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FINANCE ADVISORY COMMITTEE

December 16, 2003

Senate Hearing Room 1 - 9:30 a.m.

Members Present:

Mr. Don Anderson, Board of Regents
Dr. Tim Hogan, ASU
Mr. Kevin Keogh, City of Phoenix
Mr. John Lucking, ECON-LINC
Ms. Georganna Meyer, DOR
Mr. Elliott Pollack, Elliott D. Pollack and Co.
Mr. Hank Reardon, Reardon Economics
Ms. Debra Roubik, VisionEcon
Mr. Marshall Vest, UofA
Mr. Don Wehbey, Dept. of Economic Security

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

Mr. Stavneak said there were a couple of broad questions he wanted to propose to the Committee in terms of what their perspective is on the economy. First, while there is general agreement among forecasters that the economy is expanding, what is the pace of the recovery? Secondly, he inquired about a jobless recovery. Will the loss of manufacturing jobs be a hindrance to this expansion?

The panel has been projecting a slow recovery for about 18 months, and the recession has officially been over for two years, but it is only recently that we have begun to see revenue collections show some substantial growth. Mr. Stavneak noted he was interested in getting the panel's perspective on whether this lag in revenue collections is unusual and does it say anything about the strength of the recovery.

Mr. Stavneak indicated that the JLBC Staff presentation would include the FAC panel forecasted growth rates for FY 2004 and FY 2005 for each of the major revenue categories. These growth rates will be compared to JLBC Staff's October consensus forecast. The October estimates were based on Marshall Vest's economic model, FAC panel input from September, and JLBC Staff estimates.

Mr. Brian Schmitz, Mr. Hans Olofsson, Mr. Brian Cary, Mr. Tim Everill, and Mr. Stavneak, JLBC Staff, provided a slide presentation and handout with an overview of the major revenue categories, including historical revenue growth and forecasts for the current and following fiscal years. (See Attachment 1).

Mr. Elliott Pollack gave a slide presentation and handout on the national economy. (See Attachment 2). Mr. Pollack commented that very little has changed from the last meeting of September 3, 2003. The bad news about the recovery is there is no pent up demand for housing and autos, excess capacity, and consumers have a lot of debt

burden. The good news is there is fiscal and monetary stimulus. He thinks the employment numbers, when they are revised in February, will be revised upwards.

Representative Barnes said it looks like we will have a strong defense economy. He asked if the economy is going to shift to defense.

Mr. Pollack said there will be a shift, but it will help Tucson more than it will help Phoenix. Tucson produces more weapons and Phoenix produces semiconductors. This recovery will not be, to a major extent, based on defense. It will be based on consumer spending and retooling of businesses through computers and software.

Representative Thompson asked if tax amnesty was taken into account in the individual income tax growth rate.

Mr. Stavneak said we have received tax amnesty money, but those collections are not reflected in the numbers at this point. Overall, \$25 million was budgeted in 2004 for amnesty revenue and the latest numbers show that about \$47 million will be collected. Based on those numbers, we will have \$22 million more than expected.

Representative Barnes asked what is the annual upside, since we have brought more people into the tax base.

Mr. Stavneak said that the JLBC Staff has asked the Department of Revenue that question. He noted that in some circumstances you could go all the way back to 1982-83 in terms of applying for amnesty.

Representative Barnes asked for a copy of this information once it has been compiled.

Mr. Stavneak asked Mr. Pollack where he saw the economy in the near term. Mr. Pollack said it is going to look very similar to 1991. He does not expect to see it have the strength of the mid 1990's. You should see a very solid economy, and it will probably be 2005 until we get back above our long-term growth rate.

Mr. Stavneak said that in the mid 1990's we clearly saw double digit baseline revenue growth (before adjustments for any tax cuts that were made).

Mr. Marshall Vest, University of Arizona, gave a slide presentation and handout on the state economy. (See Attachment 3). He agreed with Mr. Pollack that the economy is shifting into a higher gear. If there are any surprises he felt they will be on the upside. He said we are out of the recovery stage and into the expansion stage, and noted that 2004 looks very much like 1994.

Mr. Tim Hogan asked about disposable income as a percent of total personal income. He asked why the ratio was going back down in the future.

Mr. Vest said it is because Global Insight feels there will be tax increases at the federal level to balance the budget.

Mr. Stavneak asked the panel members for their closing comments on the economy.

Mr. Dan Anderson said that he sees sales tax collections being a little bit stronger than what the panel as a whole is suggesting. Population has been growing much more rapidly than job growth has overall in recent years. We are bringing in a different profile of people, such as retirees who are not as connected to the labor market. He is less optimistic on corporate taxes. Overall, the next couple of years are going to be stronger as we come out of recession, but not as strong as we were in the 1990's.

Ms. Georganna Meyer said she feels corporate income tax collections will hit \$450 million this year, not including tax amnesty collections.

Mr. Tim Hogan said he feels tourism will be stronger as well as retail sales taxes, and inflation rates will be going up.

Mr. Kevin Keogh said the City of Phoenix revenue has tracked the changes at the state level but a little more muted. Recently, tourism has been picking up. At the city level, retail is still weak and not as strong as forecasted.

Mr. John Lucking noted that the huge federal fiscal stimulus has helped the recovery, as well as federal monetary policy. He does not see any changes to monetary policy until late next summer because of the election. He also noted that manufacturing is suffering for two reasons, including a normal cyclical downturn, as well as the recession. He said that the cyclical downturn is reversing, and the recovery will eventually include manufacturing. With regard to housing, he noted that mortgage rates are still low, and demographics are favorable to continued housing starts. He said that the uncertainty in terms of housing comes in 2005 and 2006, and increases geometrically as time goes out.

Mr. Don Wehbey said he shares most of the views of the panel. The economy is moving slowly in terms of jobs. October showed that we hit a new record level in employment of 2.3 million jobs without any improvement in manufacturing. Manufacturing is upward trending in the sense that the worst appears to be behind us. He continues to think it will improve. We have had a strong population growth. Employment appears to be sluggish but wages are picking up.

Ms. Debra Roubik described the private sector concept of analyzing the contributions of different product lines to corporate profit. She said that she recently applied this concept to several different state revenue categories, including retail sales and individual income taxes. She said that she is throwing out an uncharacteristic word of caution, because the contribution of these revenue sources to total state revenues has been declining. This suggests that there are holes in our collection process.

Representative Barnes asked about a potential federal tax increase.

Mr. Vest discussed Global Insight's assumption of an increase after the presidential election, along with the economic impacts of tax policy.

Mr. Stavneak thanked the Committee members for their participation

The meeting adjourned at 11:00 a.m.

Cheryl Kestner, Secretary

Tim Everill, Revenue Section Chief