Changing Dynamics and Major State Revenue Trends: Discussion

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Any views or opinions I express are mine alone and do not necessarily represent the official view or opinion of the U.S. Department of the Treasury.

What are the Trends in State Revenue?

The major trend appears to be constancy.

Trends in State and Local Tax Receipts

	2000	2005	2013
Tax Receipts ($billion)	904	1191.1	1489.5
Share of GDP	8.7%	8.9%	8.8%
Receipt Shares			
Personal Income Taxes	24.0%	21.1%	23.0%
Sales Taxes	35.0%	33.8%	33.6%
Property Taxes	28.2%	29.5%	30.0%
Corporate Taxes	3.9%	4.6%	3.7%
Contributions to Social Insurance	1.2%	2.1%	1.2%

Source: NIPA Table 3.3 State and Local Government Current Receipts and Expenditures

Motor Fuels Taxes

Why tax motor fuels?

- General revenue
- Fund transportation infrastructure
- Correct externalities
  - Pollution
  - Congestion
  - Accidents

Motor Fuels Taxes (continued)

Current challenges.

- Erosion of the tax rate due to inflation (per-unit taxes).
  - Solution: Index for inflation, periodically raise the tax rate.
- Erosion of the tax base due to
  - Alternative fuels (LNG, electricity)
  - Increase MPG
  - Reduced driving
    - Residential location patterns (millennials returning to cities)
  - Solutions: broaden the tax base, raise the tax rate
- Raising the rate to fully account for externalities
  - $1/gallon increase in the federal tax on gasoline (from 18.4 cents/gallon, unchanged since 1993; US average is 50 cents/gallon). Would raise lots of revenue.

Motor Fuels Taxes (continued)

Vehicle miles tax

- Tax based on miles a vehicle is driven.
- Good tax base for funding transportation infrastructure
  - Vary rate by type of vehicle to account for different wear and tear on roads.
- Ok tax base for congestion.
  - Vary rate by location of vehicle (e.g., registration address).
  - More ambitious plans (e.g., using GPS to get peak road use) raise privacy concerns.
- Ok tax base for pollution.
  - Vary rate by mpg of vehicle.
- Could replace or augment existing gas taxes.
- Privacy concerns lessened if measure only annual mileage, e.g., at annual safety inspection.

Motor Fuels Taxes (continued)

Increase in federal gasoline tax to fund infrastructure?

- Concern to states because of potential to reduce demand.
  - Not a big worry because elasticity appears low.
- Need an increase of about 12 cents/gallon + indexing to make the federal highway trust fund solvent over the next ten years.
- No such increase appears likely. Look at what has been proposed and done in DC.
  - Proposed gas tax increase, but spent twice – once on transportation and again on business tax extenders.
  - Proposed repatriation holiday, but that actually loses revenue.
  - Proposed ad valorem tax collected upstream from the pump, to hide the tax, but the point o collection already is at the terminal rack and no federal tax is itemized at the pump.
  - Enacted pension smoothing (use average historical interest rates to raise earnings and lower current pension contributions). Raises tax revenue now, but reduces it later. Twice.

Corporate Income Taxes

Federal tax changes important for states.

- Many states piggy-back on the federal tax base.

Lot of DC discussion of federal corporate/business tax reform.

- Three similar proposals: President's Framework, Camp (HWM), SFC.
  - Broaden base (mainly by slowing depreciation).
  - Lower the tax rate.
  - Revenue neutral (by some measure).
- Base broadening would tend to raise state corporate taxes (all else equal).
- Federal rate change would have little effect on state taxes.

No serious legislative action. No bills introduced and voted on.

Future prospects: Open question.

Corporate Income Taxes (continued)

Corporate/business cash flow tax.

- Alternative approach to corporate/business tax reform.
- Lot of academic interest, less interest among DC types.
- Expense capital purchases (no depreciation of new investment).
- Include all domestic debt flows (or disallow the deduction for interest paid).
- Convert the federal income tax to a consumption tax plus a personal level tax on capital income (the cash flow tax would be on consumption not funded by wages).
- Major change in the tax base, raises concerns for states that piggy-back.

Corporate Income Taxes (continued)

Business extenders

- About $45 billion/year in federal tax provisions have expired (55 provisions). Most are business provisions.
  - R&E credit.
  - Small business expensing limits.
- Talk of making bonus depreciation permanent (about $30 billion/year over the ten-year budget window).
- Many of these affect state tax bases.
- Prospects for extension.
  - Nothing until after the election (Congress is on recess).
  - My guess is that most will be extended by the end of the year. Bonus depreciation seems to me to be a longer shot.

April "Surprise": 2014 Edition

Two meanings for the term "surprise" in press reports.

- Income tax payments less than last year.
  - "Surprise" is not really the right term for this. Disappointment would be better.
- Income tax payments less than forecast/anticipated for this year.
  - "Surprise" is the right term for this.

US Treasury had no personal income tax "surprises" under either definition.

April "Surprise" (continued)

Why did national forecasts do better this time than state forecasts?

- Many states had no surprise, so Treasury did not do better than those states.
- Less variation in national income flows than in regional income flows (?).
  - National forecasts might be easier to get right.
- Treasury receipts forecasts made later than state forecasts (?).
  - Treasury receipts forecast made in January of 2014. Allowed use of recent data.
- Treasury has better data (?).
  - National data might be available sooner and might be less variable than is regional economic data.
- Treasury models might be better (?).
- Luck (no question mark here).