

INFORMATIONAL: REVENUE FORECAST

INTANGIBLE UPDATE:

ELIZABETH HARCHENKO, DIRECTOR, DEPT. OF REVENUE

TAPES 67 ñ 68, A/B, 69A

HOUSE REVENUE COMMITTEE

FEBRUARY 26, 1999 ñ 8:30 A.M. - HEARING ROOM A - STATE CAPITOL BUILDING

Members Present: Rep. Ken Strobeck, Chair

Rep. Anitra Rasmussen, Vice Chair

Rep. Deborah Kafoury

Rep. Jeff Merkley

Rep. Diane Rosenbaum

Rep. Lane Shetterly

Rep. Jim Welsh

Rep. Max Williams

Rep. Bill Witt

Staff: Paul Warner, Legislative Revenue Officer

Ed Waters, Economist, Legislative Revenue Office

Barbara Guardino, Committee Assistant

Witnesses: Elizabeth Harchenko, Director, Oregon Dept. of Revenue

Ralph Shaw, Chair of Governors Council of Economic Advisors

Tom Potiowsky, Acting State Economist

Sarah Gates, Office of Economic Analysis

Jim Manary, Oregon Dept. of Revenue

TAPE 067, SIDE A

005	Chair Strobeck	Called meeting to order at 8:30 a.m.
014	Tom Potiowsky	Introduced colleagues, Ralph Shaw and Sarah Gates
017	Ralph Shaw	Gave brief recap of 1998 national economy, and outlook for national economy. In 1998, real Gross Domestic Product grew at 4.1%. Questions concerning second half of 1999, particularly in regard to Y2K concerns. Consumer spending in 1998 grew at fastest pace since 1984. Job growth is strong, consumer confidence is at record levels. High technology investment rose 32%. Non-farm inventory investment has been modest. Expect accumulation of inventories due to Y2K.
054	Shaw	Record U.S. trade deficit in 1998 in goods in services, trade should continue to be a major drag on growth due to recessions in other countries, particularly in Brazil. Signs of deflation in goods prices and raw material goods. Inflation is rising at slowest pace since 1949. Including prices for imports, inflation rate could turn to deflation. Gross domestic prices for U.S. goods are falling for the first time since the mid-1950s. Continued reduction in service.
072	Shaw	<p>Low unemployment, low inflation rate. GDP growth is over 4%. Growth above 3% is possible for first half of 1999. Few clouds on horizon (Y2K).</p> <p>Current expansion is the second longest on record ñ 93 months.</p> <p>Concern with global market. U.S. economy should be able to handle almost all the shocks in 1999.</p> <p>Leading indicators of expansion: Leading index rose 1.25% in 1998, thus very low probability of recession in 1999. Four leading index components: Building permits, stock prices, money supply, interest rates. Predicts growth of 4% first 6 months.</p> <p>Gross Domestic Product Growth: Unemployment 4 1/3%. Likely most of GDP growth will come from increases in productivity.</p>
132	Shaw	<p>Areas of greatest risk:</p> <ul style="list-style-type: none"> • Manufacturing, global market decline for durable goods due to currency problems. Dollar is strong against Yen and Euro which makes U.S. goods less competitive. Problems with Brazil will affect other South American countries. Seriousness has been mitigated in U.S. financial markets. Most consumers in U.S. have been relatively unconcerned with downturns in global economy. Brightening picture for U.S. manufacturers.
166	Shaw	<ul style="list-style-type: none"> • Concern with profit squeeze and corporate layoffs (restructuring). So far layoffs have been insignificant. People are finding jobs. Layoffs could affect consumer confidence. Average American is spending more than he/she earns; savings rate is negative. Important to continue to monitor profit squeeze.

202	Shaw	<ul style="list-style-type: none"> • Volatility of stock market. Most of growth in 1998 took place first six months. Correction, then huge increase in valuations second half of 1998. Part of increase was due to anticipation of rise in profits. Companies ended the year with weaker profits instead.
219	Shaw	<ul style="list-style-type: none"> • Y2K problem: Businesses are shrinking their inventory. If components are not available, this could pose a significant problem in manufacturing. <p>Countries outside United States are behind in dealing with Y2K problem.</p>
255	Shaw	Summarized: Momentum behind this economy continues to be very strong. GDP should grow in excess of 3.5%. No signs of inflation; signs of deflation. Concerned about inflation in health care.
273	Potiowsky	Office of Economic Analysis that provides these projections has two advisory committees: Administrative Services Insiders Group, Governor's Economic Advisory Council. They provide input. Real GDP growth stood at 6.1% for fourth quarter of 1998, a large upward revision. Using this information influenced Oregon's forecast. By comparison, Oregon did not experience same growth. Oregon employment growth stood at 2%, first time since 1985 that it has fallen below national average.
321	Potiowsky	<p>Directed members' attention to "Oregon Economic and Revenue Forecast Summary," page 3 (EXHIBIT 1): Top graph: Employment Growth by State, 1991-98.</p> <p>Oregon Job Growth Ranking by Sector: End of 1998 Oregon ranked fairly low in manufacturing and construction; consumer-related industries had strong growth.</p>
276	Potiowsky	<p>Page 4, exports to Japan fell 15.9%. Manufacturing industries in Oregon were the most affected.</p> <p>Sectors that declined include food processing jobs, electronic industry, lumber, and wood products. Performing well were services, retail trade.</p>
420	Potiowsky	This picture has changed Oregon's short-term outlook. Oregon economy bottomed out second half of 1998. OEA forecasts that the economy will not deteriorate any further. They see it remaining sluggish through first quarter of 1999, then improving moderately. Projected job growth of 2.3% for 2000.
446	Potiowsky	<p>Forecast Risks: As a consumer led, export drag economy, risks are to consumer spending and to exports. Expect exports to pick up second half of 1999. Consumer side, worried about stock market and interest rates.</p> <p>If stock market turns around, that will decrease consumer confidence and spending. Federal Reserve could raise interest rates. Inflation/deflation is a toss-up. . U.S. economy is alone in the world as far as growth.</p>

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- 045 Potiowsky Summarized, picture is better than expected; economists don't see any decline in Oregon economy in 1999, rise upwards, stronger than U.S. overall average.
- 055 Sarah Gates Presented revenue forecast (page 7 of summary handout): 1997-99 General Fund Forecast. Major change is to personal income tax forecast.
- Total revenue is up \$44 million for biennium. Increase in personal income tax forecast has pushed Oregon above 2% kicker threshold. Will pay kicker fall of 1999.
- Discussed reasons for increase in income tax forecast: Improving economy; changes for assumptions regarding federal pension income tax refund.
- 092 Gates See Page 8 of summary: 1999-01 General Fund Forecast. Personal income tax is down as a result of return of the 2% surplus kicker. Total revenues are \$9.7 billion, a decrease of \$157 million.
- 110 Gates Page 9: Summary of Lottery Revenues Available to the State. Lowered forecast for next biennium due to lower video lottery. Fewer retailers are using video terminals. Decrease of \$7 million in revenue.
- Beginning in 2001-2003 biennium, lottery will have to purchase/lease new terminals. This will lower revenues by \$30 million.
- Also, 40% of lottery resources are already spoken for.
- 156 Gates Page 10: Page 10: 1999-01 General Fund-Lottery Forecast. Decrease of \$116 million.
- 172 Rep. Witt In looking at job growth in Oregon in relation to other states, Oregon was number 2 in terms of job growth in government sector. Why and where?
- 176 Potiowsky Employment due to election year. Also tribal employment.
- 182 Rep. Merkley Asked witnesses to comment on about future of high tech sector.
- 198 Shaw News became brighter due to demand for personal computers. Based on news last two weeks, demand is leveling off. This could directly affect Oregon companies including Intel. Advanced Micro Devices has 40% of overall market for personal computer chips, and is expected to increase its market share.
- 233 Vice Chair Rasmussen Questions about timber industry, particularly in eastern Oregon.

236	Potiowsky	All ships don't rise equally. Most growth is in Willamette Valley, mostly tied to high tech sector. Timber communities have continued to have high unemployment rates. Timber industry is facing steep competition, nationally and internationally. Tight supply, weak demand.
293	Rep. Witt	Asked panel to comment on low savings rate and health care inflation.
312	Shaw	Regarding health care: HMOs report substantial losses. Keizer Permanente in Oregon reported profit due to closure of a hospital. Anticipates 10% increase in health care insurance costs. First consideration is to aggregate more individuals into health care groups. Need to start thinking about a different way to deliver insurance to patients.
381	Shaw	Concerning negative savings rate, question is what is the total national savings? Individual savings versus government savings. As governments run surpluses, the result is a net positive savings. What is the definition of savings? Concerned about imbalance between higher income brackets who get capital gains and lower income bracket who continue to borrow money. Increase in taxes on capital gains reduces savings rate.
436	Shaw	Anticipates increase in savings rate, biggest increase in age 55 and above. Biggest problem with savings rate is nobody knows what it is.

TAPE 067, SIDE B

026	Rep. Rosenbaum	Are there factors that could cause change between now and May forecast?
030	Gates	Yes. Timing of federal pension refunds is the biggest factor. As payments go out, state will know how big liability is. Expects \$184 million to go out.
053	Rep. Merkley	Follow-up questions on negative savings rate.
061	Shaw	If stock market declines, lower confidence and therefore people will sell stocks and will have to pay taxes on gains. This is the primary reason for an increase in tax revenues and a decrease in savings rates.
075	Potiowsky	Paradox with trying to save more with no change in income would result in less purchasing, layoffs. If change is abrupt, this can be detrimental on economy. Slower change would be beneficial.

087	Vice Chair Rasmussen	Questions concerning Y2K anxieties affecting consumer confidence.
095	Shaw	Companies on fiscal years will face this problem. Credit cards could be a problem. Expects pieces of information for companies this fiscal year will use Y2K as focal point. Effects of Y2K depends on panic. During the 1973-74 oil embargo people lined up to wait for gasoline. There was no shortage. Inventory moved from gas stations to automobiles. Emotions will drive a great deal of what takes place. Suspects consumer reaction will show up in numbers second half of 1999.
151	Rep. Williams	Questions concerning comments on lack of growth in manufacturing.
154	Potiowsky	Directed membersi attention to page 5 of handout ñ Employment Growth by Sector 1990-2005. High tech, food processing will grow. Soft area will continue to be wood products.
193	Chair Strobeck	Summarized: Downturn originally forecast in late 1999 should not occur. Is that correct?
198	Potiowsky	Yes, if no great changes next couple of months.
206	Chair Strobeck	Recessed meeting at 9:39 a.m. Reconvened meeting at 9:45 a.m.
209	Elizabeth Harchenko	See written testimony (EXHIBIT 4) . Work Group on Taxation of Intangibles: Property owners fall into category of centrally assessed properties. Most companies operate interstate and in multiple counties within Oregon. For most property owners, Oregon law taxes only tangible property. For centrally assessed group, intangible property is included in value base. This includes licenses, contract rights, franchises, patents, trade names, good will. Policy of including value of intangibles in assessed value is old and wasn't questioned until recently. Identification and evaluation of intangibles is challenging.
295	Harchenko	Three approaches for evaluation: Cost, income, market based. Moving away from residential model to centrally assessed companies, it becomes difficult to separate out value of intangible components.
328	Harchenko	Before 1997 session, Dept. of Revenue staff worked closely with these taxpayers to figure out methods to find value of intangibles. A bill was passed but governor vetoed it and asked for a task force to resolve problems. See page 3 of report: Task force tried to identify variety of interests. Looked for common ground.

384 Harchenko Task forced learned, in valuation of large, complex properties, litigation is major resource in resolving conflicts. This takes lots of time and resources.

Task force looked for process to resolve disputes.

404 Harchenko Local government representatives wanted to assure fairness in tax burden. They argued that because of technical advances, a greater percentage of property is intangibles.

Page 4: Industry representatives were concerned about equity. Telecommunications industry, things are changing so quickly (mergers).

They wanted fairness outside industry and within industry.

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030 Harchenko Intangibles Identified (page 4, bottom): Industry representatives identified intangible properties that they believed should be exempt: Software, goodwill franchises, start-up costs, customer base, stranded costs, etc.

056 Harchenko Page 5, The Revenue Impacts: Report gives sense of potential elasticity.

Estimated a range of values. Difficulties in determining the worth of properties, etc. make values subject to debate.

122 Harchenko Attempted to translate value impact into revenue impact. This was difficult, subject to assumptions.

Status of the Issues (page 7). It became clear that the group was not going to reach a consensus within the group. Industry and local government were looking at this issue from different perspectives, and could not find a middle ground. More study will be necessary. Industry introduced its own legislation; Revenue has offered to continue to work with them.

160 Rep. Williams Questions concerning Harchenko's report estimate of 8.3% to 23.8%. How numbers translate into percentage of entire tax roll.

181 Jim Manary Utility tax roll is 5% of total tax roll. Commented on litigation in other states. Oregon looked at other states for answers. Litigation in other states. (California, Utah, Washington, Idaho). Oregon hoped they could find out what's happening in other states. Hasn't had much help. Oregon Dept. of Revenue has been working on this with industry for four years. Wants a smooth implementation, no surprises. Wants to avoid litigation.

258 Rep. Shetterly Asked if litigation in Oregon is at risk for litigation over this issue.

290	Manary	Is not aware of any forthcoming litigation.
318	Rep. Witt	Should Oregon be concerned about imposing a tax that is subject to so much guesswork?
321	Harchenko	Nature of this property makes valuation process difficult. Policy issue is the decision that the legislature needs to make. Administratorsí job is to implement lawmakersí decision, not to tell them what it should be.
360	Rep. Merkley	Expressed confusion over list of what would and would not be exempted.
365	Harchenko	Biggest problem is boundaries around what those intangibles are that should be removed from the base, and how to identify their influence.
397	Manary	Exemption has been in place 60 years. The way these businesses are appraised is different. Practical problem is, for example, railroads donít sell in pieces, they sell or merge in big units. States try to value the whole railroad then figure Oregonís piece.

TAPE 069, SIDE A

032	Chair Strobeck	Conducted administrative business.
055	Chair Strobeck	Adjourned meeting at 10:30 a.m.

Submitted by, Reviewed by,

Barbara J. Guardino Kim T. James

Committee Assistant Revenue Office Manager

Exhibit Summary:

1. Informational, Potiowsky, Oregon Economic and Revenue Forecast Summary, 12 pp.
2. Informational, Potiowsky, Oregon Economic and Revenue Forecast, 93 pp.
3. Informational, Waters, Legislative Revenue Office Forecast Summary March 1999, 6 pp.
4. Informational, Harchenko, Work Group on Taxation of Intangibles: Report of Proceedings, 10 pp.