

SENATE REVENUE COMMITTEE
MAY 13, 2005 8:30 AM STATE CAPITOL BUILDING

Members Present: Senator Ryan Deckert, Chair
Senator Gary George
Senator Rick Metsger
Senator Floyd Prozanski
Senator Charles Starr, Vice Chair
Senator Kurt Schrader
Senator Margaret Carter
Senator Alan Bates
Senator Ted Ferrioli
Rep. Wayne Scott
Rep. Tom Butler
Rep. Vicki Berger
Rep. Mark Hass
Rep. Brian Boquist
Rep. Sal Esquivel
Rep. Larry Galizio
Rep. Betty Komp
Rep. Andy Olson

Witnesses Present: Tom Potiowsky, State Economist, Office of Economic Analysis
Michael Kennedy, Senior Economist
John Hawkins, CPA, Council of Revenue Forecast Advisors

Staff Present: Paul Warner, Legislative Revenue Officer
Barbara Guardino, Committee Assistant

TAPE 119, SIDE A

005 Chair Deckert Calls meeting to order at 8:30 a.m. Welcomes members of House Revenue Committee.

INFORMATIONAL: RELEASE OF MAY 2005 REVENUE FORECAST

010 Tom Potiowsky Directs members' attention to press packet (**EXHIBITS 1, 2 and 3**) which contains a summary of the full document. (The full document will be available on the Web site.) Briefly explains the quarterly forecast process.

058 John Hawkins Explains the function of the Council of Revenue Forecast Advisors, a group of CPAs who work with individuals and industries. They meet quarterly. They see what clients are doing and what tax changes have occurred.

081 Chair Deckert Asks, at their last meeting were they able to change the forecast? The new forecasting procedures are more accurate.

088 Hawkins Changes have been made in the forecast, partly due to "final payments," where taxpayers make payments based on what occurred

		in the previous year. Dollars coming in on April 15 were higher than anticipated.
105	Sen. Carter	Asks if he sees this as a trend for the rest of the year.
110	Hawkins	Responds, does not know, but there may well be a continued trend. We hope for good times ahead, but there are variables that could change that.
118	Rep. Butler	Relative to estimated tax payments, are you advising your clients because of the AMT (alternative minimum tax) to pay more frequently? What percentage of Oregonians pay AMT?
128	Hawkins	He advises people to make payments to avoid penalties. If income increased substantially, they would have a balance due. People are making minimum payments to avoid penalties and waiting until April 15 to pay the balance. Guesses that by 2011 people paying AMT will exceed those paying regular tax. This is a growing problem.
149	Rep. Butler	Asks whether the client base pay the AMT as a result of capital gains or charitable contributions.
154	Hawkins	Responds, Oregon is a high income tax state and the two most common tax credits people lose when using AMT are state taxes and dependents.
162	Chair Deckert	Asks, what percentage of Oregonians use AMT?
166	Hawkins	About 20 to 30 percent.
180	Potiowsky	<p>Begins slide presentation: Oregon's Economic and Revenue Outlook</p> <p>Page 1, slide 2: Economic and Revenue Forecast</p> <p>Page 2, slide 1: Governor's Oregon Council of Economic Advisors Outlook for the U.S. Economy Compared to Global Insight</p> <p>Explains, the Governor's Council of Economic Advisors tried to find a consensus viewpoint on the outlook for the economy. Explains the model used. The governor's council is a little more pessimistic on the outlook than the national forecasting service. This influenced the council's forecast. Their concern is around energy issues, inflation, federal deficits, etc. They are worried the outlook won't be as rosy as the baseline. They even consider a slim possibility of recession.</p>
202	Potiowsky	Page 3, slide 1: Unemployment Rate by Region, March 2005. Oregon is now the fifth highest in unemployment in the nation. In March, Oregon had the third fastest job growth in the nation.
222	Potiowsky	Page 3, slide 2: Oregon's Total Exports (1Q 1997– 4Q current dollars)
228	Potiowsky	<p>Page 4, slide 1: Oregon Index of Leading Indicators</p> <p>Slide 2: All industry groups posted job gains since 6/03 trough (March 2005); most since previous 11/00 peak, except for manufacturing and business. Some areas, especially manufacturing, were hit hard during the recession. It has gained, but still has a distance to go.</p>

254	Potiowsky	Page 5, slide 1: Total Non-farm Employment (Annual Percentage Change). Believes 2005 is a solid year, but there are uncertainties coming.
267	Potiowsky	Page 5, slide 2: Manufacturing Industry Employment (Annual Percentage Change). Manufacturing is coming back, but not to its previous peak.
287	Potiowsky	Page 6, slide 1: Private Non-manufacturing Industry Employment (Annual Percentage Change)
302	Potiowsky	Page 6, slide 2: Comparison of Last Three Forecasts: Personal Income Growth
312	Potiowsky	Page 7, slide 1: Comparison of Last Three Forecasts: Employment Growth Slide 2: Oregon Outlook Summary. 2004 was the first job growth year after three consecutive losses. Transportation equipment sector has been particularly strong. So far the high gas prices have put a dent in growth, but not much. Wood products have done well, too.
330	Potiowsky	Page 8, slide 1: Risk to the Forecast ... Examines the downside and upside Points out the housing market is of particular concern. The stock market hasn't done well so people are turning to housing, and this sets up a speculative bubble that could burst. In particular, the Bend area is vulnerable. On the upside, it's possible that oil prices could come down rapidly.
410	Rep. Boquist	Asks question regarding regional oil prices, specifically refineries and high diesel fuel prices.
420	Potiowsky	Responds, Oregon is at a disadvantage for not having any refineries. Refineries are currently building up inventories, so that problem could somewhat correct itself. Oregon fuels will be a little bit higher, but if prices fell, Oregon would see a corresponding fall.
457	Rep. Boquist	Notes, a refinery in Washington state might close in the fall and increase the cost of diesel.
461	Potiowsky	Was not aware of that.
476	Rep. Berger	Asks the meaning of "controlled growth of China and India" (listed under "Upside").
498	Potiowsky	Worries about governments moving their economies in the wrong direction. China and India are worried about fast growth and inflation and would like to slow it down. If they can do that, it will alleviate commodity prices, which would help us.

TAPE 120, SIDE A

036	Rep. Berger	Follow up – if their efforts are uncontrollable would they go into the geopolitical risk category?
040	Potiowsky	It could go either way.

047	Sen. Ferrioli	Asks about economists' relative level of confidence in terms of percentage regarding the forecast's accuracy. What are you comfortable with in terms of a plus or minus bracket?
060	Potiowsky	Responds, he believes there's a 75% chance of a 4-5% movement around the forecast for 2005-07. Gives a 95% chance of movement of \$1 billion or more either way around that figure. The forecast has the best chance of happening.
075	Ferrioli	Notes, one indicator is significant in the risk of downturn, and one is neutral. If you flip a coin will it land on its end?
086	Potiowsky	Our baseline forecast assumes additional risk. We are looking at a 50/50 chance of going on one side (of the coin) or the other.
098	Michael Kennedy	There's a 95% chance it would fall within \$1 billion either way.
101	Rep. Boquist	Asks, is Oregon trending down? Is there a lag ramping up before a decline?
105	Potiowsky	Essentially yes. There has been strong job growth since late 2003, and businesses are doing better. But, there is some question about a "soft spot" in the U.S. economy in the first quarter. Other news points to consumer spending as not robust, even though sales are up for April. Believes things may slow in 2006 and begin softening.
127	Kennedy	Begins Revenue Forecast Page 8, slide 2: Personal income tax is the only real change. It is being driven by recent data. It's important to go back into the methodology. What are the figures telling us?
140	Kennedy	Page 9, slide 1: Recent Forecast Performance The only real change is much higher final payments. The question is, what is this telling us? Page 9, slide 2: PIT (personal income tax) Methodology Explains the methodology. One problem is, the last year there is data is 2003. In terms of final payments, economists know people owed more, but don't know why. Next December there'll be fewer estimated payments. The real question is whether they earned more or if there is a shift. This won't be known for 2-3 years.
187	Kennedy	Page 10, slide 1: Interim Liability Estimation. Gives formulas. Gives example.
215	Kennedy	Page 10, slide 2: Final/Refund Depends on Liability Growth.
255	Kennedy	Page 11, slide 1: Interim Liability Estimation Explains the upward surprise that has occurred in last 1 ½ months. There is a 10% increase in liability. The question is, why? Some other form of income went way up. Will not know until January 2006. The problem is, if you don't know the cause, you don't know if it's temporary or permanent. "Looking out into the future our economic scenario hasn't really changed." It is probably temporary. Gives example.

296	Sen. Ferrioli	In 2000-01 people over-paid their estimated quarterly taxes. Most accountants do the same thing, they let a cycle go by before advising clients to reduce their payments. This year people realized they'd under-accrued, which might account for the higher payments.
315	Kennedy	Responds, people will encounter those cyclical issues. It really doesn't go down until income drops. Getting liability right is the most productive way to make an accurate collections forecast. Improvements to this forecast have come around that methodology.
359	Kennedy	Continues with slide presentation. Page 11, slide 2: 2005 Tax Year Last year the withholding growth accelerated in the second half. It's up 7.2%. Expects growth to be closer to 6% this year. Estimated payments are up this year 17.1%.
425	Rep. Butler	Expresses concern that those estimated taxes are based upon the prior year's liability. Looking at capital markets, believes that 17.1% is the protective estimated payments, and a large portion is protection from capital gains. Is concerned that this 17.1% projection needs to be narrowed down quickly.

TAPE 119, SIDE B

025	Kennedy	Regarding the potential variation around the 2000 liability number of \$4.8 billion, we know that 17% is reflective of last year, but have no clue what's going on with non-wage income this year. Gives one scenario.
045	Rep. Butler	The markets that are hottest, with regard to real estate, generate huge amounts of capital gains. They could have created a large portion of the gain outside the stock market, and that could be short-lived. Wants to make certain the estimated tax driven number is muted.
068	Kennedy	This forecast is centered at the middle point. It doesn't assume there will be repeats, nor does it assume that capital gains will fall again. "We have absolutely no clue what drove 2004."
084	Kennedy	Resumes discussion about liability (page 11, slide 2). Page 12, slide 1: Corporate Income Tax ... Page 12, slide 2: Recent Forecast Performance. No real signals.
090	Chair Deckert	Asks, what are the kicker implications?
092	Kennedy	The kicker for corporate is projected at \$62 million.
101	Kennedy	Page 13, slide 1: Oregon Corporate Profits (billions) graph. Projects a slight softening. Page 13, slide 2: General Fund Revenue Forecast, 2003-05 biennium. Projecting \$10.5 billion total GF resources. Changes are negligible other than personal income tax. Total change for this biennium is \$105.6 million.
118	Kennedy	Page 14, slide 1: Kicker Update 2003-05. A personal kicker is irrelevant due to Measure 30. For corporate income taxes, the kicker is \$62.6 million above the forecast.

125	Rep. Boquist	Asks question concerning line 4. It shows the forecast was off 6% in 2003-05.
130	Kennedy	Responds, if you take out the \$580 million that HB 2152 would have estimated, it puts you at 2.3% above on personal income tax.
135	Chair Deckert	Asks, how much of the \$62.6 million corporate kicker goes out of state?
140	Kennedy	Above 80% of corporate income taxes are paid by multi-state corporations. Wouldn't expect it to have as much impact as a personal income tax kicker would. Corporations will take a credit on their 2005 returns.
155	Kennedy	Page 14, slide 2: GF Forecast Variance by Forecast Looking at the average forecast over the past 2 ½ decades, there is very little variation from here on.
170	Kennedy	Page 15, slide 1: Potential Variance from March Forecast
189	Kennedy	Page 15, slide 2: General Fund 2005-07 Forecast. If it seems too good to be true it probably is. Personal income tax next biennium is estimated at \$10,041.4 million.
211	Sen. Metsger	On the subject of cigarette and liquor taxes, Washington state recently increased its prices. How do cross-border sales figure into this budget?
222	Kennedy	That figure is going to be negligible. People already cross the border to purchase cigarettes and liquor here.
231	Potiowsky	Cigarette revenues are estimated to increase perhaps 1%. Consumption has been falling.
145	Kennedy	Continues slide presentation. "The total change in GF resources for next biennium is \$224 million."
249	Kennedy	Page 16, slide 1: Risks to 2005-07 Forecast Every risk has an up side and down side. Since we don't know what capital gains are doing, there is a risk there, up and down. One thing that can change this equation would be tax law changes. Looking at historical variations, there is very little likelihood (5%). The boom and bust period was unique. There is a potential for mini-bubbles that could pop, but that's not likely.
297	Kennedy	Page 16, slide 2: General Fund Revenues (\$billions). Comparison of General Fund Resource Forecasts.
315	Kennedy	Page 17, slide 1: General Fund Revenue Growth Factors out the kicker. Future growth rates adjusted for the kicker are 11-12%.
339	Sen. George	With these numbers appearing relatively flat for 2007-09, might it not be smart to look at this new-found money as something to put into reserve?

360	Kennedy	Will not speculate on this. Comments, there's been a significant drop in the gross income tax returns and the liability owed (gross effective rate). One reason is that deductions and subtractions have kept growing while income has fallen.
398	Rep. Butler	Concerning the \$11.6 billion in the general fund, how much reserve should there be in cash carryover to protect against TANS? Follow-up questions.
425	Potiowsky	TANS interest is just one element of the overall risk. In the best of possible worlds, a \$1 billion reserve would be ideal. In previous presentations, we've talked about a 4-5% range around the forecast.

TAPE 120, SIDE B

020	Kennedy	Begins overview of Lottery Revenue Forecast ... Page 18, slide 1: Lottery Revenues, 2003-05. The \$3.4 million in resources is mostly related to stronger video sales. The \$67 million limitation is not a limitation on how much will be transferred to the state school fund. Page 18, slide 2: Slot (Line) Games and VLT Sales. Assumed long-run sales impact of 12%.
034	Chair Deckert	Asks for an estimate on the percentage of retailers who will take advantage of the slot games.
037	Kennedy	The big ones. The ones that matter.
047	Kennedy	Page 19, slide 1: Lottery Revenues, 2005-07 Page 19, slide 2: Extended Lottery Forecast
054	Sen. Carter	Asks if online video gaming will result in a decrease in overall lottery revenues.
056	Kennedy	It still remains to be seen what the outcomes will be. That just becomes another risk factor on the downside of this forecast. This year it appears sales will grow 8%, although we don't assume that in the future.
075	Kennedy	Page 20, slide 1: Lottery Resource Available to the State Slide 2: For more information ...
087	Chair Deckert	Adjourns meeting at 10:00 a.m.

Tape Log Submitted by,

Barbara Guardino, Committee Assistant

Exhibit Summary:

1. INFORMATIONAL, Oregon's Economic and Revenue Outlook slide presentation, Potiowsky/Kennedy, 20 pp.
2. INFORMATIONAL, Oregon Economic and Revenue Forecast, Summary, May 2005, Volume XXV No. 2, Potiowsky/Kennedy, 16 pp.
3. INFORMATIONAL, LRO Forecast Summary, May 2005, New Facts Since the Last Forecast, Warner, 6 pp.