

FINANCE ADVISORY COMMITTEE

December 10, 1999

Highlights

- *The panel consensus is that, barring a stock market correction, the economy should continue growing.*
- *Retail sales have been outstanding, reflecting high levels of consumer confidence.*
- *Committee members had mixed views on adjusting the September forecast, but tended to favor raising the sales tax estimates.*

With the start of the 2000 legislative session imminent and the usual high degree of legislative and public interest in the revenue forecast, the JLBC Staff called a meeting of its Finance Advisory Committee (FAC) on December 10. The FAC is a panel of many of the state's leading economists that meets several times a year to advise the Staff on its economic and revenue forecast. The panelists reaffirmed the strength and resiliency of the U.S. economy, pointing out that in another 2 months the current economic expansion will be the longest on record. Unless the stock market takes a plunge, the committee foresees continued, albeit slowing, economic and revenue growth.

Staff Presentation

The JLBC Staff made the opening presentation on state revenues (see Attachment), using a computer slide show. Richard Stavneak explained that the Staff's baseline revenue forecast, published on September 30, predicted growth rates of 6.8% in FY 2000 and 6.1% in FY 2001, compared with FY 1999 growth of 10.9%. The baseline revenue figures are calculated by removing the estimated effect of tax law changes, thereby providing a more comparable comparison of revenue collections over several years. The JLBC Staff economists then described the revenue forecast by major tax category.

- Brian Schmitz explained that sales tax collection growth rates have been very strong over the past 7 years, with the exception of FY 1997, and have increased at a rate of 9.0% so far this year versus the forecast of 7.0%. He asked the committee whether an upward revision to the forecast is warranted.
- Kent Ennis highlighted the recent slowing in individual income tax collections due to lower wage withholding growth of only 5.1% year-to-

date compared to 13.3% growth at this time last year. He pointed out, however, that the success of any individual income tax forecast is dependent upon final payments made in April.

- Jim Rounds described the volatility of the corporate income tax, which has fluctuated over the past 5 years from a high of 40.3% to a low of (12.2)%. Because it is so volatile, the corporate forecast employs conservative growth projections.
- Hans Olofsson emphasized the role of the property tax in education funding. He forecasts an increase in statewide assessed property values from 5% to 6%, which would result in state education spending savings of about \$8.5 million in FY 2001.

Stavneak then asked whether the September forecast might be on the low side, since, as he pointed out, economists have consistently underestimated the strength of this economic expansion. Raising the forecast, especially the sales number, would bring it more in line with the growth rates of recent years. On the other hand, Stavneak explained, there are arguments for retaining the September forecast, such as the fact that individual income tax collections have been sluggish this year and because the *Blue Chip* consensus forecast projects slower growth than the Staff forecast.

National Outlook

Elliott Pollack, president of Elliott D. Pollack & Company, was the next speaker, and he presented the outlook for the U.S. economy. The prognosis is still rosy, Pollack said, with no indication of a recession on the horizon. The driving force behind the economy is consumer spending, and spending should remain at high levels as long as consumers continue to feel optimistic about their financial situation. For many consumers, increasingly significant portions of their wealth

are invested in the stock market, and the large market gains over the past few years have made individuals confident of their ability to afford big-ticket items. Pollack warned that if the stock market undergoes a serious correction, retail sales growth could quickly dry up. Despite concerns in the popular press about high levels of consumer debt, Pollack argued that debt payments as a percent of disposable income have actually remained flat over the last several years. Finally, he recommended that the September sales tax forecast be raised in FY 2000 to account for the robust growth year-to-date, but advised that the Staff remain careful in FY 2001 with the sales forecast.

Arizona Outlook

The next speaker was Tracy Clark, of Arizona State University, who articulated his views on the Arizona economy. Clark is as sanguine about the state economy as Pollack is about the national economy. Productivity and job growth in Arizona have been extremely strong, even though our job growth has recently slowed a bit. Furthermore, retail sales growth has consistently outstripped the expectations of state *Blue Chip* forecasters. Like Pollack, Clark cautioned that retail sales could be undone by a fall in the stock market or by interest rate hikes. He also posited that Y2K will be an overhyped nonevent. Clark suggested that there is more downside risk to the September revenue forecast than upside potential, given the inherent volatility of the stock market.

Dan Anderson, of the Department of Economic Security, was the next speaker, and he summarized the state's employment picture. Job growth has been so strong in Arizona (77,600 new jobs created over the past 12 months) that employers are having difficulty finding qualified people to fill their openings. The state's unemployment rate is just 4.0%, and in Phoenix and Tucson the unemployment rates are a meager 2.8% and 2.9%, respectively. In fact, tight labor market conditions in Phoenix have resulted in a job growth rate that is below Tucson's for the first time in years. Anderson predicted that the rate of new job creation in the state will slow from 3.5% in 1999 to 2.5% in 2000.

The final speaker of the day was Pete Ewen, of Arizona Public Service (APS). Stating at the

outset that he is bullish on the prospects for the economy over the next couple years, Ewen suggested that the demand for construction might actually go up due to several power plant projects in the works. Conventional wisdom has been that the construction sector has peaked and will soon decline, so Ewen's outlook is decidedly more optimistic than most. Acknowledging the potential for a large stock market correction, he nonetheless recommended raising the September forecasts for the sales tax and the individual income tax.

There was also committee discussion on the extent to which taxpayers will take advantage of the new school tax credits. Georganna Meyer, of the Department of Revenue, reported a high volume of calls on this subject, indicating a good deal of taxpayer interest. She also mentioned receiving a number of calls regarding the tax credits offered by the recently enacted alternative fuels bill. Finally, FAC panelist Hank Reardon, of H.C. Reardon Economics, recommended at the end of the meeting that the September sales tax forecast be raised.

This FAC meeting was attended by 30 people, including 5 legislators. The handouts of the speakers are available from our office upon request.