



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

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

Proposals offer potential savings

When streamlining the management of the state's seven pension systems was originally proposed in February by Governor Mary Fallin and Treasurer Ken Miller, annual savings of between \$10 million and \$15 million were estimated, based on savings achieved in past consolidation efforts.

Because proponents and opponents alike wanted a better indicator of potential saving, a historical analysis was requested from New England Pension Consultants (NEPC) in March.

Their cost/benefit analysis estimates that if Oklahoma's pension plans were packaged into a single investment pool, economies of scale would result in lower investment fees. Depending on

the investment management approach selected – more active management or more passive management – the savings in investment and consulting fees could result in a savings of between \$12 million to \$49 million annually.

Additionally, it has been estimated that \$3.5 million in administrative savings could be achieved annually from shared personnel, elimination of duplicative office space, operating expenses and other overhead. The state's five largest plans alone spend more than \$15 million annually on these administrative costs.

“Critics contend the savings are more likely to be near the lower end of the estimated range and that \$15 million in savings is not worth the trouble,” said

Miller. “I disagree. But even if they are right, every dollar saved is a dollar that will go back into paying benefits.” Miller referenced a recent news article about \$850,000 in Oklahoma City police radios sitting in storage. “As the state auditor rightfully pointed out, it was a ‘significant waste of taxpayer dollars.’ Certainly, most taxpayers would think that saving \$15 million a year is worth the trouble.”

NEPC also looked back over the past five and 10 years worth of investment returns for each of the plans to show that significant additional earnings could have been gained had either one of the two best-performing plans

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Potential Investment Fee Savings

	Current Fee Structure	TRS Scenario	OPERS Scenario
Total Pension Funds	\$20,353.21	\$20,353.21	\$20,353.21
Average Fees	0.35%	0.31%	0.11%
Investment Mgmt Fees	\$71.40	\$63.09	\$22.39
Custody	-\$9.55	-\$12.46	-\$6.15
Net Mgmt Fees	\$61.85	\$50.63	\$16.23
Investment Consultant	\$3.71	\$2.75	\$0.45
Total Fees in 2011	\$65.56	\$53.38	\$16.68
Total Savings		\$12.17	\$48.87

(Dollar amounts in millions)

Source: NEPC, LLC



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

What a difference a year makes

With just four weeks left until sine die, state lawmakers are wrapping up their business and heading toward the finish line. The only thing standing between legislators and the door is passing a budget, and it appears an agreement on their top constitutional duty is imminent.

Last year, most pundits agreed that what didn't happen overshadowed what did. Certainly, the opposite is true this year.

Reforming the state's worker's compensation system, lowering the income tax and repairing the Capitol infrastructure are major achievements that will greatly enhance Oklahoma's competitive economic environment, while preserving the historic Capitol building for generations to come.

The shift to an administrative worker's compensation system is estimated to save businesses hundreds of millions of dollars. These savings will be re-invested in our economy in the form of new jobs, higher salaries and capital purchases.

Oklahoma will similarly benefit with the passage of a responsible income tax reduction. The top tax rate will be lowered from 5.25 percent to 5 percent beginning in 2015, then lowered again the following year to 4.85 percent, assuming modest growth revenues are achieved.

Lawmakers committed funds to invest in our crumbling Capitol building by delaying implementation of the tax cut. The badly-needed repairs have been neglected for far too long, but now they will be addressed with more than \$100 million in funding.

The Governor and Legislature deserve much credit for these critical achievements.

“This year's legislative accomplishments will further lift our state.”

There will always be unfinished business, but every issue eventually has its day. Decades of neglect of transportation infrastructure needs were addressed in a big way in the 2005 legislative session. Reforms in education, tort and criminal justice were also made priorities in recent years.

This session's accomplishments have cleared the way for new priorities next session, and one that must be given greater attention is the long-term stability of the state's pension systems. One would be hard pressed



to find a more significant issue facing states across this country, including Oklahoma.

The previous two session's efforts at reducing unfunded liabilities were important. Lawmakers continued forward momentum this session. Establishing a fund for possible cost of living adjustments and making corrections to the firefighter's pension system were among the improvements.

But even with these actions, Oklahoma remains among the states, cities and towns across the U.S. feeling the impact of pension benefits they can no longer afford, as evidenced by a trillion dollars of unfunded obligations nationwide. With more than \$11 billion in unfunded liabilities and an average funded status of around 66 percent, Oklahoma taxpayers cannot afford to wait decades to see if the problem resolves itself.

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Commentary

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To date, the issue of pensions has mattered primarily to those receiving the benefits. But Oklahoma’s pension debt is an obligation of the state, which means it’s a responsibility of the taxpayer, to the tune of \$2,900 per citizen. Without

significant reform, Oklahoma may be unable to keep promises made to workers without either cutting spending in core areas, implementing ill-advised tax increases or raising employee retirement contributions.

Oklahoma is better off today for the solutions enacted to many of the state’s

challenging problems over the past several years. This year’s legislative accomplishments will further lift our state.

Going forward, the state can continue its momentum by turning to the problems that have been waiting for their moment in the sun.

Pension savings

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managed all assets. For example, had the Teachers Retirement System (OTRS) managed all assets with its investment strategy, increased earnings would have generated more than \$500 million in additional returns over the period 2008-2012.

Looking back over a 10-year period, the outperformance of this strategy would have, on average, created a net gain of \$173 million per year, according to the report. Over the last 10-year period, OTRS’s strategy outperformed all other funds in its peer public fund universe, as detailed in NEPC’s Investment Summary Report for the quarter ending Dec. 31, 2012, as presented to the State Pension Commission. While past performance is never a guarantee of future results, Miller said the report clearly demonstrates the net benefit outweighs the higher fee structure.

The financial benefits estimated by NEPC are based solely on unifying the investment strategy and fee structure used by the pension systems. The individual pension funds would remain separate for all purposes except investment. In other words, the funds would be packaged for

volume discounts. Actually comingling the funds would violate the Internal Revenue Code and Oklahoma Statutes.

“No one is suggesting that any of the systems’ administration is doing a poor job, only that it can be done better, cheaper and more efficiently. The purpose of the pension plans is to ensure that Oklahoma’s public workers have a secure retirement benefit. We should continually strive to eliminate waste and

duplication,” said Miller. “Espousing conservative principles should be seen in our actions, not our words. Streamlining is a common-sense solution that must be seriously considered by the Legislature between now and next session.”

He noted that legislative reforms enacted over the past two years have significantly improved the stability of the states’ pension plans, but that was

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Pension savings

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just the beginning. “The state still has \$11 billion in pension liabilities,” said Miller. “Governor Fallin and I said two years ago that pension reform should be addressed in two phases: the first, to stop the liabilities from worsening, and the second phase should be to provide

a retirement benefit plan that offers long-term stability to our future public workforce.”

Miller said that he, the Governor and legislative leaders are committed to honoring every benefit promised to current workers and retirees. But he also said the current benefit plan does not meet the needs of younger workers

entering public service. “There’s a lot of movement among the states to develop new benefit plans that are actually more attractive to today’s modern workforce,” he said. “I’m committed to working with legislators in the coming months to develop a plan that will reward public service while being fair to taxpayers as well.”

Q & A with House Appropriations and Budget Chair Scott Martin

OER: The governor has worked to remove one-time funding sources from her proposed budget. Senator Jolley has said he agrees with that approach, except during times of economic contraction. Do you agree?

SM: Generally, the use of one-time revenue to fund on-going expenditures should not be a regular practice. It is important, however, to realize that the identification of what constitutes a one-time revenue source does not always equate to any revenue that is not included in the certification of revenue by the State Board of Equalization.

For example, as a part of budget development certain balances in specific revolving funds are often transferred to the Special Cash Fund to be redirected toward legislative funding priorities (examples: Secretary of State and Insurance Department funds whose fund balances are in excess of the agency’s budget needs).

OER: How do you balance the desire to remove one-time sources of revenue to fund ongoing expenditures with what seems to be a shortage of cash to fund a budget without them?

SM: While there might be more requests than available money, we are blessed with a growing economy that helps us in meeting the state’s critical needs. Because of the state’s fiscal

year structure and the procedures in law for the transition from one fiscal year to the next there will be some amount of residual cash, especially within the structure of the General Revenue Fund.

While there may be a desire to make certain appropriations using cash, the Legislature is limited to cash that is existent in a fund – it cannot appropriate funds based on an anticipation of an available balance. Often, appropriations that might be better made with cash resources will need to be made using certified funds and will be satisfied through the allocation process during the fiscal year.

OER: What are your thoughts on funding for Oklahoma’s Capitol and infrastructure needs?

SM: The Legislature has an obligation to the people of Oklahoma to maintain the public infrastructure to ensure the state’s physical assets are safe and operate in an efficient manner. While efforts to provide funding for these assets have been lacking and limited for many years, a structure for addressing the maintenance, renovation and repair-needs continues to be put in place.

Legislation authored by Speaker T.W. Shannon in 2011 required a comprehensive inventory of state-owned properties. Speaker Shannon created the Maintenance of State Buildings

Revolving Fund in 2012 to provide a depository for the proceeds from the sale of state-owned properties.

This session Speaker Shannon is the author (with Senate President Pro-Tempore Bingman) of legislation to continue the development of a comprehensive process for the evaluation and maintenance of the state physical assets. HB 1910 includes, among its provisions, the consolidation of several entities with a role in maintaining state physical assets into the Long-Range Capital Planning Commission. The Commission is to develop an annual capital budgeting plan to address needs for the following eight years, providing a regular and consistent review of capital needs.

Funding will be vital for progress to be made regarding the needs of the Capitol and other state physical assets as recommended by the Commission. Immediate funding to complete a detailed renovation plan for the Capitol and to make emergency exterior repairs has been identified through this year’s budget agreements.

OER: How can Oklahoma prepare for federal spending cuts due to sequestration? How will Oklahoma have to adjust its budget as a result?

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Martin

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SM: Sequestration has stressed the need to show prudence on the part of the Legislature and our state agencies as we expend precious tax dollars. We continue to monitor and consult with agencies affected by sequestration and with the Office of Management and Enterprise Services (OMES) to measure the effects on programs and to the citizens of the state.

HB 1917, authored by Speaker Shannon and Pro Tem Bingman directs state agencies to develop a contingency plan and corresponding budget for a reduction in federal funding of up to twenty-five percent (25%). The measure also directs agencies to publicly disclose and display all federal funds under their control and to prioritize all federal funds as to the reliance by the agency on federal funding.

OER: What are the budget priorities of the House?

SM: Our priorities are to develop a budget that ensures the availability and delivery of the most vital governmental services to the citizens, with the highest

degree of efficiency and quality.

Top priorities include funding to provide a high quality education for Oklahoma's children, a dynamic system of colleges, universities and technology centers, the best possible health of our children and adults, services and safeguards for vulnerable children and the elderly, a responsive and efficient public safety network and continued improvements to the transportation system.

As mentioned, improving the condition of the state's physical assets in a well-developed and fiscally responsible process as provided in HB 1910 is also a high priority.

OER: Should state agencies expect funding to return to the amounts seen prior to the last recession?

SM: State agency funding should be made as a result of an identification of the resources necessary to provide efficient and effective services to the citizens.

With that objective there may be circumstances where funding might be required that meets or exceeds pre-recession amounts, while with others funding at levels below fiscal

year 2009 levels will be sufficient to provide necessary resources. Reforms, efficiencies, and technological advances have made the cost to run government less in some areas.

Meet Rep. Scott Martin

Rep. Scott Martin was first elected to the Oklahoma House in 2006 and serves as Chair of the full Appropriations and Budget Committee, and as Chair of the Conference Committee on Appropriations and Budget.

A 1991 graduate of Tulsa Memorial High School, Martin earned a bachelor's degree in Political Science from the University of Oklahoma in 1995.

Martin serves as an officer of Republic Bank & Trust in Norman. He previously served as Assistant to the City Manager for the city of Norman and Public Works director for the city of Noble.

He and his wife, Angie, are the parents of two sons, Luke and Blake.

General Revenue allocations slightly exceed estimate

General Revenue Fund allocations through the first nine months of the fiscal year remain slightly ahead of the estimate, figures released by the Office of Management and Enterprise Services show.

Allocations to General Revenue from July 2012 through March 2013 total \$3.89 billion, which is \$16.1 million or 0.4 percent above the estimate.

Net income tax allocations, a combination of personal and corporate

income taxes, are \$1.7 billion. That is \$197.1 million or 13.1 percent above the estimate.

Personal income tax contributed \$1.4 billion to the total, which is \$96.3 million or 7.4 percent ahead of the estimate.

Corporate income tax allocations total \$295.4 million. That is \$100.8 million or 51.8 percent higher than the estimate.

Gross production tax transfers total \$124.5 million, which is \$120.2 million

or 49.1 less than estimated.

Sales tax allocations are \$1.43 billion, ahead of the estimate by \$5.9 million or 0.4 percent.

Motor vehicle tax contributions to the General Revenue Fund total \$146.2 million and fall short of the estimate by \$17.9 million or 10.9 percent.

Other sources of revenue total \$496 million through the third quarter of the fiscal year. That is \$48.8 million or 9 percent below the estimate.



Gross receipts & General Revenue compared

The Treasurer's April 3 gross receipts to the treasury report and the Office of Management and Enterprise Services' April 9 General Revenue Fund (GRF) report are vastly different.

March gross receipts totaled \$944.6 million, while the GRF received \$413.9 million or 43.8 percent of the total.

The GRF received between 32.2 percent and 57.3 percent of gross collections during the past 12 months.

From March gross receipts, the GRF received:

- Personal income tax: 30.9%
- Corporate income tax: 75.3%
- Sales tax: 44.6%
- Gross production-Gas: 39.8%
- Gross production-Oil: 65%
- Motor vehicle tax: 22.8%
- Other sources: 40.7%

March GRF allocations fell short of the estimate by \$61.6 million or 13 percent. In February, collections were below the estimate by \$20.4 million or 7.4 percent.

For the month, insurance premium taxes totaled \$22.9 million.

Tribal gaming fees generated \$10.3 million during March.

Oklahoma gross revenue up in March

Oklahoma's revenue growth returned in March after seesawing within a pretty tight range for the past year, State Treasurer Ken Miller said as he released the March gross receipts to the treasury report.

"The natural gas market has stabilized somewhat and prices have risen by about 30 percent from their low," Miller said. "We are seeing those improved market conditions reflected in our collections."

Miller said notable positives in March include gross production and corporate income tax collections.

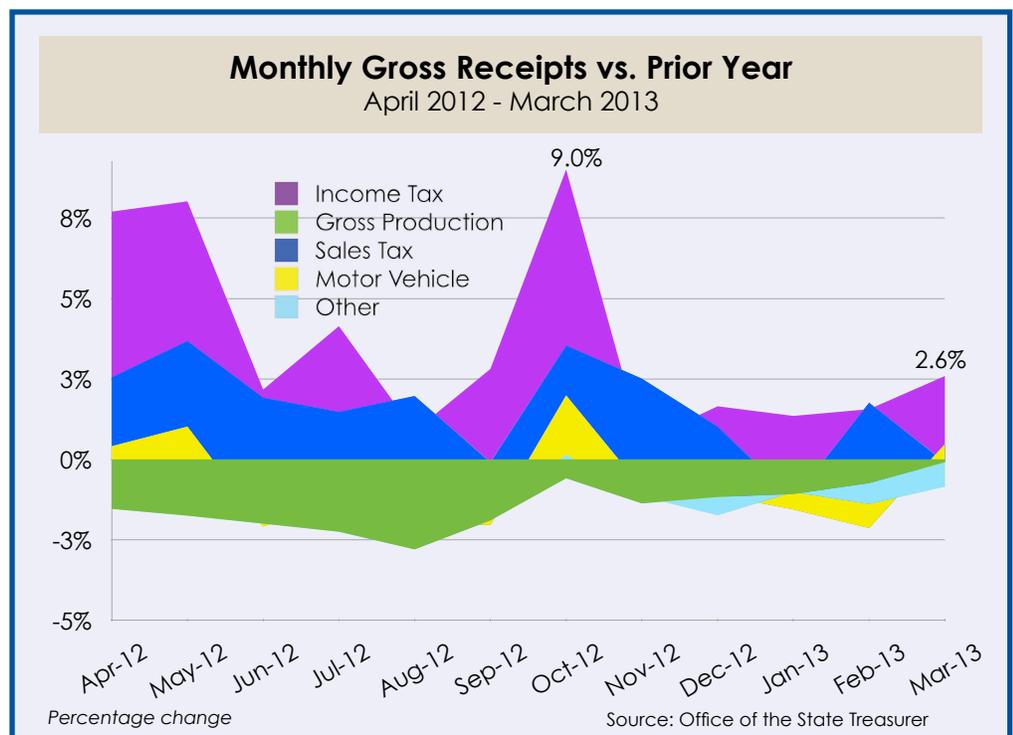
After falling far below prior year collections each month for more than a year, gross production collections this month were almost \$67 million, near where they were during March of last year.

“The bottom line indicates Oklahoma’s economy is continuing to expand . . .”

Gross income tax collections showed growth of more than 7 percent during the month, with strong corporate collections. The tax commission recorded a 6 percent hike in the number of corporations filing estimated payments in March and corporate tax

collections jumped by almost 32 percent from the prior year.

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Oklahoma unemployment percentage unchanged in March

Oklahoma's seasonally-adjusted unemployment rate was listed at 5.0 percent in March by the Employment Security Commission, unchanged from January's rate.

Reports show state employment shrank by 2,240 jobs during the month, while the jobless number dropped by 700. Since March 2012, the state has added 19,010 jobs and the number of unemployed has fallen by 1,610.

The U.S. seasonally-adjusted jobless rate was set at 7.6 percent in March.

State Unemployment				
OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
Mar '13	5.0%	1,814,440	1,723,900	90,540
Feb '13	5.0%	1,817,380	1,726,140	91,240
Jan '13	5.1%	1,818,740	1,726,380	92,360
Dec '12	5.1%	1,816,630	1,723,540	93,090
Nov '12	5.1%	1,813,130	1,720,130	93,000
Oct '12	5.2%	1,810,920	1,716,320	94,600
Mar '12	5.1%	1,797,040	1,704,890	92,150

* Data adjusted for seasonal factors Source: OESC

Revenue

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Total collections for the month were \$944.6 million, up by \$24 million or 2.6 percent from March of last year. Three of the four major tax categories were

lower than the prior month with the biggest drop among the major sources of revenue coming from motor vehicle taxes, which fell by more than 11 percent.

Sales tax receipts produced slightly less

revenue than during March of last year, down by \$5.3 million or 1.6 percent.

“The bottom line indicates Oklahoma’s economy is continuing to expand, but moderation continues,” Miller said.

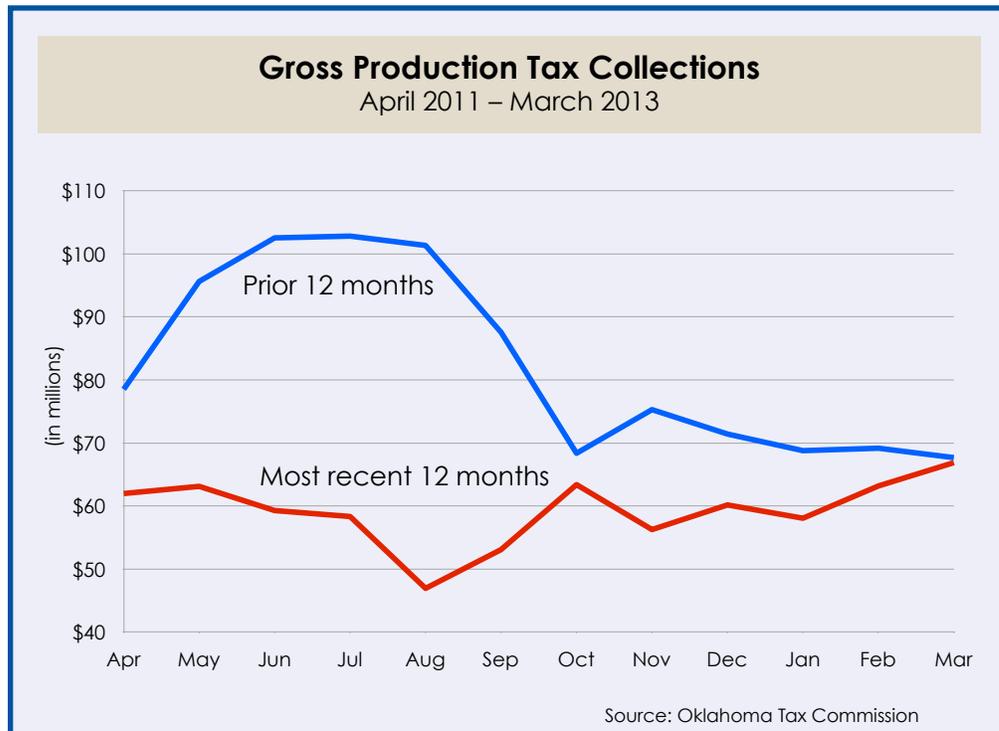
“With less purchasing of motor vehicles and slightly lower consumer spending as measured by sales tax collections, it could be that we are beginning to see the psychological impact of Washington’s inability to reach consensus on getting government spending under control in a strategic way,” he said.

Positive data

Miller said the state’s personal income, as announced late last week by the U.S. Bureau of Economic Analysis, is a ray of light on the economy.

“Oklahoma’s total personal income grew faster than the national average last year,” he said.

“Total personal income was up 4.2 percent in 2012 at \$148.8 billion, the seventh-highest change in the nation.”

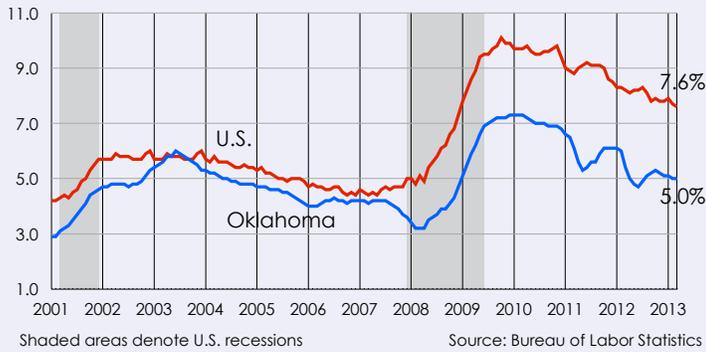




Economic Indicators

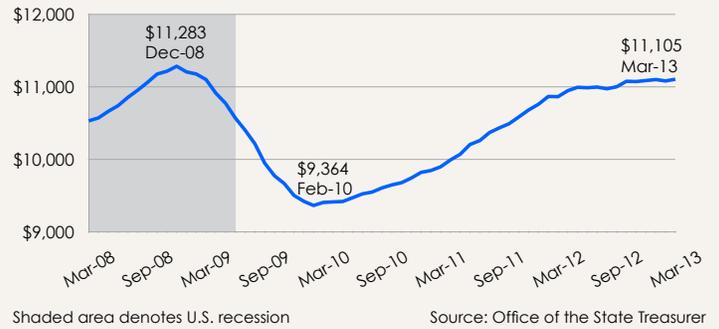
Unemployment Rate

January 2001 – March 2013



Oklahoma 12-Month Gross Receipts

March 2008 - March 2013
(in millions)



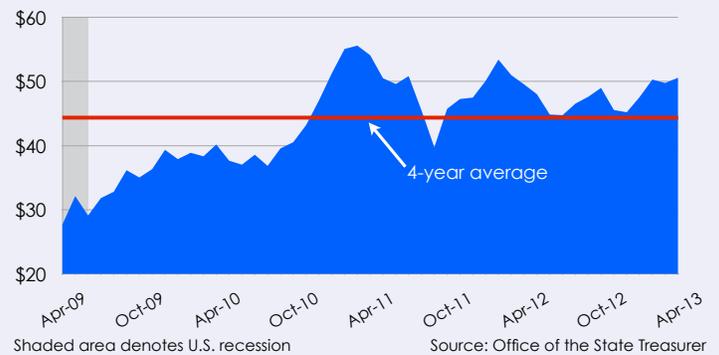
Leading Index for Oklahoma



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

Oklahoma Stock Index

(Top 25 capitalized companies)



Oklahoma Natural Gas Prices & Active Rigs



Oklahoma Oil Prices & Active Rigs

