STATE REVENUES AND STATE REVENUE FORECASTS STUDY BACKGROUND MEMORANDUM

STUDY OVERVIEW

Section 7 of 2017 Senate Bill No. 2001 (appendix), which was vetoed by the Governor, would have created a legislative revenue advisory committee to monitor state revenues and to review revenue forecasts. The committee would have consisted of the Majority and Minority Leaders of the House and Senate, the Chairmen of the House and Senate Appropriations Committees, one member appointed by the House Majority Leader, and one member appointed by the Senate Majority Leader. The committee's duties would have included monitoring state revenues and state economic activity; reviewing economic forecasting data and models; reviewing and analyzing executive revenue forecasts and alternative revenue forecasts; and reviewing and assessing agency revenues, including the delivery and cost of services, staffing, and billing processes. Although, the Governor vetoed the section, the Legislative Management appointed a legislative revenue advisory committee and assigned the committee the responsibility to study state revenues and state revenue forecasts.

OTHER REVENUE-RELATED STUDIES

Section 33 of 2017 House Bill No. 1015 provides for a study of tribal taxation issues, including tax collection agreements between the tribes and the state and the costs and benefits to the state and the tribes if tax compacts are implemented. The study is assigned to the Tribal Taxation Issues Committee.

The Energy Development and Transmission Committee was assigned a study of wind energy taxation. Section 34 of 2017 House Bill No. 1015 provides the study must consider the various methods of taxing wind energy, the current and historical distributions, and the estimated fiscal impact of any proposed changes.

Section 35 of 2017 House Bill No. 1015 provides for a study of the volatility of state revenue sources. The study is assigned to the Government Finance Committee. The study must include consideration of the volatility of the tax base and revenue sources, the volatility and sustainability of elementary and secondary education funding, and ending fund balances in the general fund and other state funds.

Section 22 of 2017 Senate Bill No. 2013 provides for a study of the oil and gas tax allocations to hub cities and hub city school districts. The study is assigned to the Energy Development and Transmission Committee. The study must include consideration of the current and historical allocations and the estimated fiscal impact of any changes to the allocations.

Senate Bill No. 2230 (2017) provides for a study of the feasibility and desirability of providing an income tax credit to individuals for premiums for hybrid long-term care partnership plan insurance coverage, which is assigned to the Taxation Committee.

REVENUE FORECASTING PROCESS

The Office of Management and Budget has the primary responsibility to prepare revenue forecasts for consideration in developing the state budget. Historically, during each biennium, the Office of Management and Budget prepares three revenue forecasts including a June preliminary revenue forecast issued prior to the start of the legislative session, a December executive budget revenue forecast presented during the organizational session, and a February or March revised revenue forecast presented to the Appropriations Committees during the legislative session. The Office of Management and Budget contracts for economic advisory services, currently Moody's Analytics, to provide economic projections as a basis for developing the revenue forecasts.

The Office of Management and Budget coordinates the development of the revenue forecasts with the Tax Department. The Tax Department uses the economic projections from Moody's Analytics along with historical tax collection data to forecast general fund tax revenues.

A revenue advisory committee provides input to the Office of Management and Budget as guidance for the development of the revenue forecasts. The committee includes private sector representatives, legislators, and other public officials. The committee meets prior to the issuance of the revenue forecasts to review the economic projections from Moody's Analytics and to provide recommendations based on current economic conditions.

The Legislative Assembly is responsible for approving the state budget including the revenue forecast. The legislative revenue forecast prepared at the end of each legislative session includes a base revenue forecast and any legislative changes. Legislative changes may include tax incentives and exemptions, tax rate changes, or

transfers from other state funds. The base revenue forecast may include any of the forecasts prepared by the Office of Management and Budget or a modified version of the forecasts.

RECENT REVENUE FORECAST ADJUSTMENTS

After the development of the December 2014 executive budget revenue forecast, oil prices and oil activity decreased significantly. As a result, the 2015 Legislative Assembly adopted revenue adjustments in January 2015 for budget status reporting purposes. The revenue adjustments reduced the 2015-17 biennium estimated general fund beginning balance by \$130 million and reduced the estimated 2015-17 biennium general fund revenues by \$550 million. In addition, the 2015 Legislative Assembly adopted adjustments to oil price and oil production resulting in a decrease of approximately \$4 billion related to the 2015-17 biennium oil tax revenue forecast.

Due to the decrease in oil activity, 2015-17 biennium general fund revenue collections were less than forecasted. In February 2016 the Office of Management and Budget released a revised forecast resulting in a decrease of approximately \$1 billion. The oil tax revenue forecast was also revised resulting in a decrease of approximately \$970 million. The general fund revised revenue forecast allowed the Governor to access the budget stabilization fund to provide for a transfer of \$498 million. The Governor also reduced agency budgets by 4.05 percent resulting in a transfer of \$72 million from the foundation aid stabilization fund to the general fund to offset the reduction for state school aid.

The Governor ordered a special legislative session in August 2016 to address additional budget challenges. The Legislative Assembly adopted revenue adjustments during the August 2016 special legislative session decreasing general fund revenues by approximately \$400 million compared to the February 2016 revised revenue forecast. The August 2016 legislative revenue forecast also provided for additional transfers from the budget stabilization fund to the general fund, a transfer of \$100 million from the Bank of North Dakota profits to the general fund, and recognized 2015-17 biennium unspent general fund appropriation authority of approximately \$20 million. The oil tax revenue forecast was revised during the August 2016 special legislative session to reflect an increase of approximately \$500 million compared to the February 2016 revised revenue forecast.

The 2017 Legislative Assembly adopted the January 2017 legislative forecast, which was lower than the December 2016 executive budget revenue forecast, to reflect current economic conditions. Excluding the adjustments for proposed statutory changes, the January 2017 legislative forecast reduced the 2017-19 biennium general fund executive forecast revenues by \$238 million, including \$67 million related to the beginning balance and \$171 million related to ongoing general fund revenues. The major reductions to ongoing general fund revenues included \$146 million related to sales and use tax collections and \$20 million related to individual income tax collections for the 2017-19 biennium. The January 2017 legislative forecast also decreased the oil tax revenue collections by approximately \$330 million based on a lower oil price for the 2017-19 biennium.

In March 2017 the Appropriations Committees adopted the March 2017 revised revenue forecast prepared by the Office of Management and Budget with an additional reduction of \$10 million to the 2017-19 beginning balance related to lower 2015-17 biennium sales and use tax collections. The March 2017 legislative revenue forecast reduced the 2017-19 biennium general fund revenue forecast by approximately \$160 million compared to the January 2017 legislative forecast.

STUDY PLAN

The following is a proposed study plan for the committee's consideration of its study of state revenues and state revenue forecasts:

- 1. Receive information regarding the revenue forecasting process, including current and historical forecasts, the methodology to develop models for economic projections, and revenue forecasting in other states.
- 2. Receive information regarding economic activity, including updates from the agriculture industry and the oil and gas industry.
- 3. Receive information regarding agency revenues, including the delivery and costs of services, staffing, and billing processes.
- 4. Receive testimony from interested persons regarding the study.
- 5. Develop recommendations and any bill drafts necessary to implement the recommendations.
- Prepare a final report for submission to the Legislative Management.

ATTACH:1