FTA REVENUE ESTIMATING AND TAX RESEARCH CONFERENCE
Summary of Proceedings

To State Tax Administrators:

SUMMARY

The 47th Annual Revenue Estimation and Tax Research Conference was held on September 20-23, 1992 in Cooperstown, New York. This bulletin summarizes a number of the papers presented at the conference. Since the 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 47th annual FTA Revenue Estimating and Tax Research Conference was held in Cooperstown, New York on September 20-23, 1992. Presiding over the conference was Laird Graeser, Director of Tax Research with the New Mexico Taxation and Revenue Department and Chair of the FTA Research Section. Welcoming the participants was James Wetzler, Commissioner of the New York State Department of Taxation and Finance.

The conference examined important issues facing state revenue estimating and tax research officials today. The major forecasting firms presented their 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 new methods in tax forecasting. Participants heard discussions on database development, issues in business taxes, revising Medicaid provider taxes, dynamic policy simulation models, managing a tax research section, and tax forecasting issues. In addition, the attenders 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 New Zealand Goods and Services (VAT) Tax, the results FTA's sales taxation of services survey, taxation of motor vehicle leasing, trends in state tax policy, and several papers discussing economic development incentives.

Economic Outlook

With the recession depressing state tax collections, conference participants were eager to know how robust the economic recovery will be. Donald W. Walls of DRI/McGraw-Hill presented his organization's forecast for the nation, while Stanley Duobinis with the WEFA Group presented the forecast for the various regions. The DRI forecast calls for a modest recovery with GDP expected to grow by approximately three percent. Increased capital spending will be the engine fueling this growth as growing exports and obsolete equipment are expected to encourage more investment. Inflation is expected to remain stable under 3.5 percent, and the unemployment rate is expected to
improve slightly. However, Walls reports considerable uncertainty surrounding this forecast. He assigns a 20 percent probability that continued low confidence would result in a lower level of economic growth (1.5 to 2.0 percent).

Walls' forecast for the various economic sectors reports mixed rates of growth. Consumer confidence has stopped dropping, but will remain weak. As a result, consumer caution is expected to limit the growth in retail sales. However, he expects automobile sales to increase with the start of the new model year due to increased pent-up demand. Low mortgage rates will stimulate new home construction, but the underlying demographics indicate only modest growth rates.

Stanley Duobinis discussed the prospects for an economic recovery from a regional perspective. While WEFA's national forecast is very similar to DRI, he notes that there will be substantial differences in the growth rates in each state. Several factors — such as defense cuts — will affect some state harder than others. In general the strongest growth will be in the center of the country. WEFA still expects the Northeast to be very weak in the short-term. Over the long term, all sections of the country are expected to see real economic growth. However, the middle Atlantic states will be below average, and the southern and western states will be the winners.

Duobinis also discussed the characteristics of the current recession compared with previous recessions. The different nature of this recession has led to a different impact in the various regions. Traditional recessions are associated in high inflation and rising interest rates, typically affecting industries such as autos, housing and other durable goods. As a result, midwestern states tend to be hardest hit. On the other hand, the current recession hit the coastal states more severely. Different factors led to this recession, including restructuring in various industries (computer and finance), plummeting consumer confidence, and an end of the Cold War.

Caleb Wistar with the New York State Department of Health discussed the recent trends in the medical industry. He noted that health care costs continue to grow faster than the overall economy (GNP), placing an increasing burden on state budgets. As a result, substantial savings can be made if these costs can be restrained. Indeed, he calculates that a cumulative total of $1.8 trillion can be saved if health care costs were constrained to a rate of growth equal to GNP through the year 2000.

Wistar cites three major problems facing health care providers today. They include increasing costs, lack of insurance, and administrative complexity. He then discussed some of the options currently being debated in Washington and numerous state capitals and how effective they were at addressing each problem. The options discussed include a universal health care system similar to Canada, a pay or play system, or some type of managed care system.

With the housing industry typically leading the nation out of a recession, participants were interested in hearing Fred Flick's talk on the real estate industry. The economist with the National Association of Realtors forecasts a slow recovery in the construction industry. While the resale market is beginning to respond to lower interest rate and lower prices, the demand for new housing is still weak. He expects the building industry to generate only two-thirds of normal activity during this economic recovery. Meanwhile, the commercial market is over-built and is unlikely to recover for some years.

The retail outlook was given by Michael Niemira, an economist with Mitsubishi Bank. He noted that the industry is currently undergoing substantial restructuring with
discount retailers showing the greatest strength. The current recession has helped accelerate this shift toward discount retailers. Changing demographics is also having an impact on retail sales, as replacement demand is becoming more important. Examining the major indicators of retail sales, Niemira noted that retail sales over the next year should see an annual rate of growth of between 4 and 5 percent. He also noted that Christmas sales this year should increase over last year's.

Ronald Snell with the National Conference of State Legislatures described how the current recession has had an adverse impact on state financial conditions. Indeed, the latest NCSL survey reports ending balances totaling -0.1 percent of expenditures. However, much of this can be attributed to California's large deficit. He reports that ending balances are projected to increase by the end of the 1993 fiscal year, where it is expected to reach one percent of expenditures. FY 1992 saw revenue growth totaling 7.0 percent, with current FY 1993 budgets projecting revenue growth of only 4.8 percent. Meanwhile, expenditures are expected to grow by only 3.0 percent, the lowest in 20 years.

Luncheon Speaker

With bond rating agencies having substantial influence over state policy, Hyman Grossman with the Standard and Poor's Ratings Group discussed how they view state finances. He pointed out several factors which most bond rating agencies examine when setting ratings. Since state revenues are ultimately linked with performance of the overall economy, indicators of economic activity are examined. Some of the key economic indicators rating agencies look at include population trends, demographics, employment, key industrial activity, labor force, personal income, and diversification of employment and tax base. They also examine a state's financial operations, in particular, how accurate are the state's budget forecasts. Grossman concluded that the rapidly changing economy means states must change the way they currently do business. Budget personnel must change their forecasting models to reflect the current economic conditions. They must reexamine the expenditure side emphasizing greater efficiency. Indeed, real rainy day funds or reserves are even more critical in these uncertain times.

Tuesday Afternoon

On Tuesday afternoon, the conference participants heard discussions concerning state tax incidence studies and new developments in revenue forecast models. Professor Robert Strauss, Carnegie-Mellon University, presented his views on how best to present incidence studies to policy makers. He noted that in these times of tight budgets, policy makers are more concerned now than ever over the who is actually paying new taxes. Thus, increasingly, state analysts are requested to estimate the incidence of new tax proposals. He encouraged analysts to show ranges of estimates to emphasize the effect of various assumptions. While this may frustrate legislative users interested in simple answers, it is important to emphasize the uncertainty behind the estimates. He also noted how changing market conditions can affect incidence studies over time. And finally, he briefly discussed the different data sources and possible modeling techniques for preparing these estimates.

Michael Vlaisavljevich with KPMG Peat Marwick pointed to the micro simulation model as the single most important innovation in state revenue forecasting over the past 10 years. Initially used exclusively for tax policy analysis, micro simulation models have recently become useful tools for baseline forecasting. He points out how the many tax law changes make it difficult to develop and maintain consistent series of revenue and economic data. As a result, traditional econometric forecasting techniques have become more difficult and less reliable. Micro simulation models can convert an economic and demographic forecast into annual revenue forecast, without depending on historical
relationships between economic variables and receipts. Indeed, some states have begun using micro simulation techniques on sales, property, and business taxes, in addition to individual income taxes.

**Wednesday Morning**

During the final day, the conference participants heard talks on several issues of importance to state revenue estimators. Thomas Neubig with Price Waterhouse discussed the tax treatment of motor vehicle leasing. Neubig noted that the vehicle leasing industry has seen increased growth over the last several years. However, many states apply their sales tax to leasing agreements in ways that distort the individual decision. Some states tax both the initial purchase and the value of the lease (double taxation), some accelerate the tax on lease payment, while others do not allow for a resale credit for leased vehicles. He showed that the sales tax can be applied to the lease payments or the initial purchase of the product. The total amount of sales tax collected will be the same under either option.

Steve Gold, Director of the Center for the Study of the States, discussed recent trends in state tax policy. He noted that 1992 was not a good year for state tax reform as very few states made any significant change in their tax system. The most significant change dealt with enactment or changes in health care provider taxes. However, Gold points out how matching federal funds and changing reimbursement rates make it difficult to interpret these changes as actual tax increases. Also, the uncertainty surrounding new federal regulations may lead to future revisions. The second area of change in 1992 was the continued increasing share of tax revenue generated by local governments. Gold pointed out how increased state fiscal stress caused a reduction in local aid, forcing these governments to turn to their own revenue sources. He concluded that fiscal stress during the 1990’s will continue to pressure state policy makers into reforming their tax structures.

Ronald Alt presented the results from FTA’s latest sales taxation of services survey. Illustrating the trend in economic activity toward the service sector, Mr. Alt pointed out how some states added several services to their sales tax base since the 1990 survey. All of these states added only selective lists of services, with no state implementing a broad based expansion such as Florida in 1987 and Massachusetts in 1991. The largest number of states (28) added selected business services to the tax base. Meanwhile, twenty-five states added several personal services.

Henry Thomassen, Economic Adviser to the Georgia Governor, discussed how revenue forecasters have dealt with errors in their forecasts. He noted that forecasters typically divide errors into known and unknown effects, with the latter commonly referred to as random noise. Most forecasters do not examine the characteristics of these unknown errors. However, Thomassen shows how a periodic review of this component can be helpful in improving state revenue forecasts. Indeed, they should examine this error over time to find any pattern. If this error tends to be self correcting, then no policy response is necessary. However, a pattern in this error component may indicate a necessary policy response or revision in forecasting techniques.

Professor Michael Wasylenko of Syracuse University addressed the conference concerning the effectiveness of fiscal incentives for state economic development. He divided state incentives into traditional tax concessions or training programs and new wave programs. The latter consist of low-cost loans, incubators, research and development assistance, and export assistance. He noted that the literature is mixed on the effectiveness each program. Generally, tax incentives have been shown to be more effective during the 1970’s, while being less effective during the rapid growth of the
Meanwhile, there is little or no evidence on the effectiveness of many of the new wave programs. Finally, he pointed out how some economic development incentives may be necessary. However, there may be more justification for using employment training programs and keeping the fiscal system competitive than individual incentives.

Mark Muchow with the West Virginia Department of Taxation discussed his state’s recent experience with tax credits. Throughout the 1970’s and 80’s, West Virginia enacted several types of investment tax credits designed to encourage investment and job creation. After a thorough review of the super credit, state officials concluded that the effective economic and job gains were not worth the cost in tax revenue losses. As a result, state officials revised the law in 1991 to increase the eligibility requirements and imposed an alternative minimum tax.

Jared Mullen with the New Zealand Inland Revenue Department discussed the Goods and Services (VAT) tax in his country. Faced with a tax system comprised mainly of individual income and indirect (excise) taxes in the early 80’s, policy makers began examining ways of making the revenue system more equal, minimize distortions, and make it more certain and simple. As part of this plan, a value added tax was implemented to replace a nationwide wholesale sales tax which was very complex. Mullen described some of the complexities with the tax such as exemptions for necessities, taxation of housing, taxation of government services, Charities, and financial services.

Other Topics
On Tuesday, participants were able to attend several concurrent breakout sessions dealing with special topics of revenue estimating, data generation, and tax policy analysis. One session dealt with new issues in business taxation. Talks were given on estimating NOLs, the new Texas franchise tax, allocation of bank corporate taxes, and analyzing the revenue impact of LLCs. In a session dealing with database development, several speakers talked about the Consumer Expenditure Survey, sampling techniques, and using EFT data for taxpayer databases. A separate session dealt exclusively with Medicaid provider taxes as representatives from Tennessee, Minnesota, and New Mexico discussed the basis of their tax systems. One session included discussions of new tax policy models being used by state analysts. Presentations included the Massachusetts model, Texas model, a general equilibrium model, and vector autoregression modeling. Several tax incidence projects were discussed in a session, with presentations by Florida, Massachusetts, and Minnesota. In addition, Professor Strauss discussed the preliminary results of his sales tax survey.

Several roundtable type sessions gave participants the opportunity to share some of their ideas. One of these sessions dealt with new roles for tax research departments. Two others dealt with revenue forecasting problems, a personal income tax workshop and sales tax workshop.

Further Information
FTA does not publish the proceedings of the Revenue Estimating and Tax Research Conference. Interested persons may obtain copies of papers presented at the conference from FTA, if a complete paper was submitted. Listed below are the papers that 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.

Sincerely,

Harley T. Duncan
Executive Director
1992 FTA Revenue Estimating Conference Papers


Michael P. Niemira, *The Outlook for Retailing: Responding to the Consumer of the 1990s*, Tables Accompanying Remarks

Fred Flick, *Real Estate Industry Outlook*, Table Accompanying Remarks


Hyman C. Grossman, *How Standard & Poor's Views State Finances*

Robert P. Strauss, *Measuring and Presenting Tax Burden and Incidence Analysis to State Policy Makers*


Ronald Alt, *FTA Survey on Sales Taxation of Services — an Update*, Tables Accompanying Remarks

Michael Wasylkenko, *The Effectiveness of Fiscal Incentives for State Economic Development*, Outline of Remarks

Mark Muchow, *The West Virginia Investment Tax Credit Experience*

Jarred Mullen, *Goods and Services Tax in New Zealand — Experience of a Multi-Stage VAT*

**Business Tax Estimating Issues**

Craig Daugherty, *The Revised Texas Franchise Tax: What in the World is "Earned Surplus"?* Outline of Remarks


Karen Schlain, *Analyzing the revenue Impact of Limited Liability Companies*, Outline of Remarks

**Database Development for Revenue Estimation**


I. A. Nooe, *Federal/State Electronic Filing of Individual Income Tax Returns Project*

Philip Spilberg, *Summary of Data Base Resources Used by the Research Bureau of the California Franchise Tax Board*

**Issues In Health Care Financing**

Stanley M. Chervin, *Tennessee's Revised Medicaid Providers Tax*, One Page Summary

Robert Cline, *Minnesota HealthRight Revenue Provisions*

**Multi-Tax Policy Simulation and Dynamic economic Analysis**

Karry Barton, *Texas Tax Burden Model*, Outline and Table Accompanying Remarks

Gary Eng and Sandra Smith, *Vector Autoregression Modeling for tax Revenue Forecasting*

James Wooster and Thomas S. Neubig, *The Massachusetts Multi-Tax Incidence and Dynamic Economic Impact Model*, Tables Accompanying Remarks

**Managing a Tax Research Section — New Stresses, New Opportunities**

John J. Hudder, *Supporting Audit, Compliance and Litigation Activities*

**State Tax Incidence Studies**

Kenneth Trager, *The Impact of Fiscal Year 1988-89 Out-of-State Tourism on the Florida Economy*

Kenneth Trager, *Who Pays Florida's Sales Tax? — An Empirical Examination of Florida's Sales Tax*
Kenneth Trager (Co-authored by Frank Williams), *An Alternative Methodology for the Study of Tax Incidence: An Analysis of 1988 Florida Sales Taxes*

Robert P. Strauss, *Patterns of State Sales and Use taxes on Households: 1991 (Some Preliminary Results)*, Outline and Tables Accompanying Remarks

**Personal Income Tax Forecasting Workshop**
Yeang-Eng Braun, *Wisconsin Personal Income Tax Forecasting Methodology*

**Sales Tax Forecasting Workshop**
John S. Heleman, *The Texas Sales Tax Model*, Outline of Remarks