

Recommendation:

Apply Dynamic Analysis to Major Tax Proposals

The Policy Foundation is recommending that the state Department of Finance and Administration apply dynamic analysis to Gov. Beebe's grocery tax cut and the other fiscal measures. In 1998, the Murphy Commission, a Policy Foundation project, made a similar recommendation:

"All tax proposals should be submitted to a process of dynamic scoring in order to assess the economic impact. Findings should be reported to the public before enactment of the policy."

In this episode the policy has been enacted. The people of Arkansas would still benefit from applying dynamic analysis to major tax proposals such as those enacted this year. Dynamic scoring attempts to measure feedback effects when tax rates are increased or decreased. DFA has not used dynamic analysis, and some department officials have expressed skepticism of the process. But the idea has been taken seriously by leading academic economists in two papers published since 2004¹, and deserves consideration.

Dynamic analysis would provide more information to citizens about the fiscal impact of tax proposals.

DFA is capable of conducting dynamic analysis of major tax proposals but has not been asked to do so in this episode.

-- Greg Kaza

¹ The dynamic scoring session at the 117th annual American Economics Association meeting in Philadelphia (Jan. 7-9, 2005) is published in the May 2006 issue of *The American Economic Review* (pp. 412-40). Thirteen AEA presidents have won the Nobel Prize in Economics.