BULLETIN

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B-231
November 21, 1991

FTA REVENUE ESTIMATING AND TAX RESEARCH CONFERENCE
Summary of Proceedings

To State Tax Administrators:

SUMMARY

The 46th Annual Revenue Estimation and Tax Research Conference was held on October 27-30, 1991 in Cincinnati, Ohio. This bulletin summarizes a number of the papers presented at the conference. Proceedings of the conference are not published; readers are asked to contact FTA for papers in which they are interested. A listing of the papers currently available from FTA is appended.

The 46th annual FTA Revenue Estimating and Tax Research Conference was held in Cincinnati, Ohio on October 27-30, 1991. Presiding over the conference was Bob Cline, Director of Tax Research at the Minnesota Department of Revenue and Chair of the FTA Research Section. Welcoming the participants was Roger Tracy, Commissioner of the Ohio Department of Taxation.

The conference examined important issues facing state revenue estimating and tax research officials today. The major forecasting firms presented their projected outlook for the U.S. economy as a whole, the geographic regions, and various industrial sectors. Presentations were also given on studies estimating the incidence of state taxes and analyzing the impact of tax incentives for economic development projects. Participants heard discussions on database augmentation, issues in forecasting, an update on federal tax research activities, and several papers on sales and income tax issues. In addition, the attendees were given the opportunity to discuss revenue estimating and research experiences among their colleagues in smaller regional roundtable groups. The final day of the conference saw discussions on various topics including the Canadian Goods and Services (VAT) Tax, the results of audit coverage and revenue estimation surveys, and presentations by notable academic writers on tax competition and economic development incentives.

Economic Outlook

With the recession depressing state tax collections, conference participants were eager to know when the recession will end. Donald W. Walls of DRI/McGraw-Hill presented his organization's forecast for the nation, indicating an economic recovery is currently under way. He noted that many of the economic indicators are telling us that the bottom has been reached. However, he cautions that the turnaround will be modest by historical standards — with GNP growing by only 3.3 percent during the first four quarters of the recovery. While a double-dip recession is not expected, he noted that the weak recovery could deteriorate if retail sales do not pick-up. Revenue forecasters should watch their January sales tax receipts (Christmas sales) closely, as a weak Christmas season could be an indicator of another economic slow-down.

DRI/McGraw-Hill expects retail spending to increase modestly pointing to a steady increase in consumer confidence. Medical services and motor vehicles sales will see the largest gain in 1992, with other durable goods expected to grow at a slower pace. The unemployment rate is expected to remain above 6.5 percent throughout much of 1992, keeping wage increases low. As a result, personal income will exhibit sluggish growth, along with state and local revenue bases.

Walls also pointed out how the current recovery differs from earlier ones and warned state revenue forecasters against making comparisons with the 1980's. Many of the industries driving the strong economic growth during the previous decade will not be contributing to growth in the 90's. The real estate market is slowly recovering from the overbuilding of the 80's. Banks, many suffering from losses in the real estate industry, are pursuing tight lending policies. Walls also noted that there will be no macroeconomic stimulus from the federal and state governments during the next several years.

Mark Haas of the Michigan Department of Treasury presented his forecast for automobile sales and production. He noted that, while the economy may be recovering from the recession, consumer confidence and high real interest rates will keep retail sales of automobiles and other durable goods growing at a slow pace. Forecasting an 8.8 percent increase in total motor vehicle sales in 1992, Haas pointed out that much of this growth will be in small truck sales. This reflects the growing popularity of the new mini-vans. He also forecasted a modest increase in automobile production next year. Many of the plant closings in recent years have led to an increased concentration of auto production in some states. Three states—Illinois, Michigan, and Ohio—have increased their share of passenger car assemblies during the past several years.

Brian Richard from the Federated Department Stores discussed his forecast for national and regional retail sales in 1992. With modest growth in wages and a slow-down in the rate of inflation, he forecasts an increase in retail sales of 5.5 to 6 percent. However, the size of the overall increase is largely dependent on a recovery in manufacturing and housing. The increase in retail sales will vary throughout the country, with the rate of growth in the Northeast expected to lag behind the national average. Meanwhile, the Southeast is expected to see the most significant growth in retail sales. The other regions are expected to see growth rates similar to the national average, with the Midwest exhibiting slightly above average growth.

Conrad Peter Schmidt from the Defense Budget Project discussed his recent paper, which analyzed the impact of defense cuts on state economies. He pointed out that current federal budget projections show total defense spending falling from its peak of 6.5 percent of GNP in 1986 to 3.7 percent in FY 1996. Schmidt calculated that this may result in about 1.1 million defense related jobs being effected through FY 1996. Impacts will differ due to different reliance in each state on defense-related activities. Alaska, California, Connecticut, Hawaii, Maryland, Virginia, and the District of Columbia will have the most significant impact. However, no state will see employment losses that exceed one percent of their labor force.

Marcia Howard of the National Association of State Budget Officers reviewed the deteriorating state fiscal conditions in 1991. As the economic recession hit, many states had to implement cutbacks to balance their budgets for FY 1991. Howard pointed out that 28 states implemented targeted budget cuts, while 14 enacted across-the-board cuts. Hiring freezes went into effect in 25 states, and 18 enacted travel freezes. Only 17 states tapped their rainy day funds. Thirty-one states enacted tax/revenue increases in their 1992 budgets raising $15.0 billion in new revenues. Despite these increases, FY 1992 ending balances are projected to remain low at 1.9 percent of annual expenditures.

Luncheon Speaker

Fritz Scheuren, director of the IRS Statistics of Income Division (SOI), discussed recent efforts at improving quality within his division. Pointing to the similarities in purpose of state tax research departments and SOI, he discussed his general management philosophy concerning quality. He feels that the key to improving quality and productivity lies in how you view the output provided to your customers. By focusing on providing a service to the customer rather than producing a final product, SOI encourages more interaction with the end consumer earlier and more often in the production process. It also encourages better interaction with suppliers and more innovation. Finally, Scheuren discussed the role that the manager should play. A manager should take the lead in implementing new programs or projects; let his employees continue by getting out of the way; become a follower by listening and observing his employees; and then starting the process again.

State Tax Incidence Studies

The issue of who pays state and local taxes is an important question being asked by policy makers today. With this in mind, a part of the Monday afternoon session was dedicated to a discussion of state tax incidence studies. The session began with a presentation by Rosemary Marcus, from the U.S. Congressional Budget Office, who discussed the various controversies and issues surrounding tax incidence studies. Some of the important issues she pointed out include the time period discussed, how you treat in-kind transfer payments, who actually bears the burden of a particular tax, and how you separate tax changes from income changes. For each issue, Marcus discussed how they affect policy making decisions, economic activity, and the availability and quality of data.

Robert McIntyre from the Citizens for Tax Justice discussed their recently released study which estimated the tax incidence for each state. The study listed (what they call) the terrible ten — states that tax poorer households at a rate which is three times the level they tax the richest taxpayers. A common theme among many of these states is the lack of a personal income tax. McIntyre also talked about the many problems their organization encountered when calculating these estimates. While the IRS provided them with good information on the different tax rates and bases in each state, estimates of household expenditures proved to be a more difficult task. The only data available on consumer expenditure is the Consumer Expenditure Survey. However, this database required many hours trying to separate the unusual cases to get a good estimate of expenditures. While the IRS was able to provide the organization with good data on the level of household income, it did not include some sources of data not keyed by the service. The amount of taxes paid by business also proved to be a difficult problem to solve.

And finally, Robert Strauss, an economics professor at Carnegie-Mellon University, presented the results of his study of state tax equity following the federal Tax Reform Act (TRA) of 1986. He found that many states followed the lead of the federal government by reducing the progressivity of their income tax systems after TRA. The median state effective income tax rate fell from 1.9 percent in 1985 to 1.3 percent in 1987. During the same period, his measure of horizontal equity (treating similar taxpayers the same) increased, reflecting the general base broadening enacted after TRA. And finally, Strauss briefly highlighted some results of his current project estimating the tax incidence of the state sales tax. Examining seven state sales taxes, he found that the degree of regressivity varied by state depending on the mix of products taxed/exempted.

Wednesday Morning Session

During the final day, the conference participants heard talks on several issues of importance to state revenue estimators. Céo Gaudet, from the Department of Finance, Canada, discussed the new Goods and Services Tax (GST) that Canada enacted this year. Replacing the Federal Sales Tax on manufactured goods, the GST was intended to improve the competitiveness of Canada and bring the country in line with the other industrial countries using a VAT type tax.

By granting credits for taxes paid, Gaudet pointed out that the GST avoids tax pyramiding common in the old federal sales tax. The lower rate and broader base also make the tax less burdensome on taxpayers. To improve the transition, taxpayers were given a tax credit for the sales taxes they paid.

Jack Crabbe from the Ontario Ministry of Revenue presented the results of their recently completed survey on corporate tax audits. He noted that almost 40 percent of the jurisdictions reported auditing more than 9 percent of their corporate taxpayers. One-quarter of the respondents reported an audit coverage of less than one percent. The survey examined the ratio of desk to field audits and the productivity of each. It found a wide variation in all the ratios examined. Crabbe noted that there is no relationship between jurisdiction size and the results. Most jurisdictions have the largest level of audit coverage from desk audits, while a higher recovery per audit hour is generated by field audits.

Ronald Alt from the Federation of Tax Administrators discussed the preliminary findings from FTA's survey on state revenue estimating practices. The survey found that 26 states have a single agency, usually under the executive branch, who makes the state's official revenue forecast. In these states, the legislature typically plays an advisory role. In 15 states, the forecast is generated by consensus among a group representing the executive and legislative branches. Four states have revenue forecasting procedures which cannot be summarized as a single agency or consensus. Eighteen states have a council of Economic Advisors, and the revenue estimate binds the budgets of 32 states. The survey also asked states how often their estimates were updated and how many years they forecast revenues. When estimating the impact of tax law changes, 17 states reported that they regularly estimated the incidence of the change (9 occasionally), and 5 states regularly estimate the economic impact (9 occasionally). A brief discussion on the computer econometric and revenue forecasting models used by the state was also given. Mr. Alt noted that FTA expects to release a final report summarizing the results in more detail by the end of the year.

Daphne Kenyon from Simmons College talked about the various studies examining interstate competition among the states. She noted that in the competition for businesses states compete in several arenas — not just in taxation. She identified four areas of competition, including the level of government services or infrastructure, overall tax levels, levels of individual taxes, and in efforts to export taxes. Indeed, two states can be competing in one arena while cooperating on another at the same time. She cited several studies to indicate that interstate competition has increased recently. Some studies point to other factors, such as education, overall economic growth, etc., that are more important than taxes.

Michael Wasylenko, from Syracuse University, agreed that tax incentives are much less powerful than other factors. However, he pointed out that many times it is the most visible tool available to state policy makers. It is easier to offer tax credits or other tax breaks to a business than increase education spending, which takes a longer period. Wasylenko also pointed out how difficult it is to quantify whether a tax break was effective or not. Indeed, there is considerable controversy in the literature whether tax incentives have a zero sum effect (everyone gives tax breaks so it has no real effect on a business' location decisions). However, many economists agree that the smaller the region, the more effective tax incentives are. Wasylenko concluded that any business needing a special tax break may not be the type of business a state would want to attract.

Other Topics

On Tuesday, participants were able to attend several concurrent break-out sessions dealing with special topics of revenue estimating, data generation, and tax policy analysis. One session dealt exclusively with revenue forecasting issues, where papers were presented on sales tax forecasting, personal income tax forecasting, and using micro-simulation models to forecast income tax revenues. Separate sessions on sales and income tax estimation issues were held, which included papers on the Kansas sales tax on services, the Canadian GST (VAT) tax, sales tax exemptions for manufacturing, income tax reform in Arizona, the California waters edge election option, and estimating the impact of IRA's. A session discussing techniques in building and augmenting databases was also offered.

Several sessions were held that catered to participants interested in understanding key tax policy issues. One session had presentations from some states who completed tax incidence studies, including Minnesota, Utah, and New York City. Another concurrent session was dedicated to papers estimating tax compliance — California, Florida, and the IRS. A session was also setup to keep state tax research updated on the latest research and data available at the federal level.

Further Information

FTA does not publish the proceedings of the Revenue Estimating and Tax Research Conference. Interested persons, however, may obtain copies of papers presented at the conference from FTA, if a complete paper was submitted. Listed below are the papers which can be obtained from FTA. If topics were mentioned but the papers are not listed below, and you wish further information, please contact us and we will put you in touch with the presenter.

Conference Papers

Dr. Donald Walls, DRI/McGraw-Hill, *A Weak & Uneven 1992 Economic Recovery: New Challenges for State Governments*, tables accompanying discussion.

Mark Haas, *The Automotive Outlook*, (with Dan Kitchel and Doug Drake), tables accompanying discussion.

Conrad Peter Schmidt (coauthored by Steven Kosiak), Defense Budget Project, *Potential Impact of Defense Spending Reductions on the Defense Labor Force by State.*

Conrad Peter Schmidt, Defense Budget Project, *Defense Market Transition Tables*, tables accompanying discussion.

Marcia Howard, National Association of State Budget Officers, *State Fiscal Conditions*, tables accompanying discussion.

Fritz Scheuren, IRS Statistics of Income Division, *Quality Improvements at the IRS Statistics of Income Division*, Outline of remarks.

Robert Strauss, Carnegie-Mellon University, *Measuring the Equity of State Taxes: Results for Personal Taxes before and after TRA 1986*,

Robert Strauss (coauthored by Marcus Berliant), Carnegie-Mellon University, *State & Federal Tax Equity: Estimates before and after the Tax Reform Act of 1986*, prepared for the National Bureau of Economic Research, 1991.

Robert Strauss (coauthored by Marcus Berliant), Carnegie-Mellon University, *Horizontal and Vertical Equity: A Theoretical Framework and Empirical Results for the Federal Income Tax 1966-1987*, University of Rochester working paper no. 291, 1991.

Robert Strauss (coauthored by Daeng Nazier), Carnegie-Mellon University, *A Mathematical Programming Approach to Limiting the Regressivity and Maintaining the Revenues of Consumption-Based Taxes*, Carnegie Mellon University working paper 91-34, 1991.

Jack Crabbe, Ontario Ministry of Revenue, *Corporations Tax Audit Coverage Survey Results*, 1991.

Ronald Alt, Federation of Tax Administrators, *FTA Survey on Revenue Estimation*, tables accompanying discussion.

Daphne Kenyon, Simmons College, *Interstate Competition Among the States*, tables accompanying discussion.

Michael Wasylenko (coauthored by Robert Carroll), Syracuse University, *The Shifting Fate of Fiscal Variables and Their Effect on Economic Development*, Annual Proceedings of the National Tax Association-Tax Institute of America, p. 283-290, 1990.

Yahia Ahmed, IRS Statistics of Income Division, *Sampling for Tax Policy Analysis*, outline of remarks

Richard Kasten, Congressional Budget Office, *CBO's Method for Simulating the Distribution of Combined Federal Taxes Using Census, Tax-Return, and Expenditure Microdata.*

Steven Stotts, Kansas Department of Revenue, *Computing the Fiscal Impact of a Kansas Sales Tax on Services.*

George Kuo, Department of Finance Canada, *Estimating Revenues from the Canadian Goods and Services Tax*, preliminary report.

Leslee Katayama (report prepared by Doug MacDonald), Utah State Tax Commission, *Review of the Sales and Use Tax Exemption for Manufacturing Machinery and Equipment.*

Karey Barton, Texas Comptroller of Public Accounts, *Texas Sales Tax Handouts*, tables accompanying discussion.

John Peloquin, Minnesota Department of Finance, *Emerging Issues in Personal Income Tax Forecasting: The Relationship Between AGI, AGI Components, and NIPA Measures of Income*, Highlights.

Stephen Pollock, KPMG Peat Marwick, *A Microsimulation Models Approach to Forecasting Income Tax Revenue*, tables accompanying discussion.

Rod Hoheisel, Minnesota Department of Revenue, *Tax Incidence Study State of Minnesota*, outline accompanying discussion.

Minnesota Department of Revenue, *Minnesota Tax Incidence Study.*

Thomas Williams, Utah Tax Commission, *Who Pays Utah's Household Taxes?*, preliminary report.

Timothy Bennett and Robert Cox, Kentucky Office of Financial Management & Economic Analysis, *Kentucky's Experiences in Analyzing Economic Development Projects and Their Potential Impacts.*

Tom Dunn, Colorado Department of Revenue, *Cost-Benefit Analysis of Economic Development Projects in Colorado*, outline of remarks.

Kathleen Barnett, New York City Department of Finance, *Estimating the Impact of Economic Development Projects: The Use of an Average Taxes-per-Worker Methodology*, outline of remarks.

Georganna Meyer, Arizona Department of Revenue, *Results of the 1990 Arizona Individual Income Tax Reform.*

Phil Spilberg, California Franchise Tax Board, *Unitary Taxation of Multinational Corporations: California's Experience With Water's Edge*, a report prepared by the California Franchise Tax Board.

Robert Ebel, KPMG Peat Marwick, *Estimate of Revenue and Distributional Effects of S.612 - The Savings and Investment Incentive Act of 1991 - as Introduced by Senators Bentsen and Roth*, a KPMG Peat Marwick Report.