

INFORMATIONAL MEETING

MAY ECONOMIC FORECAST TAPES 151 - 152 A/B

**SENATE REVENUE COMMITTEE**

**and**

**HOUSE REVENUE COMMITTEE**

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**MAY 15, 1997 - 8:30 A.M. - HEARING ROOM A - STATE CAPITOL BUILDING**

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Members Present: Sen. Ken Baker, Chair

Sen. Neil Bryant, Vice Chair

Sen. Joan Dukes

Sen. Verne Duncan

Sen. Tom Hartung

Sen. Randy Leonard

Rep. Lee Beyer, Vice Chair

Rep. Tom Brian, Chair

Rep. Tony Corcoran

Rep. Randall Edwards

Rep. Anitra Rasmussen

Rep. Lane Shetterly

Rep. Mark Simmons

Members Excused: Rep. Leslie Lewis

Rep. Ken Strobeck

Witnesses: Paul Warner, Office of Economic Analysis, Department of

Administrative Services

Dave Griffiths, Office of Economic Analysis

Staff: Ed Waters, Economist

Carol Phillips, Committee Assistant

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**TAPE 151, SIDE A**

005 Chair  
Baker Opened meeting at 8:45 a.m.

009 Paul  
Warner Exhibit A - Economic and Revenue Forecast. In economic terms there is very little new information compared with March economic forecast. There are, however, some signs of slowing in the state's economy. Construction appears flat in the first quarter, but some of that may be due to weather. Anticipates some flattening of Construction sector and expects some slowing in Manufacturing; but overall state remains strong and expects growth to continue through next biennium. This forecast is built on the assumption that Oregon continues to grow as a state faster than United States as a whole.

026 Warner In revenue terms, the resource picture is improved. The cornerstone of revenue is personal income tax, which is very little changed. Continues to be surprised in Corporate Collections. Received more in corporate payments in April than expected, and that is built into forecast for 1997-99. Video lottery, insurance premium tax, and deferred property tax payments from Senior Deferral Program have all added to the resource picture. Bottom line compared with March forecast is there is about \$99 million more in General Fund resources available for expenditures and about \$55 million more in lottery resources, which includes carry-forward, for a total resource increase \$154 million before Education Trust Fund payment.

Discussed page 3 Exhibit A - Percentage Change in Personal Income - Inflation Adjusted, 1979-2003. State has been at a level above 4% in real growth, which is an increase in purchasing power, since 1994. Believes 1997 will continue to be above 4% in

043 Warner real income growth, dropping to 2.5% by 1998-99. Key factor in projected slowing of growth is Manufacturing sector, which has been very strong. It has been above 2.5% and expects it to continue this year. That would give Oregon four years in a row above 2.5% in manufacturing job growth. The last time national Manufacturing growth was above 2% was 1984. Growth is occurring in Electronics sector as well as Metals, which is enjoying a boom as a result of Boeing's expansion. Oregon Metallurgical and Precision Castparts in particular are undergoing major expansions. Transportation equipment like rail cars and heavy trucks are also growing rapidly. Lumber and Wood Products sector in first quarter has shown largest quarterly jump in jobs since 1988 and increased 11%, but expects that sector to be relatively flat over next few years.

072 Sen. Hartung Asked a question regarding Intel in Washington County; 75% of what Intel does is Research and Development. Wanted to know where that shows up in forecasting: Employment or Manufacturing?

076 Warner Answered that the Intel expansion has had a major effect on the economy, and the jobs are reflected in the Electronics industry. Those jobs have a bigger impact because the wages are higher, with the average salary about \$55,000; and they have more secondary effects because the spending increases jobs in retail trade and services.

085 Rep. Corcoran Referred to page 4 Exhibit A with a question about the estimated downturn in manufacturing jobs in Oregon but upturn in U.S. as a whole. Asked what would cause that assumption.

091 Warner Stated there were several factors. The biggest factor that will cause gradual convergence of Oregon's growth rate with that of the U.S. is rising land and labor costs. Good example of that is the growth in the Tri Cities area with the expansion of Oregon Metallurgical and Precision Castparts. Primary reason is lower land and labor costs. Will see traditional manufacturers look to other cheaper areas in state in which to expand. Expects some slowing in U.S. economy; and the value of the dollar has risen significantly, putting pressure on U.S. manufacturers in export markets.

108 Sen. Dukes Asked if Intel was included in figures on page 4 Exhibit A, and how it would affect the chart.

110 Warner Responded that Intel's work force is about 10,000 and has been expanding around 1,000 a year over the last several years. It would not have a dramatic effect in terms of direct jobs. Intel is a big player, but the overall electronics sector has grown by about 5,000 jobs over the last few years. Intel is a part of that, but there are other electronics firms expanding as well. Now Hyundai is coming on line, and LSI Logic and many suppliers like Mitsubishi in Salem are in the same category. Whole industry has been very strong. Intel's impact is big on the state for two reasons: (1) it pays high wages creating more income taxes and (2) because they are so large and profitable they have had a huge impact on corporate income tax.

Asked if the figures suggest any differences in other parts of the state, or will the

127 Sen. Willamette Valley continue to grow. The coast, eastern, and southern Oregon don't have  
Dukes the large populations, and industries have serious declines ahead.

132 Warner Responded that the Office of Economic Analysis ("OEA") is seeing more growth rate  
differential over the last few years. In the late 1980s and early 1990s expansion was  
broadly based around the state. But in the 1994 to 1996 "boom" period, the expansion  
was led by high tech concentrated in Eugene, Corvallis, Salem, and Portland Metro  
areas. The rest of the state has not expanded as rapidly. There are increases in  
unemployment outside the Willamette Valley. Higher land and labor costs could force  
other manufacturers out of the Valley, with an alternative location the rest of Oregon.  
There are some hot spots, i.e. Umatilla and Morrow Counties. Central Oregon has  
slowed somewhat but continues to be fairly strong and the Ontario area has been strong.  
In general, the rest of the state compared with the Willamette Valley has slowed in the  
last two years.

150 Rep. Asked about the kicker and the combined increase of \$83 million.  
Brian

152 Warner Answered that the kicker is affected by both the increase in revenue and any changes in  
appropriations. Net kicker up about \$81 million. Continued that another key factor the  
OEA sees as slowing the economy is the Construction sector. The state has been in a  
Construction boom but now anticipates flattening of that boom with only gradual gains.  
The conclusion of several large projects (Hyundai and Westside Light Rail) will  
contribute to that slowing. There is also a slowing from California with driver license  
conversions down 13% in the first quarter versus a year ago. In-migration has lessened  
from California, but still getting it from other states. Puget Sound area booming, so  
fewer will be coming from Washington.

182 Warner Continued that there are enough positives to keep Construction from declining. The  
Raytheon project in Umatilla will have a major effect on that region. Have heard of some  
projects being put on hold due to shortage of labor and materials, particularly in Portland  
Metro area, because the high tech firms hired all the specialty construction workers.  
Expect in-migration to continue at about 30,000 to 35,000 per year.

194 Warner Stated that in summary economic outlook is unchanged from March and is generally  
favorable; as long as U.S. stays out of recession can anticipate fairly healthy growth  
though not matching the growth of the last three years. The biggest risk would be if the  
national economy grows too strong this year and ends up generating inflation; interest  
rate increases would result and recession would follow. That same pattern ended the two  
previous long expansions in the post-war period in the 1960s and 1980s. The  
Construction, Real Estate, and Financial Services sectors are the biggest source of local  
risk. The proposed US Bank merger may mean layoffs of 1,500 or so people in high  
paying jobs and will have impact in Portland area.

Discussed General Fund revenue numbers on page 6 Exhibit A. Has increased General  
Fund estimate for this biennium, despite the fact that personal income tax forecast is

217 Warner lowered by \$17.7 million. Sees large increase in refunds, so that lowers estimate slightly. Area with large change is corporate income taxes, driven by April elections. Anticipated \$50 million but got \$82 million. Other change is in All Others category, with an adjustment in Interest Earnings to General Fund. Interest Earnings are calculated after all other funds have been paid, then whatever is left over becomes General Fund Interest Earnings. There is about \$35 million in Interest Earnings earned last biennium that was recorded this biennium, so that is added into forecast.

268 Chair  
Baker Stated this is more of a paper shuffle of dollars rather than actual growth or newfound revenues.

271 Warner Agreed with that definition. Is working with Treasury and State Controller to try to stabilize the accounting method and has several suggestions. Bottom line in terms of General Fund resources: there is an increase of \$83 million relative to March projections. For 1997-99 will carry \$81.4 million forward from March estimate. Both personal and corporate income are down slightly because of the kicker.

290 Sen.  
Leonard Asked what is the effective income tax rate for corporations and individuals with the kicker?

294 Warner Answered about 3.5% for corporations for that one year. The household tax rate would be about 5.2%. For example, effective rate as a percent of adjusted gross income for \$100,000 is 7.32%, for those making \$20,000 to \$30,000 the rate is 4.59%.

357 Sen.  
Duncan Stated we always hear about national average and where Oregon fits within income tax structure. Asked where Oregon stands within the nation in both corporate and household tax. Then if kicker is returned, where would corporate and household tax stand within nation?

368 Warner Responded that the department has done estimates, but one of the problems is getting comparable current data from other states. The latest information available is for 1992-93. Estimates Oregon will drop into bottom ten by 1998-99 as a result of Measure 5 and Measure 47, which lowered property taxes from about 5.2% to 3.3% of income. Personal income taxes are rising relative to income. Effective tax rate has risen by about \_\_\_% over the last five years.

411 Warner Referred to page 21 Exhibit A which indicates an additional bottom line increase of \$154 million over March estimate less the \$7.9 million deduction for Education Trust Fund.

#### **TAPE 152, SIDE A**

034 Dave  
Griffiths Interjected that the net effect in exact figures is \$153.7 million less \$7.9 million for the Education Trust Fund leaving \$145.8 million additional to the bottom line.

Discussed page 11 Exhibit A. The best predictor they have for estimating corporate income taxes is national corporate profits, which have been volatile historically. Oregon

has had growth above 10% for the past three years, which is unprecedented since the 1970s. Expects a slowing and think profits will get squeezed. Page 12 Exhibit A shows corporate income taxes without the distorting effects of the 2% kicker in various years. Have had a doubling of corporate income tax over last two biennia compared with 1991-93 biennium. Stronger profits than expected occurred, and Oregon's share is rising significantly. That is better described on page 13 Exhibit A, showing Top Oregon Corporate Taxpayers by Industry. Biggest change in recent years has been the electronics industry, which pays 13.5% of all corporate tax. Intel's last two quarterly reports indicate profits nearly 100% above previous year.

040 Warner  
079 Sen. Stated the charts indicate a downturn coming in 1998 but going back up in 1999. Asked  
Dukes if there was a reason for that projection.

084 Warner  
Answered the key reason for the assumption is Oregon is near the end of a cyclical increase in profits and that costs will catch up. One of the key factors of limited labor cost is lower benefit cost. Most states have fairly flat corporate profits, but Oregon is going against national trend right now. Another big industry paying a lot of taxes is Depository Institutions (Banking sector), and that reflects the strength of the economy and strength of Real Estate sector, but anticipates some softening in those numbers. Anticipates that corporate income taxes will be relatively flat by pulling out all the effects of the kicker credits next biennium.

126 Griffiths  
Discussed page 16 Exhibit A - Summary of Lottery Revenue Available to State. Total available resources are \$727.8 million. Overall changes to forecast are large and unusual and will be fine-tuned by technical adjustments. Regarding line items, other than interest earnings, the 1995-97 numbers are actuals for Lottery because there is a quarter lag between lottery sales and transfers.

169 Sen. Asked if the decline in video lottery from close of last session is a result of new tribal  
Dukes casinos.

171 Griffiths  
Stated it was difficult to be definitive about that. One point is that when there is a correlation between tribal gaming and video lottery sales, it does not necessarily mean casinos are to blame. Statistical model now includes estimated tribal gaming revenues as a variable. Nationally gaming revenues have been increasing over the past ten years at double-digit rates. Track has not been growing as quickly, but tribal gaming and riverboat casinos have been doing well. Overall gaming revenues are shifting from one sector to another. Overall gross amounts wagered on all gaming industries has shown sustained growth.

197 Rep. Asked if the correlation with tribal gaming is changing given the nature of the two  
Edwards compacts recently negotiated.

200 Griffiths  
Stated that was another uncertainty in the forecast because of lack of sufficient time to evaluate what the impacts will be. In exchange for the 6% net profits there is the extension of certain games to roulette and others at specified intervals. Two of the tribes have signed, and negotiations are proceeding with other tribes. Another uncertainty is the

expansion of wrap-around facilities such as hotels, which will be happening later this year. Continued detailed discussion of Summary of Lottery Revenue Available to State.

310 Griffiths Discussed page 18 Exhibit A - Sales Per Terminal and Projected Terminals and page 19 - Forecast and Actual Video Sales. This indicates about \$1,000 per terminal. Sales per terminal peaked in early 1995. Two tribal casinos opened at that time and took away a portion of sales. Have about 9,000 terminals now, and it is projected over next biennium to add about 800 more. Have changed assumptions about terminal growth in that it will take longer to process retailers because of required paperwork and because of the federal issue about disability access to retailers and terminals. Questions and discussion interspersed.

364 Griffiths To summarize, assumes tribal gaming will continue to grow at double digit annual rates. Approximately 425 terminals per fiscal year will be added. There will be two groundbreaking for casinos this year; one at Klamath and one for the Umatilla at Burns. While it may not have a large impact on lottery revenues because these new casinos will not be close to population centers, it is still an additional risk to the forecast.

389 Warner Page 21 Exhibit A - General Fund - Lottery Forecast (\$ in Millions). The beginning balance is up about \$108 million going into next biennium. Revenues are up about \$45 million projected for 1997-99 which leaves an increase of \$153.7 million. If you pull out the Education Trust Fund, it is an increase of \$145.8 million compared with March projection. Feels that they have been on a trend where projections have been consistently raised. 1995-97 grew about 20% with 6% inflation. There were growth rates like that in the 1970s, but they were accompanied by much higher inflation. It is very unusual to see that much real after-inflation growth. Recommend healthy ending balance be maintained, and have whatever emergency funds are available at hand in case these projections turn out to be too optimistic.

438 Sen. Leonard Asked what total tax burden on corporations is in Oregon compared with other states.

#### **TAPE 151, SIDE B**

033 Warner Answered that the corporate tax burden (notwithstanding the fact that many states do not have corporate income tax) has ranked Oregon around 30<sup>th</sup> or so. The biggest difficulty in looking at household versus business tax burden is that most experts estimate about 20% to 25% of sales taxes are really paid by businesses. Estimates that 10% of personal income tax is paid by businesses filing through Subchapter S Corporations that pay personal income tax. Biggest change seen in terms of household/business shift has been in property tax, and that is the result of different patterns in assessed value growth with residential property growing at twice the rate of commercial and industrial property in 1990s. That has caused a major shift of the tax burden toward households.

068 Sen. Leonard Asked if there was something wrong with the model the Office of Economic Analysis uses in terms of trying to project what revenues will be. In other words, what is so extraordinary that is occurring that the OEA is not able to catch, and is there something

that should be done differently to be able to accurately project what revenues will be?

074 Warner Responded there are two components of the model: The first element is national profits, which are overall profits in the economy that come from gross domestic product data. Projections are by BRI McGraw-Hill, which is a national forecasting service. The OEA uses that base and proportions out Oregon's share. A key element in OEA's error has been underestimating national profits. May 1995 forecast was about 20% low on what 1996 profits turned out to be. Second element is Oregon's share, and that is something OEA missed, too. If you look back historically at Oregon's income as defined for tax purposes as a share of corporate profits it has traditionally been about .7 or .75 of 1%. Looking at the 1995 returns, Oregon has jumped to a full 1%, which is a significant change. OEA expected a gradual increase, not a big jump.

114 Griffiths Added that the experience of many western states is they have had very strong unanticipated corporate profits, and Oregon is not alone in this situation. Revenue forecasters get together to relate common experiences, and that has been one of the issues they found. Questions and discussion interspersed.

137 Warner Added that OEA factored in everything it can, i.e. growth in geographic areas, in industries, etc. Has been a sharp increase in the metals industry with 15% increase in employment. A number of manufacturing industries have had sharp increases in growth. Computer software has had strong increases as well, but that shows up in Business Service sector, not Manufacturing.

155 Rep. Simmons Concerned today with small business portion of economy. Oregon will be phasing in the highest minimum wage in the nation. Has the OEA factored that into the forecast and what effect it will have?

165 Warner Answered yes, that was factored into the forecast. One reason Oregon has done so well in the 1990s is because it did so bad in the 1980s. Costs will always be a factor in location decisions. Minimum wage has been considered. Impacts in computer model are not huge. The concern may be for the longer term because it is occurring at same time other cost factors are pushing up in the state. There are risks it will make us less competitive over time. The effects on domestic industries are probably not going to be negative in economic terms because all the fast food companies compete with each other within Oregon. Where you run the risks are in the export sectors selling products outside the state. The biggest long-term risk may be in the Agricultural sector because they are competing on a world wide basis where costs are extremely important. The figures for increased minimum wage have not been broken out by region. The higher the current wage is, the smaller the effect will be. In Hillsboro, for example, you cannot hire someone at current minimum wage, but you can in southern Oregon where there is higher unemployment, more slack labor markets, and an overall lower wage. Thus the amount of increase will be bigger, so the effect on a company's costs will be bigger.

215 Rep. Edwards Stated that in March Warner said one of the difficulties of trying to estimate business income is the fact that it is so erratic and hard to predict. Asked what is outstanding right



now and are there any estimates of what has not been used to date?

227 Warner Answered the effects of the kicker credit when it is taken has been a major problem in forecasting. They are still getting 1995 returns in now but can see what proportion has been taken. Based on those returns they can isolate about \$120 million or so of the \$167 million. Will be about \$20 million spill-over into next biennium. Found in first quarter that refunds were \$36 million, which was extremely high. A lot of that was credits on 1995 returns that were just taken in the first quarter of 1997. The Revenue Department informed him that some of their taxpayers were unaware of the kicker credit. They had not taken it because they were unaware of it; then they filed final returns and got a large credit.

251 Rep. Edwards Stated that personal incomes are probably easier to predict, but asked what caused underestimation in model?

257 Warner Responded that percentage differences have been underestimated, mainly because of stronger economy than anticipated. Biggest difference has been in higher income groups. Been very accurate on wage and income projections, but underestimated non-wage and salary income sources like capital gains, Subchapter S, property sales, etc. which have shown tremendous growth, and these tend to be concentrated in higher income group with higher effective tax rate. That also makes the personal income tax volatile as well, more so than a sales tax. Questions and discussion.

305 Chair Baker Adjourned meeting at 10:03 a.m.

Carol Phillips

Committee Assistant

Kim James

Office Manager

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Exhibit Summary:

A. Warner, Oregon Economic Revenue Forecast, 23 pages

B. Yunker, Memorandum dated 5/15/97 re Selected Other Funds Revenue, 7 pages

C. Scherzinger, Forecast Summary, 6 pages