

MINUTES

**MONTANA HOUSE OF REPRESENTATIVES
57th LEGISLATURE - SPECIAL SESSION
COMMITTEE ON TAXATION
SENATE/HOUSE JOINT**

Call to Order: By **CHAIR Bob DePratu**, on July 30, 2002 at 9:00
A.M., in Room 303 Capitol.

ROLL CALL

Members Present:

Sen. John Bohlinger, Chair (R)
Sen. Alvin Ellis, Vice Chair (R)
Sen. John Bohlinger, (R)
Sen. Mack Cole (R)
Sen. Pete Ekegren (R)
Sen. Jon Ellingson (D)
Sen. Bill Glaser (R)
Sen. Dan Harrington (D)
Sen. Emily Stonington (D)

Rep. Bob Story, Chair (R)
Rep. Ron Erickson, Vice Chair (D)
Rep. Joan Andersen (R)
Rep. Keith Bales (R)
Rep. Joe Balyeat (R)
Rep. Eileen J. Carney (D)
Rep. Larry Cyr (D)
Rep. Rick Dale (R)
Rep. Ronald Devlin (R)
Rep. John Esp (R)
Rep. Gary Forrester (D)
Rep. Daniel Fuchs (R)
Rep. Verdell Jackson (R)
Rep. Jesse Laslovich (D)
Rep. Trudi Schmidt (D)
Rep. Butch Waddill (R)
Rep. David E. Wanzonried (D)

Members Excused: Rep. Roger Somerville, Vice Chair (R)
Rep. Gary Branae (D)
Rep. Karl Waitschies (R)

Members Absent: none

Pam Schindler, Committee Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing(s) & Date(s) Posted: Revenue Estimating Resolution,
7/29/2002

Executive Action: none

Sen. DePratu welcomed members and stated that public comment will be taken later when House Taxation Committee reconvenes.

HEARING ON RULES OVER REVENUE ESTIMATING RESOLUTION

Informational Testimony:

Paul Polzin, Bureau of Business and Economic Research at the University of Montana-Missoula, Missoula, Montana

EXHIBIT(tah-4a01)

Mr. Polzin stated "Montana's economy successfully dodged two bullets in the past year. The first bullet came in the spring of 2001 as the U.S. economy began the current recession. The U.S. recession was heavily concentrated in high-tech, automobile manufacturing, and communications. Montana does not have many of these industries, and that is why we avoided this bullet, he said. Montana does have a few high-tech firms, and they suffered just like their counterparts elsewhere in the nation. "It's just that Montana's economy is less dependent on high-tech than in other parts of the nation". The second bullet was fired on September 11 when the terrorist attack crippled the travel and transportation industries, Polzin said. Nonresident travel is one of Montana's important basic industries, but luckily the terrorist attack occurred after the summertime peak in nonresident visitation."

"Billings and Missoula did experience noticeable drop-offs in business travel during September and October, but there was no noticeable blip in other statewide date". This recession hasn't hit Montana as hard as the recessions of the 1980s, Polzin said. In the 1980s, construction and wood products were hurt badly. This time, low interest rates have kept Montana's construction and wood products strong and helped to counter some of the weaknesses in industries like high-tech manufacturing. For the nation as a whole, employment growth has slowed dramatically and even declined. But Montana shows only a slight slowing and continued growth. Overall, we are projecting slightly slower growth in 2002, Polzin said. Montana's economy will likely grow 1.2% in 2002, as compared to 2.1% in 2001."

"Our forecast for 2002 has more uncertainty and a greater margin of error than normal. The actually 2002 growth rate depends on how some of the state's major employers react to a variety of threats, he said. "It's not just the recession, but these companies also face problems with respect to electricity prices, management, and regulation". Some of the companies facing these challenges include Columbia Falls Aluminum Company, Jore Manufacturing, Northwest Energy (Montana Power Company) and ASARCO." **EXHIBIT(tah-4a02)** (Please see exhibit for additional information)

Revised Montana Forecast: Mr. Polzin is forecasting a deceleration; slight increase in 2003 and he suggests we not compare Montana to U.S. Economy.

Forecast Risks: 2/02-7/02

Columbia Falls Aluminum	will go up
Jore Manufacturing	no change
Stillwater Mining	will go up
MPC	no change
ASARCO	will go down, not re-open
U.S. Economy	will go up
Stock Market	?

{Tape : 1; Side : A; Approx. Time Counter : 0 - 255}

Questions from Committee Members and Responses:

Representative Balyeat to Mr. Polzin: Have we really dodged a bullet or are we a non-responsive economy?

Response: Montana has different industries, and the industries it has were not effected by Sept. 11. We have fewer of the industries that were effected.

Representative Balyeat to Mr. Polzin: Is it true that the general economy of Montana isn't suffering as the rest of the country, we are seeing serious revenue shortfalls due to being heavily dependent on n capital gains?

Response: Not an economic problem, it's due to a revenue shortfall expenditure.

Representative Balyeat to Mr. Polzin: How, if agriculture is 50% of Montana, how will it be indicative of non-farm income?

Response: need to change the non-farm product to be the gross state product.

Representative Balyeat to Mr. Polzin: if that is what it is, is it a close indicator state to state?

Response: I have not looked at other states. Re: gross state products.

Representative Harrington to Mr. Polzin: Re: the shortfall economy, comment on the other reasons why Montana has fiscal problems.

Response: The U.S. economy looks so poorly; however Montana does not look so bad.

Representative Harrington to Mr. Polzin: What are the underlying causes in Montana's economy? Could it be past legislative actions?

Response: Possibly.

{Tape : 1; Side : A; Approx. Time Counter : 255 - 485}

{Tape : 1; Side : B; Approx. Time Counter : 485}

Representative Erickson to Mr. Polzin: Explain transfer payments? Also federal dollars going to farmers?

Response: Transfer payments are largest single item from US, Government. Social Security.

Representative Erickson to Mr. Polzin: You appeared to "duck" the Stock Market question. Will you be willing later to answer this question; especially in 2003?

Response: When we get more information; carry overs, etc. Also would be a good research project.

Representative Erickson to Mr. Polzin: Re: capital gains-did you look at other states; look at their decreases?

Representative Story to Mr. Polzin: In the table you have \$21B as growth in person income in 2001; \$4.7B is from dividends/interest-is that correct.

Response: I think that is why you're here.

Mr. Polzin more; will be here for the House Taxation Committee meeting if necessary.

{Tape : 1; Side : B; Approx. Time Counter : 485 - 552}

Information Testimony:

James Stack, President-InvesTech Research, Whitefish, Mt.

EXHIBIT (tah-4a03)

There are theories that the recession ended in January, 2002, however we are in uncharted waters now. Not 1 recession since the Federal Reserve was started in 1913 that has remained in a "Bear" Market has continued to hit new lows 5 months after it started. Economic reality is that not one of the last 7 recession were forecast. You will not see in advance, the Stock Market disconnected from economic reality. You should not discount NYC events. Consumer confidence has dropped 11%, 5th biggest drop in 60 years.

In the late 1990's, we were in a "stock market bubble" and probably will not resolve the excesses. It is the biggest and

longest "Bear" market in 60 years. Economic Realty: no one stood up here and told you that we would be entering a recession. This "Bear Market" will have more impact than any other "Bear Market" in years. Gross National Product vs. "paper wealth". There were "Bear Markets" in 69,70,73 and 74. Montana will not be immune. Economic Risks are related to Consumer Confidence. 40 year low for short term interest rates.

Problems: 1.) Consumer confidence is most critical; if consumer confidence continues to fall, that will indicate we're going into a recession. If you want to know where we will be in 2003, watch that consumer confidence.

2.) Business confidence is on very stable footings

3.) Interest rates

4.) Federal Reserve: what is so unusual is to have the Federal Reserve have so few tricks in their bag.

5.) Federal and State Budget Projections

The Legislature should think of "surprises". We need to keep our feet on the ground. We started from such a high level that looking back obviously there was a "market bubble" , it's going to have an impact.

Montana economy hinges on tourism, non-resident travel, wood products. After Sept. 11, people stopped traveling. Housing starts vs. economic recession you will see a sharp contraction in home building. This recession we did not see it; due to interest rates being at a 40 year low.

Mr. Stack would encourage this legislature to think in terms of "surprises". "Surprises" in the next 6-12 months will be on the negative side not positive. The stock market is not to be ignored. Those loss profits will not come back.

Questions from Committee Members and Response:

Senator Stonington to Mr. Stack: Curious about the turnover of money; those people that are selling equities, where are they putting those monies?

Response: Stock Market is a 2 way action. For everyone that sells their stock, there is another person who buys it. When stocks are sold, money is only pulled out when the company buys it back. Real estate is going up.

{Tape : 1; Side : B; Approx. Time Counter : 552 - 960}

{Tape : 2; Side : A; Approx. Time Counter : 0}

Senator Stonington to Mr. Stack: I have attended conferences speaking about state revenue vs. taxes, as the national revenues

go down, state revenues will not go down as fast. Just because of the timing of state taxes, do you know anything about that?

Response: I cannot comment on that.

Senator Ellis to Mr. Stack: Money Market Funds are up, is that accurate?

Response: That is accurate. Long-term investors are pulling back from the stock market. What causes this is demoralizations, inflationary actions, loss of confidence.

Senator Ellis to Mr. Stack: Valuations are where they should be?

Response: Even if corporate earnings were back up to peak levels, still have a price to earnings ratio of 30%. Low interest rates can support high value levels.

Senator Ellis to Mr. Stack: Eastern part of state think that worth is related to what "piece is worth"; anticipate this lack of confidence is going to attack that value?

Response: Loss of confidence will impact. As long as market stays down, the more impact on confidence will have. State tax collections may lag behind federal. 2nd houses are not being built.

Representative Forrester to Mr. Stack: Loss of stock prices to 30% is that because of loss consumer confidence? What would company to go down?

{Tape : 2; Side : A; Approx. Time Counter : 0 - 100}

Response: Lots of companies were over driven in the 90's. Do not read too much in individual stock prices.

Representative Balyeat to Mr. Stack: Bear market gone before recession? Probable?

Response: Stock market is saying going into recession. Federal Reserve trying to keep it going. Wall Street more trouble ahead.

Representative Balyeat to Mr. Stack: Headed into a double digit recession?

Response: Yes.

Representative Balyeat to Mr. Stack: Not much to do when this happens?

Response: Fiscal/Monetary policy.

Representative Balyeat to Mr. Stack: Federal Reserve?

Response: Federal Reserve will go down.

{Tape : 2; Side : A; Approx. Time Counter : 100 - 192}

Representative Balyeat to Mr. Stack: How will Public/State government respond to expansion; increase all funds budget by 23%. Is this a problem that we're headed for a 2nd dip in recession?

Response: We all make decisions on recent memories. Tend to forget the lessons of recession. Prepare for "surprises". Be thinking "pre-emptively".

Senator Bohlinger to Mr. Stack: Consumer Confidence? What is criteria for Consumer Confidence indicators?

Response: 2 major studies, one from University of Michigan and the other from Confidence Board. Very basic survey, re: will you buy a car, etc? Expectation component. Consumer Confidence drops sharply before recessions usually.

Chairman Depratu calls a recess until 10:35 a.m.

{Tape : 2; Side : A; Approx. Time Counter : 192 - 311}

Chairman Depratu calls meeting back to order, 10:35 a.m.

Informational Testimony:

Terry Johnson, Chief Fiscal Analyst, Legislative Fiscal Division, State of Montana

EXHIBIT(tah-4a04)

Revenue Estimates for the General Fund, revised July 29, 2002

Page 1: Overview of budget review, background info of tax resources, revenue description/tax rates.

Page 13: Corporation Income Tax, general fund revenues, estimates.

Page 4: Figure 1-why we are here today. 1st column-post session; \$53.8M balance. Revenue estimated \$2.77B. Revised \$2.534B decline in revenue. 5.7% decline in anticipated revenue.

{Tape : 2; Side : A; Approx. Time Counter : 311 - 511}

{Tape : 2; Side : B; Approx. Time Counter : 511}

July 2003 Biennium forecast: \$2.741B disbursements, \$217M difference.

Page 5: Executive proposal: current year revenue \$2.525B, Legislative fiscal Division projects, \$2.524, difference of \$1M. Supplemental Appropriations different from the executive. If you adopt the executive numbers, projected deficit of \$21.8M. LFD numbers will be a \$36.9M deficit. Majority of that is being driven by the higher supplemental costs.

Page 6: Figure 3, reasons for significant difference. Total differences between the two offices is about \$15M. Met with the executive last week to go over the differences, we went over the various categories and we have highlighted the differences.

Executive vs. LFD:

Individual Income Tax	\$3.5M	difference
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Corporate Income Tax	\$3.5M	difference
Common school and interest income	\$(1.4M)	higher LFD
All other Revenue	\$(1.2M)	higher LFD
Estate Tax	\$ 1.4M	difference
Oil and Natural Gas Prod.	\$ 1.2M	difference
Public Institution Reimburse.	\$(3.7M)	higher LFD
Remaining Categories	\$(2.2M)	higher LFD

Fire reimbursement from the Federal Government.
Lois Steinbeck will provide additional information.

Page 9: graph and chart is what 2001 Legislature enacted.

Summary: Have we reached the lowest level? What got us here? Look at the information of individual and corporate income tax. Also non-wage component-capital gains, interest dividends and rents. The numbers "you" have to pick should be realistic picks; can re-assess in January. Options? Higher estimates; and hope it comes true, if revenue declines, we'll be back here. Or do low estimates using additional revenue.

{Tape : 2; Side : B; Approx. Time Counter : 511 - 803}

Questions from Committee Members and Responses:

Senator Ellingson to Mr. Johnson: Optimism regarding individual income tax (increase?)

Response: 2001-2002 Wage salary component; saw a growth rate of about 3%. Assume it continues to 2002-2003. That's the wage and salary component. Overall income that is taxed, about 65% total income is generated is from wages and salaries. We will come up with a growth rate of a positive 2%.

Senator Ellingson to Mr. Johnson: Assume the worst, no capital gains tax increase, do you know what part of income comes from capital gains?

Response: 8-10% total income on forms come from capital gains. 2000-calendar year-need info, 2001 number comes in November. Capital gains income could get worse.

Senator Ellingson to Mr. Johnson: 10% income tax revenue is capital gains derived? In the neighborhood of \$50M? One-half of that comes from equities?

Response: Total income on tax return forms is \$12-14B. Of that, capital gains are 8-10%.

Senator Ellingson to Mr. Johnson: State tax income is \$8-10M. Is that result of federal legislation?

Response: It's a combination of 2 things, state estate tax and federal estate tax.

Representative Balyeat to Mr. Johnson: unable to hear clearly.

{Tape : 2; Side : B; Approx. Time Counter : 803 - 999}
{Tape : 3; Side : A; Approx. Time Counter : 0}

Representative Balyeat to Mr. Johnson: Compile revenue from Capital gains?

Response: Capital losses offset any income.

Representative Balyeat to Mr. Johnson: \$3.4M difference in the income tax revenue vs. executives numbers. refund accrual-please clarify.

Response: underlying assumption is the 2% growth. Add back \$3.4M accrual then apply the growth rate of 2%.

Informational Testimony:

Chuck Swysgood, Director of Budget and Planning, State of Montana

Concentrate on areas of differences, word of caution, there is a difference. Subtract extra revenue, \$5.8 difference.

Questions from Committee Members and Responses:

Senator Ellingson to Mr. Swysgood: Amount of tax revenue from capital gains, can someone give me last year available for estate tax revenue?

Response: Director Kurt Alme, Dept. of Revenue, less than \$100K. Federal government matches the state estate tax. track what Federal government allows us to have.

Senator Ellingson to Mr. Alme: when you provide information on the Capital Gains will that be broken down by source?. Will that include Equity Transactions as opposed to what might come from Land Transactions? Do you have the information?

Response: We do not.

Senator Ellingson to Mr. Alme: Can anyone? It's a pretty important question.

Response: We don't have that particular. We cannot answer that specific question.

Senator Ellingson to Mr. Johnson: Sources of information? See tremendous differences with projected capital gains revenue that may come from land transactions.

Response: Rep. Balyeat was pretty close in terms of amount of tax revenue from capital gains. Our office and budget office had contacted the Dept. of Rev. to do a study on capital gains; very dated information. It will not reflect this income tax year. It's strictly on an income basis, not a tax basis.

Chairman DePratu adjourned the meeting.

{Tape : 3; Side : A; Approx. Time Counter : 0 - 169}

ADJOURNMENT

Adjournment: 11:30 A.M.

SEN. BOB DEPRATU, Chair

PAM SCHINDLER, Secretary

BD/PS

EXHIBIT (tah-4aad)