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FORECASTING THE REVENUE IMPACT OF TAX CUTS

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You asked whether any states, when forecasting the revenue impact of tax reductions, consider potential revenue increases that could result from the cuts. Forecasts that include such considerations use so-called “dynamic scoring” methods because they take account of changes in people’s behavior and the broader economy that tax changes produce.

According to a June 2012 journal article on this topic, 36 states use dynamic revenue estimating models in preparing fiscal notes on proposed tax changes, at least some of the time. The article, which is based on a survey of all 50 states, provides an overview of how states estimate the revenue effects of proposed tax changes and how the estimates are incorporated into the legislative process (Mikesell, John L., [“Revenue Estimating/Scoring by States: An Overview of Experience and Current Practices with Particular Attention to the Role of Dynamic Models,”](#) *Public Budgeting & Finance*, Vol. 32, No. 2, Summer 2012, pp. 1-24).

Mikesell identifies three methods for making such estimates and lists states in five categories according to the methods or combinations of methods they use. We briefly summarize the three methods below. A copy of the article is attached.

1. **Static scoring** is based on the assumption that a proposed tax change will have no impact on the behavior of households or businesses. “Estimators use this approach when they lack a basis

for making behavioral adjustments with sufficient confidence” or when the proposed change is “small and insufficient to induce a discernable behavior change,” Mikesell says (p. 9).

2. **Microdynamic scoring** assumes that those subject to a tax change will alter their behavior in response, and adjusts the estimated tax base accordingly. For example, if a tax on a certain item, such as gasoline or cigarettes, decreases, microdynamic scoring assumes that people will buy more of it, offsetting some of the revenue loss from the lower rate. “The underlying logic of the microdynamic model is universally accepted,” Mikesell comments (p. 10).
3. **Macrodynamic scoring** seeks to estimate all revenue effects, both direct and indirect, that a particular tax change is likely to produce in a state’s economy. Estimates using macrodynamic scoring rely on complicated computer models of a state’s economy and the factors that affect it, including any increases in economic activity that may offset a revenue loss from a tax reduction. Macrodynamic scoring is the “broadest and most complete approach” to revenue estimating, according to Mikesell (p. 11).

Table 1 shows Mikesell’s listing of states by the types of methods they use to estimate the revenue impact of proposed tax changes (p.13). The table shows a scoring continuum from states that use only static scoring (right-hand column) to those that regularly use macrodynamic models (left-hand column). The states in the middle columns (the majority) use various combinations of the static and dynamic methods.

Table 1: State Scoring Methods for Proposed Tax Changes

STATIC		→ DYNAMIC		
<i>Static Scoring Only</i>	<i>Static Scoring Generally; Microdynamic Scoring Sometimes</i>	<i>Microdynamic Scoring Regularly</i>	<i>Maintain, But Rarely Use, Macrodynamic Scoring Model</i>	<i>Regularly Use Macrodynamic Scoring Model</i>
Arizona	Alabama	California	Florida	Tennessee
Illinois	Arkansas	Delaware	Georgia	Texas
Michigan	Colorado	Hawaii	Iowa	
Missouri	Connecticut	Indiana	Massachusetts	
Minnesota	Mississippi	Idaho	Nebraska	
New Mexico	Nevada	Kansas	Oregon	
Oklahoma	North Carolina	Kentucky	Rhode Island	
Pennsylvania	North Dakota	Louisiana	Vermont	
South Dakota	South Carolina	Maine		
West Virginia	Utah	Maryland		
Wyoming		Montana		
		New Hampshire		
		New Jersey		
		Virginia		
		Washington		
		Wisconsin		

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