Appendix A: Estimating the impact of a potential tax hike

While traditional revenue estimation (often called static scoring) assumes no effect from taxes on economic activity, the economic model used in this report (often referred to as dynamic scoring), assumes that individuals and businesses adjust their economic decisions in response to changes in the economic environment, such as higher taxes. Most economists agree that taxes influence national income.

The model used for this report, the neoclassical growth model, is among the most widely used tools for empirical and theoretical research in macroeconomics and is the most widely taught model of capital accumulation and long-run growth. It is the foundation for modern growth theory.

The neoclassical framework emphasizes economic agents' inter-temporal decisions – meaning individuals' decisions to save, invest or work more depends on the consumption and leisure tradeoff – in a general equilibrium setting. The advantage of these models is that they make the economic mechanisms at work within the model transparent and account for forward-looking behavior.

The estimated model can serve as a baseline to provide plausible counterfactual scenarios that describe how the economy will behave conditional on the outside influences affecting it.

The purpose of this report is to investigate how economic activity in Illinois would adjust to spending financed by further income tax hikes, using the neoclassical growth model as a predictive tool.