

CENTER FOR CONTINUING STUDY OF THE CALIFORNIA ECONOMY

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TO: Commission on the 21st Century (COTCE) Members and Staff

FROM: Stephen Levy

SUBJECT: A Common Set of Evaluation Criteria for Components of a Revenue Neutral Tax Reform Package

This memo builds on CCSCE's memo dated June 30, 2009 *Considerations in Evaluating Tax Reform Packages* and on the discussion at the July 16, 2009 COTCE meeting. On July 16 the commission agreed to evaluate a number of new tax reform components introduced in the Commission's expanded July Plan.

The evaluation demands on staff will be considerable given these new alternatives and the need for the evaluations to be timely and transparent. All parties to the COTCE discussions and especially the Legislature, which has been asked to consider the COTCE recommendations in September, will benefit from a comprehensive and timely set of evaluations and commission discussion.

Ideas for a Common Set of Evaluation Criteria

There are criteria that are relatively easy to quantify or "score" using the CBO language for evaluating tax proposals. There are also criteria that have been important in commission discussions but are harder to quantify.

Quantifiable Criteria

All parties agree that the progressivity (relative burden by income group) of each tax is important.

All parties agree that volatility is important but the commission has not decided whether to treat volatility by revenue reforms or by spending reforms (rainy day fund) or by some combination of both. So for the next round of analysis a common measure of volatility for each tax will be helpful.

All parties agree that a forecast of the growth rate for each tax is important. A forecast of revenue growth for each measure is essential for being able to develop packages of reforms that are revenue neutral. I suggest “impact on local tax revenues” as a new quantitative criterion. Discussions by California Forward and others suggest that state and local revenue and reform issues are related. Moreover, the consideration of expanding the sales tax base, the net business receipts tax, and the more frequent reassessment of non-residential property will have an impact on local government revenues. Reports and testimony presented to the commission have stressed the current and future local government revenue challenges and the relationship of these challenges to state tax reform.

Partly Quantifiable Criteria

All parties agree that simplicity and reduction of administrative burdens are one component of evaluating tax reform proposals.

I suggest “impact on transportation funding” as a new but reasonably quantifiable and important criterion. The carbon tax and sales/net receipts tax reforms could affect both transit district funding and overall transportation funding depending on choices made by the commission. The long-run declining growth rate in current transportation funding sources has been identified by the Legislative Analyst’s Office and others as a 21st century revenue problem in need of reform.

More Difficult to Quantify Criteria

The criteria slide from the last commission meeting begins with “Economic Growth”, which means the impact on jobs and investment. Part of the motivation for the tax packages considered so far by the commission was to increase incentives for businesses to locate and expand in California.

The linkages between taxes and incentives are often controversial in how they play out quantitatively in the real world even when there is agreement in theory. Moreover people have different ideas of what the focus of California’s competitiveness strategies should be. But all parties agree that the impact of tax reform proposals on economic growth is an important criterion.

Presenting Information for each Component Before They are Put into Tax Reform Packages

The quantitative information for the previous tax packages considered by the commission was developed for the packages as a whole except for the progressivity information on the personal income tax. I have seen the July plan memos from Chairman Parsky

<http://www.cotce.ca.gov/documents/correspondence/>

and do not know if the intent is to evaluate and discuss the July plan as a total package. These are considerations for the commission members.

Speaking for myself and a number of outside observers whose views I know, it will be difficult if not impossible to evaluate the July plan reforms unless evaluation information is prepared and presented in advance for each component. For example, what are the growth and progressivity implications of the BNRT, whatever income tax structure is proposed, the split roll proposal, whatever carbon tax is proposed and the expanded sales tax alternative to the BNRT? I do not see how commission members or other interested parties can evaluate implications or possible alternative if staff only presents results for all of these reforms combined into one or two packages.

Underlying Economic Assumptions

My understanding is that staff has used economic growth forecasts from the Department of Finance for such variables as personal income, taxable sales, and corporate profits. My experience has been that the DOF forecasts are reasonable. But additional economic assumptions about the future will be required to complete the evaluation of the additional tax reform alternatives included in the July plan. And it would be helpful to members and outside reviewers if these underlying assumptions and whatever is used for the net receipts tax or base broadening in the sales tax are posted on the website.

Length of Period for Assessing Revenue Neutrality

All parties agree that revenue neutrality is a concept that applies over time. A tax package can be revenue neutral compared to the existing tax system in the first year but if the components grow at different rates, revenue neutrality can disappear quickly. I have three recommendations.

One, use a time period that extends beyond 2016. A ten-year comparison is reasonable.

Two, publish data for tax revenues by component for each year including, where available, historical data on current taxes by type.

Three, use a variety of time periods for evaluation. This will allow all users to feel comfortable that the revenue neutrality results are robust and not influenced by a particular set of beginning and ending years.

Workshops

I note the agreement to have special workshops for the BNRT since it is new and complicated. Is it possible in addition to have a separate workshop on the split roll, carbon tax and expanded sales tax base so that members, outside

interested parties get a chance to see and discuss staff's evaluation measures for these potential reforms before the rush and pressure of the September meetings and the Legislature's follow up?