

How Accurate Are Vermont Revenue Forecasts?

Whenever a General Fund budget is being hashed out in Montpelier, each million dollars (even each hundred thousand dollars) is fought over by legislators wishing to steer funds towards their favorite programs. They closely watch revenue forecasts and monthly collections reports to see if there might be “extra” money to satisfy everyone’s desires.

This raises the natural question of the accuracy of the revenue forecasts. In January of each year a consensus General Fund revenue forecast is released for the current fiscal year and for the next fiscal year. How closely do these forecasts track actual revenues received? This article looks at the last ten “consensus” revenue forecasts prepared for the Vermont General Fund and measures how they stacked up against actual revenues.

Revenue Forecasts for the Current Fiscal Year

The January forecast for the current fiscal year tells the legislature how much of a shortfall (or surplus) they need to adjust to quickly to try to end the fiscal year on June 30th in the black (or how much extra they could spend if they wished).

The middle column of the adjoining table shows the error in each forecast for the then-current year. For example, the January 2001 forecast for fiscal year 2001 was too pessimistic and fell short of actual revenues by \$27 million. In January 2002 the forecast for the current year was \$28 million too optimistic.

Over the entire period under review the January forecast for the current fiscal year has missed actual revenues by an average of \$25 million. And the forecasts have underestimated revenues (a minus sign) nine of the last ten years. What does this mean?

- The fact that there is an error in the forecast is not surprising. Forecasting is an art, not a science. Forecasting the tax shortfall or windfall at settlement time in April is very difficult. We do not intend this article to be a criticism of the accuracy of the forecasts. Rather we simply show that if forecasters are calling for General Fund revenues of \$1,119 million by June 30, 2011 (as they are today), it is best to assume revenues have just a 50-50 chance of coming in somewhere between \$1,096 and \$1,144 million and a 50-50 chance of falling outside that range.

Accuracy of Revenue Forecasts

(in millions of \$)

— Error —

Forecast Date	Current FY	Next FY
Jan 2001	-\$27	\$71
Jan 2002	\$28	-\$11
Jan 2003	-\$7	-\$57
Jan 2004	-\$36	-\$131
Jan 2005	-\$60	-\$111
Jan 2006	-\$41	-\$78
Jan 2007	-\$31	-\$41
Jan 2008	-\$8	\$99
Jan 2009	-\$1	\$28
Jan 2010	-\$12	na
Absolute average	\$25	\$70

- Vermont’s revenue forecasters underestimated revenues in nine out of ten years. This bias may be just an anomaly in the ten years considered or the result of a bias of the forecasters to underestimate current year revenues. We don’t know. But it leads *VEN* to expect the actual revenues will come in closer to the high end of the range rather than at the lower end.

Forecasts for the Coming Fiscal Year

Each January forecasters also prepare an estimate of the revenues for the next fiscal year and the legislature cobbles together a budget based on the expected revenues.

In the third column of the table above we measure the accuracy of those forecasts. (One forecast needed to be adjusted for a tax law change which occurred after the forecast was issued.) In January 2001, a forecast for FY02 was issued and the forecast was too optimistic by \$71 million. The January 2002 forecast for FY03 was too pessimistic by \$11 million.

On average, January forecasts for the coming fiscal year have an average error of \$70 million. In general the forecasts underestimate revenues during economic expansions and overestimate revenues during contractions. There’s no bias one way or the other as there is with the current year forecast. This means that the revenue forecast for FY12 of \$1,184 million has a 50-50 chance of falling in the range of \$1,114 to \$1,256 million. ■