

NORTH DAKOTA LEGISLATIVE MANAGEMENT

Minutes of the

LEGISLATIVE REVENUE ADVISORY COMMITTEE

Wednesday, August 15, 2018
Roughrider Room, State Capitol
Bismarck, North Dakota

Senator Ray Holmberg, Chairman, called the meeting to order at 9:00 a.m.

Members present: Senators Ray Holmberg, Dwight Cook, Joan Heckaman, Rich Wardner; Representatives Larry Bellew, Al Carlson, Jeff Delzer, Corey Mock

Others present: Representative Mike Nathe, Bismarck
See [Appendix A](#) for additional persons present.

It was moved by Representative Mock, seconded by Senator Wardner, and carried on a voice vote that the minutes of the December 5, 2017, meeting be approved as distributed.

Chairman Holmberg said the purpose of the Legislative Revenue Advisory Committee is to monitor state revenues and to review state revenue forecasts. He said the state revenue forecasts are reviewed every session by the Legislative Assembly, but the creation of the committee allows the forecasts to be reviewed before the start of the legislative session.

STATE REVENUES UPDATE**Legislative Council**

The Legislative Council staff presented a memorandum entitled [Oil and Gas Tax Revenues Monthly Update](#), which provides information on actual oil and gas tax revenue allocations for July 2018 and for the biennium to date. The Legislative Council staff said the oil and gas tax revenue allocations for the biennium to date are approximately \$515 million, or 33 percent more than the forecast. He said the oil and gas tax revenue allocations under the state's share are approximately 3 months ahead of schedule.

The Legislative Council staff presented a memorandum entitled [Oil and Gas Tax Revenues Quarterly Update Summary](#), which includes a chart showing the status of the allocations under the state's share.

In response to a question from Representative Delzer, the Legislative Council staff said the state disaster relief fund is not anticipated to receive any oil and gas tax revenue allocations during the 2017-19 biennium because the balance of the fund exceeds the \$20 million limit.

The Legislative Council staff presented a memorandum entitled [General Fund Revenues Monthly Update](#). The Legislative Council staff said the actual tax and fee general fund revenue collections for the biennium to date through June 2018 totaled \$1.92 billion, or \$75 million more than the forecast. He said the general fund revenue collections through June 2018 reflect the total collections for the first fiscal year of the 2017-19 biennium.

The Legislative Council staff presented a memorandum entitled [General Fund Revenue Quarterly Update Summary](#). The Legislative Council staff said approximately 40 percent of the general fund revenue collections through June 2018 relate to sales, use, and motor vehicle taxes. He said the 2017-19 biennium general fund revenue collections could total \$4.41 billion based on the actual collections through June 2018 and the original forecast amounts for the remainder of the biennium.

The Legislative Budget Analyst and Auditor presented a memorandum entitled [Budget Outlook - 2017-19 and 2019-21 Bienniums](#), which provides information on estimated revenues and appropriations for the 2017-19 biennium and the 2019-21 biennium based on current budget factors and anticipated costs to continue various programs next biennium. The Legislative Budget Analyst and Auditor said the estimated general fund balance for the end of the 2017-19 biennium is \$65 million after a \$73 million transfer to the budget stabilization fund. He said the estimated general fund shortfall for the end of the 2019-21 biennium is \$635 million. He said additional appropriation authority may be requested for inflationary increases and other program initiatives. He said sources of funding that may be available to address the shortfall include the strategic investment and improvements fund balance, additional earnings from the legacy fund, and the tax relief fund balance.

In response to a question from Chairman Holmberg, the Legislative Budget Analyst and Auditor said the estimated appropriations shown on the memorandum do not include any estimates for the costs associated with health insurance premium rate increases for state employees.

Representative Carlson said the 2019 Legislative Assembly may need to consider salary increases for state employees for the 2019-21 biennium budget. He said additional funding would be required for salary increases because the estimated general fund shortfall does not include estimates for salary increases.

Office of Management and Budget

Mr. Joe Morrissette, Director, Office of Management and Budget, presented information ([Appendix B](#)) regarding the status of the 2017-19 biennium revised revenue forecast and the 2019-21 biennium preliminary forecast. He said the advisory council on revenue forecasting, which includes industry representatives, met on July 16, 2018, to discuss economic conditions and forecasts for the state's tax bases. He said the Office of Management and Budget anticipates the revenue forecasts will be released in early September 2018. He said the rate of growth is slowing for retail sales and motor vehicle sales. He said individual and corporate income are anticipated to be stable for the next few years. He said North Dakota oil prices are anticipated to remain at \$53 per barrel for the 2019-21 biennium while oil production gradually increases from 1.2 million barrels per day to 1.3 million barrels per day.

Tax Department

Mr. Ryan Rauschenberger, Tax Commissioner, presented information ([Appendix C](#)) regarding trends in taxable sales and purchases and the income tax refund reserve accounts. He said the taxable sales and purchases related to oil extraction and wholesale trade increased significantly between 2007 and 2013, but decreased from 2013 to 2017. He said the taxable sales and purchases reported in Fargo, Bismarck, Grand Forks, and Minot have decreased year over year for the past eight quarters. He said the reason for the decreases in the major cities is unknown. He said the Tax Department monitors the status of income tax refunds and the balance of the income tax refund reserve accounts. He said the balances of the funds appear to be sufficient to provide refunds with \$33 million in the corporate income tax refund reserve account and \$12 million in the individual income tax refund reserve account as of June 30, 2018.

Chairman Holmberg said the psychological impact in Grand Forks due to the closing of a large retail store has been significant and may be reflected in the decreases of taxable sales and purchases in Grand Forks.

Mr. Rauschenberger presented information ([Appendix D](#)) regarding the estimated impact of tax-related legislation. He said the federal Tax Cuts and Jobs Act is anticipated to decrease individual and corporate income tax collections by a combined total of \$4.9 million during the 2017-19 biennium and by \$28.9 million in the 2019-21 biennium. He said the phase-in of the single sales factor corporate income apportionment method started in the 2015-17 biennium and will be completed by the 2019-21 biennium. He said 104 of 10,874 corporate entities elected to use the double-weighted sales factor in tax year 2016 resulting in a \$2 million loss of corporate income tax collections for the state. He said fewer corporations are using the election than anticipated primarily because of companies experiencing net operating losses. He said the Tax Department anticipates more corporations will elect the single sales factor method once the phase-in is complete.

In response to a question from Senator Cook, Mr. Rauschenberger said online retailers that meet certain sales thresholds are required to register with the Tax Department by October 1, 2018. He said the online retailers are required to begin collecting sales taxes during the fourth quarter of 2018 if the retailers have not already started the collections. He said the Tax Department will have more information on the fiscal impact of online sales after the fourth quarter collections are reported to the department during the first quarter of 2019.

Insurance Department

Mr. Jon Godfread, Insurance Commissioner, presented information ([Appendix E](#)) regarding insurance premium tax collections. He said the actual collections for the 2017-19 biennium are anticipated to be 12 percent less than the forecast. He said the trends in insurance premium tax collections are delayed approximately 24 months compared to the trends in the underlying economic activity. He said economic activity decreased in 2015 when oil activity decreased, but the insurance premium tax collections did not begin decreasing until 2017. He said the department is in the process of reviewing the forecast for the 2019-21 biennium.

In response to a question from Representative Delzer, Mr. Godfread said fire districts receive payments from a portion of the insurance premium tax collections. He said the amounts paid to the fire districts reduce the deposits in the state general fund.

INDUSTRY UPDATES

Oil and Gas Industry

Mr. Ron Ness, President, North Dakota Petroleum Council, presented information ([Appendix F](#)) regarding trends in the oil and gas industry. He said workforce shortages and natural gas capture requirements are the primary challenges impacting the operations of oil companies. He said the outlook for the industry is positive with companies spending \$292 million per week on oil well development in the Bakken Formation. He said a \$1 change in oil price results in a \$90 million change in oil and gas tax collections for a biennium based on current oil production levels. He said oil and gas development activity in the Bakken Formation is anticipated to be stable for the next few years if oil prices remain at the current level.

In response to a question from Representative Delzer, Mr. Ness said the state collects approximately \$200,000 of sales taxes from each completed oil well. He said approximately 80 oil wells are completed per month resulting in \$16 million of sales tax revenue per month for the state.

Mr. Bruce Hicks, Assistant Director, Oil and Gas Division, Department of Mineral Resources, Industrial Commission, presented information ([Appendix G](#)) regarding oil production trends. He said oil drilling rigs are primarily located in Dunn, McKenzie, Mountrail, and Williams Counties. He said some drilling rigs have been moved to other counties where drilling has become economical with the higher oil prices. He said the estimated number of oil wells drilled but not completed with hydraulic fracturing has increased in recent months due to the limited availability of fracturing crews and the restrictions on natural gas flaring. He said oil production recently surpassed 1.2 million barrels per day, which is similar to the peak production levels during 2014. He said an average oil well in the Bakken Formation produces an estimated 765,000 barrels over 47 years with the majority of oil production in the first 5 years. He said an average oil well costs \$9 million to drill and complete with a net profit of \$27 million.

In response to a question from Representative Carlson, Mr. Hicks said some oil wells are being refractured. He said the refracturing process has been used on older oil wells originally completed as a single-stage fracture. He said new oil wells are completed with approximately 50 stages in the fracturing process. He said refracturing the older oil wells increases oil production to economical levels based on current oil prices.

Mr. Justin Kringstad, Director, North Dakota Pipeline Authority, presented information ([Appendix H](#)) regarding oil price and production forecasts. He said approximately 72 percent of the oil produced in North Dakota was exported by pipeline in May 2018. He said North Dakota's oil price discount related to transportation costs decreased after the Dakota Access Pipeline began operations resulting in an additional \$3 of revenue per barrel of oil when sold by producers. He said the state collected approximately \$130 million more oil and gas tax revenues between June 2017 and June 2018 because of the higher oil prices received by oil producers. He said West Texas Intermediate oil prices may decrease for the next few years based on estimates from the federal Energy Information Administration. He said oil production growth in North Dakota may be limited for the next few years because of export infrastructure constraints and natural gas flaring restrictions.

In response to a question from Representative Mock, Mr. Kringstad said the pipeline capacity for exporting oil from North Dakota is 1.23 million barrels per day. He said the pipeline capacity is sufficient for current production levels, but more capacity may be needed if oil production increases. He said rail exports may help relieve pipeline capacity issues, particularly if oil producers can receive a pricing premium at coastal refineries.

Agriculture Industry

Ms. Julie Ellingson, Executive Vice President, North Dakota Stockmen's Association, presented information ([Appendix I](#)) regarding trends in cattle inventory and prices. She said North Dakota cattle inventory increased from 1.82 million in 2017 to 1.86 million in 2018. She said the increase was lower than average due to the 2017 drought. She said cold conditions during the 2018 calving season resulted in a higher rate of calf deaths. She said cattle prices are anticipated to remain stable for the next 2 years but could be impacted by adverse weather conditions or global trade issues.

Mr. Neal Fisher, Administrator, North Dakota Wheat Commission, presented information ([Appendix J](#)) regarding trends in wheat production and prices. He said farmers planted approximately 6.6 million acres of spring wheat in North Dakota in 2018, which is a 23 percent increase compared to 2017. He said wheat yields are anticipated to be consistent across the state in the 2018 harvest season. He said North Dakota wheat is exported to over 100 countries each year. He said wheat prices have increased in recent months but operating costs remain high. He said rising interest rates may increase financing costs for farmers and reduce their profitability.

Ms. Stephanie Sinner, Executive Director, North Dakota Soybean Council, presented information ([Appendix K](#)) regarding soybean production and prices. She said soybean production in North Dakota increased from 25 million bushels in 1996 to 250 million bushels in 2016. She said 71 percent of North Dakota's soybeans are exported primarily to countries in Southeast Asia. She said an estimated \$1.5 billion of North Dakota soybeans are exported to

China each year. She said soybean exports from the United States to Southeast Asia have decreased significantly since April 2018, related to trade tariffs. She said North Dakota soybean prices are anticipated to be approximately \$8.90 per bushel for the 2018 harvest season with an estimated breakeven price of \$7.99 per bushel.

Other Industries

Mr. Matthew Larsgaard, President and Chief Executive Officer, Automobile Dealers Association of North Dakota and North Dakota Implement Dealers Association, presented information ([Appendix L](#)) regarding trends in the farm equipment and automotive industries. He said farm equipment sales were strong in early 2018, but overall remain lower compared to peak sales in 2013. He said farmers are keeping equipment for longer periods before replacing it due to uncertainty with crop prices and operating profits. He said equipment sales have been driven by improvements in technology and efficiency. He said automobile sales have slowed in 2018, but parts and repair services have grown. He said sales of pickup trucks are anticipated to decrease as new home construction in eastern North Dakota slows. He said rising interest rates may impact automobile dealers' profitability as costs increase to finance inventory and floor models. He said the federal income tax reform may increase farm equipment and automobile sales due to favorable tax treatment for depreciation on new purchases.

Mr. Russ Hanson, Executive Vice President, Associated General Contractors of North Dakota, presented information ([Appendix M](#)) regarding trends in the construction industry. He said state funding for road construction projects decreased in the 2017-19 biennium compared to the 2015-17 biennium resulting in a decrease in new road construction projects. He said bids for projects are more competitive which benefits the project owners but limits contractors' profitability. He said workforce shortages in the skilled trades are a challenge for the construction industry. He said North Dakota's construction industry grew faster than the United States average from 2008 to 2015. He said growth in North Dakota's construction industry decreased from 2015 to 2018 while the United States average increased.

In response to a question from Representative Carlson, Mr. Hanson provided information ([Appendix N](#)) regarding changes in construction employment. He said the employment changes reflect the construction activity. He said construction employment increased from 2017 to 2018 in Fargo but did not change in Bismarck and Grand Forks.

NORTH DAKOTA ECONOMIC CONDITIONS

Job Service North Dakota

Ms. Marcia Goetz, Co-Manager, Labor Market Information, Job Service North Dakota, presented information ([Appendix O](#)) regarding gross domestic product and employment trends in oil-producing and non-oil-producing counties. She said the state's gross domestic product totaled \$55.5 billion in 2017 compared to \$28.9 billion in 2007. She said North Dakota ranked 45th in the United States in 2017 for gross domestic product compared to 49th in 2007. She said the unemployment rate in the core oil-producing counties was 2.2 percent in June 2018 while the statewide unemployment rate was 2.9 percent. She said the mining, quarrying, and oil and gas extraction industries account for 16 percent of the total employment in the oil-producing counties. She said statewide employment in the mining, quarrying, and oil and gas extraction industries had the largest increase from 2016 to 2017 followed by the transportation and warehousing industries. She said statewide employment in the construction industry had the largest decrease from 2016 to 2017.

IHS Markit

Overview

Mr. Brendan O'Neil, Managing Director, Economics Consulting, IHS Markit, presented information ([Appendix P](#)) regarding an overview of IHS Markit. He said IHS Markit is a publicly traded company with its headquarters in London, England. He said the company provides global information and analysis for a variety of industries.

Mr. James Diffley, Executive Director, Industry Services and Consulting Group, Economics and Country Risk, IHS Markit, presented information ([Appendix Q](#)) regarding the forecasting models for North Dakota's tax revenues. He said IHS Markit is in the process of developing custom models to forecast sales and use tax collections, motor vehicle excise tax collections, individual income tax collections, corporate income tax collections, and oil and gas tax collections. He said the models are based on data from IHS Markit's existing macroeconomic models for the United States as well as data from industry-specific forecasts for the agriculture and energy industries.

Dr. Yan Jiang, Consulting Principal, Economics and Country Risk, IHS Markit, presented information ([Appendix R](#)) regarding an overview of the economic drivers used in the forecasting models for North Dakota's tax revenues. She said the sales and use tax forecasting model is based on personal consumption expenditures while the individual income tax forecasting model is based on wages and personal income. She said the corporate income tax forecasting model is based on corporate taxable income and crude oil prices.

Senator Cook said IHS Markit should consider including a component for the sales taxes associated with oil wells in the forecasting models.

National, Regional, and State Economic Trends

Mr. Diffley presented information ([Appendix S](#)) regarding an overview of the trends in the United States economy. He said the United States real gross domestic product is anticipated to increase by 2.9 percent in 2018, 2.7 percent in 2019, 1.9 percent in 2020, and 1.6 percent in 2021. He said the federal income tax reforms and federal spending may contribute to economic growth in the short term while rising interest rates and low unemployment may cause a slowdown in economic growth in later years. He said the tariffs imposed on trade have had a minimal impact on the national economy but are a risk for future economic growth.

Ms. Julie Gressley, Senior Consultant, Industry Services and Consulting Group, Economics and Country Risk, IHS Markit, presented information ([Appendix T](#)) regarding an overview of the trends in the Midwest economy. She said North Dakota had employment growth in recent months but lags behind the growth in other states in the region including South Dakota, Minnesota, and Nebraska. She said the South and West have had more employment growth in the last year than the Midwest and the Northeast.

Mr. Karl Kuykendall, Principal Economist, United States Regional Service, Economics and Country Risk, IHS Markit, presented information ([Appendix U](#)) regarding an overview of the trends in the North Dakota economy. He said the North Dakota economy is improving but has not returned to the 2014 peak level of activity. He said the economic growth in other states has limited the growth in North Dakota because of competition for capital investments and employees. He said personal income is anticipated to grow by 5.5 percent annually in North Dakota through 2023 compared to a national average of 4.7 percent.

Industry Trends

Mr. Imre Kugler, Associate Director, Upstream Consulting, IHS Markit, presented information ([Appendix V](#)) regarding an overview of the trends in the oil industry. He said West Texas Intermediate oil prices are anticipated to remain at approximately \$70 per barrel through 2019. He said oil production in the United States is anticipated to increase at approximately the same rate as the increase in global demand, keeping prices stable. He said capital investment may shift from the Permian Basin in Texas to the Bakken Formation as infrastructure constraints limit the growth in the Permian Basin.

Mr. Brandon Kliethermes, Senior Economist, Agriculture Service, Economics and Country Risk, IHS Markit, presented information ([Appendix W](#)) regarding an overview of the trends in the agriculture industry. He said Argentina, Brazil, and the United States are the primary producers of soybeans. He said demand has increased for soybeans from Brazil due to a drought in Argentina and tariffs imposed on imports from the United States. He said farm income may decrease in the short term, but is anticipated to increase overall through 2025.

Economic Risks

Dr. Jiang presented information ([Appendix X](#)) regarding an overview of upside and downside risks for the United States economy. She said upside risks for the United States economy are based on growth in the housing market while downside risks are based on a loss of consumer confidence. She said growth in the housing market could increase the growth in the national gross domestic product to 5 percent based on an optimistic scenario. She said a loss of consumer confidence could cause the national gross domestic product to decrease by 2 percent based on a pessimistic scenario.

Representative Carlson said IHS Markit should consider including the information from local industry representatives in the forecasting models.

Chairman Holmberg said the committee's next meeting will be in Bismarck on September 13, 2018. He said the committee will receive information from IHS Markit regarding the state's revenue forecasts.

No further business appearing, Chairman Holmberg adjourned the meeting at 3:15 p.m.

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