

HOUSE REVENUE COMMITTEE
JANUARY 30, 2003 8:30 AM STATE CAPITOL BUILDING

Members Present: Representative Lane Shetterly, Chair
Representative Wayne Scott, Vice Chair
Representative Joanne Verger, Vice Chair
Representative Phil Barnhart
Representative Vicki Berger
Representative Pat Farr
Representative Mark Hass
Representative Elaine Hopson
Representative Max Williams

Witness Present: Tom Potiowsky, State Economist, Office of Economic Analysis
Michael Kennedy, Revenue Economist, Office of Economic Analysis

Staff Present: Paul Warner, Legislative Revenue Office
Kathy Tooley, Committee Assistant

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004	Chair Shetterly	Calls meeting to order at 8:33 a.m.
023	Tom Potiowsky	Presented "Overview of Revenue Forecast Process", (Exhibit 1), referring to the publication "Oregon Economic And Revenue Forecast", (Exhibit 2).
032	Potiowsky	Continued presentation, beginning "Oregon's Revenue Forecast Process", (Page 1, Slide Bottom, Exhibit 1).
046	Potiowsky	Continued presentation, beginning "Revenue Forecast Methodology", (Page 2, Slide Top, Exhibit 1).
048	Rep. Barnhart	Question and discussion interspersed.
069	Potiowsky	Continued presentation, beginning "General Fund Forecast Components", (Page 2, Slide Bottom, Exhibit 1).
074	Potiowsky	Continued presentation, beginning "Economic and Revenue Models", (Page 3, Slide Top, Exhibit 1). Questions and discussion interspersed.
101	Potiowsky	Continued presentation, beginning "Personal Income Tax Models, (Page 3, Slide Bottom, Exhibit 1).
128	Michael Kennedy	Presented overview of models behind the corporate and personal income tax forecast, beginning "System being modeled", (Page 4, Slide Top, Exhibit 1).
143	Kennedy	Continued presentation, beginning "Personal Income Tax Model", (Page 4, Slide Bottom, Exhibit 1).
149	Kennedy	Continued presentation, beginning "Developing Total Liabilities: Tax Calculator", (Page 5, Slide Top, Exhibit 1).
152	Chair Shetterly	Asks Kennedy to inform the Committee about national consultant firm,

154	Potowski	<p>“Global Insights”.</p> <p>Global Insights is a firm that provides extensive information on variables that affect the Oregon Economic Model. It provides a sense of what is happening in the national economy; and other factors such as the Iraq War and possible impacts on the national economy and on Oregon. Global Insights was originally made up of two forecasting groups, DRI (Data Resources), and WEFA (Wharton Economic Financial Group). Global Insights also consults with PGE and Pacific Power.</p>
175	Rep. Williams	How accurate are they?
177	Potowski	In some areas okay. Corporate profits are hard to predict and the company does as well as others.
214	Kennedy	Continues presentation, beginning “Personal Income Tax: Quarterly Collections Models”, (Page 5, Slide Bottom, Exhibit 1).
238	Kennedy	Continued presentation, beginning “Personal Income Tax: Quarterly Collections Models, (Page 6, Slide Bottom, Exhibit 1). (Slides switched order).
242	Kennedy	Continued presentation, beginning “Timing of Collections related to the 2001 tax year (Millions), (Page 6, Slide Top, Exhibit 1).
258	Kennedy	Continued presentation, beginning “Personal Income Tax Collections Forecast”, (Page 7, Slide Top, Exhibit 1).
267	Kennedy	Continued presentation, beginning “Corporate Income Tax Models”, (Page 7, Slide Top, Exhibit 1).
269	Kennedy	Continued presentation, beginning “Corporate Income Tax Model”, (Page 8, Slide Top, Exhibit 1).
272	Kennedy	Continued presentation, beginning “Corporate Income Tax Quarterly Collections Models”, (Page 8, Slide Bottom, Exhibit 1).
		Questions and discussion interspersed.
377	Kennedy	Continued presentation, beginning “Corporate Income Tax – Relationship Between Collections and Liability”, (Page 9, Slide Top, Exhibit 1).
382	Kennedy	Continued presentation, beginning “Corporate Income Tax Quarterly Collections Models”, (Page 9, Slide Bottom, Exhibit 1).
385	Kennedy	Continued presentation, beginning “Corporate Income Tax Collections Forecast”, (Page 10, Slide Top, Exhibit 1).
405	Kennedy	Continued presentation, beginning “Close of Session Forecast”, (Page 10, Slide Bottom”, Exhibit 1).
410	Rep. Verger	Are there any industries that you particularly, local or national, that closely measure what is happening in the economy?
416	Potowski	The high tech industry, especially semi-conductors and the influence they have on corporate profits income. Also, lumber and wood industry, national and international factors affect that, for example Canadian soft lumber. Transportation equipment is another area trucking industry affects Freightliner. Interest rates, gasoline prices affect RV makers.
451	Rep. Verger	Is there an industry that allows prediction of an economic decrease?

- 457 Potiowsky There are few indicators: The Institute of Supply Management can indicate when manufacturing might have problems. In high tech, the Semi-Conductor Book to Bill Ratio, looks at orders in and shipments out, which indicates strength. Turning points are extremely difficult to predict. Office of Economic Analysis is in the process of building a leading economic indicator model for Oregon which may become a quicker barometer.
- 494 Chair Shetterly Has the model changed over the past 5 to 10 years in measuring performance, or has it been consistent.

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- 035 Kennedy The structure of the model has been the same since it was developed. The liability model has changed in terms of what is driving income.
- 045 Warner The structure is pretty much the same as it has been since 1981. The key difference is in the components of adjusted gross income and the components of the tax base. Another change is the emergence of high tech and the semi-conductor industry over the past 10 years, which the model has been able to capture. The key is getting the upper income group which is paying a large part of the tax burden.
- 066 Rep. Hass Have stock options and bonuses and capital gains from the high tech sector been factored into new models?
- 072 Potiowsky Have incorporated into model, but collection of data provide delays.
- 089 Kennedy Continues presentation, "Revenues Exhibit Considerable Volatility", (Page 11, Slide Bottom, Exhibit 1).
- 092 Kennedy Continued presentation, "Actual revenues compared to COS Forecast and naïve trend (13.5%)". (Page 12, Slide Top, Exhibit 1).
- 113 Kennedy Continued presentation "Data available for December forecast", (Page 12, Slide Bottom, Exhibit 1).
- 122 Kennedy Continued presentation, beginning "Quarterly PIT Collections Volatile – Product of Numerous Factors", (Page 13, Slide Top, Exhibit 1).
- 190 Kennedy Continued presentation, beginning "Data available for December forecast", (Page 13, Slide Bottom, Exhibit 1).
- Questions and discussion interspersed.
- 260 Potiowsky Continued presentation, beginning "Unusual Times for the Economy", (Page 14, Slide Top, Exhibit 1).
- 287 Potiowsky Continued presentation, beginning "Estimated Data Available for the May 2001 Forecast Compared to Revised Data to Date", (Page 14, Slide Bottom, Exhibit 1).
- 303 Potiowsky Continued presentation, beginning "Latest Revenue Forecast", (Page 15, Side Top, Exhibit 1).
- 315 Kennedy Continued presentation, beginning "General Fund Revenue Forecast", (Page 15, Slide Bottom, Exhibit 1).

322	Kennedy	Continued presentation, beginning "Historical and Forecast General Fund growth, not including Kicker refunds", (Page 16, Slide Top, Exhibit 1).
347	Kennedy	Continued presentation, beginning "Factors Influencing Projected Growth in General Fund Revenues", (Page 16, Slide Bottom, Exhibit 1).
352	Kennedy	Continued presentation, beginning "Factors Influencing Projected Growth in General Fund Revenues", (Page 17, Slide Top, Exhibit 1).
366	Rep. Williams	Commented that a 13.6% growth rate, even a 7% growth rate seems aggressive.
384	Chair Shetterly	Should see how this fares in March forecast.
391	Kennedy	Will answer in next few graphs. Continued presentation, beginning "Personal Income Growth", (Page 17, Slide Bottom, Exhibit 1).
390	Chair	Does the coming boom forecast assume the same manufacturers in high tech in Washington County that we had in the 90's, or production overseas.
438	Kennedy	The economic model forecast is less optimistic because Oregon may not be the recipient of the increase in high tech to '90s levels.
451	Potiowsky	For December, the economic forecast indicates that Oregon is coming out of recession, but not to 90's levels. High tech projections do not get back to pre recession rates until late 2004.

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030	Kennedy	Continued presentation, beginning "Factors Influencing Projected Growth in General Fund Revenues", (Page 18, Slide Top, Exhibit 1).
037	Kennedy	Continued presentation, beginning "Capital Gains, Retirement Income Outpace Gross Income Growth", (Page 18, Slide Bottom, Exhibit 1).
039	Kennedy	Continued presentation, beginning "Factors Influencing Projected Growth in General Fund Revenues", (Page 19, Slide Top, Exhibit 1).
041	Kennedy	Continued presentation, beginning "Effective Tax Rates Climbs in 1990s", (Page 19, Slide Bottom, Exhibit 1).
065	Kennedy	(Continued presentation, beginning "PIT Forecast slightly below long term trend", (Page 20, Slide Top, Exhibit 1). Questions and discussion interspersed.
185		End of Revenue Forecast Overview.
188	Chair Shetterly	Informed new members of the Committee of Paul Warner's background as the former State Economist 1989-1999.
215	Warner	At the Chair's direction, provided the Committee with a review of revenue forecasting methodology, "Revenue Forecast Review", Exhibit 3, and a memo to the House Revenue Committee, entitled "Review of Revenue Forecasting Process", Exhibit 4. The scope of the review included: <ul style="list-style-type: none"> • An explanation of the large forecast error for 2001-2003 fiscal year.

- Recommendations for methodological improvements for the forecast process.
- Recommendations for improvements in the forecast process.
- Recommendations for any statutory changes that could potentially improve forecast results and/or process..

Told the Committee that he has worked with Legislative Council to begin drafting some of these recommendations.

250 Warner

Explained economic forecasters are generally conservative, and that this was the first forecast below the close of session estimates since 1981-83. Looked at December vs. May forecasts for 2001, 2002 calendar years. Shortfall fell primarily between following four areas.

- Wage and salary income is \$10.6 billion less for 2001-2002. with a revenue reduction of 37% or \$742 million
- Corporate income accounts for 23% of error, \$464 million, attributable to the change in the national profit forecast, \$272 million; bonus depreciation enacted by Congress, \$100 million; and the remaining \$75 million due to the apportionment factor.
- Capital gains, 17%, \$340 million
- Business income and investment income, 10%, \$203 million.

Questions and discussion interspersed.

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064 Warner

Gave history of Forecast Process starting in 1980. Its first task was to develop the Oregon Econometric Model the structure of which is basically the same today, (Page 3, Exhibit 4).

103 Warner

Discussed strengths of the current system, (Exhibit 3). Four strengths stand out:

- Formal links to National Forecast Model.
- Governor's Council of Economic Advisors
- Maintain a Single Forecast Point
- Regular Formal Quarterly Updates.

155 Warner

Recommended technical changes (Exhibit 3):

- Updating taxpayer sample to 2000 tax year, will be adjusted because 2000 tax year was not a normal year
- Industry specific data, withholding by sector
- Leading Index can help with citing turning points with monthly read
- Personal income and adjusted gross income
- Wage rates/bonus projections
- Produce Methodology review on a regular annual schedule.

210 Warner

Recommended structural and reporting changes (Exhibit 2)

- Establish a Revenue Forecast Board, requires statutory action.
- Create a Legislative/Executive Board that would have appointing authority for state economist position, may require statutory action. A function of the board would be the release of forecasts simultaneously to appointing authorities.

251	Chair Shetterly	A 4 member board has its problems, asked Warner to look into drafting legislation to go to a 5 person board, to avoid a deadlock. Questions and discussion interspersed.
312	Chair Shetterly	For the record, "There has never been as far as I know, and I will say this on the record, any issue as to the independence of the actual numbers in the forecast or the information going into it or the credibility of (the State Economist)."
280	Warner	Continued with a third structural/reporting recommendation, <ul style="list-style-type: none"> • Create a Revenue Forecast Advisory Committee that would review preliminary revenue numbers and make recommendations or reactions to the forecast. The ultimate decision maker in the forecast process to rest with the State Economist.
359	Chair Shetterly	Asked if the committee would be a corollary to the Governor's Council on Economic Advisors; on the revenue side of the forecast process?
350	Warner	Answered yes. Warner recommended that the committee be exempt from open meetings law given the sensitivity of the revenue numbers and the need for candid advice.
392	Warner	Continued with a fourth structural/reporting recommendation: <ul style="list-style-type: none"> • Recommended a monthly revenue tracking report. This would be a procedural change and would not require a statutory change.
417	Warner	Historically, the Office of Economic Analysis, had one duty and that was to forecast General Fund Revenue. Additional duties consistent with their mission such as lottery forecast, and prison inmate forecast; have been added. Recommended through the Legislative Fiscal Office Budgetary Review process that other ancillary functions be given to other agencies.
442	Chair Shetterly	Asked the Committee if anyone felt uncomfortable with possible legislative changes as a result of the revenue forecasting recommendations.

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033	Rep. Berger	Told the Committee she was concerned that forecasting took a lot of hits, and that the recommendations were an overreaction to forecast errors resulting from rapid changes in numbers and "folks taking heat for it".
038	Chair Shetterly	Felt it would be an overreaction if the committee suggested creation of an economic forecaster within the legislative branch, but felt recommendations were a fine tuning of the process.
060	Potiowsky	Advised the Committee that a lot of the items in "C and D" (Exhibit 3) were thought about before 2001 such as formation of a Revenue Forecast Advisory Committee.
082	Warner	Advised the Committee that he does not see a fiscal impact. The Advisory Committee would be people within government appointed on a voluntary basis. There may be a fiscal impact with the Forecast Board.
099	Rep. Hopson	Felt moving some of the functions to other agencies needs investigation so

that the core mission of the State Economist is not weakened.

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| 105 | Chair Shetterly | Ask Warner to continue to work with Potiowsky and Legislative Counsel to draft legislation for Committee review.. |
| 115 | Chair Shetterly | Meeting adjourned at 10:30 a.m. |

Tape Log Submitted by,

Kathy Tooley, Committee Assistant Reviewed by Kim Taylor James

Exhibit Summary:

1. Potiowsky, Kennedy, "Oregon's Revenue Forecast process", 21 pages.
2. Potiowsky, "Oregon Economic and Revenue Forecast", 103 pages
3. Warner, "Revenue Forecast Review", 1 page
4. Warner, Memo "Review of Revenue Forecasting Process", 7 pages