

STATE OF ARIZONA

Joint Legislative Budget Committee

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1716 WEST ADAMS
PHOENIX, ARIZONA 85007

PHONE (602) 542-5491

FAX (602) 542-1616

<http://www.azleg.state.az.us/jlbc.htm>

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FINANCE ADVISORY COMMITTEE

September 3, 2003

Senate Hearing Room 1 - 9:00 a.m.

Members Present:

Mr. Dan Anderson, ABOR
Mr. Tracy Clark, ASU
Mr. Pete Ewen, APS
Dr. Tim Hogan, ASU
Mr. Kevin Keogh, City of Phoenix
Mr. David Petersen, State Treasurer
Mr. Elliott Pollack, Elliott D. Pollack and Co.
Mr. Hank Reardon, Reardon Economics
Mr. Martin Shultz, Pinnacle West
Mr. Don Wehby, Dept. of Economic Security

Mr. Richard Stavneak, Director, JLBC Staff, opened the meeting and welcomed the committee members and guests. He mentioned that the committee usually meets 3 times a year to review the state of the economy and to give the Legislature some advice and guidance with regards to where the Finance Advisory Committee (FAC) members think the economy is headed.

Mr. Stavneak said that the JLBC Staff would do an initial presentation in terms of what the existing revenue forecast is for Fiscal Year 2004. Mr. Elliott Pollack will give his presentation on the national economy, the JLBC Staff will present on Marshall Vest's model with regard to the FY 2004 forecast, and Mr. Tracy Clark will present his views on the state economy.

Mr. Martin Shultz, Pinnacle West, said that the Citizens Finance Review Committee (CFRC) would welcome any comments or input via e-mail from economists and legislators on long-term revenues and forecasting.

JLBC Staff Presentation

Mr. Richard Stavneak, Mr. Brian Schmitz, Mr. Hans Olofsson, and Mr. Brian Cary, JLBC Staff, provided a slide presentation and handout on the General Fund, Sales Tax, Individual Income Tax and Corporate Income Tax.
([Click here to view handout.](#))

Elliott Pollack Presentation

Mr. Elliott Pollack, Elliott D. Pollack and Company, gave a slide presentation and handout on the national economy.
([Click here to view handout.](#))

Representative Allen asked that if the deficit continues to go up, with the cost of war figured into it, how long does Mr. Pollack anticipate before we start getting out of the deficit and will inflation kick in.

Mr. Pollack said that inflation will be a problem 2 to 3 years from now. Interest rates are tough to forecast and deficits are impossible to forecast. For the near term what he can forecast is there is not enough demand for money for it to be much of a problem.

Representative Johnson asked, in regards to monetary stimulus, how long the federal government can continue to print money with no backing.

Mr. Pollack said it will depend on the growth of the money supply. It has not been strong and if it gets above 6% for an extended period of time you have a problem. If they keep it in the 5% to 7% range, that is enough to have 4% growth and 2% inflation. When the fed gets nervous about the economy they will pump in a little more.

In response to Representative Barnes, Mr. Pollack said the economy will look a lot better a year from now than it does today.

Mr. Stavneak asked how the national outlook affects Arizona.

Mr. Pollack said the major thing affecting the Arizona economy is the U.S. economy. The export related industries, high-tech manufacturing, especially semiconductors for Arizona, are highly cyclical and depend on what goes on in the national economy. Tourism is a function of incomes; if incomes are picking up then tourism will pick up.

Mr. Dan Anderson, ABOR, said if you look at it historically, Arizona always does better than the nation when the nation is expanding.

Mr. Stavneak said, in terms of manufacturing jobs, we are down about 13%. We lost about 25,000 manufacturing jobs. He asked if in the short term, is that much of a factor in weighing down the economy.

Mr. Pollack said absolutely, we are tied to semiconductors and aerospace, which are great barometers. They are both highly cyclical.

Representative Barnes asked if there was something the Legislature could do to keep the economy going.

Mr. Pollack said that he does not think they need to do anything. If the economy is strong the government does not need to be counter cyclical. They do not need to put in stimulus when the economy is strong and then have it go away because the economy is bad. He said one thing to do is fund the Rainy Day Fund and not touch it.

University of Arizona Model Presentation

Mr. Tim Everill, JLBC Staff, presented the results of Mr. Marshall Vest's model. ([Click here to view handout.](#))

Senator Burns asked how the predictions of increased economic activity and revenue flow ties to the General Fund.

Mr. Stavneak said that based on input from the panel, the JLBC Staff would look at how that ties to General Fund revenue numbers. He said it would probably be somewhere around 5% to 7% depending on the level of risk.

Representative Robson asked how long we can continue to ride on sales tax numbers that are based on big ticket items.

Mr. Tracy Clark, ASU, said in regards to auto sales, the most recent numbers from July rose to an annualized level of 17.3 million units, up from 16.4 in June. There has been big incentives to buy, however, most people already have a new car. If you inject enough incentives into the system, they do work. Mr. Clark said he does question how long that growth can continue. Arizona has held at about 16 million units a year for a long time, and particularly if people get the idea that they need to trade in high gas usage vehicles for more economical cars, you might see it continuing. People like spending their money on cars.

Mr. Anderson said that if gas prices rise that might actually help to boost automobile sales because of people getting more economical cars. There is an incredible amount of capacity in the system and the only way to get rid of it is if something happens like gas price hikes.

Tracy Clark Presentation

Mr. Clark of ASU gave his perspective on the state economy. He said that most of what is happening in Arizona is happening at the national level. As far as the gas crisis, it was very short in terms of its impact on the economy, unless you ran a delivery service or a taxi service that depended on fuel for your business. It has made everyone realize how dependent we are on the fuel delivery system. Something needs to be done to increase our gas supplies. The big difference between putting in a pipeline and a refinery is that refineries are not run at full capacity. If there is a supply interruption they can just increase production.

Most of the things that are impacting Arizona are happening at the national level, however, there are some interesting things that are specific to Arizona. If you look at employment, in 2000 employment growth was 0. That enabled us to rank 9th in the nation in terms of job growth. There were only 8 other states that did better than 0. That tells you how dramatic the jobs impact of the recession at the national level has been. In June we grew by .6% in total, in July .6%, and that was 13th in the nation. The consensus in the Arizona Blue Chip in 2003 is 2.0%, and 3.4% 2004.

Mr. Clark said that most of the employment growth is in services. Manufacturing is still below last year's level. We are very dependent on high-tech manufacturing. We got through the Iraq crisis and are growing again. That growth is evident in all of the areas that are geographically tracked for semiconductors, and eventually that will erase the capacity issue. Semiconductor employers are going to have to start hiring more people but probably not until late 2004. There is no evidence that they are having to replace equipment to make semiconductors or expand production.

In 2002, retail sales grew by 1.3%. In 2003 the panel is forecasting 4.5% and a projection of 5.6% in 2004. Mr. Clark's own forecast is 3.8% in 2003, and 5.5% in 2004. Year-to-date, we have had growth of 3.4%. Retail will continue to strengthen. People will continue to purchase houses even though rates are up, because they are low by historical standards. Single family housing is another critical area. In 2002, single family housing grew by 9.3%. The forecasts from the Blue Chip consensus panel are for (3)% in 2003 and (3.3)% in 2004. His own forecasts are for (1.5)% in 2003 and (5.0)% in 2004. In terms of population growth, it will reach a low point in 2004 and then reaccelerate. The low point is still over twice the national average. He does not see a dramatic increase in commercial construction until 2005, at the earliest. In terms of the overall revenue picture, his numbers are slightly below the FAC numbers. Personal Income Tax is going to be strong, everything points to corporate being strong, but corporate is difficult to forecast.

Senator Allen said that she understands Wal-Mart is the largest single employer. She asked if this job growth is going to be higher paid jobs or in the service industry, which is typically lower pay. She asked if this population will have money to spend or just run up debt with the \$400 child tax rebate.

Mr. Clark said just because of its literal size it is always going to be the biggest piece of the pie. For every X number of people moving into the valley there will be a certain number of service jobs to go with that. He thinks we will see higher wage job growth as the recovery goes on. But it highlights a very important aspect in terms of long range planning that the Legislature has to focus on and that is bringing research jobs to the valley, which brings in other people that engage in knowledge that feeds the economy.

Mr. Pollack said that the manufacturing wage is actually higher than the national average. The most cyclical component of the economy is where the high wage jobs are. We lost them on the way down but will gain them back on the way up. He also thinks it is a misperception that all service jobs are at Wal-Mart or McDonalds. Doctors, lawyers, which are advanced services, can pay quite well.

Mr. Anderson said if the cycle is correct the state has already lost all the high paying jobs that it is going to and will start getting them back now.

Representative Johnson asked what would happen if the Legislature approved a sizeable tax increase, and has anyone figured that into their forecast.

Mr. Clark said it depends dramatically on what kind of tax increase or fee increase. It is virtually impossible to do a forecast without specific parameters. The biggest thing is consistency. If people knew that they had to have a one-

time increase to fix a particular problem, they would not mind as much. Most people do not make financial decisions based federal taxes as opposed to state taxes.

Representative Thompson asked if there was a tax reform that could be used to accelerate the recovery, such as single sales factor.

Mr. Pollack said that is something they are looking at and in his opinion, and the answer might be yes.

Mr. Clark said that by the time all of this would get implemented the economy would already be accelerated. It would not make the recession shorter or boost the unemployment numbers. However, it could be used for future information.

Mr. Stavneak invited the panel members to make any final comments.

Treasurer David Petersen said the state is raising the retirement contribution, effectively starting in July, for the pension system. They project it to be about \$200 million and said that what was going in government employee paychecks is now going to pensions. Both Mr. Clark and Mr. Pollack said people will see that as a pay cut.

Mr. Hank Reardon said that he agrees with Mr. Pollack and Mr. Clark's comments. We are not having much joy right now, things are going to get better, but slowly. He believes the national economy with be the state's driving force.

Mr. Don Wehby, DES, said that when they released their forecast figures last week, and revised the March forecast with the update, they forecast fewer jobs than they did in March. Basically it is around 10,000 fewer jobs. That is not surprising; they anticipated stronger growth in the 2nd and 3rd quarter than they found. They are still optimistic about the 3rd and 4th quarter. With the most recent figures, the forecast indicates a 1.2% growth for 2003, and a modest increase to 2.4% in 2004. In looking at 2005, they see continued recovery. We are not seeing very structured growth in manufacturing. We won't see a full recovery in Arizona until we actually get some strength in that industry. The other goods producing industries such as construction, continues to push forward and there is continuing confidence that winter tourism will continue to improve.

Mr. Pete Ewen, APS, said they are very supportive of the views and comments expressed at today's meeting. In general when one looks at the economy in areas they specifically track, things are looking good. Households continue to see wage increases. The difficulty for the panelists is translating that growth path in the economy into what it means for revenues. There are so many "disconnects" between sources of revenue and the economy. In general, he thinks things are in an upward trend.

Mr. Tim Hogan, ASU, said he is not sure where the forecast increase in sales tax revenues came from. Housing has been very strong, so there is not likely to be much growth there. This idea of wanting to bring in high quality jobs and focus on employment growth, you have to realize that if more people come here not only does it bring in more revenues it generates more costs. You will have to build more schools and highways and things like that. What we need to concentrate on is raising the incomes of people who are here and raising the revenues of firms that are here, making it more profitable.

Mr. Dan Anderson said he feels a little more optimistic on the economy than what is forecasted. The next couple of years should bring better times, however, not a quick recovery.

Mr. Stavneak introduced the newest FAC member, Mr. Kevin Keogh, City of Phoenix, Finance Director.

The meeting adjourned at 11:05 a.m.

Cheryl Kestner, Secretary

Tim Everill, Revenue Section Chief

NOTE: A full tape recording of this meeting is on file in the JLBC Staff office at 1716 West Adams.