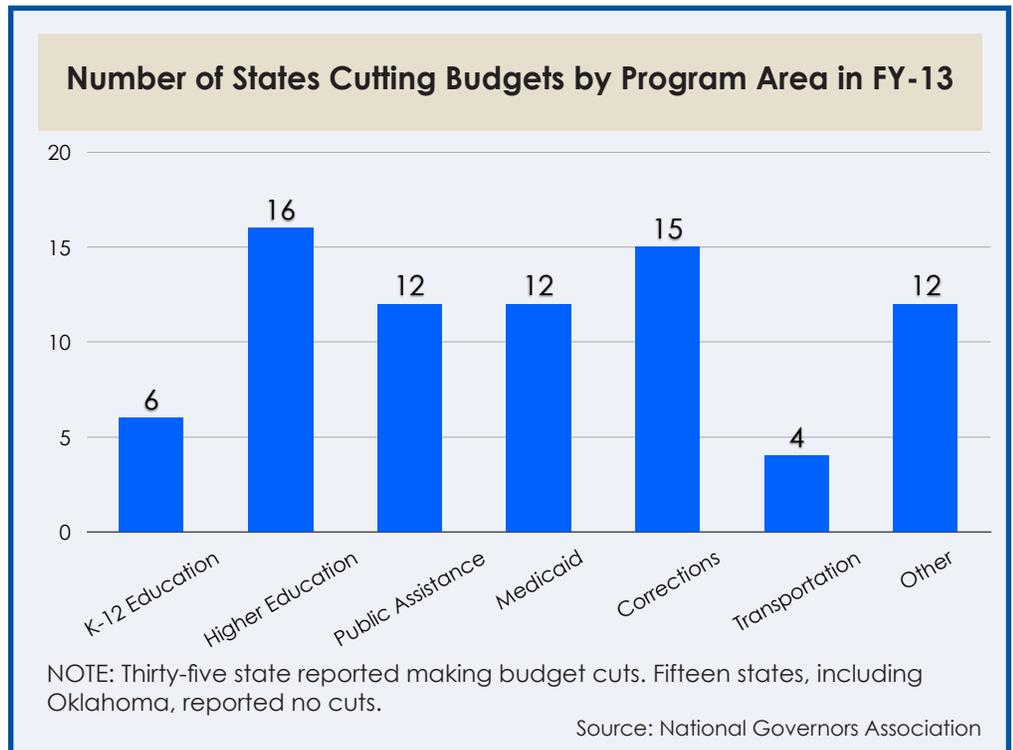
The CMS estimates that the ACA's expanded eligibility criteria will increase Medicaid expenditures by a total of \$619 billion by 2020, almost 11 percent over projections for Medicaid spending without the act. Even if the federal government bears the cost for 90 percent

of that expense, states will have to cover the remaining 10 percent while making up for expected reductions in other areas of federal support.

Accompanying the latest CMS actuarial report is a statement by the chief actuary that, "determining how to optimally balance our collective demand for the best possible health care with our non-unlimited ability to fund such care through private and public efforts represents one of the most challenging policy dilemmas facing the nation."

States are discovering just how challenging a task it is to try and contain or reduce Medicaid costs, especially when they must receive federal approval

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## Budget busters

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of most changes that affect the eligibility of participants or increases costs to patients or health care providers. Some states, like California and New Jersey, have proposed dramatic Medicaid cuts only to have many of the savings proposals rejected by federal authorities.

Medicaid and unfunded pension benefits risk doing to states what entitlement spending has done to the federal government. If states cannot get their respective fiscal houses in order, other state priorities will likely remain static.

States trying to build a budget can only

speculate as to where and how deep the cuts may be. Oklahoma policymakers have already asked agencies that receive federal funds to develop a contingency operations plan should those funds cease to exist.

The report by The Budget Crisis Task Force is just one of the warnings being issued to states. While the report does not propose specific policy reforms, it does call for budget practices that better reflect the financial relationships among all levels of government, and cautions against states employing temporary measures that avoid or delay hard fiscal decisions.

The task force report is blunt in its conclusion: “The existing trajectory of state spending, taxation, and administrative practices cannot be sustained. The basic problem is not cyclical. It is structural.”

### The “Boomer” Effect

The baby boom generation describes the 76 million Americans born between 1946 and 1964.

It's projected that every day for the next two decades, nearly 8,000 “boomers” will turn 65 years of age.

By 2030, one in five Americans will be over the age of 65 and many states will have more Medicare-eligible seniors than school-age children.

Sources: AARP, Governing

## Economic news briefs

In an average month in the U.S., more than 1 million jobs are destroyed. Thus, when a net increase of 200,000 jobs is reported in a month, in reality 1.2 million new jobs were created.

With federal employment at 2.6 million, even a cut of 2 percent would mean 56,000 jobs lost each year—a very small amount compared to the jobs destroyed each year in the private sector. The private sector could easily absorb those idled workers. Gradual government downsizing would not be a threat to the economic recovery.

Wages typically begin to accelerate three to four years into an economic recovery. Nationally, they have not done so in this recovery until, possibly, last month.

In December hourly wages jumped 1.7 percent, the biggest gain since the recession ended. If sustained, these types of wage gains might force the Fed to pull back from its very stimulative policy earlier than it had planned.

The Fed paid a profit of \$12 billion to the Treasury in 2012. That is three times the annual profits before the crisis. The

average return on its portfolio of bonds is 3.5 percent. A recent paper by Fed economists showed that once the Fed starts tightening policy those profits could turn to losses by 2017.

Cumulative losses could eventually reach \$40 billion. That would not be a huge problem for the Fed or the Treasury but it could create political headaches from critics in Congress.

*Reprinted from Baird Fixed Income Commentary, January 28, 2013.*



## General Revenue allocations top estimate

Allocations to the state's General Revenue Fund (GRF) exceeded the estimate by 1.4 percent in the first half of Fiscal Year 2013, according to the Office of Management and Enterprise Services.

Collections allocated to the GRF during the first six months of the fiscal year total \$2.644 billion, topping the estimate by \$37.5 million.

Most of the excess came from income tax allocations, which total \$1.232

billion. That is \$144.8 million or 13.3 percent above the estimate.

Personal income tax allocations to the GRF total \$1.051 billion, topping the estimate by \$73 million or 7.5 percent.

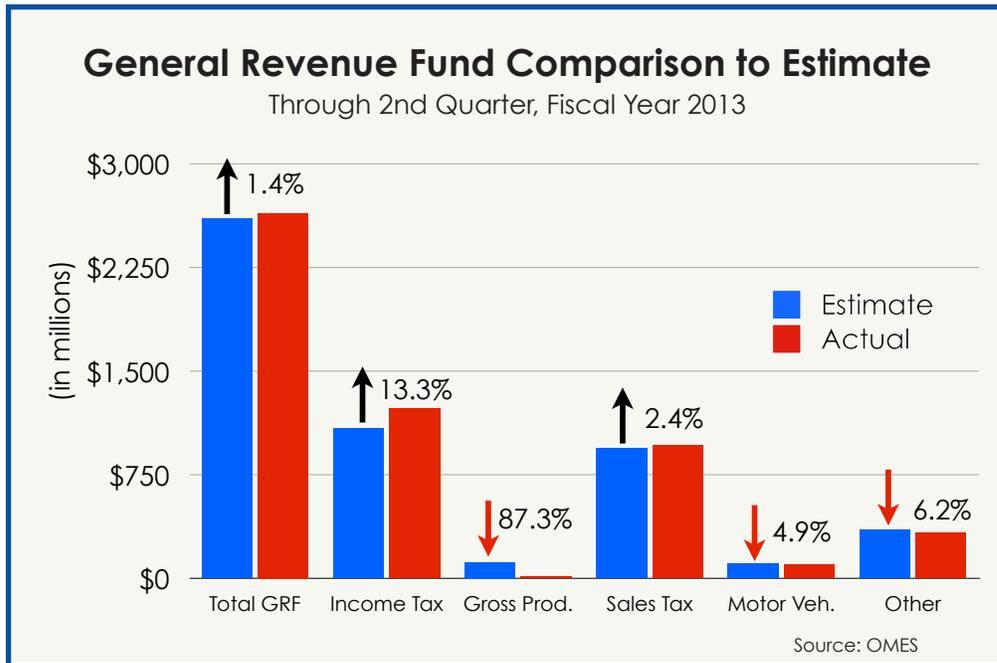
Corporate income tax provided \$180.9 million to the General Revenue Fund. That is \$71.8 or 65.8 percent more than estimated.

Gross production tax allocations significantly missed the estimate during the first half of the fiscal. Collections of \$15 million missed the mark by \$103 million or 87.3 percent.

First quarter motor vehicle collections to the GRF are \$102.7 million, missing the estimate by \$5.3 million or 4.9 percent.

Other sources total \$331.4 million, falling below the estimate by \$21.9 million or 6.2 percent.

During the two quarters, the GRF received 49.4 percent of gross collections.



## Oklahoma adds jobs as unemployment falls again in December

Oklahoma's seasonally-adjusted unemployment rate dropped to 5.1 percent in December, according to the Oklahoma Employment Security Commission.

Reports show the state added 460 jobs during the month, while the jobless number shrank by 820. Since December 2011, the state has added 56,800 jobs and the number of unemployed has fallen by 19,390.

The U.S. jobless rate remained at 7.8 percent in December.

OKLAHOMA	State Unemployment			
	Unemp. rate*	Labor force*	Employment*	Unemployment*
Dec '12	5.1%	1,824,040	1,730,720	93,320
Nov '12	5.2%	1,824,400	1,730,260	94,140
Oct '12	5.3%	1,821,890	1,725,620	96,270
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
Dec '11	6.3%	1,786,630	1,673,920	112,710

\* data adjusted for seasonal factors

Source: OESC



## Gross receipts & General Revenue compared

The Treasurer's January 3 Gross Revenue report and the Office of Management and Enterprise Services' January 15 General Revenue Fund (GRF) report contain key differences.

December gross receipts totaled \$974.77 million, while the GRF received \$518.9 million or 53.2% 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 December gross receipts, the GRF received:

- Personal income tax: 72.3%
- Corporate income tax: 76.1%
- Sales tax: 44.7%
- Gross production-Gas: 14%
- Gross production-Oil: 13.7%
- Motor vehicle tax: 22.6%
- Other sources: 49.2%

December GRF allocations topped the estimate by \$4.4 million or 0.9 percent. In November, collections dropped below the estimate by \$28.1 million or 7.1 percent.

For the month, insurance premium taxes totaled \$41.5 million.

Tribal gaming fees generated \$10.4 million during December.

## 2012 brought moderated economic growth to Oklahoma

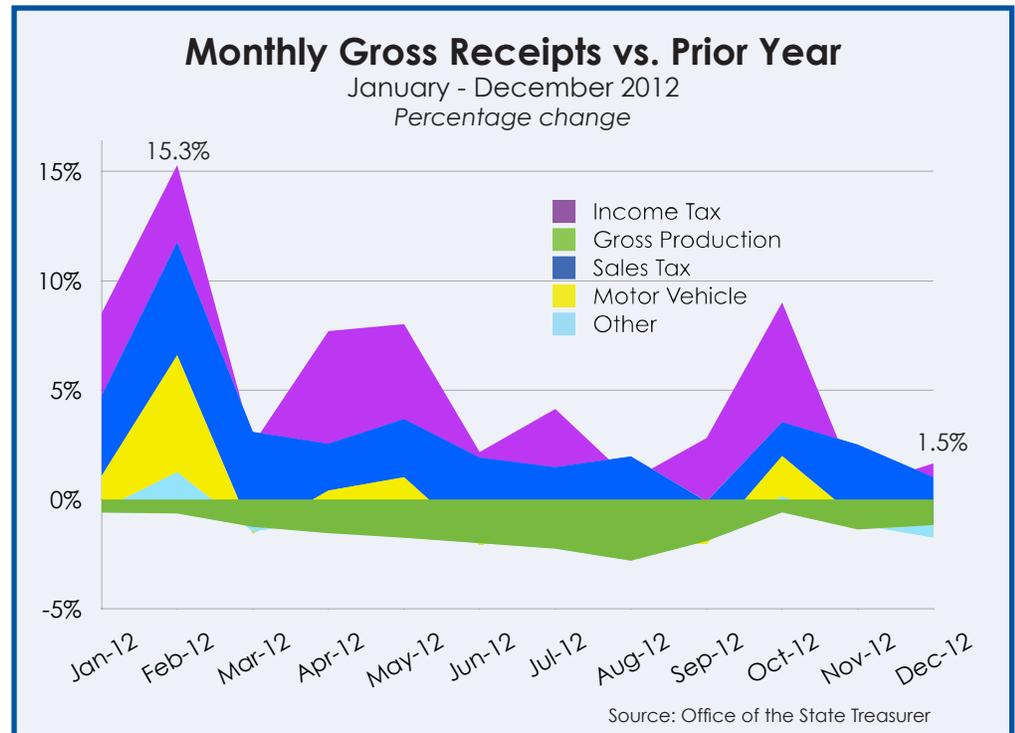
Oklahoma's economy continued to grow, but the pace of recovery slowed during 2012, State Treasurer Ken Miller said today as he released the state's monthly gross receipts to the treasury report.

"December receipts were 1.5 percent better than the prior year and total year collections surpassed the previous year by 3.8 percent," Miller said. "That compares to growth last December of 11.1 percent and a 2011 growth rate of 9.6 percent."

**“Oklahoma’s recovery has been stronger than in most other states, but we need our country to do well so we can continue our economic gains.”**

Miller said December was the eighth time in the past year that collections exceeded those of the same month of 2011. In four months of 2012, collections dipped slightly below prior year collections. "Twelve-month collections now stand more than \$1.7 billion higher than in February of 2010. Since we hit the trough almost three years ago, almost 90 percent of the revenue lost from our peak in December 2008 has been recovered," he said.

**SEE REVENUE PAGE 7**





## Revenue

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Miller said sales tax collections indicate a healthy Christmas shopping season in Oklahoma. December sales tax collections, reflecting sales between mid-November and mid-December, were \$20.45 million or 5.9 percent higher than the last holiday shopping season, a similar growth rate to sales during the same period in 2011.

### Averting the cliff

Miller said the fiscal cliff deal reached earlier this week by Congress and the President brings both good news and bad.

“The good news is that 98 percent of Americans will avoid a tax increase and the Bush tax cuts were made permanent, providing needed certainty to families and small businesses,” Miller said. “Quite obviously, that’s good news for the Oklahoma economy as it is

never advisable to raise taxes during a recession or weak recovery. Oklahoma’s recovery has been stronger than in most other states, but we need our country to do well so we can continue our economic gains.”

Miller said the bad news involves Washington’s appetite for spending.

“This deal does nothing to address Washington’s overspending that must be corrected lest our federal leaders spend this country into oblivion,” he said. “During the coming months, policymakers must be cognizant of the near-term weak recovery but must finally get serious and implement a long-term solution that safeguards the economic and national security interests of our country.”

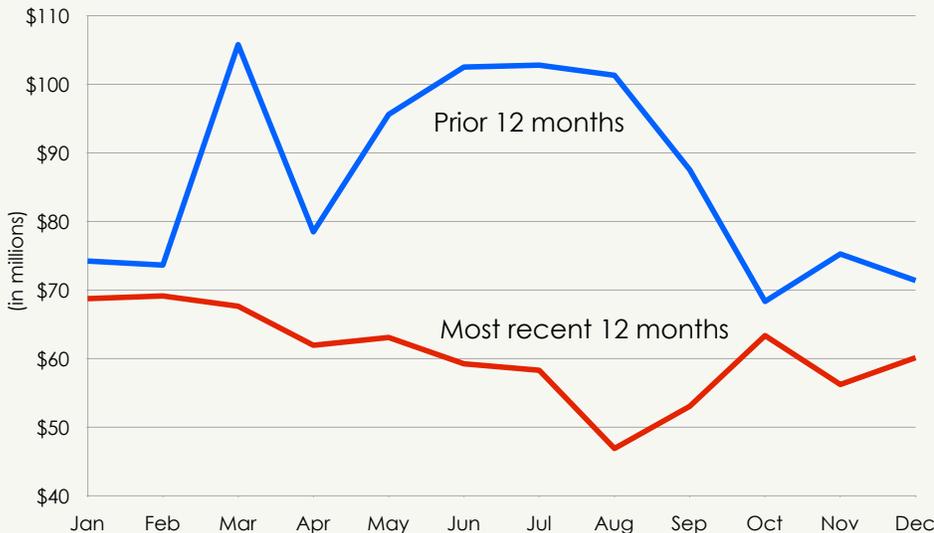
Miller said the biggest problem with spending cuts that would be started in two months if no further agreement is reached is that they disregard entitlements.

“Unfortunately with sequestration, the cuts are heavily weighted toward defense spending when the real problem, entitlement spending, is largely ignored,” he said.

“A strong defense is critical to our nation’s security and our state’s economy. Studies show Oklahoma could lose up to 20,000 jobs, including 4,000 military positions, if sequestration is triggered. This would be devastating to Oklahoma and can be avoided if Congress implements strategic rather than across-the-board spending cuts.”

### Gross Production Tax Collections

January 2011 – December 2012



Source: Oklahoma Tax Commission

## Coming soon to a computer near you: Oklahoma Treasury Online Checkbook

What if you could find out in a simple and easy way at the treasurer’s website where, exactly, the state government spends all of your taxes?

We are only a few weeks away from giving you the tool you need to make that happen.

The Oklahoma Treasury Online Checkbook – with details on the dollars government takes and spends – will go live soon. Look for details in our next issue.

### Oklahoma Treasury Online Checkbook

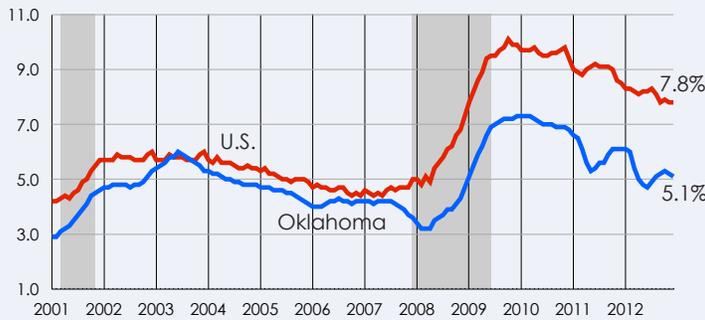




## Economic Indicators

### Unemployment Rate

January 2001 – December 2012



Shaded area denotes U.S. recessions

Source: Bureau of Labor Statistics

### Oklahoma 12-Month Gross Receipts

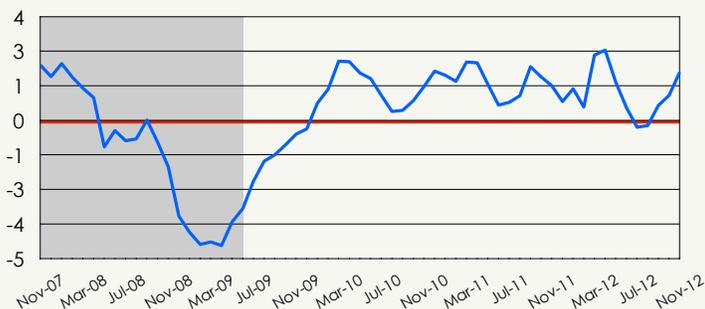
December 2008 - December 2012  
(in millions)



Shaded area denotes U.S. recession

Source: Office of the State Treasurer

### Leading Index for Oklahoma



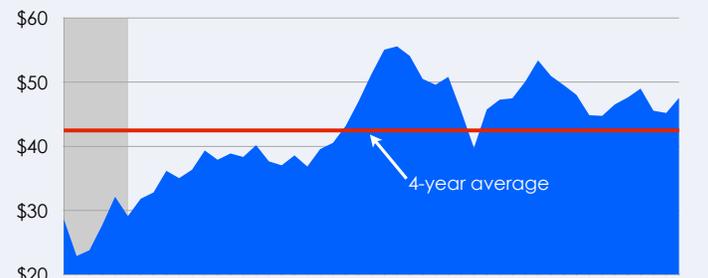
This graph predicts six-month growth by tracking leading indicators of the state economy including initial unemployment claims, interest rate spreads, manufacturing and earnings.

Shaded area denotes U.S. recession

Source: Federal Reserve

### Oklahoma Stock Index

(Top 25 capitalized companies)



Shaded area denotes U.S. recession

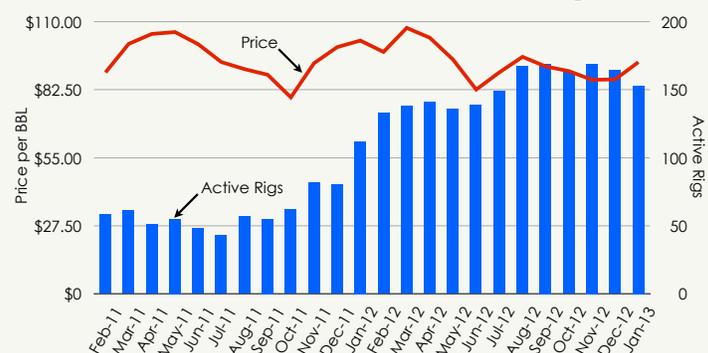
Source: Office of the State Treasurer

### Oklahoma Natural Gas Prices & Active Rigs



Source: Baker Hughes & Bloomberg

### Oklahoma Oil Prices & Active Rigs



Source: Baker Hughes & Bloomberg