BRIEFINGS
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Florida TaxWatch

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Modernizing Process of Estimating Fiscal Impact of Legislation Benefits Florida

Senate Bill (SB) 1178 and House Bill (HB) 121 in the 2010 General Session provide for the use of analytical and empirical techniques including, but not limited to, cost-benefit analysis, return-on-investment criteria, and dynamic scoring models when requested by either the President of the Florida Senate or the Speaker of the Florida House of Representatives in contemplation of proposed legislation. When requested by either the Senate President or House Speaker, special impact sessions of consensus estimating conferences will be convened to evaluate proposed legislation based on these techniques. Moreover, the information used in the evaluations will be made available to the public unless otherwise exempt from disclosure. The Florida Office of Economic and Demographic Research (EDR) will be charged with developing and implementing the policies, procedures, and protocols to effectively carry out the legislation.

These measures will improve the processes by which the economic and fiscal effects of proposed legislation are assessed, analyzed, and evaluated. As a result, the Legislature will possess information and data that are more thorough and complete, and which address not only the initial, static economic and fiscal impacts of proposed legislation, but also the longer-term, dynamic effects on the Florida economy. These dynamic effects, which often evolve over a number of years, frequently have a greater bearing on the health of the Florida economy than the immediate, initial effects. Decision-making in using scarce tax dollars, in choosing among policy options, and in enacting legislation that supports and encourages a vibrant Florida economy should improve as a result, to the benefit of all Floridians.

The current process by which Consensus Estimating Conference (comprised of representatives of the Governor's office, the Florida Senate, the Florida House of Representatives, and the EDR) estimates the fiscal impact of proposed legislation, although carried out to the highest professional standards, suffers from a number of limitations. Taxation and spending changes, as well as other legislation, affect the incentives faced by consumers, businesses, and entrepreneurs. Consumer, business, and entrepreneur behaviors will change over time as a consequence. Consumers may change their buying patterns, purchasing less of some products and more of others. Businesses may shift the mix of resources they use, or the locations where they operate, or the types of products they offer. Entrepreneurs may direct their business and job creating efforts away from some endeavors and towards others. Over time, the cumulative effects of such behavioral changes will be seen in Florida's economic growth, its industrial structure, its employment and wages, and its fiscal health. The current models and techniques employed by the Consensus Estimating Conferences are not designed to capture such effects.

For example, a new tax on cigarettes is likely to change consumer purchase patterns, in turn will change sales, and profits, of the entire constellation of retailers, wholesalers, distributors, etc. involved in the market for cigarettes, which will in turn change tax revenues relative to that predicted by a simple extrapolation consisting of the same number of packs but at a new tax rate. A simple extrapolation of current structure to a new taxation regime is likely to be inaccurate because changes in tax structure alter incentives and taxpayer behavior. Accounting for these taxpayer behavior changes is called "dynamic scoring," and will often be important in assessing implications for future economic growth and budgets. In a limited fashion the Conference has recently employed dynamic scoring.

For instance, with the new tobacco tax passed last year, the Conference did consider some changes in consumer spending and reduced its revenue estimate accordingly. However, there is not currently a consistent approach in Florida revenue estimating process of modeling the revenue or expenditure impact of possible behavioral changes by those likely to be affected by proposed legislation.

In recent years, newer generations of analytical and empirical methods for assessing economic and fiscal impacts have been developed, tested, and refined. These methods incorporate advances in economic and statistical theories, and when combined with the greater availability of data and advances in computational hardware and software have found wide acceptance, increasing applications, and growing usage. Conceptually, dynamic scoring is attractive because it makes use of all information that is available as to how taxpayers will likely respond to a change in policy, and economic theory and evidence tells us that these responses will occur. One of the reasons dynamic scoring is attractive is because it eliminates some of the current budgetary bias against tax cuts by recognizing that a cut in taxes may be met with increased taxable economic activity.

While a clear improvement, ***The Florida Council of Economic Advisors at Florida TaxWatch*** notes that none of the proposed analytical and empirical techniques are a panacea. The potential shortcomings of dynamic scoring are not trivial. Incorporating feedback effects into budgetary estimates necessarily involves making additional assumptions about economic behavior. It is arguably more susceptible to political pressure about which assumptions to use and the magnitude of the effects. A further consideration is that the timing issues associated with the legislative process, where most bills must be analyzed in a compressed time period during the session, will make consistent implementation difficult. Another factor is that even detailed simulation models will likely not contain sufficient detail to allow precise calculation of fiscal impact without making *ad hoc* behavioral assumptions. An additional important issue is that many tax structure changes have their impact on the budget (e.g., for a tax decrease) or benefit to the budget (e.g., for a tax increase) in this year's budget, while the payoff from the changed taxpayer behavior is seen only in later years, even though it then may well occur for multiple years. This situation would create problems due to the need to balance the Florida budget in any given year. The net to take from these points is that the current move towards dynamic scoring will be a plus for Florida, as it is conceptually correct and is likely becoming more workable over time due to better computing power.

There are shortcomings of the current process, which by law place undue emphasis on the short-term, immediate consequences for state revenues and expenditures. Legislation that otherwise may boost economic growth, job creation, wages and incomes, and state revenues in the longer–term may be rejected as a consequence. SB 1178 and HB 121 seek to address this existing, potentially serious limitation by making dynamic scoring analysis and estimation a formal part of the economic and budgetary analysis. Legislators, as a result, will have better information on which to base their decisions to the benefit of all Floridians.

The Florida Council of Economic Advisors at Florida TaxWatch commends the Florida Legislature for writing SB 1178 and HB 121 and fully supports the passage of the bill into law.

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