Fact Sheet

The Importance of the Consensus Forecasting Group in the State Budget Process

Legislators developing the state budget rely heavily upon accurate forecasts determining how much money the state will have to spend. Despite its critical nature, deriving accurate revenue forecasts is difficult, because it requires assumptions about the growth of the economy – assumptions that may or may not hold true. According to state law, the role of revenue forecasting belongs to the Consensus Forecasting Group (CFG).[1] This apolitical body uses revenue forecasting tools and a staff of professional economists to assist in its predictions. Following are some facts about the often misunderstood group and the job of forecasting state government revenues.

The CFG is a nonpartisan group of seven distinguished experts chosen jointly by the Legislative Research Commission (LRC) and State Budget Director. Referred to as "an oddly apolitical collection of economic experts," state statute does not outline term limits or size of the group. [2]

- The members are all experts in their fields:
  - Chairman Dr. Lawrence K. Lynch (appointed 1994) – Emeritus professor of economics at Transylvania University
  - Maria Gerwing Hampton (appointed 2007) – Vice president and senior branch executive of the Louisville Branch of the Federal Reserve Bank of St. Louis
  - Dr. Bruce K. Johnson (appointed 2007) – Professor of economics at Centre College
  - Dr. James R. McCabe (appointed 1996) – Associate professor of finance at the University of Louisville
  - Dr. James F. O'Connor (appointed 1999) – Professor of economics at Eastern Kentucky University
  - Dr. David E. Wildasin (appointed 2007) – Endowed professor of public finance at the Martin School of Public Policy and Administration, University of Kentucky
  - Dr. Virginia Wilson (appointed 2007) – Adjunct professor at the Martin School of Public Policy and Administration, University of Kentucky [3]
- CFG is staffed by a team of professional economists employed by the Legislative Research Commission and the Office of the State Budget Director.

By statute, the group convenes in the fall and winter prior to the even-year budget sessions to provide the state with a revenue projection on which the biennial budget is based. The Governor can also summon the group as he or she deems necessary when unexpected economic conditions arise.

- CFG, with the Office of the State Budget Director, must provide a budget planning report to each branch of state government by August 15 prior to the upcoming budget session.
  - The planning report includes projections for the Commonwealth's fiscal condition, revenue estimates and their expected impact, and projections of employment, personal income, and other economic indicators.
- The group provides preliminary revenue estimates for two fiscal years by October 15 prior to the budget session.
- By the 15th day of the legislative session, the State Budget Director must certify and present official CFG revenue estimates to the General Assembly. These estimates become the official revenue estimates of the Commonwealth.[4]

To arrive at an estimate of future revenues, the state subscribes to Global Insight, a national forecasting service which provides detailed models of U.S. economic activity. Staff members at the state budget office combine this national model with its own Kentucky-specific models. The economic experts from LRC and Office of the State Budget Director complete all of the research for CFG.

- CFG examines revenue baselines, debates and questions them, and finally reaches consensus upon which of the forecasts to recommend. Sometimes they will agree to use a blend of all three forecasts.[5]
- Using a combination of these models, the state budget office provides CFG with three different base lines: optimistic, control, and pessimistic, for each major revenue source.

The average difference in the first fourteen years between CFG forecasts and actual revenues was only 0.8 percent.[6] Before CFG was established by law in 1994, the executive and legislative branches each made their own forecasts which were often politically charged and differed dramatically.[7]While the only certain thing about revenue forecasting is that CFG forecasts will never exactly match the amount of revenues collected, the fourteen-year average for the group shows a strong record of close predictions.

A consensus-based system moves away from a system of political influence and contributes to unbiased revenue estimates. State revenue forecasts can often be a source of controversy because manipulation of the budget constraint can be used to control the spending plan. Having one body of independent experts reach consensus about which baseline to use during the budget process fosters budget deliberations based on policy, not politics. [8]

- It is important that there are no political agendas shaping the forecast and that the process is transparent and uniformly adopted and accepted.
- Without the expertise of the CFG and the staff from LRC and Office of State Budget Director supporting the group, legislators would not know how much money they have to allocate. CFG provides a useful checks and balance system ensuring forecasts are made as accurately and independently as possible.

For additional information about how other states complete revenue forecasting, see: National Council of State Legislatures (December 1997). "Revenue Forecast: Legislative Budget Procedures, Budget Framework." Available at http://www.ncsl.org/default.aspx?tabid=12637. Accessed August 2009.

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[1] KRS 48.115. Available at http://www.lrc.ky.gov/KRS/048-00/115.PDF. Accessed July 2009.
[2] Loftus, Tom (29 December 2008). "Economic future hard to predict: State group must make best effort." *The Courier-Journal*.
[3] Ibid.
[4] KRS 48.120. Available at http://www.lrc.ky.gov/KRS/048-00/120.PDF. Accessed July 2009.
[5] Loftus, Tom (29 December 2008). "Economic future hard to predict: State group must make best effort." *The Courier-Journal*.
[6] Henderson, Feoshia (13 August 2008). "Forecasting group fares well on a 14-year average." *The Kentucky Gazette*.
[7] Henderson, Feoshia (13 August 2008). "Forecasting group fares well on a 14-year average." *The Kentucky Gazette*.
[8] Mikesell, John (2008). "State Revenue Forecasting in the State of Indiana: A Consensus System in a Politically Divided State," in Jinping Sun and Thomas D. Lynch, ed., *Government Budget Forecasting, Theory and Practice* Atlanta: CRC Press.

Principles for a State Tax and Budget System

Taxes and other sources of revenue provide the state of Kentucky with the funding it needs to pay for all services, programs, and operations. Kentucky policymakers should ensure the state's revenue system is aligned to meet the state's needs without placing unreasonable burdens on taxpayers. To do that, the state should follow commonly accepted principles, as outlined here, when making spending and revenue decisions. Kentucky Youth Advocates uses these principles to guide our analyses of state fiscal matters.

Adequacy	The Commonwealth must have sufficient revenues to make necessary investments that help the state progress and help all Kentuckians be self-sufficient and have the opportunity to lead prosperous lives. Tax changes should be evaluated based on the need for adequate levels of revenue and the impact on Kentucky's citizens.
Sustainability	Our budget and revenue-raising decisions should be made with future needs in mind. Sound budgeting requires revenues that are sustainable over time and spending decisions that support priorities for Kentucky's future. Good revenue systems are broad enough to produce relatively consistent revenue over time so the budget is not continually threatened by the ups and downs of Kentucky's economy.
Transparency	A good tax and budget system requires that taxpayers be informed and aware of spending and revenue decisions and the reasons for those decisions. Residents of the Commonwealth should have easy access to information about the tax structure and the state budget. Kentuckians should also be able to attain information about spending decisions and the impact of those decisions on the state.
Fairness	Our tax system should be fair and progressive. Tax laws should take into account taxpayers' ability to pay and should treat income the same whether it comes from wages or investments. The law should impose similar tax burdens on people in similar circumstances and minimize the burden on low-income individuals.
Responsibility	Kentucky state government and local governments should work together to achieve common goals. State policymakers need to consider how state tax decisions affect local government.