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The Problems with Asymmetric Information

Getting To The Real Bottom Of The Sales Tax Fracas

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Asymmetric information and economic malpractice consistently go hand in hand throughout Wawarsing and Ulster County in general. Whether it is the 18% unemployment rate in Wawarsing based on social services data, the unknown details of the capital budgeting decision methods and project labor agreements signed by the Nevele, or the elevated levels of ground water contamination in the DEP leak buyout zone (*per* **USGS Scientific Investigations Report 2012-5144**), the government and the oligarchs consistently withhold information that if made available, could alter the decision-making of the people.

An effective way of coping with asymmetric information and economic malpractice is by revealing information in an attempt to improve such unsatisfactory conditions. Economic stories tend to have a long shelf life due to the lagging indicators associated with them. The three stories I mentioned are all ongoing to one degree or another, while a fourth story some may remember as a closed case, is quickly resurrected by the revelation of information.

On March 13, 2014 the Ulster County Executive issued a press release concerning sales tax receipts Ulster County received from New York State for the period of December 2013 and January 2014. During this period the Ulster County sales tax was reduced from 8% to 7%. The additional 1% was reinstated February 1, 2014. The press release stated that the loss of revenue during this two month period "is $5.4 million compared to the same period the year before". The press release identifies the loss of the 1% sales tax during the December 2013 - January 2014 timeframe and the actions of Assemblyman Cahill as the primary causes of the sales tax revenue reduction.

This press release was the equivalent of spiking the football in the end zone and celebrating because the reduced sales tax revenue number of $5.4 million exceeded the loss of $1.9 million per month projected by county officials. Essentially the March 13th press release had the tone of, the damage is worse than expected and the Assemblyman is to blame. The first problem is, there are absolutely fatal laws with the economic reasoning that underlies the $1.9 million per month reduction in revenue projection, as well as the year over year reduction of $5.4 million. The second problem is the actual numbers themselves.

In order to quantify the potential loss of sales tax revenue from a 1% reduction in the sales tax rate, everything else had to be held constant. The forecasts and projections of the county "losing" $1 million every two weeks and $1.9 million every month the sales tax rate was reduced from 8% to 7%, did not take into account the rate of economic exchange in Ulster County and the rate of economic exchange in the State of New York during the time period. If you are attempting to quantify the potential loss of revenue during a given time period, economic exchange variables have to remain constant or be based on past data with slight modifications.

A perfect example is the $5.4 million number. Ulster County sales tax revenue was $5.4 million less in December 2013 – January 2014 at the 7% rate, than it was in December 2012 – January 2013 at the 8% rate. In the spirit of *Ceteris Paribus* (holding other things constant) the correlation between the lower sales tax rate and the lower sales tax revenue during the December 2013 – January 2014 timeframe must be evidence of causation! As reported in *The Freeman* on March 13th "County sales tax receipts for this past December and January totaled $13.33 million, Hein said. That's down more than 28 percent from the $18.69 million in receipts for the December 2012-January 2013 period. Hein attributed Ulster's setback to the county's Dec. 1 loss of its authority to levy an extra 1 percent sales tax that had been in place since 2002".

Not so fast. A Local Government Snapshot on the subject of local sales tax collections was released by the NYS Comptroller's Office in February 2014. "Year-over-year growth in county sales tax collections was much slower in the fourth quarter of 2013 than it was in the first three quarters. In fact, the fourth quarter marked the weakest period of growth since the first quarter of 2010, when the State was just emerging from the recession". According to the February 2014 report statewide county sales tax collections were down -3.2% in December 2013. Despite Ulster County's 7% tax rate in December 2013 and the -3.2% county sales tax collections statewide, Ulster County enjoyed an increase in sales tax collections from 2012 to 2013 of less than 3% according to the report.

The January 23, 2014 edition of *Shawangunk Journal* reports the Ulster County Commissioner of Finance estimated the 7% sales tax rate "costing" the county $990,000 in revenue. The $990,000 number is misleading because there is a two month lag between the sales tax revenue the county receives and what period it is from. If the $990,000 number is exactly accurate for the period of December 1, 2013 through the week of January 23, 2014, then the projected - $1.9 million a month number was wildly inaccurate given the passage of almost eight weeks at the 7% rate.

Unfortunately the math continues to deteriorate. In the same very short article on page 5 of *The Journal* from January 23, 2014 the county's revenue is reported to have fallen 6% in the fourth quarter of 2013 or $1.7 million. Again, questions of the two month lag come into play, but given the Comptroller's report in February that indicates state wide county sales tax growth (excluding NYC) of 4% in October, and 6% November, it may be possible to sustain a $1.7 million loss during the fourth quarter of 2013 and be down $990,000 toward the end of January.

The NYS Comptroller released another Local Government Snapshot on the subject of county sales tax collections in July 2014. The July Snapshot says "Ulster County had a decline in sales tax collections of 5.7 percent in the first six months of 2014. This decline was due to a delay of the regularly scheduled renewal of an additional 1 percent increment in the sales tax rate, causing the County's rate to drop from 4 to 3 percent from December 1, 2013 to February 1, 2014 – at which point the additional 1 percent rate renewal became effective".

This may sound like an official end to the story, but it isn't even close. Why would Ulster County's sales tax revenue decline 5.7% in the first six months of 2014 due to a two month decrease of 1% in the sales tax rate in December and January? From January – June 2013 Ulster County collected $50,179,243 in sales tax, and from January – June 2014 Ulster County collected $47,302,526. That year over year difference is $2,876,717.

Let's add it up. Let's add nine months, the fourth quarter of 2013 in which Ulster County "lost" $1.7 million in sales tax revenue and add it to the $2,876,717 it "lost" in sales tax revenue during January-June 2014. Sales tax revenue "losses" for the period October 2013 – June 2014 equal $4,576,717 million.

From the County Executives March 13th press release: "The County received sales tax receipts from New York State reflecting significant losses for the months of December 2013 and January 2014. Those are the months during which the County became the only county in the State of New York to lose a portion (1%) of its 20 year sales tax authority. The loss is $5.4 million compared to the same period a year before. Furthermore, the negative financial impact of the "Cahill Crisis" is actually worse than was originally feared".

Where does this $5.4 million number come from and how is it in anyway related to the 7% sales tax rate in Ulster County from December 1, 2013 – January 31, 2014? If county collections of sales tax were -3.2% statewide in December 2013 and Ulster County was -6% or -$1.7 million in sales tax revenue for the fourth quarter of 2013 which would include the month of December, how do you get to a loss of $5.4 million over two months when the first six months of 2014 have you down $2.8 million? $2.8 million divided by 6 (for the first six months of 2014) equals $466,666. If we take $466,000 as an estimate of what was "lost" in January due to the 7% rate and add it to the $1.7 million "lost" in the entire fourth quarter of 2013, and then add in the $990,000 estimate of revenue lost revenue given by the Commissioner of Finance toward the end of January this sum equals $3,156,666.

Even if "the loss is $5.4 million compared to the same period a year before" how much of that "loss" is due to the 7% rate and how much is due to constantly fluctuating levels of economic exchange? Are we to believe economic activity from the previous year was held perfectly constant and continued through the duration of the 7% rate in order for its impact to be quantified?

Whose numbers are inaccurate? Are the numbers the Ulster County Commissioner of Finance reported to *The Journal* inaccurate ($1.7 million and $990,000)? Are the numbers the County Executive provided in his press release inaccurate ($5.4 million)? Are the numbers from the Comptroller's report inaccurate ($2,876,717)? *The Freeman* reported on March 13th "Cahill also said Hein's math was "fuzzy." The assemblyman said information from the state Department of Taxation and Finance showed Ulster County received about $10 million in December and $5.8 million in January, for a total of $15.8 million".

If we take the Assemblyman's number of $15.8 million instead of the County Executive's number of $13.33 million and subtract $15.8 million from the prior year's number of $18.69 million we end up with a difference of $2,890,000.

Why are there four sources of numbers on this subject that do not add up? We have numbers from the County Executive, numbers from the Commissioner of Finance, numbers from the NYS Comptroller's Office, and numbers an Assemblyman provided from the NYS Department of Taxation and Finance, and none of them add up!

It is clear the projections from Ulster County of "losing" $1 million every two weeks and losing $1.9 million every month the 7% sales tax rate was in effect were inaccurate. If the $5.4 million number is valid, the $1.9 million per month projection was off by $1.6 million. If the $990,000 number is valid the "loss "of $1 million every two weeks projection was off in the neighborhood of $3 million given the eight week time period from December 1, 2013 to January 23, 2014.

For the sake of icing this asymmetric information and economic malpractice swirl cake, a story in the May 12, 2014 edition of *The Freeman* titled "New York state auditors find Ulster County budgets 'reasonable'" actually ran. Ulster County budgets were audited from 2008-2013. An accounting audit may have found the budgets reasonable, but if these budgets faced an audit of basic economic principles the results would be absolutely unsatisfactory.

Budgets and taxes are the basic foundation of public goods and services. Budgets and taxes are fundamentally economic in nature. A budget is an allocation of scarce resources and is therefore economic. Increases and decreases in tax rates are economic due to the elasticity in price, cost, and value that are subject to be changed by the tax rate. When the county budget is manufactured in the outdated departmental line item fashion and released in the form of a 500+ page flipbook, two things occur simultaneously. The first is that the accessibility of the information decreases. The second is that the provider of the information increases their political leverage.

As the new budgeting season approaches the people of Ulster County ought to demand better. To reduce the use of asymmetric information for the purposes of committing economic malpractice several changes are necessary.

First, is the identification of all state mandates the county is required to pay for and the identification of the amount the county is required to pay.

Second, is the development of performance measurement and outcome based budgeting. The establishment of performance measurement will serve as a basis to evaluate all of the departments and programs the county has under its control. These departments and programs can then be funded in accordance with what is necessary to fulfill their missions and goals based on outcomes.

If the State requires county budgets to be in the outdated departmental line item format, the county should go ahead and comply while also producing an outcome based budget rooted in performance measurement on an Excel Spreadsheet accessible on the county website.

It is obvious part time legislators are not going to be interested in fighting trench warfare over a line item departmental budget with the elected County Executive and full time professional public administrators in the Departments of Budget and Finance. So they shouldn't. The County Legislature should establish the system of performance measurement and outcome based budgeting. This can be done through the committees that oversee the various departments and programs the county actually has control over. The committees, department heads, and program managers ought to be able to establish performance measurement and outcome based budgeting.

Third, is the application of basic economic principles to the county budget. I'm not confident that anyone in a leadership position in Ulster County can accurately describe the differences between economic development and economic growth. I'm not confident that the leadership of Ulster County can identify the behavioral responses households and firms make in reaction to elasticity in property and sales tax rates. I'm not confident the leadership of Ulster County understands how improvements to the rules of the game can lead to increases in capital stock, increases in resource availability, and increases in technological innovation that are prerequisites for economic growth.