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Revenue and Transportation Interim Committee

61st Montana Legislature

SENATE MEMBERS

KIM GILLAN--Chair
RON ERICKSON
JEFF ESSMANN
CHRISTINE KAUFMANN
JIM PETERSON
BRUCE TUTVEDT

HOUSE MEMBERS

ROY HOLLANDSWORTH--Vice Chair
DICK BARRETT
CYDNIE (CARLIE) BOLAND
BRIAN HOVEN
MIKE JOPEK
BILL NOONEY

COMMITTEE STAFF

JEFF MARTIN, Research Analyst
LEE HEIMAN, Staff Attorney
FONG HOM, Secretary

MINUTES

August 2, 2010

Room 137, Capitol Building
Helena, Montana

Please note: These minutes provide abbreviated information about committee discussion, public testimony, action taken, and other activities. The minutes are accompanied by an audio recording. For each action listed, the minutes indicate the approximate amount of time in hours, minutes, and seconds that has elapsed since the start of the meeting. This time may be used to locate the activity on the audio recording.

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COMMITTEE MEMBERS PRESENT

SEN. KIM GILLAN, Chair
REP. ROY HOLLANDSWORTH, Vice Chair

SEN. RON ERICKSON
SEN. JEFF ESSMANN
SEN. CHRISTINE KAUFMANN
SEN. JIM PETERSON
SEN. BRUCE TUTVEDT

REP. DICK BARRETT
REP. CARLIE BOLAND
REP. BRIAN HOVEN

COMMITTEE MEMBERS EXCUSED

REP. MIKE JOPEK
REP. BILL NOONEY

STAFF PRESENT

JEFF MARTIN, Research Analyst
LEE HEIMAN, Staff Attorney
FONG HOM, Secretary

Visitors

Visitors' list, Attachment #1.

COMMITTEE ACTION

- Requested a bill draft for the revenue estimating resolution.

CALL TO ORDER AND ROLL CALL

- 00:04:06 SEN. GILLAN called the meeting to order at 1:08 p.m. The secretary called roll. Rep. Jopek and Rep. Nooney were excused.
- 00:05:26 The minutes of April 29-30, 2010, meetings were approved unanimously on a voice vote.

AGENDA

• **INTRODUCTION OF NEW STAFF MEMBERS**

- 00:06:05 Lee Heiman introduced Robert Stutz as the new director of the Legal Services Office.
- 00:07:24 Jeff Martin introduced Megan Moore as the new Legislative Services Division research analyst.

• **SUMMARY OF AGENDA - Jeff Martin, Research Analyst**

- 00:09:59 Mr. Martin gave an overview of the agenda.

• **ECONOMIC FORECASTS AND REVENUE ESTIMATES - Patrick Barkey, Director, Bureau of Business and Economic Research, University of Montana**

- 00:13:53 Dr. Barkey gave a presentation on the forecasting process (**Exhibit 1**). He commented on Figure 5 "Actual and Projected Percent Change in Nonfarm Labor Income, Montana, 1995-2009" in The Outlook 2010 magazine (**Exhibit 2**).

• **FORECASTING LOCAL AND STATE TAX REVENUES - Myles Watts, Department of Agricultural Economics and Economics, Montana State University**

- 00:36:11 Dr. Watts gave a presentation on forecasting local and state tax revenues (**Exhibit 3**).

• **ECONOMIC INFORMATION AND FORECASTS - Terry Johnson, Legislative Fiscal**

Division

00:55:08 Mr. Johnson gave a presentation on the Legislative Fiscal Division's revenue process assessment (**Exhibit 4**).

▶ **OTHER RESOURCES AND ENTITIES FOR ECONOMIC INFORMATION AND FORECASTING - Cathy Duncan, Legislative Fiscal Division**

01:23:20 Ms. Duncan gave a presentation on economic forecasting from other entities (**Exhibit 4, page 20**).

▶ **INDIVIDUAL INCOME TAX AND CORPORATE TAX - Terry Johnson**

01:36:40 Mr. Johnson discussed the revenue estimating profiles on the individual income tax and corporate income tax (**Exhibit 4, page 29**).

Questions

01:46:43 SEN. ESSMANN said that the estimated income tax includes estimated payments by the self-employed. The estimated payments are not all capital gains and it would be influenced by the financial health of sole proprietorships and small businesses. He asked what historically is the split in estimated payments between the capital gains and the small businesses. **Mr. Johnson** said that the presentation by Stephanie Morrison will provide some answers to Sen. Essmann's questions.

01:48:19 SEN. TUTVEDT asked Dr. Barkey and Dr. Watts about the range of the state forecast. **Dr. Barkey** said it is narrower than a year ago because of the stimulus bill and banks not wanting to lend to one another. **Dr. Watts** said that relative to five or six years ago, the variability is higher today. He said the variability and the risks are about the same as they were a year ago.

01:51:33 REP. HOLLANDSWORTH asked Dr. Watts about taking into account tax law changing and projections for older people who are not risk takers. **Dr. Watts** said that the better forecasters take into account the demographics and tax law changes into their models.

01:53:28 SEN. ERICKSON asked what the committee can do about the information from Global Insight? **Dr. Watts** said that several years ago they discussed with Global Insight their concerns with the way Global Insight modeled Montana, and in particular, how they looked at energy prices. He said that someone needs to meet with Global Insight and carefully go through those models. **Dr. Barkey** said that he agrees with Dr. Watts. They look at the Global Insight's forecast as a plausible starting point. He would think that the fiscal analysts would be doing the same thing. With regard to the oil price specifically, that has been a hard one to forecast. Global Insight has done a poor job and in situations like that, one should get a second opinion and average the two.

- 01:58:19 SEN. ERICKSON said that the committee doesn't know how each of the forecast variables found on page 27 of the Legislative Fiscal Division's report affect their final revenue estimate. He asked if any analysis could be done to determine the sensitivity of revenue estimates to bad numbers from either of these two sources. **Ms. Duncan** said that with some of the items, they could do that.
- 02:01:04 SEN. PETERSON asked if would be possible to go back and do more analysis of the historical aspects of these national forecasts to build a better Montana model. Can they take that information and go back to a previous recession and do some analysis on the lag time based on the data available. **Dr. Barkey** said that the answer to Sen. Peterson's first question is yes. With respect to Moody's, he is not sure how long Moody's has been in the state forecasting business. With respect to Global Insight, we could request that information be provided for their evaluation. **Dr. Barkey** said that he likes the suggestion of going back to previous recessions, that while every recession is different, he doesn't think that the lag time with respect to how Montana behaves in a national recession is necessarily fixed. **Dr. Watts** said it would be useful to go back at least 40 years to see how Montana comes out of recessions relative to the national economy. His major concern is that most of these models are developed at the national level and then customized to states.
- 02:07:14 REP. BARRETT asked how much error is from bad predictions from Global Insight versus the error that we make when we try to model the Montana impact of those. Montana oil prices can be wrong. Is that because of the model or because of the garbage in, garbage out problem. **Dr. Barkey** said the errors that occur in predicting Montana's oil price are entirely due to the errors in the forecast of what serves as a national price because the differences are regarding transportation costs which don't vary much with the economy. He said in regard to revenue forecasting, there will always be errors in input. The forecast process involves taking the forecast information that you have and if one of those pieces of information is from a vendor, then you can use it or not.
- 02:14:31 SEN. TUTVEDT asked Dr. Barkey about a presentation he gave in Flathead County. **Dr. Barkey** said that the point he made at the Flathead County presentation was that those measurements of income in Montana had been reduced significantly. That influenced their forecast and caused them to revise their forecast down especially in the out years.
- 02:16:44 SEN. GILLAN asked about changes in some of the internal constructs to the forecasting models. **Dr. Barkey** said that economists forecasted a recession but didn't do a good job of predicting the severity. **Dr. Watts** said that you will see some substantial changes in the way things are modeled. For example, they are going to redesign how they predict personal savings rates. Some are working on marginal propensity to consume at the various income levels, particularly at the

upper income level where they are not consuming as they have in the past. They will probably move away from the trend models and back toward structural models so that they don't have the historical carryover as quite a heavy portion of the total explanatory power.

BREAK

02:33:16 The meeting reconvened at 3:37 p.m.

► **INCOME TAX AND NUMBERS - Stephanie Morrison, Fiscal Analyst**

02:34:09 Ms. Morrison discussed the charts found on pages 43 and 44 on growth assumptions (**Exhibit 4, pages 43 and 44**).

Questions

02:46:45 REP. BARRETT said if you had these regression equations and had used them to predict total revenue over the last 14 years, and if you had the actual data to input into these as opposed to predicted data from Global Insight, it would appear that the effect would be that almost all of the prediction error would go away. **Ms. Morrison** said that if the Legislative Fiscal Division had accurate inputs for each year, and had been able to predict with certain accuracy the kind of income that was going to be coming in to Montana residents over that time period, there would be a fairly accurate revenue picture.

02:49:31 REP. BARRETT said as stated in Dr. Barkey's terms, if you use these models, you would have very small model estimation errors and almost all of the errors would have come from input. **Ms. Morrison** said, based on look back, that looks to be the case.

02:51:50 SEN. PETERSON asked if Mr. Johnson had enough historical data to identify anomalies in the models to see where the inconsistencies are and relate that back to national forecasts. **Mr. Johnson** said that the models used in the 1980s have changed dramatically because of technology. Individual income tax estimates in the 80s were not done in the same way it is done today.

02:55:10 SEN. PETERSON asked if Mr. Johnson about the lag time in and out of recessions. **Mr. Johnson** said Dr. Barkey pointed that out that there are significant differences between recessions. The situations in 2001 and 2002 were barely a blip on the revenue screen compared to what we are seeing now. He said that there has been a number of tax policy changes over the years and it would be difficult to line up the data to make that type of comparison.

02:58:21 SEN. ERICKSON asked Mr. Johnson if it would help the process if we spent money for Moody's data. **Mr. Johnson** said that it would be beneficial to the committee to have an alternative to look at then you have something to contrast

against.

03:00:38 DR. BARKEY said that the Bureau is willing to help in any way to improve revenue forecasts.

03:01:20 DR. WATTS said he is interested in participating in any model reviews. He also said that Mr. Johnson and the fiscal analysts do an outstanding job.

- **LEGISLATIVE REVENUE ESTIMATING PROCESS AND OPTIONS TO REVISE PROCEDURES - Jeff Martin**

03:03:11 Mr. Martin discussed the memo (**Exhibit 5**) regarding the revenue estimating process and options for estimating general fund revenue.

- **LEGISLATIVE FISCAL DIVISION'S PERSPECTIVE ON THE LEGISLATIVE REVENUE ESTIMATING PROCESS - Amy Carlson, Director, Legislative Fiscal Division**

03:14:29 Ms. Carlson discussed the subcommittee concept that Mr. Martin brought to the committee's attention.

03:16:49 SEN. GILLAN said that the idea would be an automatic transmittal regardless on whether any definitive action was taken. **Ms. Carlson** said that there is a consequence if the House doesn't move the bill.

No Public comment given

- **COMMITTEE REQUEST DRAFTING OF REVENUE ESTIMATING RESOLUTION**

03:27:08 Mr. Martin said the committee should request a bill draft for the revenue estimating to ensure timely drafting.

Motion by Sen. Peterson

03:27:41 SEN. PETERSON **moved** that the committee request a bill draft for revenue estimates. The motion **passed** on voice vote.

No Public Comment given

- **RECESS**

03:31:23 SEN. GILLAN recessed the meeting at 4:34 p.m. to reconvene at 8:00 a.m. on August 3, 2010.

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