

Revenue Volatility: The Rhode Island Experience

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Background

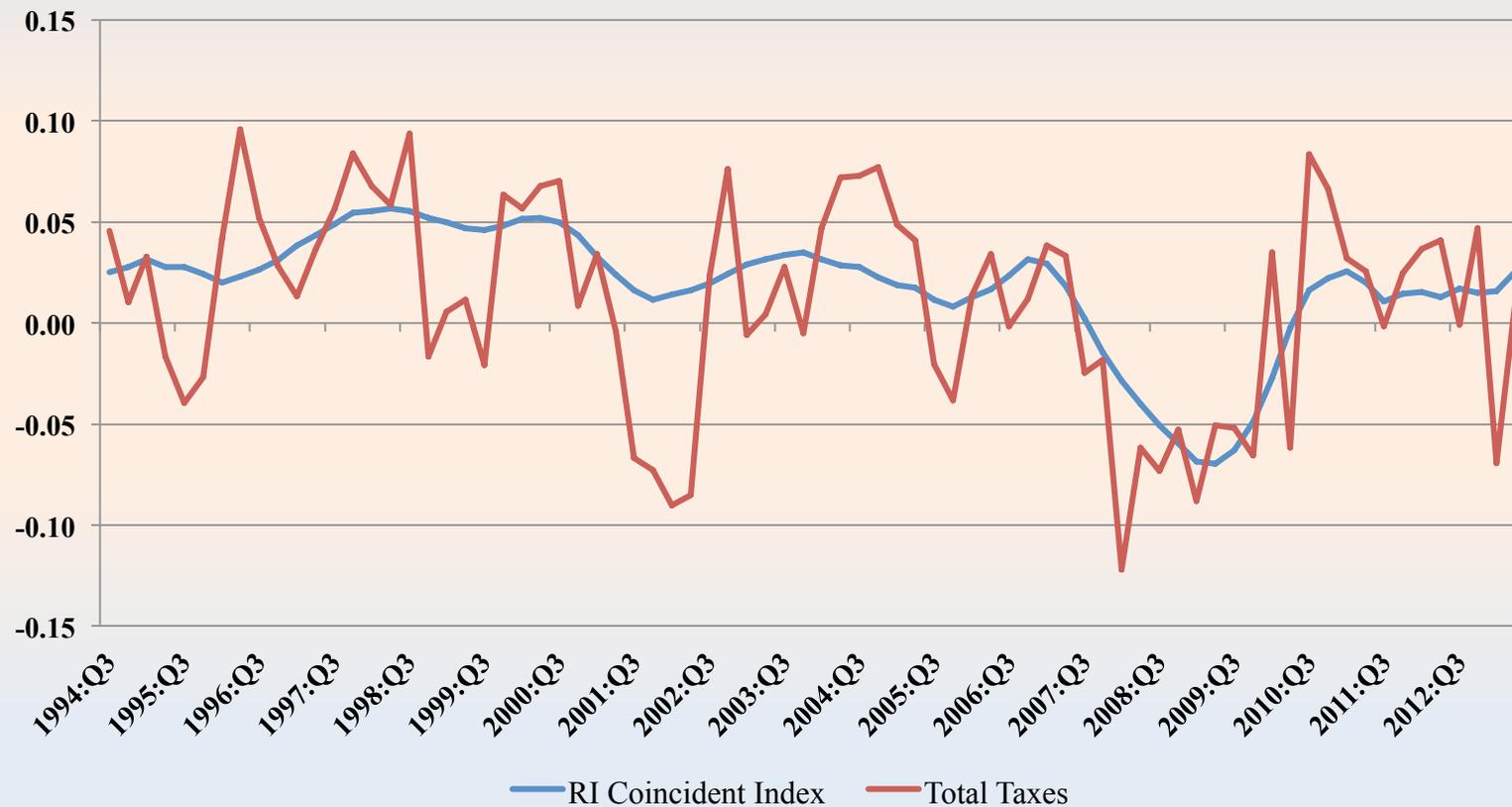
- The basis for this presentation is McGranahan and Mattoon, *State tax revenues over the business cycle: Patterns and policy responses*, Chicago Fed Letter, The Federal Reserve Bank of Chicago, June 2012, Number 299.
- Revenue data contained in this presentation was compiled by the Office of Revenue Analysis from state government sources rather than the U.S. Census Bureau.
- The nominal revenue data was converted to real terms using the CPI-U for the Boston region as provided by Moody's Analytics.

Background

- The coincident indicator for Rhode Island was downloaded from the Philadelphia Fed's website and used as the measure of Rhode Island economic activity.
- Due to data access limitations, the period covered by the analysis is generally from 1994:Q3 through 2013:Q2. Quarterly data is used to the greatest extent possible.
- The charts in the presentation look at year-over-year growth rates in revenues, sources of income and the Rhode Island coincident index. To the extent possible adjustments have been made to the data to account for anomalies in the data.

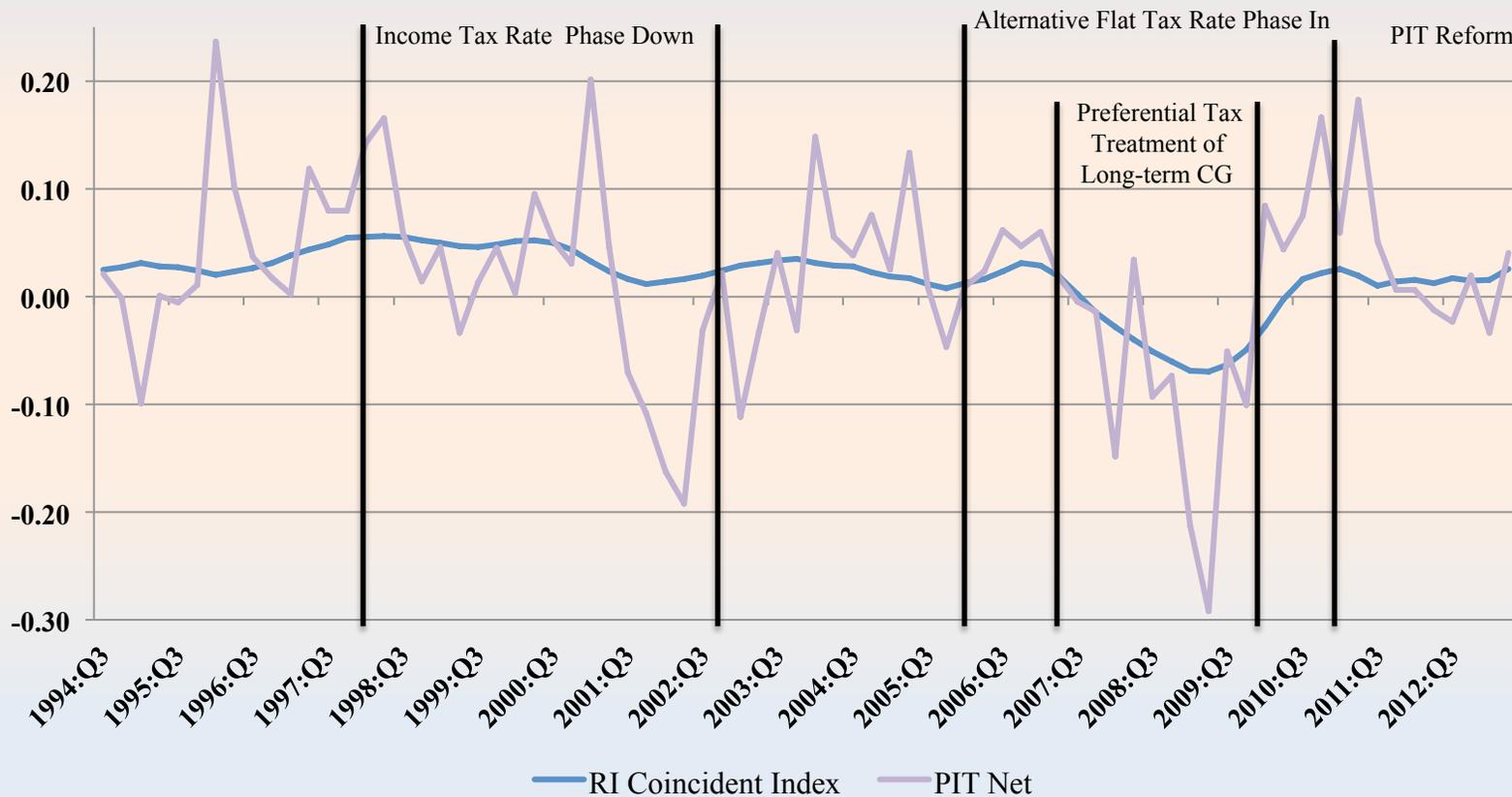
Total Taxes and RI Economic Conditions

Rhode Island's total tax revenues appear to be getting less volatile from the 1990s to the 2000s.



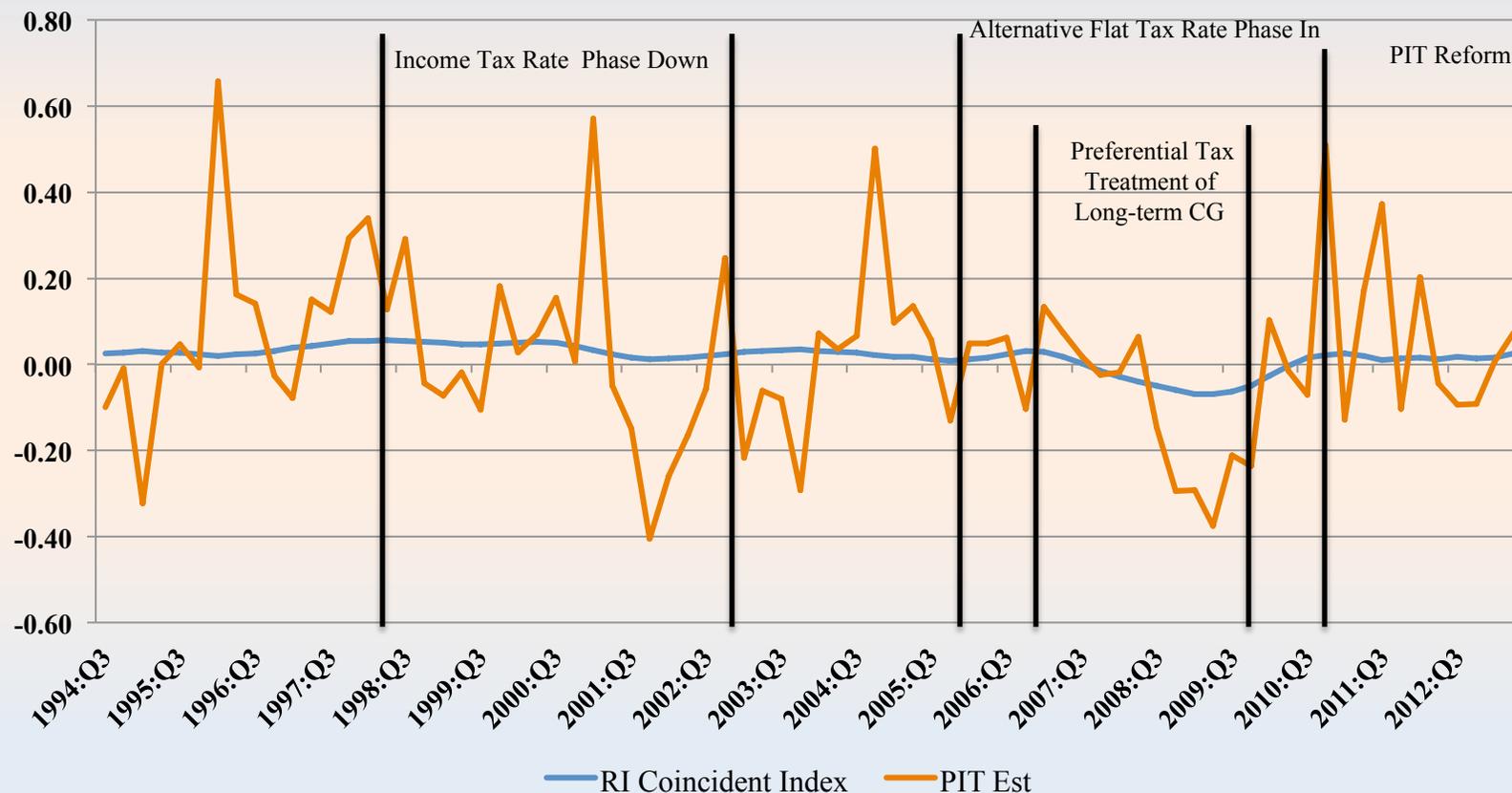
Sources of Tax Volatility: PIT

Rhode Island's personal income tax (PIT) has been consistently volatile over the time horizon.



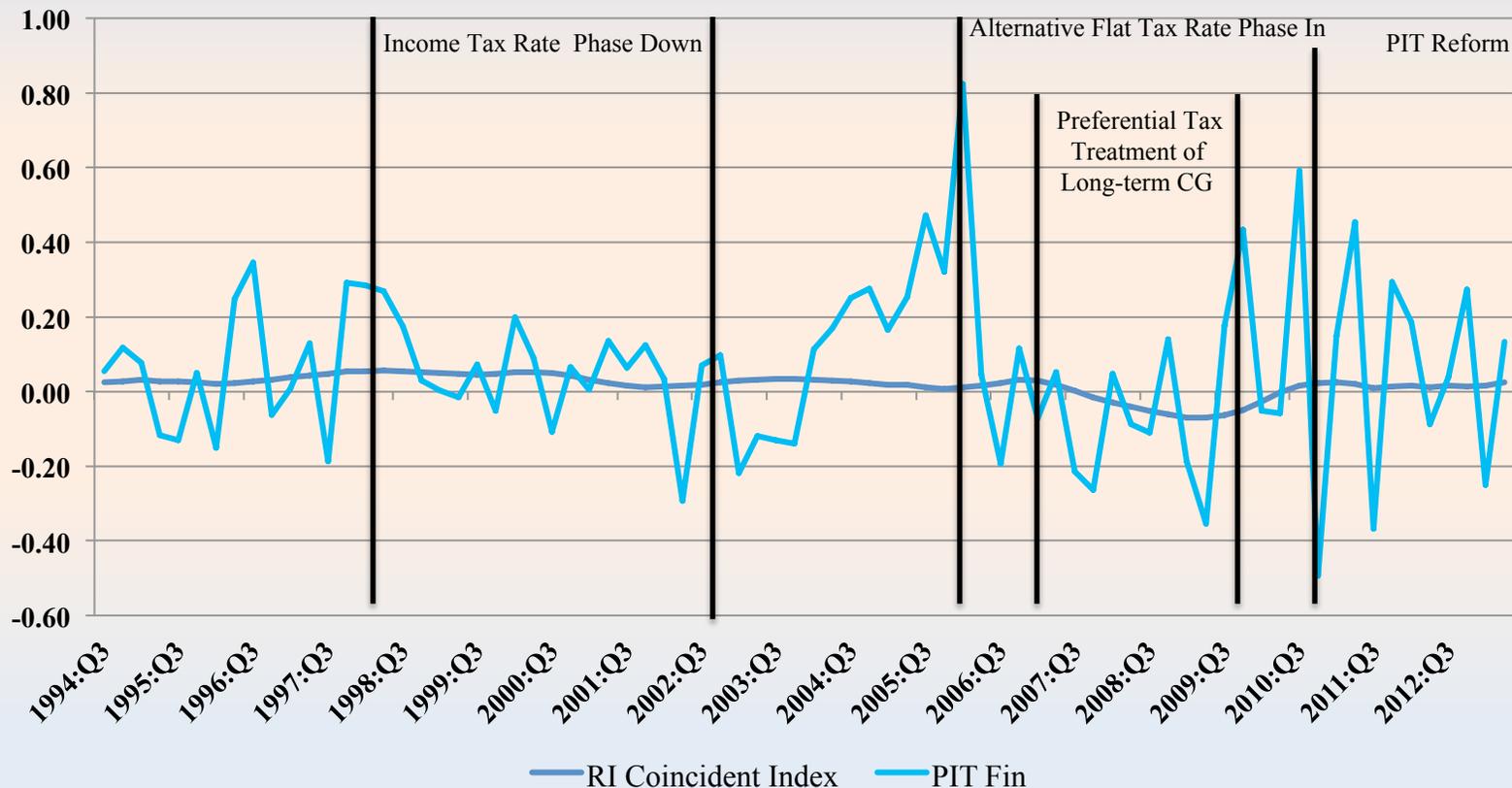
PIT Components: Estimated Payments

Rhode Island estimated personal income tax payments have been very volatile regardless of state economic conditions.



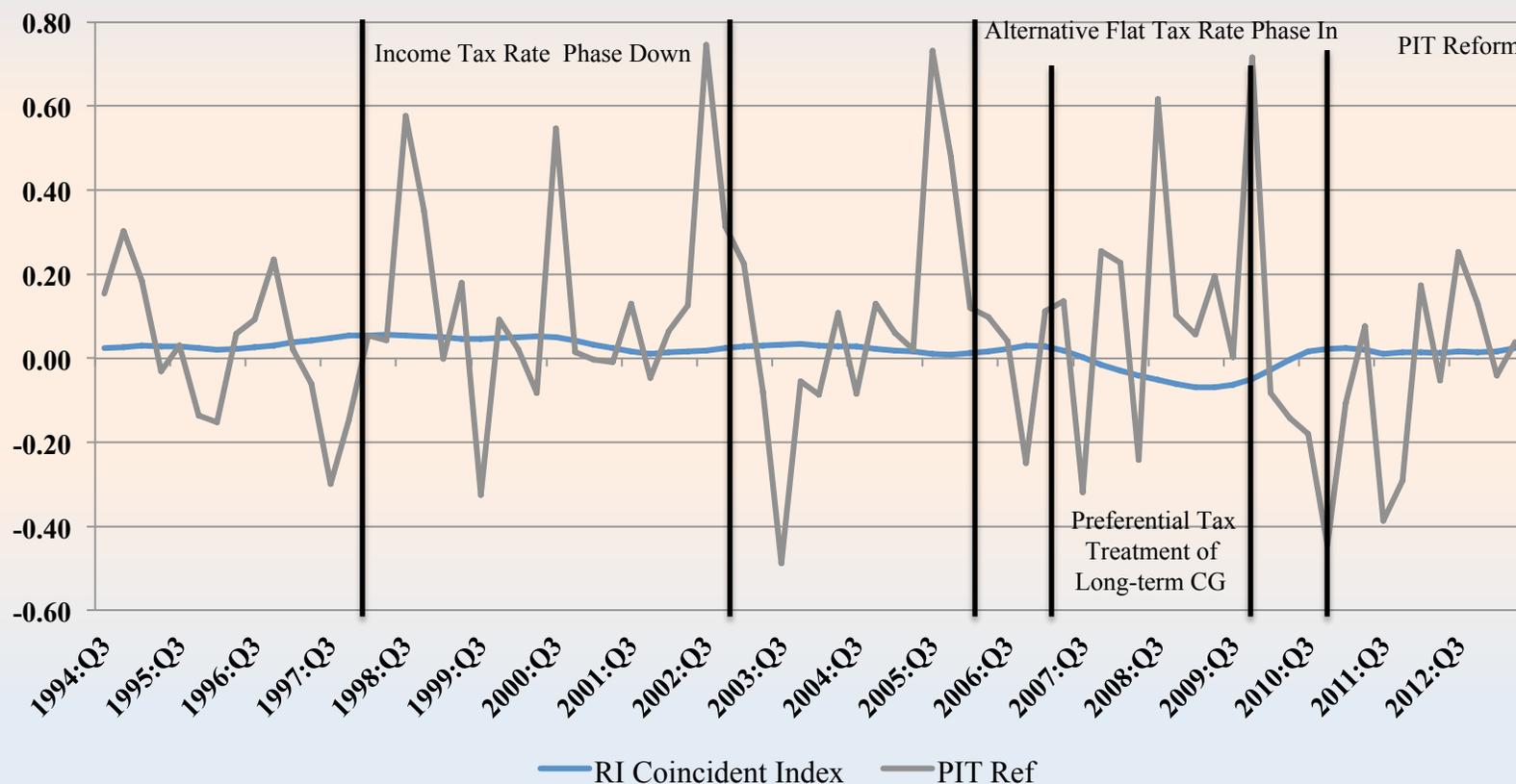
PIT Components: Final Payments

Rhode Island personal income tax final payments have become more volatile over time especially after 2008.



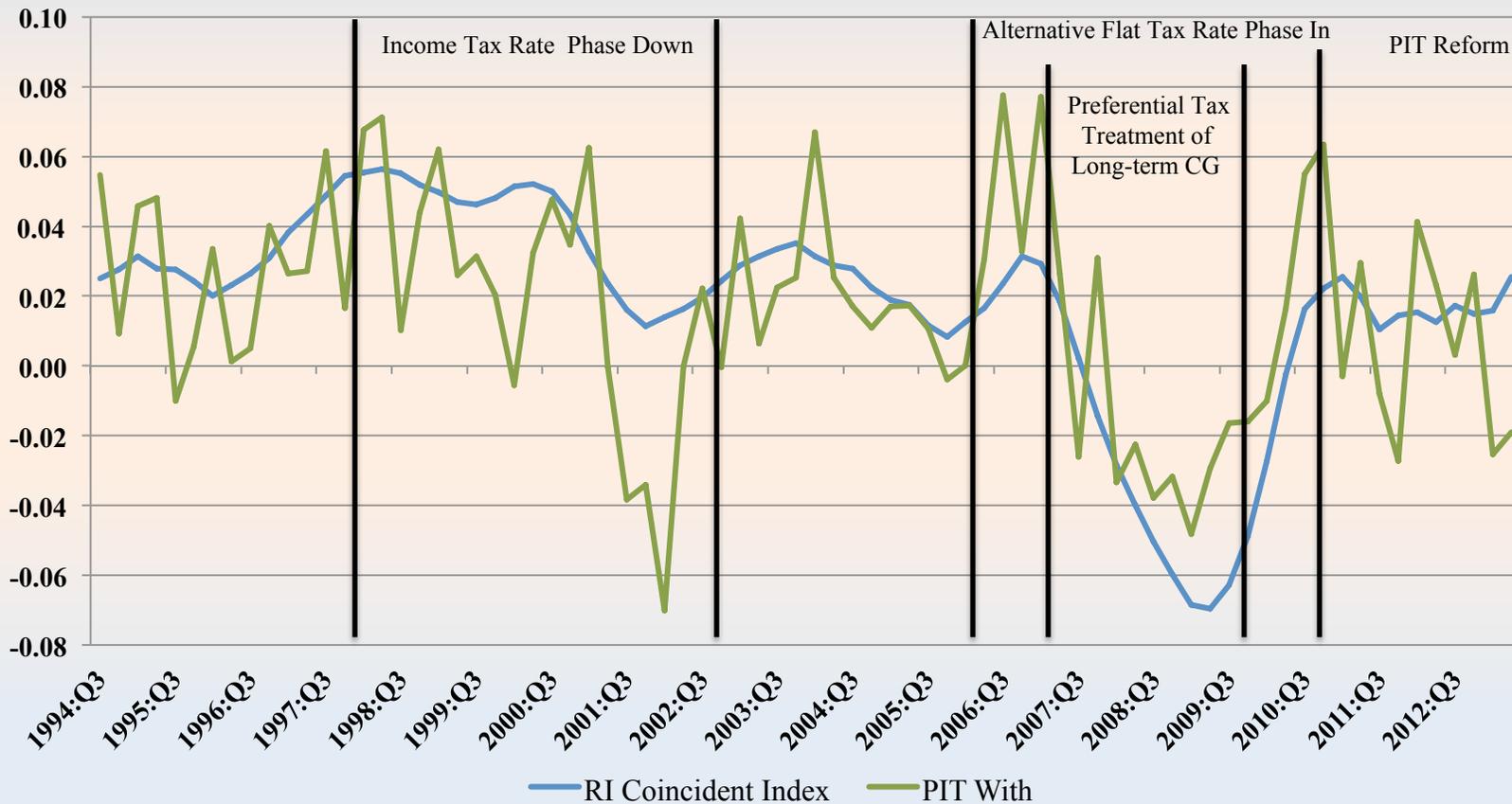
PIT Components: Refunds

Rhode Island personal income tax refunds have shown consistent and large volatility but appear to be less volatile recently.



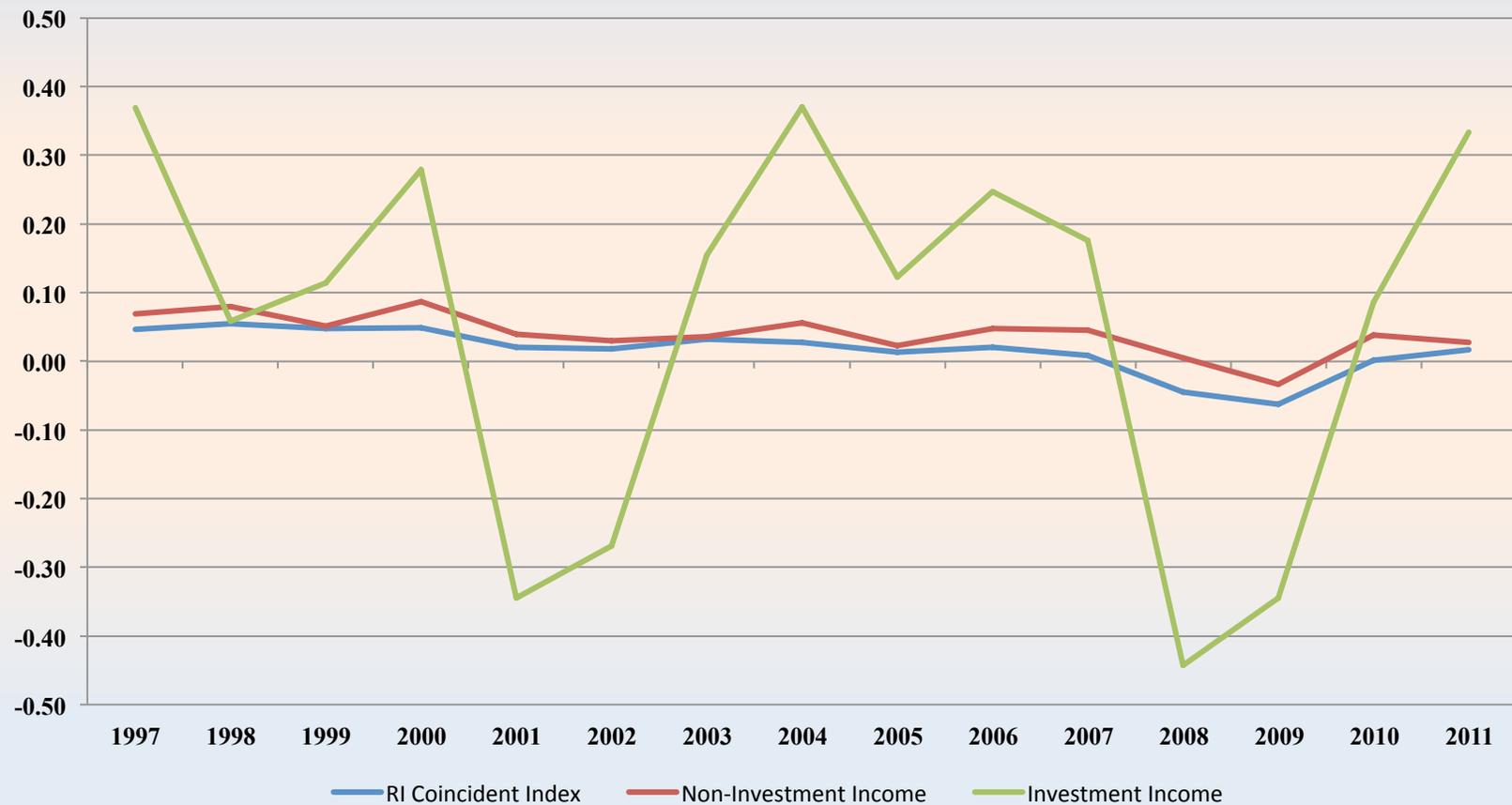
PIT Components: Withholding

RI personal income withholding tax payments follow the state's economic conditions closely but are surprisingly volatile.



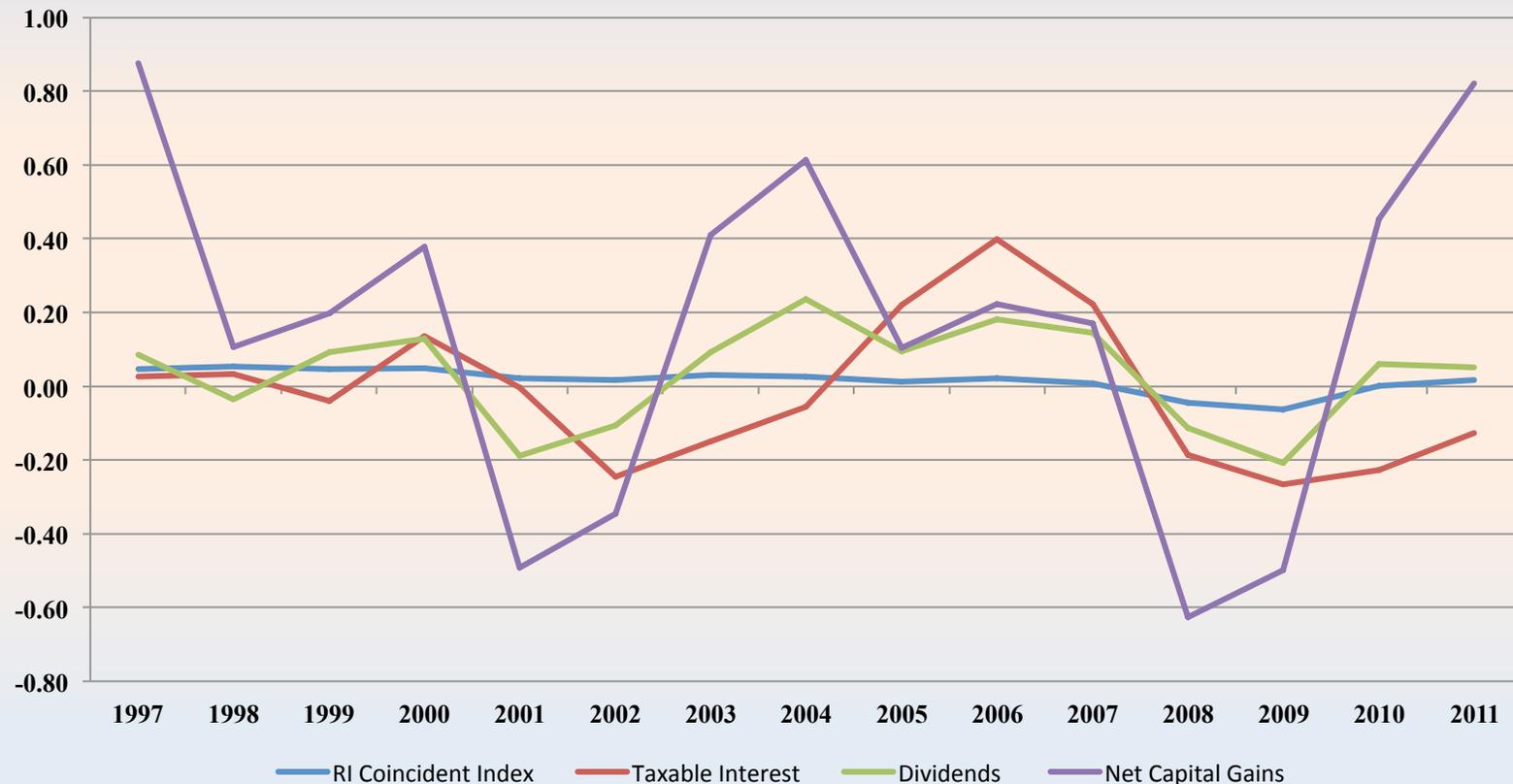
Dynamics of Taxable Income

Non-investment income has moved in accord with RI's economic conditions but investment income has shown wide swings.



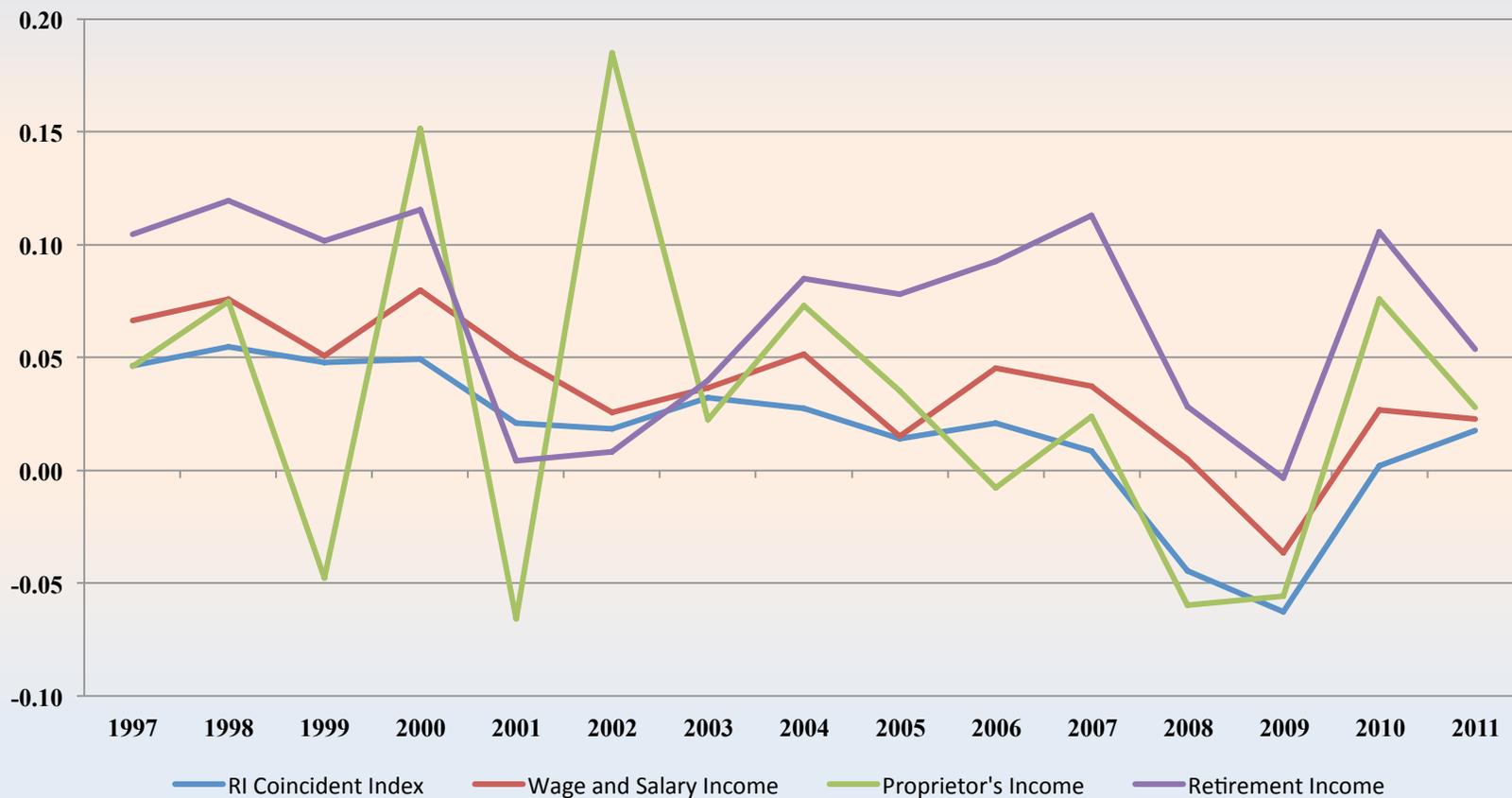
Components of Investment Income

Investment income volatility is not only due to net capital gains as both taxable interest and dividends have had large swings.



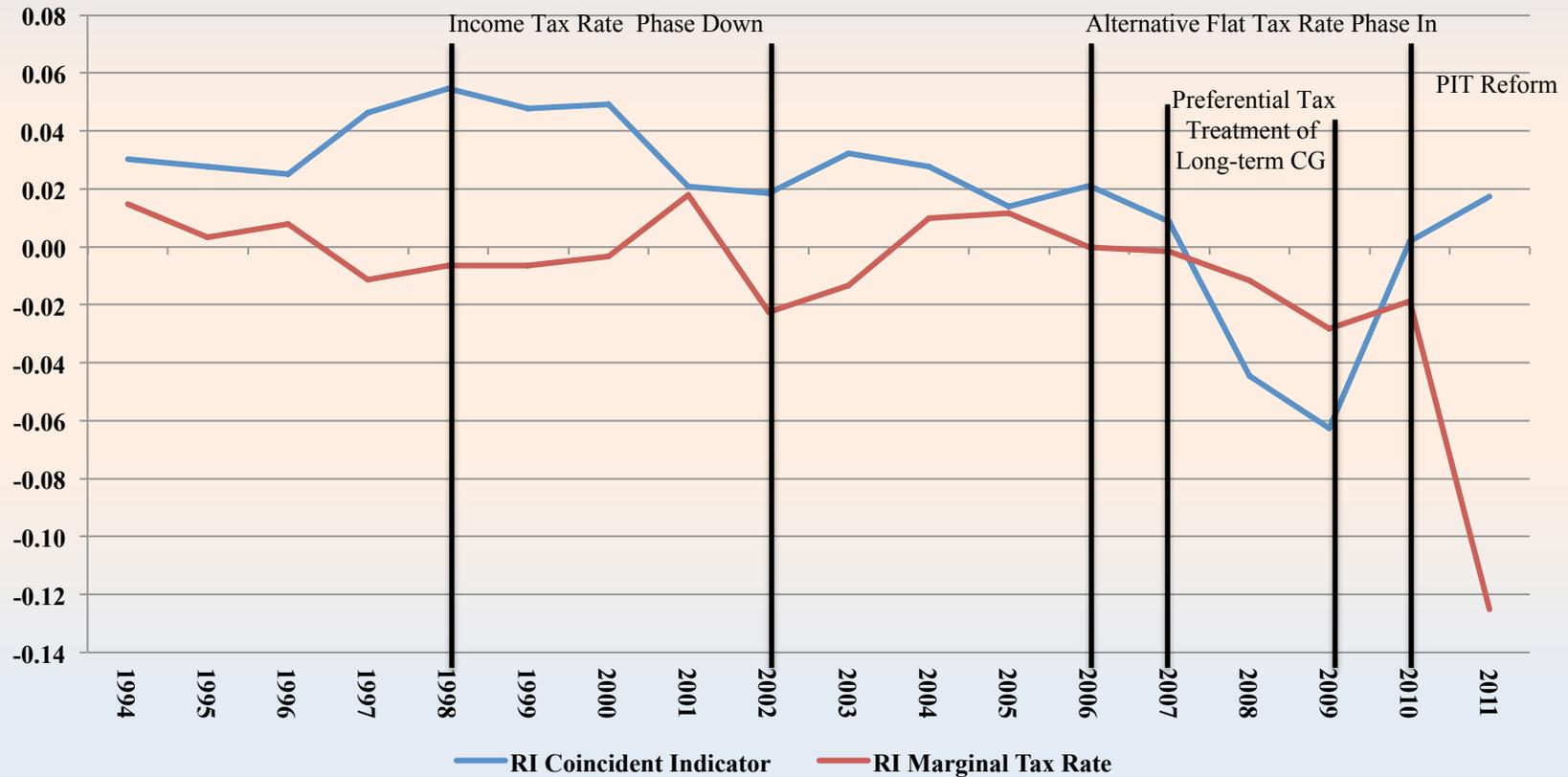
Components of Non-Investment Income

Wage and salary income tracks RI's economic conditions closely but proprietor's income and retirement income are more volatile.



RI Personal Income Tax Policy

RI personal income tax policy has seen tax rate changes preceding opposite changes in the state's economic conditions.



Sources of Tax Volatility: SUT

Rhode Island's sales and use tax (SUT) has tended to follow the state's business cycle but generally underperformed it.



Adjusting to the Volatility of Revenues

McGranahan and Mattoon suggest four ways that state policymakers can adjust to revenue volatility:

1. Adjust revenue policy
2. Rely on the federal government for aid
3. Adjust expenditures
4. Manage state assets to offset volatile revenue streams

Adjusting to the Volatility of Revenues

How has Rhode Island performed on these benchmarks?

1. Adjust revenue policy

- Enacted a personal income tax reform that
 - a. Lowered marginal tax rates
 - b. Taxed all income as ordinary income
 - c. Eliminated the use of itemized deductions
 - d. Reduced the number of credits that could be used against personal income tax
- Expanded the sales tax base to exempt items
 - a. Over-the-counter drugs
 - b. Software downloaded digitally
 - c. Road transportation services
 - d. Pet care services

Adjusting to the Volatility of Revenues

How has Rhode Island performed on these benchmarks?

2. Rely on federal government for aid
 - YES!
 - Used federal largesse in FY 2002 in the form of \$50.0 million in expenditure credits and \$50.0 million in cost share changes in the Federal Medical Assistance Percentages (FMAP)
 - Used ARRA education monies in FY 2009 to supplant state education aid payments and cost share changes in the FMAP

Adjusting to the Volatility of Revenues

How has Rhode Island performed on these benchmarks?

3. Adjust expenditures

- In FY 2009 eliminated the reimbursement of foregone local property tax revenue from the exemption value of motor vehicles
- Passed constitutional amendment that reduced the percentage of estimated general revenues that can be budgeted from 98.0 percent to 97.0 percent increasing the budget reserve fund
- In 2011 passed the Treasurer's Rhode Island Retirement Security Act which reduced the unfunded state pension liability by \$3.0 billion

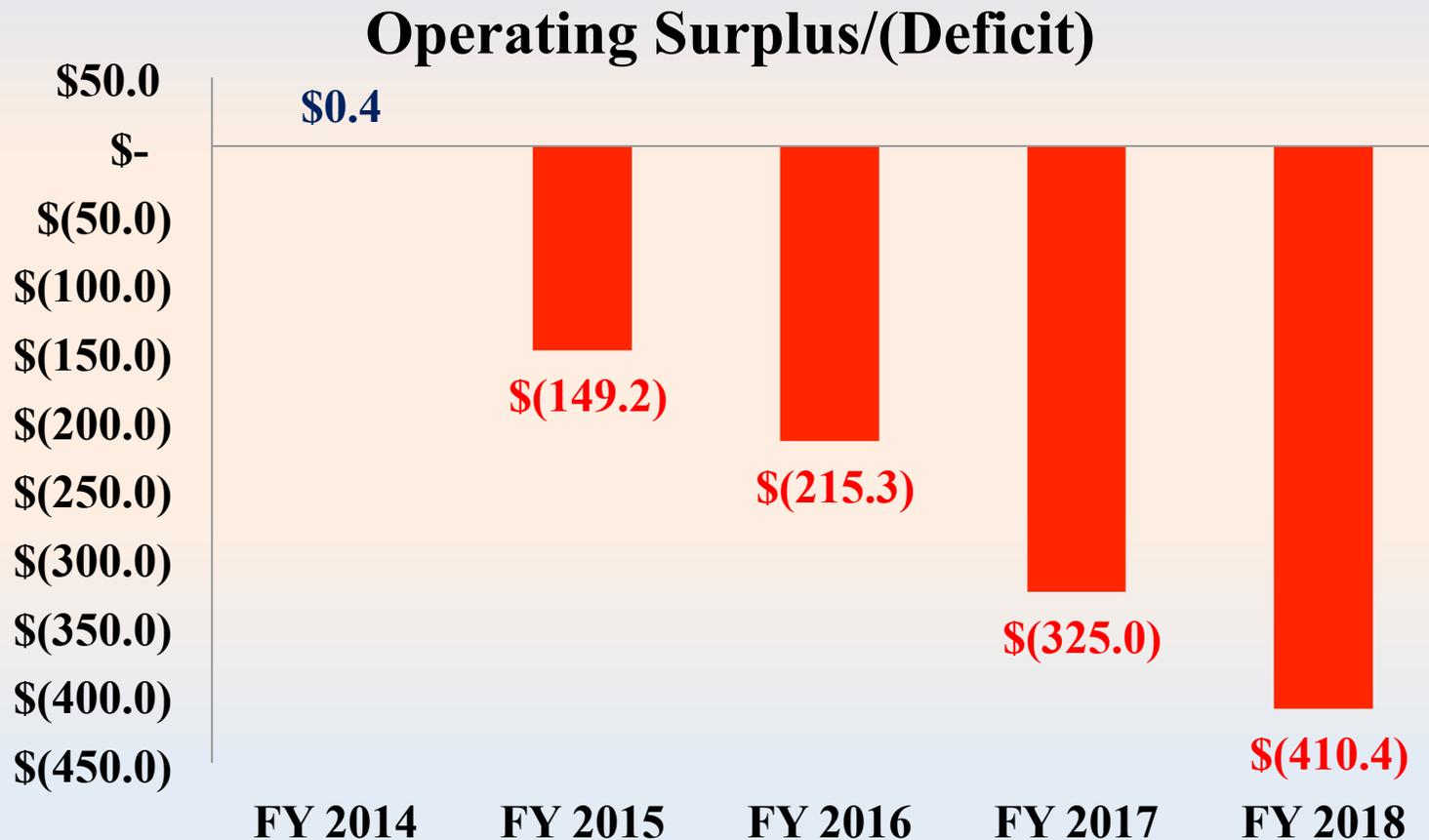
Adjusting to the Volatility of Revenues

How has Rhode Island performed on these benchmarks?

4. Manage state assets to offset volatile revenue streams
 - In FY 2002 and FY 2003, the State used \$353.8 million of MSA payments (annual and securitized)
 - In FY 2001 through FY 2013, the State has used \$95.0 million of “scooped” excess reserves from quasi-government agencies
 - In FY 2007 and FY 2008, the State used \$166.5 million of securitized MSA payments
 - Expanded gaming at state operated facilities

Effectiveness of RI's Adjustments

So how has Rhode Island's response to revenue volatility worked out? You be the judge.....



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Thank You