BULLETIN

Federation of Tax Administrators • 444 North Capitol Street, N.W., Washington, D.C. 20001 • (202) 624-5890

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Summary of Proceedings
1994 FTA Revenue Estimating and Tax Research Conference

To State Tax Administrators:

Summary

The 49th annual FTA Revenue Estimating and Tax Research Conference was held October 23-26, 1994 in Albuquerque, New Mexico. This Bulletin summarizes the presentations made at the conference. Also, enclosed is a complete listing of the conference papers available from FTA. Please call us if you are interested in receiving a copy of any of these papers.

The 49th annual FTA Revenue Estimating and Tax Research Conference was held October 23-26, 1994 in Albuquerque, New Mexico. Presiding over the conference was Georganna Meyer, Arizona Department of Revenue and Chair of the FTA Research Section. Welcoming the participants was Dick Minzner, Secretary of the New Mexico Taxation and Revenue Department.

The program included presentations by the major forecasting firms and states discussing their economic forecasts. One part of the general session was dedicated to analyzing and understanding the implications of various economic development incentives. Participants also had the opportunity to attend smaller regional roundtable sessions, where they were able to discuss their estimating, analysis and tax collection experiences with their peers in other states. All day Tuesday was dedicated to various concurrent sessions covering various issues of interest to state economists. Some of the topics included natural resource taxation, modeling economic feedback effects in revenue forecasts, transfer pricing effects, estimating gaming revenues, and managing innovative research efforts.

On Wednesday morning, the participants heard several presentations on miscellaneous topics of broad interest among state economists. An international forecast of oil production and prices was given. It was followed by a presentation on Computable General Equilibrium Models and their use in modeling state economies. An analysis of how revenue simulation models can be used to understand the implications of different welfare reform proposals was also given. Two other presentations included an economist discussing his experiences advising eastern European countries, and an update on the District of Columbia tax burden study.

Economic Forecasts

The conference began with several presentations on the economic outlook by the major forecasting companies. The forecasts included the overall macro economic outlook, regional outlook, and the economic implications from international trade. This was followed by forecasts for various sectors, such as retailing, automobile sales and productions, and health care.

All three forecasting firms presented very similar outlooks for the coming calendar year. David Wyss, with DRI/McGraw-Hill, expects the second half of 1994 to remain strong, although somewhat slower than the previous four quarters. He projects real GDP growth of 3.8 percent for the entire year. This slowdown, however, is expected to continue as the high rate of consumer debt and higher interest rates slow personal consumption expenditures. While this will be tempered slightly by growing demand from exports, it will still not be enough to keep real GDP growth from falling to 2.1 percent in 1995.

Presenting the economic outlook from the regional perspective, Mark Zandi, with Regional Financial Associates, presented a more optimistic forecast. He focused his discussion on the difference between the actual and the natural unemployment rates. Defined as the unemployment rate which causes no acceleration in the inflation rate, the natural rate of unemployment presents a good indicator of relative activity throughout the country. Nationally, the actual unemployment rate is just below the natural rate, indicating an economy producing at capacity that may be building inflationary pressures. This means that the Federal Reserve will continue to increase interest rates over the next several months, further slowing economic activity. Thus, similar to the DRI forecast, Regional Financial Associates expects a slowdown in economic growth next year.

Using individually estimated natural rates for different regions, Zandi was able to show the current levels of economic activity across the country. The Midwest, reflecting the increased level of manufacturing activity, has been operating with an unemployment rate well below its natural rate. This reflects a shortage of labor which will soon be reflected in wage and price increases. In the opposite situation is California, which has only begun to recover from the latest recession. It has an unemployment rate well above the natural rate. Meanwhile, the other western and mountain states have seen the two rates remaining close due to a net in-migration of people.

Kurt Karl presented the WEFA forecast, concentrating on the outlook for international trade and its impact on the U.S. economy. Overall, he expects U.S. national economic growth to finish the year with a real growth rate of 3.7 percent. Similar to the other two forecasts, Karl expects 1995 to have slightly less growth, projecting a 2.7 percent growth rate. He presented figures to indicate how inflation has bottomed out, with the core producer price inflation beginning to rise. In addition, the manufacturing sector is currently producing at its maximum.

In looking at international markets, Karl expects some improvement. While the dollar is still high compared with most currencies, it has fallen significantly relative to the (German) Mark and (Japanese) Yen. In addition, these countries are now beginning to see a recovery from the recession that they felt a few years after the U.S. recession. With the implementation of the North American Free Trade Agreement, Canada and Mexico have become more important trading partners. Both countries are expected to fuel additional growth, as Mexico is now seeing an economic recovery. Canada has seen growth rates similar to the U.S.

Outlook by Sector

Michael Niemira, with Mitsubishi Bank, discussed his view on the current and future outlook for the retail sector. He notes that retailing is currently doing well, with all segments seeing at least some growth. Even the California market is beginning to show signs of growth. However, Niemira noted that there are substantial differences in the rate of growth of different segments. The strongest growth can be found in consumer electronics, with automobile sales also showing a lot of strength. The discount and specialty stores are seeing strong growth at the expense of the chain stores, which have seen continuously shrinking margins. And finally, Niemira expects the 1994 Christmas season to be good but not great. His forecast of a 5.0 percent growth over the previous year is better than the 3.7 percent registered last year but below the 5.6 percent in 1992.

Mark Haas presented the automotive outlook for the Michigan Department of Treasury. The Director of the Office of Revenue and Tax Analysis began by examining the overall economic outlook to describe the link between key economic variables and auto sales. He noted how income and affordability are the strongest indicators of auto sales. With real disposable income forecasted to rise, and interest rates expected to remain relatively low, auto sales will continue to see strong growth over the next several years. Also, the growing average age of the passenger car fleet (now at an all-time high of 8.1 years) will put additional pressure for more new car sales. He forecast total car sales of 9.1 million units in 1994, which is expected to remain steady about 9.0 million units per year through 1996. Haas expects the shift towards purchases of light trucks to continue, forecasting a growth in the unit sales to 5.6 million units in 1994. It is forecasted to increase to 5.9 million units by 1996.

Michael Vlaisavljevich with KPMG Peat Marwick, told the participants to expect more state activity in the health care arena during the next year. He noted that states' efforts at health care reform programs stalled in 1994, due to Federal efforts. States that were working on reform programs delayed their efforts to avoid possibly having to reverse policy after implementation of any new federal requirements. With the failure of federal reforms, however, many states are expected to revive their efforts. Indeed, he noted several states that have already implemented reform programs including Florida, Minnesota, Oregon, Tennessee and Washington. He expects tax analysts to play a key role in analyzing and evaluating the different proposals, due to their expertise and tools. Indeed, Vlaisavljevich pointed to the Microsimulation Model as a valuable asset to better understanding the implications on different types of households from the various options.

Monday Afternoon

The afternoon general session was dedicated to presentations on economic development incentives as viewed from different perspectives. Frank Schaefer, an accountant with Grant Thornton, presented the private sector perspective. He pointed out how his clients "don't have a conscience about taking incentives and playing states off against each other." However, incentives are not the only issue that businesses look at in their location decisions. Referring to a recent case, Schaefer listed construction and materials cost, quality of labor, availability of transportation, and the quality of life, that were all ranked above tax incentives. Still, he advised his client to examine total state and local tax burdens. In the end, the tax incentive did play a role in the company's decision. He advised state officials to assemble all the information on state and local taxes in one place to assist new businesses.

John Hudder presented the state government's perspective. Currently working for the New York Legislative Assembly, Hudder has had many years of experience examining incentives for the state. Still, he notes that state officials need a better method for evaluating incentives than the current revenue in/revenue out approach. This approach fails to take into account how effective the incentive is at meeting its objective (creating new jobs). Using the analogy of the *Tax Expenditure*, he suggests that state officials examine tax incentives similar to how general expenditures are treated. General expenditures are subject to annual appropriations where they must continually prove that they meet their goals. States could similarly require businesses to reapply or be recertified to keep the tax incentive, providing a means for a reevaluation of a particular incentive program's effectiveness on a regular basis. Also, a state could require businesses not meeting the requirements or objectives of an incentive to pay back the amount of the tax benefit.

Don Walls, with Walls and Associates, gave a consultant's view of tax incentives. Looking at states' past performances in dealing with business incentives, he noted how state officials have not approached the table in a good bargaining position. Officials typically focus on taxes and fail to do adequate market research. As a result, most states are constantly chasing jobs by offering packages of tax breaks, looking only at the dollar cost per job. He suggests that states need to take a balanced approach examining the total benefits verses total cost.

Walls pointed out how the state can take the consultant out of the picture by adopting one-stop-shopping for businesses. This provides one place for businesses to learn about the state while enabling officials to better focus their sales pitch on other key benefits to their state (i.e., educated work force, low-cost transportation, etc.). And when particular incentives are needed, Walls recommends that state officials target these incentives. He notes that states can generate more jobs per dollar in incentives by targeting specific industries. Some key indicators useful for identifying these industries are businesses which are in fast growth areas and sell to national/international markets. States should focus on attracting industries that produce output (not jobs) who provide a good market for key localized industries.

Wednesday Morning General Session

The Wednesday morning general session had several presentations covering miscellaneous topics of interest to state economists. It began with a presentation by Michael McKee on the use of computable general equilibrium (CGE) models for state and federal policy analysis. As a professor at the University of New Mexico, McKee has used CGE models in various applications over the years. While the CGE model cannot do specific revenue estimates, it is useful for understanding the impact of different scenarios. These types of models can be used to understand the revenue and economic impact of large tax policy changes. And, since they model the interaction of different industries, they can provide valuable data on how a policy change affects different types of businesses. However, McKee noted that results of CGE models are highly dependent on the specific assumptions used to create it. Thus, they should be used with caution. Still, this can be helpful in bringing into the debate the validity of these assumptions, which are hidden with other policy models.

Tom Burns, Chevron's Chief Economist, discussed current trends and issues in oil and gas production. He noted how the oil and gas industry has changed dramatically over the last 15 years. Since the 1970s many new countries have become involved in producing natural resources, increasing the size of known reserves and reducing prices. This has led to a change in how nations/states approach natural resources policy. In the past, governments viewed resources as being fixed, with the level of taxation having no economic impact. However, governments are beginning to see that resource policies can affect investments in natural resource production. Burns pointed out a recent example in Nigeria, where labor problems and low world oil prices made investors nervous. As a result, the total level of investment fell, and Nigeria saw a direct decrease in total oil production. Similarly, new technology such as enhanced oil recovery could lead to direct increases in production in some countries/states. However, these new technologies require large capital expenditures. As a result, countries/states are beginning to view the natural resources industry similar to other industries that may need specific tax incentives.

Paul Wilson, with the Minnesota Department of Revenue, examined different options for welfare reform. He noted that more and more state tax officials are being asked to provide assistance to the poor through the tax system. Numerous examples of this already exist, such as the Earned Income Tax Credit (EITC), specialized child/dependent care credits, property tax credits, and health care credits. The rationale for tying welfare programs to the tax system is to provide an incentive to work. However, this causes a problem with high marginal income tax rates as many of these programs are phased out for higher income households.

Wilson contrasted the traditional welfare programs with income-tax-based programs that provide relief to the poor. He noted that both types of programs have their benefits and problems. Traditional welfare programs respond quickly (providing cash when needed) and use a comprehensive definition of income. However, they have high administrative costs and do not provide for any type of recapturing of benefits when unemployment is temporary. An income tax based system does have lower administrative costs, but only provides money when annual tax returns are filed. It also uses a limited definition of income (AGI) for eligibility requirements, which may not necessarily indicate need. He pointed out that the best solution may be to incorporate some provisions of the welfare system into the tax system. Indeed, he cited several options to do this, such as refunding tax credits monthly, developing more comprehensive measures of income, and providing an asset test for the EITC.

The newly developing countries of eastern Europe provide new challenges for the tax analyst, according to James Wooster. Formerly a state economist, Mr. Wooster currently works for the U.S. Treasury Department advising several eastern European countries. He noted that there is a wide variance in the degree of technical and economic knowledge in these countries. Still, each one faces similar problems in modernizing their tax systems. Their traditional revenue sources—state owned firms—are declining, while no system is in place to collect revenues from the newly developing private sector. He described many problems these officials have been facing as they implement newer VAT taxes, write rules and regulations for their current income taxes, and create taxpayer education programs. He sees a role for state tax administrators in providing examples and helping to train these tax administrators.

Julia Friedman announced that the 1994 District of Columbia tax burden study is currently being printed. Despite being widely distributed and used by many state officials, she noted that continuation of this study may be jeopardized by the financial crises currently facing the District. She outlined three options: decrease the number of cities; publish an update every two years (requiring congressional action); or receive outside assistance. Preferring the last option, she asked that the research director of each state tax agency assist them in compiling information on local property taxes. In addition, she would hope that states would comment on the current methodology and form a group to suggest improvements.

Breakout Sessions

Several concurrent breakout sessions were held all day Tuesday covering many different topics. Three separate sessions examined different aspects of natural resource taxation. One dealt with the effectiveness of tax incentives for oil, gas, and coal production. Another examined the long-term outlook for natural resources taxation. The third session discussed issues with forecasting natural resources production.

Three sessions were held to address several issues of interest to state revenue estimators. In one session, several papers addressing specific technical issues in revenue estimation were given. Other sessions focused on specific topics, such as estimating gaming and lottery revenues and accounting for economic feedback effects.

The final two sessions addressed international taxation issues and managing a research section.

Training Track

New this year were three separate training tracks, intended to give the participants a more detailed description of a specific topic than a normal conference presentation would provide. One of these dealt with how a state would develop a tax incidence study. The faculty included Robert Cline, Rod Hoheisel and Paul Wilson from Minnesota, Yeang-Eng Braun from Wisconsin, and Steve Pollack with KPMG Peat Marwick. "What Economists Should Know about Lawyers and the Law" was organized by Rick Pomp, while the session on "Mathematics of Revenue Estimating and Forecasting" was conducted by Hank Thomassen, Georgia Governor's Office.

Papers

Attached is a list of the papers available from FTA. Please contact Ronald Alt for copies. If you are interested in a topic addressed at the conference for which no paper is available, we can put you in contact with the presenter.

Sincerely,

Harley T. Duncan
Executive Director

Papers Available from FTA

David Wyss (DRI), *The Soft Landing* - Summary and Tables accompanying remarks.
Kurt E. Karl (WEFA), *U.S. Economic Outlook* - Figures accompanying remarks.
Mark Haas (Michigan Dept. of Treasury), *The Automotive Outlook* - Figures accompanying remarks.
Michael P. Niemira (Mitsubishi Bank), *The Retail Sector Outlook* - Tables accompanying remarks.
Frank Schaefer (Grant Thorton), *The Practitioners' Viewpoint: Incentives to Locate/ Did We Get Everything?* - Summary of remarks.
John Hudder (New York Legislature), *State Tax Incentives for Economic Development: Criteria for Their Adoption.*
Donald W. Walls (Walls & Associates), *Targeting Economic Development Policies: A Systematic Approach.*
Georganna Meyer (Arizona Dept. of Revenue), *Economic Development Policy Survey: Summary of Responses with 1994 Update* - paper circulated without presentation.
Thomas G. Burns (Chevron), *Oil markets in the 1990's: Is There a Crisis in Our Future?* - Figures accompanying remarks.

Training Track

Bob Cline and Rod Hoheisel, *Tax Incidence Training Track* - Outline and Tables.

Breakout Sessions

Greg Albrecht (Louisiana), *The Current Status of the New Gaming Industries in Louisiana.*
Deborah R. Bierbaum (New York), *Managing a Research Shop: Assisting in the Litigation Process* - Tables accompanying remarks.
Stanley M. Chervin (Tennessee Dept. of Revenue), *Nonfarm Sole Proprietorships in Tennessee: 1992.* (SAS programs used are also available from the author).
Alan Clayton-Matthews (Massachusetts Dept. of Revenue), *Cointegration: An Application Using Tax Revenue to Measure the State of the Economy* - Tables accompanying remarks.
James Francis (Florida Dept. of Revenue), *Performance Accountability Measure Project* - Handouts accompanying remarks.
David T. Griffiths (Oregon), *Lottery and Video Gaming: Estimating Cross Price Elasticity of Video Gaming and State Lottery* - Tables accompanying remarks.
Daniel K. Lee (Mississippi), *Overview of the U.S. Gaming Sector and Revenues* - Figures accompanying remarks.
Douglas A. Macdonald (Utah State Tax Commission), *Who Bears the Corporate Tax Burden in Utah?*
Thomas S. Neubig, *VAT and Its Implications for State and Local Governments* - Outline of remarks.
Stephen H. Pollock, *Evaluating Business Tax Competitiveness.*
Margaret A. Ray, (Texas Christain University), *Regional Economic Development and Pari-Mutuel Racing: The Odds*, reprinted from The Review of Regional Studies.
Sherman Robinson, Sandra Hoffmann, and Shankar Subramanian, *Defense Cuts' Role in the California Recession* - Paper summarizing analysis using a Computable General Equilibrium Model
Karen Schlain (New York City), *Entity-Level Taxation of Partnerships: The New York City Experience* - Figures accompanying remarks.
Thomas M. Williams (Utah State Tax Commission), *Family Based Statistics of Income*, Research Publication 94-9.

Natural Resource Taxation Papers

Jim Carmichael, (Natural Resources Canada), *Canadian Natural Gas Exports Forecast Through the Year 2000.*

Frank D. Katz, (New Mexico Taxation and Revenue Dept.), *Dual Taxation on Indian Lands: A Legal Perspective and Update of the Issue.*

Charles L. Logsdon, (Alaska Dept. of Revenue), *Forecasting Alaska's Petroleum Production Tax.*

F.D. Martin and R.E. Blaylock, (New Mexico Institute of Mining and Technology), *Oil and Gas Tax Incentives: History and Future.*

Mark Muchow, (West Virginia Department of Tax and Revenue), *An Analysis of Benefits and Costs of an Application of the West Virginia Super Credit to Coal Severance Taxpayers, 1985-1993.*

Nicolas Sisto, (University of Toronto), *Taxation and Mine Behavior.*

Doug Stangeland, (British Columbia), *British Columbia Mineral Tax: a Tax on Resource Rent.*

Anthony V. Popp, (New Mexico State University), *An Analysis of Tax Incentives for Enhanced Oil Recovery.*

Greg Terzian, (ICF Resources), *A Methodology for Assessing the Costs and Benefits of Oil and Gas Incentives* - Outline of remarks

U.S. Department of the Interior, *Sources of National and International Mineral Information.*

Carlos A. Ulibarri and Thomas L. Marsh, (Battelle Memorial Institute), *Tax Revenue and Innovations in Natural Gas Supply: New Mexico.*

Frank A. Ward, (New Mexico State University), *Mineral Tax Policy Analysis Through Economic Models of Exhaustible Resources.*

Addendum

Mark Zandi, Regional Financial Associates, *The Regional Economic Outlook*, Tables accompanying remarks.

Michael Vlaisavljevich, KPMG Peat Marwick, *Implications of Health Reform for State Fiscal Policy*, Outline of remarks.

Henry Thomassen, Georgia, *Tax Surges as fiscal Stimulants*.

Mark Haas, Michigan Department of Treasury, *School Finance Reform*, Figures accompanying remarks.

Alan Clayton-Matthews and Daniel Swaine, Massachusetts Department of Revenue, *Cointegration: An Application Using Tax Revenues to Measure the State of the Economy*, Figures accompanying remarks.

Alan Clayton-Matthews and Daniel Swaine, Massachusetts Department of Revenue, *The Economic Impact of Corporate Taxation in the REMI Model: Issues in the Evaluation of Key Model Components*, Outline of remarks.

Ronald Duncan, Office of the Navajo Tax Commission, *Dual Taxation on Indian Lands: A Legal Perspective and Update of the Issue*.

U.S. Department of the Interior, *Procedures to Prepare Federal Onshore Oil and Gas Royalty Estimates-Fiscal Years 1994-96*.

Scott Sitzer and Andy Kydes, U.S. Department of Energy, *Price and Production Forecasts in the National Energy Modeling System*.