

FINANCE ADVISORY COMMITTEE

August 29, 2000

Highlights

- *Several of the economists on the panel predicted that the state and national economies will keep growing at a healthy level, although at a slightly lower rate of growth.*
- *Several panelists, however, said their forecasts could be too optimistic if Proposition 202, the Citizens Growth Management Initiative (CGMI), is approved by the voters. In particular, Elliott Pollack believes that Proposition 202 could significantly hinder the construction industry in the state. There were no initiative proponents at the meeting to present their viewpoint.*
- *Excluding issues related to the CGMI, the panel appeared slightly more optimistic about the economy than at the last meeting 5 months ago.*

The JLBC Staff called a meeting of the Finance Advisory Committee (FAC) on August 29th to solicit input on the condition of the economy from the state's leading economists. The FAC is a 16-member panel that meets several times a year to provide guidance to the Staff on its economic and revenue forecasts. The collective opinion of the group is that the current economic expansion shows no signs of ending any time soon. In fact, panelists agreed that the outlook has brightened over the last 5 months, due to an upward revision of some employment and construction data.

Staff Presentation

The JLBC Staff gave the first presentation, focusing on state revenues. (A copy of this presentation is attached and is also available on our web site.) Final FY 2000 revenues were \$18.2 million, or three-tenths of 1%, above the forecast. The Staff economists described the primary issues related to the major tax categories in FY 2001 and beyond.

- Brian Schmitz pointed out that sales tax growth in FY 2000 of 9.8% was the highest since FY 1995 — a remarkable achievement considering the maturity of this economic expansion. Consumer spending on big-ticket items such as cars and furniture posted double-digit increases in FY 2000. He asked the committee for its opinion on how long sales taxes can continue to grow at this high rate.
- Hans Olofsson described the individual income tax and the property tax. The individual income tax grew by 9.1% in FY 2000, but this was down from the previous year's growth of 12.6%. Estimated payments, often linked to capital gains from the stock market, came in below expectations.
- Jim Rounds commented on corporate income tax collections. Revenues from the corporate income

tax declined from \$545 million in FY 1999 to \$523 million in FY 2000, mostly due to a 17.1% increase in refunds.

- The JLBC Staff also explained that tax changes taking effect in FY 2001 and FY 2002 include both new tax cuts and taxpayer savings that will result in new state spending. For FY 2001, the Legislature has already approved total tax savings of \$121.7 million. Of that amount, \$75.5 million are direct tax reductions to the General Fund and \$46.2 million are tax savings that increase state spending. For example, a vehicle license tax (VLT) reduction of \$21.4 million in FY 2001 will result in reduced State Highway Fund collections. This tax savings will have a General Fund impact as the state will reimburse the Highway Fund from general revenues.
- The JLBC Staff also noted 2 future events that could boost state revenues. First, the construction of 13 newly approved and proposed power plants will positively affect future net assessed value. If some or all of these power plants are built in the state, there will be a boost in property tax collections. The Staff also noted that the state's planned spending of over \$1 billion on school building repairs could have a positive impact on the economy.

National Outlook

Elliott Pollack, of Elliott D. Pollack & Company, presented the outlook for the U.S. economy. The basic underlying dynamics of the national economy are still very strong, he asserted, and his forecast calls for more,

albeit slower, growth. Because of favorable demographic conditions, outstanding productivity levels, and high consumer confidence, Pollack projects that the economy should be strong for the next decade. The length of the current expansion has already set an all-time record at 112 months, and Pollack sees no recession on the horizon. He did identify a few areas of concern, including the fluctuating stock market, the widening trade gap, and the Citizens Growth Management Initiative (see discussion below). He cautioned that the economy remains susceptible to “shocks.” For example, an energy crisis or a foreign war could disrupt the stock market, cause consumers to lose confidence, and slow the economy.

State Outlook

The next speaker on the agenda was Tracy Clark, of Arizona State University. Clark informed the panel that since March, Arizona has been the nation’s leader in overall job growth. We are the number 2 ranked state in service sector growth, but only number 33 in construction employment growth. Relative to the revenue forecast, Clark opined that retail sales tax collections could start to slow if interest rates remain high. The two stalwarts of recent retail sales taxes, auto sales and furniture sales, are both sensitive to high interest rates. On the income tax side, he thinks revenues from this category should continue to grow. In general, Clark described his outlook as being more optimistic about the economy than he was 6 months ago.

Labor economist Dan Anderson, of the Department of Economic Security, spoke next on employment and population growth in the state. Affirming that Arizona is number 1 among all states in employment growth, he also explained that job growth in Tucson is pacing the state. The state’s population is just shy of the 5 million mark, with 150,000 new residents being added each year.

Marshall Vest, from the University of Arizona, commented on the relationship between building awards and contracting tax collections. His research shows that there is a 1 or 2 year lag between when building awards are made and when contracting taxes are paid. Since building awards are continuing to grow, we can expect contracting tax revenues to grow as well.

Other Issues

Northern Arizona University professor Wally Duncan surmised that the Federal Reserve Bank will leave interest rates unchanged at its next meeting because the Fed does not want to influence the November

presidential election. Duncan thinks interest rates will likely remain stable throughout this year, before possibly declining next year.

The FAC also briefly discussed the economic impact of illegal immigration. Border states such as Arizona typically have a wider income gap between the rich and poor than other states, and panelists speculated that this is due to the large numbers of undocumented immigrants willing to take low paying jobs. State Treasurer Carol Springer suggested that this population fills an important, though little known, role in Arizona’s economy.

Risks to the Forecast

Several panelists identified two risks to the Staff’s ability to accurately forecast revenues. In November, the public will vote on the Citizens Growth Management Initiative (Proposition 202). Pollack argued that this growth control plan would change the underlying dynamics of the state’s economy. Clark worried that it could slow Arizona’s employment growth, and Springer also opined that the plan would slow the economy. There were no Proposition 202 proponents at the meeting to present their viewpoint.

Another challenge in revenue forecasting is the increasing number of income tax credits available to taxpayers. Georganna Meyer, of the Department of Revenue (DOR), pointed out that prior to 1993 the highest number of individual income tax credits ever available in any one year was 7. In tax year 2001, there will be 27 tax credits available. For the corporate income tax, the highest number of tax credits available prior to 1993 was 3. In tax year 2001, there will be 19 tax credits available. Since companies can wait and use the credits as much as 15 years in the future, we can never be quite certain when these credits will be taken.

The attendance at this meeting of the FAC numbered 42 individuals, including 7 state legislators and the State Treasurer.