

## American Economics Group

Clear and Effective Economic Analysis

Presentation for:

**Federation of Tax Administrators 9/22/03**

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[www.AmericanEconomics.com](http://www.AmericanEconomics.com)

### **The Economy is Recovering :**

- **The National Economic Setting**
- **Implications for State Revenue**
- **State & Local Tax Erosion**



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### **National Forecast:**

#### **Overview 09/22/03**

- **Recession, Terror and War Impact Waning**
- **Firm Recovery Path Evident**
- **Real GDP Growth to Average 3.5% in 2004**



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## Forecasts by Michael K. Evans, Ph.D.



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## National Forecast:

### POSITIVES:

- Consumer purchases remain robust
- Capital spending beginning to show strength
- Exports to jump in 2004
- Stock market rising



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### National Forecast: **Highlights**

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#### **NEGATIVES:**

- **High unemployment continues as expected**
- **Motor vehicle profits below estimates**
- **Federal tax cut offset by state cutbacks**
- **Tax cut diluted by spending on imports**
- **War spending adds to huge deficit**



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### National Forecast: **Overview**

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#### **High tech equipment still lagging:**

- **Computers**
- **Software**
- **Telecommunications**



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### Real GDP Growth

2003 First half	2.2%
2003 Second half	4.5%
2004 Full year	3.5%



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### Nominal GDP Growth (with inflation)

2003 First half	4.0%
2003 Second half	6.0%
2004 Full year	5.5%



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### Unemployment Rate

<b>2003 First half</b>	<b>6.0%</b>
<b>2003 Second half</b>	<b>6.0%</b>
<b>2004 Full year</b>	<b>5.6%</b>



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### Additional Employment

<b>2003 Second half</b>	<b>40,000 / mo.</b>
<b>2004 Full year</b>	<b>100,000 /mo.</b>



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### Real Wages (chg)

(with inflation)

2003 First half	3.5%
2003 Second half	3.5%
2004 Full year	3.5%



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### Let's Examine Components of Demand:

- Consumption
- Investment (capital spending)
- Exports less Imports
- Federal + State Fiscal Position



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### Real Personal Consumption Expenditures (chg)

2003 First half	2.8%
2003 Second half	4.0%
2004 Full year	3.5%



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### Non-Residential Fixed Investment (chg)

2003 First half	1.0%
2003 Second half	5.0%
2004 Full year	7.5%



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### Housing Starts (mil.)

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<b>2003 First half</b>	<b>1.73</b>
<b>2003 Second half</b>	<b>1.75</b>
<b>2004 Full year</b>	<b>1.73</b>



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### Automobile / Truck Sales (mil.)

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<b>2003 First half</b>	<b>16.0</b>
<b>2003 Second half</b>	<b>16.8</b>
<b>2004 Full year</b>	<b>17.0</b>



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### Export Growth (chg)

<b>2003 First half</b>	<b>-1.0%</b>
<b>2003 Second half</b>	<b>4.0%</b>
<b>2004 Full year</b>	<b>8.0%</b>



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### Exports less Imports

<b>2003 First half</b>	<b>-\$525 bil.</b>
<b>2003 Second half</b>	<b>-\$550 bil.</b>
<b>2004 Full year</b>	<b>-\$600 bil.</b>



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## Federal Deficit

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2003 Full year	\$450 billion
2004 Full year	\$600 billion



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### Let's Examine Prices and Income:



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### Consumer Price Index (chg)

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<b>2003 First half</b>	<b>2.0%</b>
<b>2003 Second half</b>	<b>1.5%</b>
<b>2004 Full year</b>	<b>2.0%</b>



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### GDP Deflator (chg)

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<b>2003 First half</b>	<b>1.7%</b>
<b>2003 Second half</b>	<b>1.5%</b>
<b>2004 Full year</b>	<b>2.0%</b>



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### Real Personal Income (chg)

2003 First half	2.3%
2003 Second half	5.0%
2004 Full year	4.0%



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### Nominal Personal Income (chg)

(with inflation)

2003 First half	4.0%
2003 Second half	6.5%
2004 Full year	5.5%



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### Corporate NIPA Profits (chg)

<b>2003 First half</b>	<b>4.0%</b>
<b>2003 Second half</b>	<b>8.0%</b>
<b>2004 Full year</b>	<b>12.0%</b>



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### Corporate S&P Profits (chg)

<b>2003 First half</b>	<b>8.0%</b>
<b>2003 Second half</b>	<b>12.0%</b>
<b>2004 Full year</b>	<b>17.0%</b>



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## National Forecast: **Overview**

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### Let's Examine Interest Rates:



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## Treasury Bills (3 mo.)

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<b>2003 First half</b>	<b>1.25%</b>
<b>2003 Second half</b>	<b>1.25%</b>
<b>2004 Full year</b>	<b>1.25%</b>



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### Treasury Notes (10 yr.)

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2003 First half	3.5%
2003 Second half	3.75%
2004 Full year	4.0%



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### Key Taxes: Slow Growth

- **Personal Income Tax**
  - **Low capital gains**
- **Corporate Profits Tax**
  - **Lagged loss write-offs**



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### Economic Forecast for The States:

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#### Results depend on:

- ✓ Each state's mix of industry
- ✓ Degree of Tax Avoidance / Tax Planning
- ✓ Migration of businesses



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### Sorting States into Four Groups :

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#### Expected Growth in Personal Income 2002 to 2007

- **Tier 1: Best (over 20%)**
- **Tier 2: Second Best (15% - 20%)**
- **Tier 3: Average (10% - 15%)**
- **Tier 4: Lowest (Under 10%)**



## States Expected to Perform Best 2002-2007

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**Tier 1:** Five Year Growth in Real Personal Income over 20%

### States 1

Idaho

Oregon

Nevada

California



## Second Best Performance 2002-2007

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**Tier 2:** Five Year Growth in Real Personal Income 15% - 20%

### States 2

Wyoming

Kentucky

Washington

Wisconsin

Indiana

Virginia

Arizona

Minnesota

Vermont

New Hampshire

Alaska

Missouri

Iowa

Tennessee

Florida

Illinois

Arkansas



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**Average Performance 2002-2007**

**Tier 3: Five Year Growth in Real Personal Income 10% - 15%**

**States 3**

Delaware	Texas	West Virginia
Mississippi	Kansas	Pennsylvania
North Dakota	New Mexico	Massachusetts
Georgia	Louisiana	South Carolina
Hawaii	Connecticut	Oklahoma
Montana	Nebraska	Colorado
South Dakota	North Carolina	Ohio
Michigan	Alabama	Rhode Island
Maryland	New Jersey	

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**Lowest Performance 2002-2007**

**Tier 4: Five Year Growth in Real Personal Income under 10%**

**States 4**

District of Columbia
Utah
Maine
New York

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**Erosion of State Taxes from  
Tax avoidance / Planning :**

• **Personal Income Tax:**

- Loss growing at 0.4% per yr.
- Now at 4.1% of Collections
- Gamesmanship at higher incomes



**Erosion of State Taxes from  
Tax avoidance / Planning :**

• **General Sales Tax:**

- Loss growing at 0.6% per yr.
- Now at 5.7% of collections
- Internet sales a significant cause



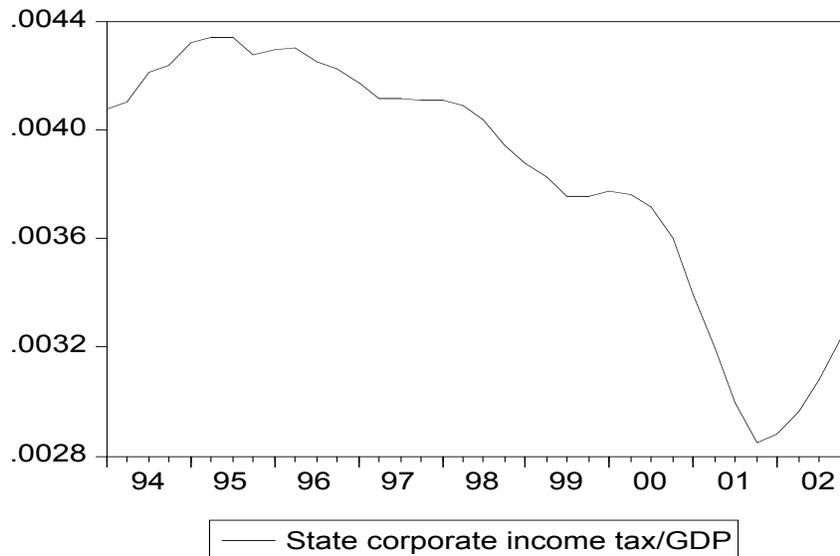
## Erosion of State Taxes from Tax avoidance / Planning :

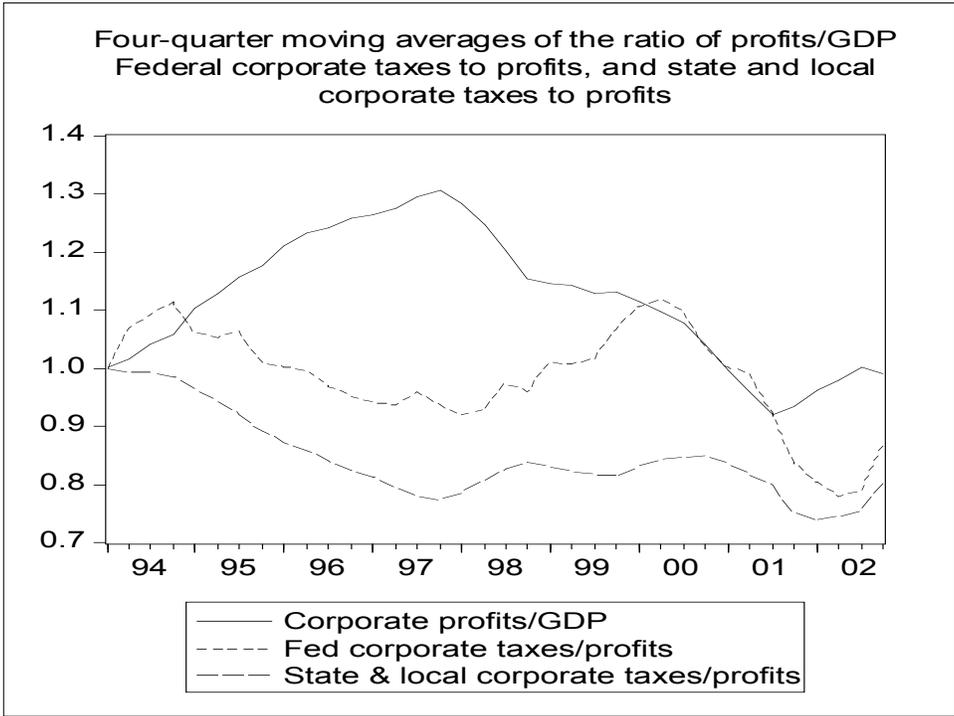
- **Corporation Tax:**

- Loss growing at 3.3% per yr.
- Now at 27.9% of collections
- Transfer pricing / location strategy
- Domestic & International involved



Ratio of state and local corporate income taxes to GDP,  
taking into account all three factors causing the decline





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**FIRST CUT ESTIMATES:  
Sorting States into Four Groups**

**Total Annual Loss from Tax Avoidance / Planning:  
Combined PIT, Sales & Corp. Taxes**

- **Tier 1:** Over \$1.0 bil. per year
- **Tier 2:** \$500 mil. to \$1.0 bil.
- **Tier 3:** \$200 mil. to \$500 mil.
- **Tier 4:** \$100 mil. to \$200 mil.
- **Tier 4:** Under \$100 mil.

  
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**Highest Tax Avoidance Loss**

**Tier 1: Losing over \$1.0 billion/year**

**Tax Loss 1**

- California
- New York
- Florida
- Michigan
- Illinois
- Pennsylvania
- New Jersey



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**Tax Avoidance Loss**

**Tier 2: Losing between \$500 mil. and \$1.0 billion/year**

**Tax Loss 2**

- Massachusetts
- Ohio
- Texas
- Georgia
- North Carolina
- Minnesota
- Indiana
- Wisconsin
- Virginia



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Tier 3: Losing between \$200 mil. and \$500 million/year

Tax Loss 3

Maryland	Louisiana
Washington	Oregon
Tennessee	Alabama
Arizona	Kansas
Connecticut	Mississippi
Missouri	Oklahoma
Colorado	Arkansas
Kentucky	Iowa
South Carolina	Utah



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Tier 4: Losing between \$100 mil. and \$200 million/year

Tax Loss 4

New Mexico	Nevada
Hawaii	Maine
West Virginia	Rhode Island
Nebraska	New Hampshire
Idaho	



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Tier 5: Losing under \$100 million/year  
Tax loss 5

Delaware

Montana

North Dakota

Vermont

South Dakota

Wyoming



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### Sorting States into Four Groups :

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Total Percentage Loss from Tax Avoidance / Planning:  
Combined PIT, Sales & Corp. Taxes

- **Tier 1:** Losing over 5.0% of revenue
- **Tier 2:** Losing between 4.5% - 5.0%
- **Tier 3:** Losing between 4.0% - 4.5%
- **Tier 4:** Losing under 4.0%



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**Highest Tax Avoidance Loss\***

**Tier 1: Losing over 5% of Revenue/year**

**Tax loss 1**

<b>Tennessee</b>	<b>Massachusetts</b>
<b>Michigan</b>	<b>New York</b>
<b>Indiana</b>	<b>New Jersey</b>
<b>New Hampshire</b>	<b>Georgia</b>
<b>California</b>	<b>Florida</b>
<b>Arizona</b>	<b>Mississippi</b>
<b>Illinois</b>	<b>Kansas</b>

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**Tax Avoidance Loss\***

**Tier 2: Losing between 4.5% to 5.0% /year**

**Tax loss 2**

<b>Idaho</b>	<b>Maine</b>
<b>Utah</b>	<b>New Mexico</b>
<b>Minnesota</b>	<b>Arkansas</b>
<b>Nebraska</b>	<b>West Virginia</b>
<b>Pennsylvania</b>	<b>Ohio</b>
<b>Colorado</b>	<b>North Carolina</b>
<b>Wisconsin</b>	<b>Hawaii</b>
<b>South Carolina</b>	<b>Maryland</b>
<b>Connecticut</b>	

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**Tier 3: Losing between 4.0% to 4.5% /year**  
**Tax Loss 3**

- Oregon
- Rhode Island
- Iowa
- South Dakota
- Missouri
- Kentucky
- Virginia
- Louisiana



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**Tier 1: Losing under 4% of Revenue/year**  
**Tax Loss 4**

- North Dakota
- Washington
- Alabama
- Oklahoma
- Delaware
- Montana
- Nevada
- Texas
- Vermont
- Wyoming



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**Thank You for Participating**

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