BULLETIN

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1996 Annual FTA Revenue Estimation and Tax Research Conference (Summary of Proceedings)

To State Tax Administrators:

Summary

The 51st annual FTA Revenue Estimating and Tax Research Conference was held September 8-11, 1996 in Boston, Massachusetts. Presiding over the conference was Yeang-Eng Braun, Wisconsin Department of Revenue and Chair of the FTA Research Section. This bulletin summarizes the proceedings and lists the various papers available from FTA.

The 51st annual FTA Revenue Estimating and Tax Research Conference was held September 8-11, 1996 in Boston, Massachusetts. Presiding over the conference was Yeang-Eng Braun, Wisconsin Department of Revenue, and Chair of the FTA Research Section. Welcoming the participants was Mitchell Adams, Commissioner of the Massachusetts Department of Revenue.

The program included presentations by the major forecasting firms and industry representatives discussing their economic forecasts for the next 18 months. Presentations were made on the status of Federal tax reform, state and local tax burden measurement, and various management and compliance research issues. The entire day of Tuesday was dedicated to various concurrent sessions covering issues of interest to state economists. Some of the topics included natural resources taxation, estimates of the revenue effects of gambling activities, federal tax reform, taxation of telecommunications and deregulated industries, emerging tax policy topics, dynamic modelling, revenue forecasting methodology, and revenue departments on the Internet.

On Wednesday morning, the participants heard several presentations on topics of broad interest to state economists. Representatives of the Rockefeller Institute of Government—Center for the Study of the States discussed their *State Revenue Report.* A presentation on the impact of Federal tax reform on state taxation was given, and a representative from the Census Bureau updated the participants on the transition to the North American Industry Classification System. Finally, presentations were made on resources for economists on the internet and the Pennsylvania Tax Blueprint Project.

Economic Forecasts

The conference began with several presentations on the economic outlook by the major forecasting companies. They included the overall macro economic outlook, regional outlook, and the international issues affecting the economic outlook.

Cynthia Latta, a Senior Financial Economist with DRI/McGraw-Hill, used the phrase "the Goldilocks Economy" to describe her economic outlook. With state governments enjoying their third good year in a row, she asked the question, is the economy slowing down or speeding up? She identified a number of problem areas that are expected to slow growth, including health care, education, credit card balances and the growth in personal bankruptcies. Still, the Federal Reserve is unlikely to raise interest rates with key indicators pointing in opposite directions. While the unemployment rate is reaching very low rates, the factory operating rate is still too low to cause inflationary pressures.

Overall, Latta projects that economic growth will slow during the third and fourth quarters, finishing the year with a real growth rate of 2.5 percent. It is expected to continue at a steady rate of growth of 2.2 percent in 1997 and beyond. Consumers are expected to be the primary driving force, with total consumption expected to grow by 2.7 percent in 1996 and 1997. Vehicle sales and housing will remain strong, benefiting from low interest rates.

Peter Jaquette, Vice President of U.S. Macroeconomic Services with WEFA Group, discussed international issues affecting the economic outlook. He noted that international trade has become an increasingly important sector of the U.S. economy, accounting for more than 20 percent of current GDP. With this in mind, Jaquette turned his discussion toward examining how the major trading partners of the U.S. are doing. Altogether, he expects international trade (imports minus exports) to remain a net negative on GDP but much smaller than during the early '90s.

The current and forecasted growth rates for the two major trading partners of the U.S. are mixed. Canada has seen a sharp slowdown in GDP growth, which is expected to improve slowly during the next several years. Mexico experienced a recession last year following the devaluation of the peso. However, Mexico now is seeing strong growth. These trends have had a direct impact on U.S. exports, with exports to Canada falling and exports to Mexico rising. Both Japan and Europe are growing very slowly. While growth in the Japanese economy is expected to increase, an increase in the value of the yen is expected to mute any substantial growth in exports to Japan. Slow growth in Germany is expected to keep the growth rate in exports to Europe slow.

Mark Zandi, Chief Economist for Regional Financial Associates, discussed several factors accounting for the different economic conditions in the different regions. Overall, total job growth is expected to continue with the trends seen during the last several years, with a 1.6 percent growth rate. The Mountain states and some Southeastern states are expected to have above-average rates of growth, while the Northeast, Alaska and Hawaii will have below-average growth rates.

Zandi used the concept of the natural rate of unemployment, where the number of people losing jobs equals the number gaining jobs. Areas where the unemployment rate is below the natural rate are said to have tight labor markets—midwestern, mountain and some southern states. Where the unemployment rate is above the natural rate, labor markets are soft—California, Delaware, New Jersey, and New York. During the past several years, areas with tight markets have received some relief in the form of migration from soft market areas. However, with the economies of California and New York improving, this relief is expected to decrease. As a result, the tight labor markets could lead to higher wage demands and increased inflationary pressures. Zandi discussed a possible scenario in which the Federal Reserve delays reacting to this inflationary pressure, causing a recession in 1998. The impact on the different states would vary depending on the level of consumer debt, labor tightness, and other factors.

Other General Session Speakers

With Federal tax reform being a major topic for debate in the upcoming elections, Jane Gravelle of the Congressional Research Service discussed the key proposals being debated. She noted a common general theme to all of the proposals is the total replacement of the income tax with a

consumption-based tax. She then outlined the different plans, including the Unlimited Savings Allowance (USA), a flat tax, value-added tax (VAT), and retail sales tax. While the current income tax is fairer across income groups, it is believed that a consumption tax is less burdensome and avoids some of the differential tax treatment of different types of capital assets.

All of the proposals have various problems which would make them difficult to implement, according to Gravelle. In general, she noted that all consumption taxes are regressive, taxing the poor more than wealthy individuals. While there are ways to counter this regressivity, these changes would add to the complexity of the new tax system. Shifting to a new system also introduces different winners and losers, which complicates the political ability to enact a new tax. Indeed, some of the losers cited by Gravelle include state and local governments, which would be required to pay taxes, and charities which would lose the deductibility of contributions. Finally, she noted many transitional problems that make implementation very difficult. Some proposals would provide large loopholes for higher income taxpayers to avoid taxation.

Gravelle then discussed the key proposals and highlighted some of the problems of each plan. A retail sales or VAT tax would mean a major shift in the point of collection for taxes. As a result, these taxes would require large jumps in prices—or a sharp drop in overall wages—creating a substantial barrier to implementation. Also, a federal retail sales tax—to replace the revenue from the current income tax—would require such a high tax rate as to make it unenforceable. While a flat tax avoids many of the problems found in a sales or VAT tax, it would apply to the sales of certain capital assets. With some assets currently being depreciated, this type of tax would require high rates or some very complex transition rules.

Gravelle concluded with a few words on incorporating behavioral feedback effects into revenue estimates. She believes that the level of knowledge is not advanced enough for real dynamic forecasting. Indeed, she points to the wide variation in the results by various outside experts who have modeled the federal tax reform proposals (from 0 percent to 13 percent feedback). Also, she noted that a recent study on capital gains tax cuts provides evidence that the elasticities are much looser than originally expected (around 2 percent).

Robert Tanenwald, Federal Reserve Bank of Boston, presented his opinions on how business tax burdens should be measured. He cited a recent Massachusetts example to illustrate how the public debate on state and local tax burdens is poorly informed. During the debate, one company released four studies to illustrate the high tax burden in the state, each with different results. One ranked states according to the highest corporate tax rate and excluded other taxes businesses pay. Two other studies used state and local corporate income tax revenue and the sum of corporate tax revenue and nonresident property taxes as a percentage of personal income. A key problem with this study is that personal income is unrelated to business profits. A fourth method ranked states according the percentage of state and local taxes collected from business. This method does not take into account the different types of industries in the various states.

Tanenwald then discussed results of his recently completed study testing the hypothesis that tax burdens affect business location decisions. Calculating the after tax rate of return for five groups of representative businesses in different states, Tanenwald ranked the states. These rankings were compared with business capital expenditures to find no significant relationship between tax burden and business location.

Keynote Luncheon Speaker

Fredrick Briemyer, Chief Economist with State Street Bank, gave the keynote address. Entitled "The Massachusetts Economic Landscape—Past, Present and Future," the presentation described the substantial changes in the state during the past several decades. Beginning in the late '70s, Massachusetts' economy was booming, benefiting from three key industries: the mini-computer industry saw strong growth from increased use of technology; the Federal defense build-

up led to strong growth in the defense-related businesses; and the banking industry in the state benefited from low interest rates and strong growth in financial intermediation. However, in the late '80s, these benefits began disappearing. Decreases in Federal defense spending, a reduction in proprietary mini-computer use, and over-extended bank loans led to a rapid slowdown in the state's economy. As a result, state policymakers began an effort to improve the business climate through lower taxes. Briemyer attributes much of the recovery currently taking place in the state to this policy change. While employment has not recovered to the '70s levels, he expects continued growth from many new areas, including tourism and land development.

Monday Afternoon Concurrent Sessions

Participants had the opportunity to choose between two concurrent sessions in the afternoon. One session offered topics on the economic outlook for various sectors, including retailing, automobile sales/productions and housing. The second session dealt with management and compliance research. A presentation was given on the Minnesota Tax Compliance Study which won the FTA research award. A representative from the Denver DORA office gave an update on the IRS compliance research activities. New York City presented their work on developing an audit algorithm, and California demonstrated a new data base program to track tax policy analysis.

Wednesday Morning General Session

The Wednesday morning general session had presentations of general interest to revenue estimators and tax policy analysts. Donald Boyd and Elizabeth Davis of the Center for the Study of the States, gave an update of the *State Revenue Report*. Published quarterly, it is intended to provide information on state tax collections to a widely varying audience, including government analysts, nonprofit associations, banks and bond rating agencies, and academics. The Center utilizes information from monthly reports provided by states, supplemented by contact and input from state tax personnel. They concluded by asking the conference participants for comments and suggestions for improving the report.

Ronald Alt, Senior Research Analyst with the Federation of Tax Administrators, discussed some of the resources useful to economists on the Internet. After a discussion of how the Internet operates and how to navigate around, he showed some useful web sites and samples of the different data available. Some of the sites illustrated included the Census Bureau, Bureau of Labor Statistics (BLS), GAO, the Congress Thomas site, and Internet Resources for Economists page.

Daniel Hassell, Pennsylvania Department of Revenue, discussed the Pennsylvania Tax Blueprint Project. Entirely supported by private sector funds, the project will develop data and resources for analysis while letting the policymakers examine solutions to the state's tax problems. Currently in the works are several models, including an individual and business tax simulation model, consumption tax model, business tax competitiveness model, a tax incidence model, and a dynamic feedback model. The project is controlled by a steering committee consisting of legislative, executive branch representatives, business and labor leaders, and private citizens.

Robert Strauss, Professor with Carnegie Mellon University, discussed his latest work on Federal tax reform and the impact on states. In his studies, he found some important implications in a shift from an income to a consumption-based tax. Under a true consumption-based tax, state and local government spending would be taxable, adding to the expenditures of already strapped local government budgets. The Federal change would also drastically affect the ability of states to administer their current income taxes. This includes the fed-state disclosure programs. State and local governments receive approximately 1.9 billion documents from the IRS for their tax compliance activities. Other disclosure of income tax return information helps the Census Bureau, the Bureau of Economic Analysis, and other statistical agencies develop and improve their data bases. This shift would greatly affect the GDP and other measures that are important to all policy analysts. Strauss will continue to examine the impact such a change in Federal tax would have on state and local governments.

Bruce Goldhirsch, U.S. Census Bureau, discussed the recent efforts by the Federal statistical agency to develop a North American Industry Classification System (NAICS). Scheduled to go into effect January 1, 1997, the new system would revise and update the older Standardized Industrial Classification (SIC) system originally developed in 1937. The new system utilizes a 6-digit numbering scheme (SIC was only 4-digits) to report on 19 sectors. It created many new sectors, including knowledge-based industries, management support, restaurants/accommodations, culture, and others. The Census Bureau plans to phase in the new system over a 5-year period and use dual coding and bridging tables to continue existing series.

Breakout Sessions

On Tuesday, conference participants were offered several concurrent breakout sessions. Some of the topics included natural resource taxation, the revenue effects of gambling activities, federal tax reform, taxation of telecommunications and deregulated industries, emerging tax policy topics, dynamic modelling, revenue forecasting methodology, and revenue departments on the Internet.

Papers Available

General Session - Monday, September 9

The Goldilocks Economy, Cynthia M. Latta, Ph.D., DRI/McGraw-Hill
International Issues Affecting the Economic Outlook, Peter Jaquette, Vice President, U.S. Macroeconomic Services
The Regional Economic Outlook, Mark Zandi, Chief Economist and co-founder, Regional Financial Associates, Inc.
State Business Tax Climate: How Should It Be Measured and How Important Is It? Robert Tannenwald, Senior Economist, Federal Reserve Bank of Boston

General Session - Wednesday, September 11

State Revenue Report, Donald Boyd and Elizabeth Davis, Center for the Study of the States
Resources for Economists on the Internet, Ronald Alt, Federation of Tax Administrators
The Pennsylvania Tax Blueprint Project, C. Daniel Hassell, Deputy Secretary for Fiscal Policy, Pennsylvania Department of Revenue
Implications of Federal Consumption Taxation for the State and Local Sector and our National Economic Statistics, Robert P. Strauss, Carnegie Mellon University
NAICS, The Development of the North American Industry Classification System, Bruce Goldhirsch, Special Assistant for Classification Activities, Services Division, Bureau of the Census

Economic Outlook by Sector

Motor Vehicle Outlook, Mark Haas, Dan Kitchel and Andrew Lockwood, Office of Revenue and Tax Analysis, Michigan Department of Treasury
Retail Outlook, Carolyn M. Scott, McCoy, Scott & Company

Management/Compliance Research

The Minnesota Tax Compliance Experiment, Stephen Coleman, Ph.D., Minnesota Department of Revenue
Development of an Audit Scoring Algorithm for the New York City General Corporation Tax, Karen Schlain, Business Tax Statistics Unit, New York City Department of Finance

Dynamic Modelling

Dynamic Revenue Analysis in California, An Overview, P. Berck, E. Golan, B. Smith, presented by Bruce Smith, California Department of Finance

General Equilibrium Analysis of Intel's Expansion in New Mexico, Michael McKee, University of New Mexico, and Tom Clifford, New Mexico Taxation and Revenue Department
The Massachusetts Experience with Dynamic Revenue Estimation: A Critical Evaluation, Daniel G. Swaine, Economist, Office of Tax Policy Analysis, Massachusetts Department of Revenue
The Massachusetts Dynamic Analysis Model, by Alan Clayton-Matthews, presented by Daniel G. Swaine, Massachusetts Department of Revenue
Dynamic Revenue Estimates for Washington State, Ray Philen, Washington Department of Revenue
Tax Reform Analysis, John Hakken, Coopers & Lybrand
The REMI Economic-Demographic Forecasting and Simulation Model, George I. Treyz, Department of Economics, University of Massachusetts

Taxation of Telecommunications/Deregulated Industries
Improving New York State's Telecommunications Taxes, A Background Study and Status Report, Arthur Friedson, New York State Department of Taxation and Finance
Taxation of Electronic Commerce: Conflicting Signals? Martin I. Eisenstein, Esq., Brann & Isaacson

Business Tax Climate Measures
Measuring Business Tax Climate: A Representative Corporation Approach, Yeang-Eng Braun, Division of Research and Analysis, Wisconsin Department of Revenue
Manufacturing Tax Study, E.M. "Skeets" Johnson, Washington Department of Revenue
Using Representative Business Models to Shape Tax Policy, Patrice Cohen, New York Department of Taxation and Finance
State-Local Business Taxation and the Benefits Principle, William A. Testa, Assistant Vice President, Federal Reserve Bank of Chicago

Emerging Tax Policy Topics
Michigan's Property Tax Reform-Before and After, Mark Haas, Director, Office of Revenue and Tax Analysis, Michigan Department of Treasury
Single Factor Apportionment Ratio -- Sales Factor Only -- For Apportionment of Corporate Income: Analysis and Estimate, Georganna Meyer, Arizona Department of Revenue

Forecasting Roundtable
The Pennsylvania Revenue Estimation Process, Kathleen Ross, Pennsylvania Department of Revenue
Overview of Virginia's Economic and Revenue Forecasting Process, John R. Layman, Principal Economist, Virginia Department of Taxation
Revenue Forecasting in Utah, Douglas Macdonald, Chief Economist, Utah State Tax Commission

Taxation of Gambling Activities
Overview of Gaming: Experiences from Selected States, Ranjana G. Madhusudhan, New Jersey Department of Treasury, Office of Tax Analysis
FTA Gaming Session, Louisiana Summary, Greg Albrecht, Legislative Fiscal Office

Energy Tax Forecasting and Policy Analysis
U.S. Electricity Outlook, Joyce Yanchar, DRI/McGraw Hill

Disseminating Information on the Internet
Utah State Tax Commission, Public Access Information Source, Tom Williams, Utah State Tax Commission
Disseminating Tax Information on the Internet, Mike Sobul, Ohio Department of Taxation
The FTA Home Page, Ronald Alt, Federation of Tax Administrators

Paper Not Presented

Economic Development Policy Survey: Summary of Responses with 1996 Update, Georganna Meyer, Arizona Department of Revenue

Sincerely,

Harley T. Duncan
Executive Director