

Legislative Services Agency Fiscal Services Division

Revenue Estimating

History in Iowa

Other States

Best Practices

March 22, 2017

House Appropriations Committee

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History and Purpose

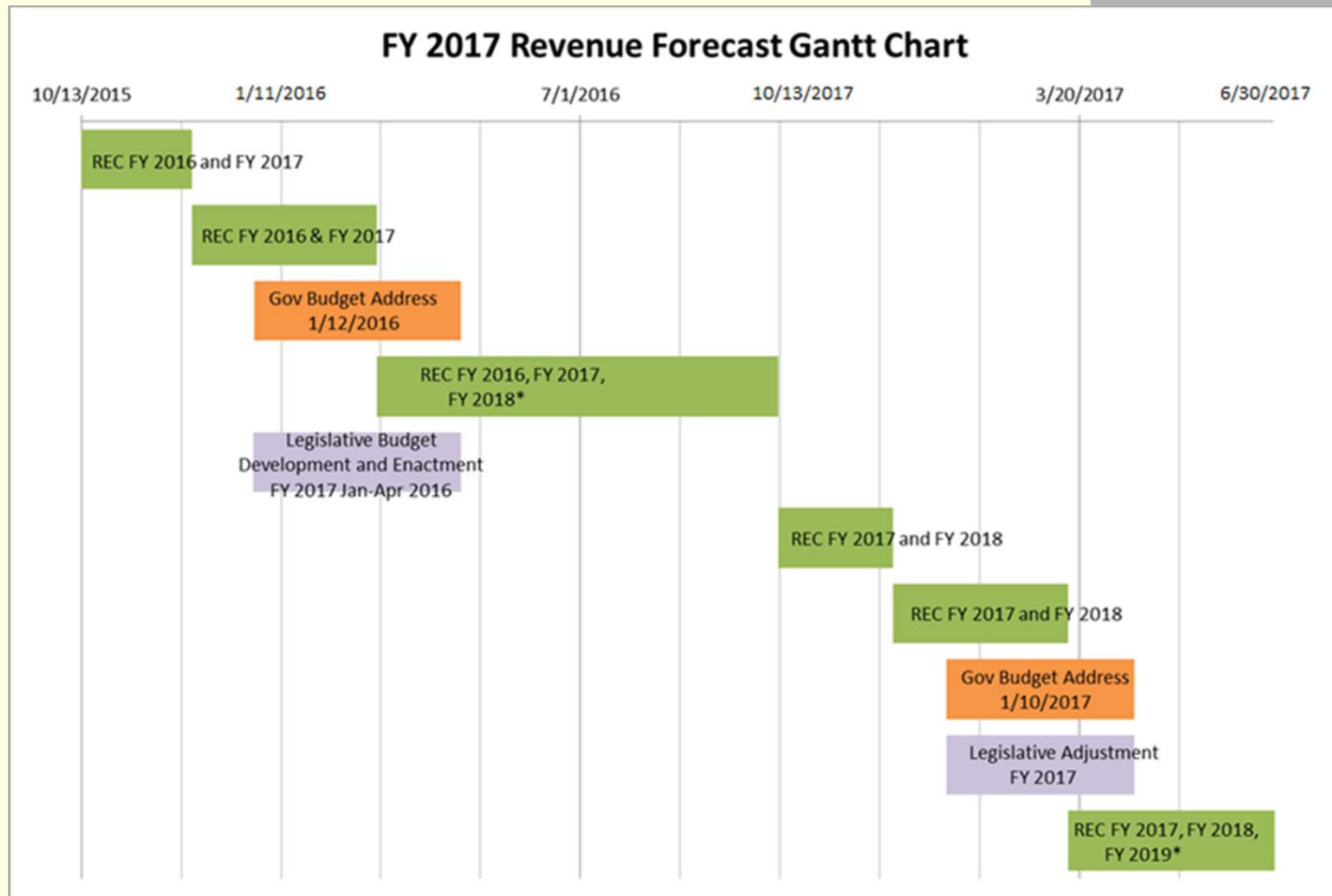
The Revenue Estimating Conference (REC)

- **Created in SF 2175 – Government Reorganization Act of 1986 (See Iowa Code §8.22A).**
- **Purpose was to establish one consensus revenue estimate to be used by BOTH the Governor and Legislature in the budget process.**
- **Consensus estimate provides a shared reality and a shared vision of the economic parameters.**

Revenue Estimating Conference – Who and When?

- **Three members:**
 - **Governor or Governor's Designee**
 - **LSA Director or Designee**
 - **Third person agreed to by the other two members**
- **Duties & purposes are outlined in Code §8.22A.**
- **Minimum three yearly meetings – October, December and March.**
- **Must meet before Dec. 15 of each year and again in the proceeding March.**
- **Provides estimates of General Fund revenues available for the budgeting process.**
- **Basis of the Expenditure Limitation Law.**

REC Estimate Timing

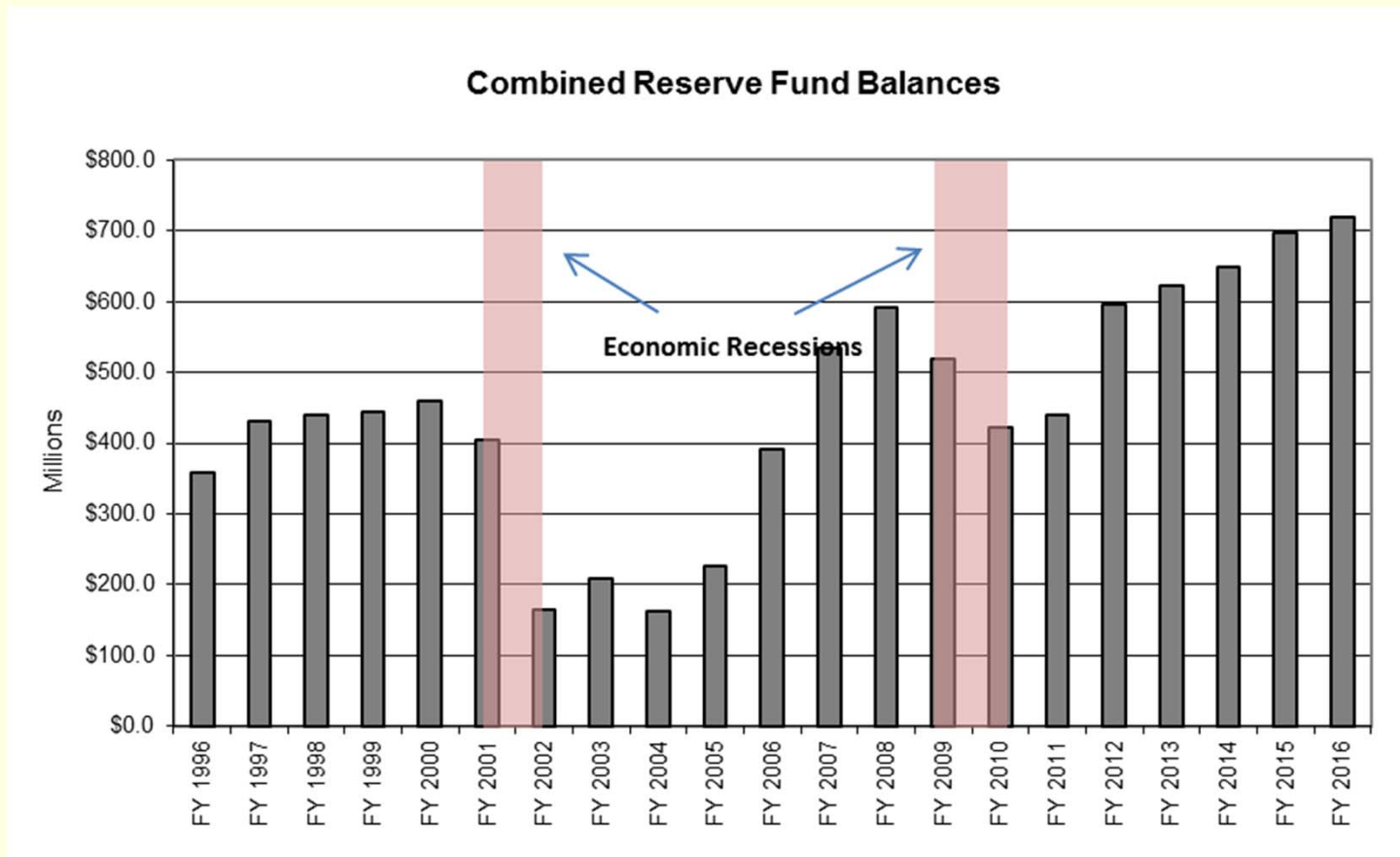


* New to the process in 2016, estimating for second future year.

Expenditure Limitation

- **Passed in 1992 (See Iowa Code Sec. 8.54) to provide budget stability & create reserve funds balances:**
 - **Can only spend 99% of adjusted revenues estimates**
 - **Created the Cash Reserve Fund, a second Rainy Day Fund**
 - **Amended provisions of the Economic Emergency Fund (the original Rainy Day Fund)**
 - **Provided a mechanism to eliminate the GAAP deficit**
 - **Redirected the flow of the General Fund surplus to fund the reserve funds and the GAAP deficit**
 - **Expenditure Limitation Law applies only to the upcoming fiscal year**

Expenditure Limitation and Impact on Reserve Fund Balances

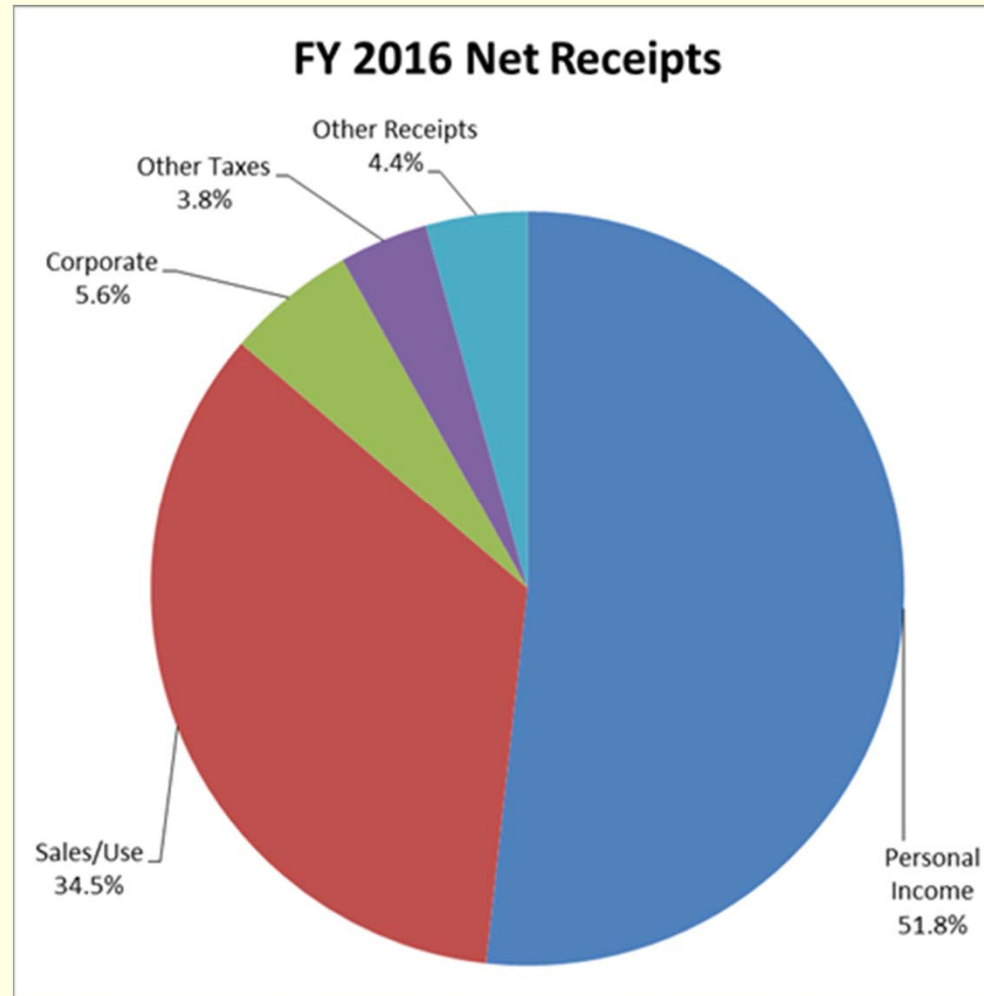


REC Estimate Components

- **General Fund: Cash tax receipts, other receipts, lottery transfers, and other transfers (July 1- June 30).**
- **Accruals of tax receipts & other receipts associated with the FY hold-open period June 30 through August 31. This adjustment converts cash receipts to a FY basis.**
- **Refunds paid from FY receipts.**
- **School Infrastructure transfers from FY receipts.**
- **Estimates include current fiscal year and one future fiscal year. Beginning in 2016, estimates for two future years were provided at the March meeting.**

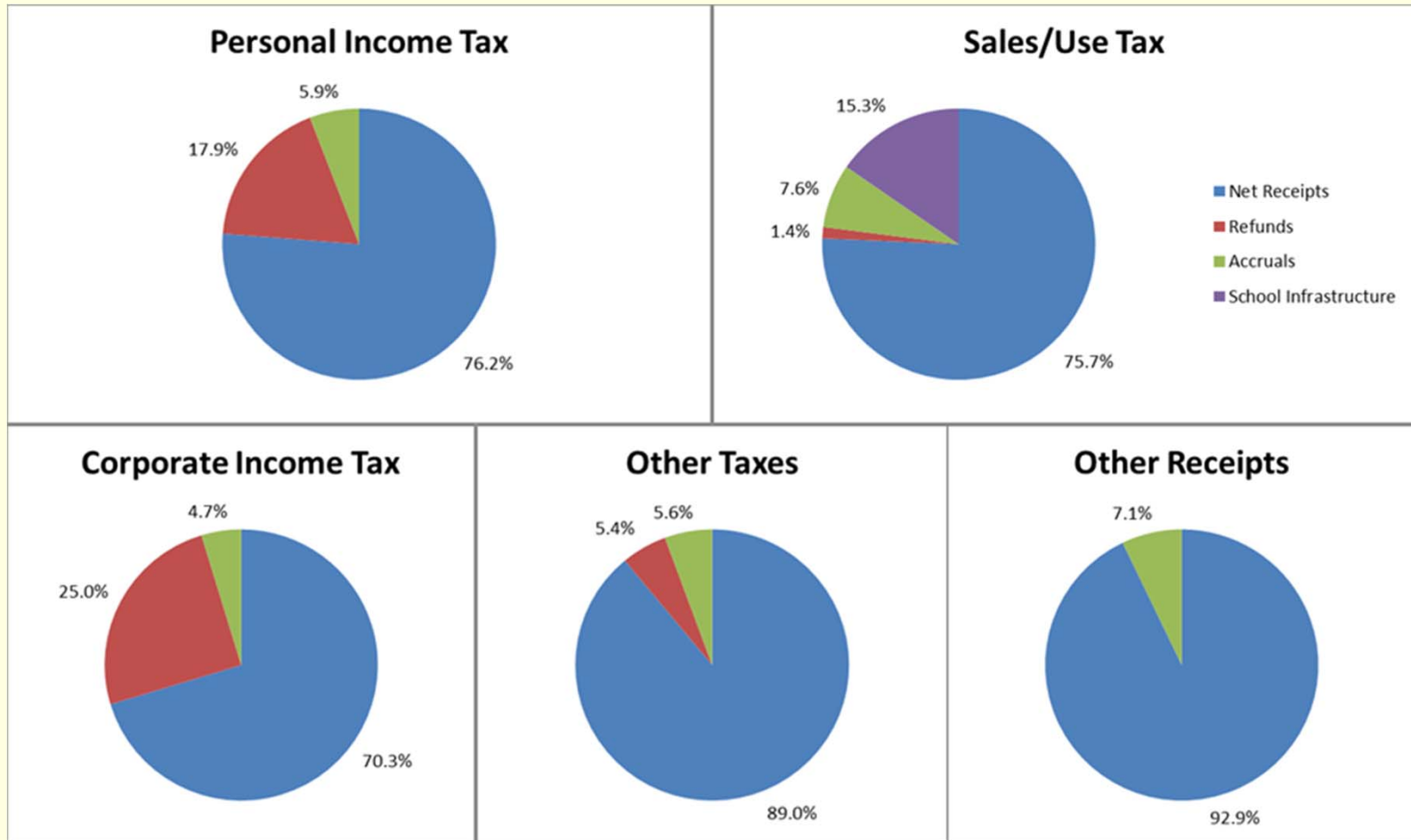
REC Estimate Components

Taxes & Receipts



REC Estimate Components

Refunds



REC Resources

- **Dept. of Revenue tax analysis – Tax Research Division (6 to 7 FTE positions)**
- **LSA & DOM research & analysis**
- **Widely available sources of economic indicators (federal Bureau of Labor Statistics, Bureau of Economic Analysis, etc.) Some of which are featured on the LSA website “Economic Trends”**
- **Variety of Iowa-specific indicators**
- **Moody’s Economy.com**
- **Used to have access to:**
 - **Governor’s Council of Economic Advisors**
 - **University of Iowa state revenue model (now defunct)**

REC Meeting Process

Meeting Preparation

- **Department of Revenue staff provides economic overview and current receipts info to LSA and DOM staff and REC members.**
- **LSA and DOM independently develop net revenue estimates (gross receipts minus tax refunds issued).**
- **Approximately one day prior to the REC meeting, both estimates are shared with REC members.**

REC Meeting Process

At the Meeting

- **The REC meeting is a public meeting. Legislators, staff, press, and department representatives attend.**
- **The two estimates are released to the public.**
- **Members discuss the direction of the Iowa economy, the impact of law changes, and the impact those two forces will have on projected General Fund revenue.**
- **REC members either accept one of the two projections, or modify one of the projections and approve it as modified.**

REC Meeting Process

After the Meeting

- **December meeting – the consensus estimate is used by the Governor and the Legislature in developing the budget for the next FY.**
- **The LSA and the DOM monitor General Fund revenue and publish monthly updates comparing actual revenue to projected revenue.**

Accuracy of Revenue Forecasts

- There will **ALWAYS** be error. The question is how much?
- The Nelson A. Rockefeller Institute of Government comprehensive study of state revenue forecasting errors (1987-2013)
 - Forecasting error varies by tax instrument. Median absolute percentage errors:
 - Corporate Income tax (11.8%)
 - Personal Income tax (4.4%)
 - Sales tax (2.3%)
 - Sum of the three taxes (3.5%)
 - Smaller states and states dependent on a few sectors of the economy tend to have larger errors or more variable errors.

Accuracy of Revenue Forecasts

- **Rockefeller study:**
 - **Tax revenue forecasts show a conservative bias – tend to underestimate revenues rather than face significant shortfalls.**
 - **Forecasting errors are larger in periods around recessions.**
 - **The closer the forecast is to the onset of a fiscal year, the more accurate the forecast.**

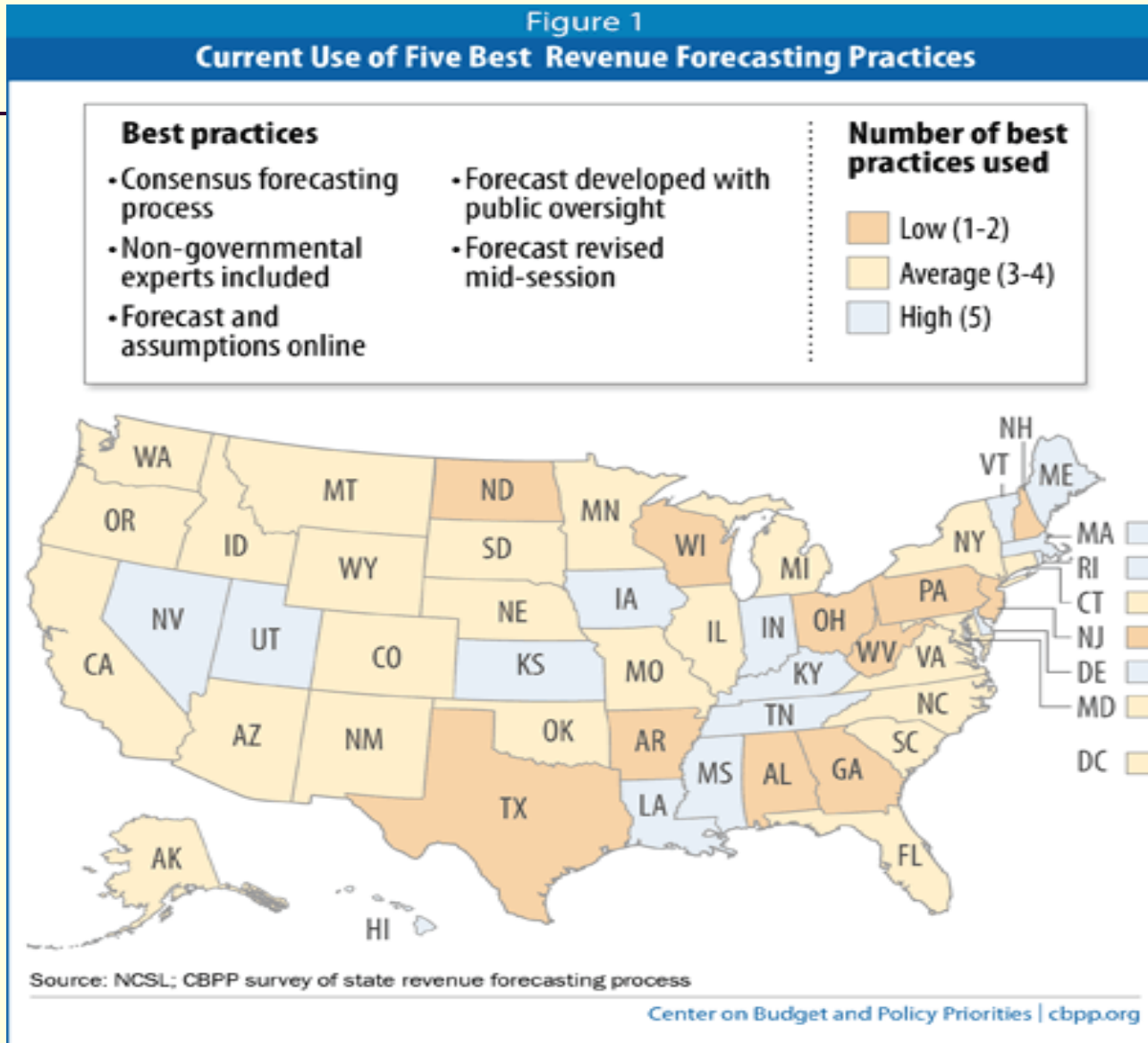
Other States

- **According to NASBO, 31 states have a formal revenue-estimating group that provides revenue estimates for the executive budget.**
- **25 states have a consensus revenue forecast (3 to 25 participants).**
- **21 states have a council of economic advisors.**
- **Projections range from 0 to 10 years out.**
- **Executive agency provides an estimate in some states:**
 - **Idaho, but the Legislature determines if the forecast is “reasonable.”**
 - **Texas, but the Legislature can override with a 4/5 vote.**

Best Practices in Revenue Estimating

- **Report issued by Center on Budget and Policy Priorities (Sept. 2014) outlines five best practices.**
 - **The Governor and Legislature should jointly produce the revenue estimate – consensus forecast.**
 - **The forecasting body should include outside experts.**
 - **The forecast and its assumptions should be published and made easily accessible on the Internet.**
 - **Meeting of the forecasting body should be open to the public.**
 - **Estimates should be revised during the year.**

Best Practices in Revenue Estimating



Sources of Forecasting Error

- **Inaccurate estimates of economic growth**
- **Inaccurate estimates of law change impacts on revenue**
- **Timing errors**
- **Federal tax law changes – coupling and federal deductibility**
- **Volatility**

Volatility

Often the largest source of error in revenue forecasts.

- **Refers to yearly variations in a state's various tax revenue streams and also variations in aggregate revenue generated by the state's tax structure.**
- **Impacted by:**
 - **State's tax structure**
 - **State size and economic diversity**
 - **Federal government actions that impact state law**
 - **Changes in consumer spending in relation to goods vs. services (Netflix account instead of DVD purchase, etc.)**
 - **Macroeconomic events (recessions, natural disasters)**

Fiscal Services Division Website

Daily Receipts:

www.legis.iowa.gov/publications/fiscal/dailyReceipts

Iowa Economic Trends:

www.legis.iowa.gov/publications/fiscal/economicTrends

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