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2015 Was a Good Year for State Revenue Forecasters, But the Road Ahead Is Uncertain

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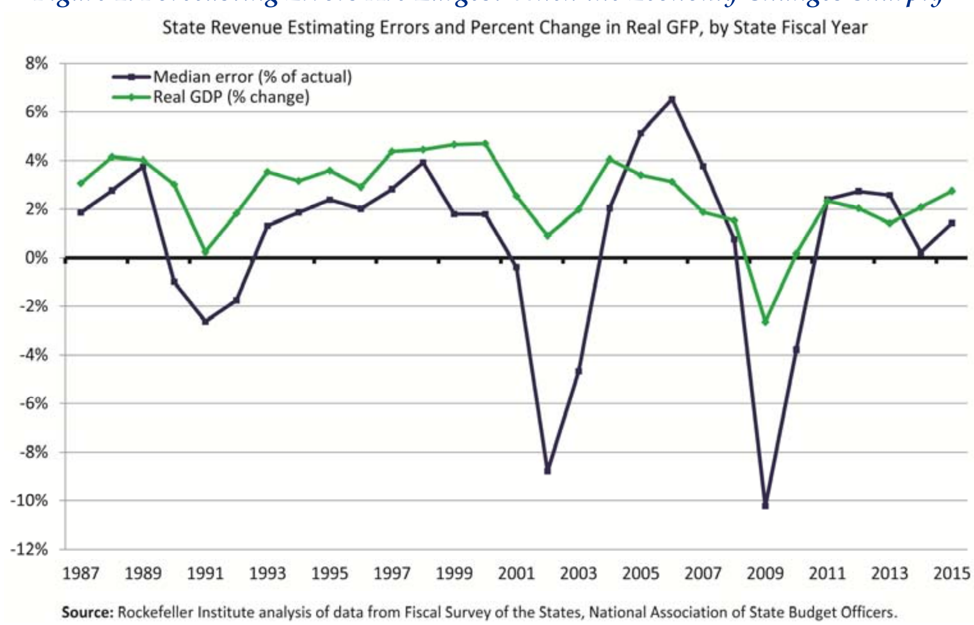
States must forecast revenue accurately to avoid disruption to their budgets. It is a difficult job — uncertainty about the economy, financial markets, and taxpayer behavior mean that estimates will never be completely on target. As we have documented in work supported by the Pew Charitable Trusts, forecasting errors were particularly large in and after the last two recessions as a result of increased volatility in taxes. However, recent years have been much better, and new data suggest that 2015 was a good year for state revenue forecasters.[1]

Figure 1 shows the median state revenue forecasting error, by state fiscal year, for the sum of personal income, sales, and corporate income taxes. The median forecast error in 2015 was positive 1.4 percent. That is just about perfect from a budget forecaster's perspective — small and in the right direction, given that shortfalls can cause greater disruption than overages. The figure also shows that very large revenue estimating errors often are associated with slowdowns or downturns in real gross domestic product: when the economy catches a cold, state budgets catch the flu.

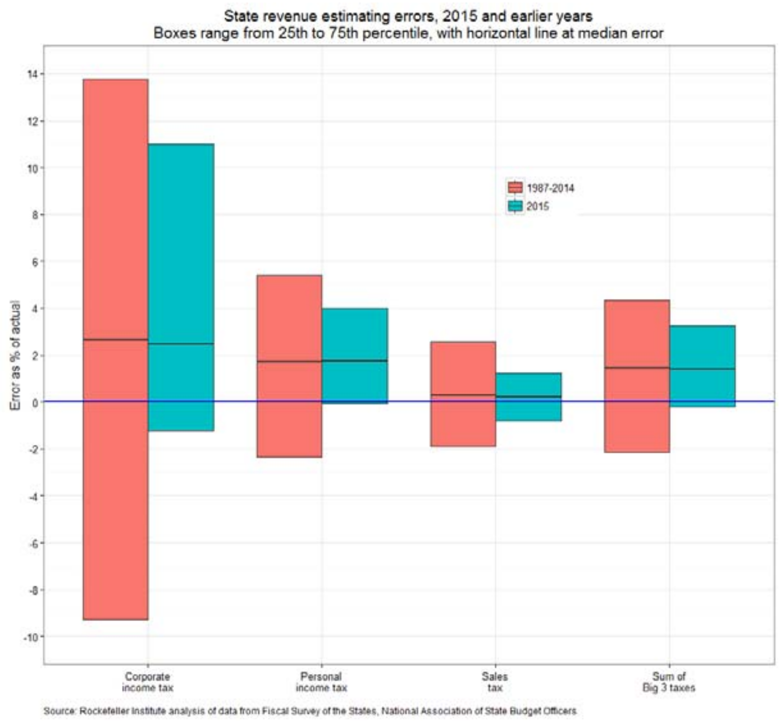
Figure 1. Forecasting Errors Are Largest When the Economy Changes Sharply



[1] National Association of State Budget Officers, *Fiscal Survey of the States: Fall 2015*, December 2015, Table 23.

Figure 2 shows the median, 25th percentile, and 75th percentile state forecast errors, by tax, for 1987 through 2014 and for 2015 (the entire period for which we have data). The median forecast error for each tax was about the same for 2015 as for earlier years, but the spread was smaller — states generally were pretty close to the mark in 2015. The figure also shows that (a) the median state forecasting error is positive for each tax in each period — suggesting again, that states may believe that small positive errors are better than small negative errors, and (b) errors for the corporate income tax are much larger than for the personal income tax, which in turn are larger than errors for the sales tax. Fortunately, most states do not rely very heavily on the corporate income tax.

Figure 2. State Forecasters Had a Good Year in 2015, With Small Errors By Historical Standards



Fiscal year 2015 was a good year, but what lies ahead? Unfortunately for state forecasters, there is more uncertainty. Income tax returns for 2015, due generally in April 2016, will be highly uncertain due to the weak and volatile stock market; some states face risks due to steep and prolonged declines in oil prices; and all must grapple with the implications of the Federal Reserve Board's recent interest rate hike. Revenue forecasting is an essential part of budgeting, and it remains fraught with peril.

The Rockefeller Institute recently included data on state revenue forecasts in its quarterly *State Revenue Reports*, beginning with *State Revenue Report* #100. The next *Revenue Report* will include state forecasts for fiscal year 2017.

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