Massachusetts Taxpayers Foundation

News Release

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MTF Forecast: Slower Growth in Tax Revenues in FY 2017

Tax revenues will increase by $980 million, or 3.8 percent, to $26.69 billion in fiscal 2017 representing a slowdown in tax collections below the previous five year trend of 4.6 percent annual growth, according to a new forecast released today by the Massachusetts Taxpayers Foundation (Figure 1 on page 2).

For fiscal 2016, the Foundation projects tax revenues of $25.71 billion, $100 million higher than the current benchmark of $25.61 billion and an increase of $780 million, or 3.1 percent, over the $24.93 billion in taxes collected in fiscal 2015.

There are several factors driving the Foundation's projections of slower growth in the Massachusetts economy and revenues available for the 2017 budget. Three of the primary factors impacting expected revenue growth are: another income tax rate reduction, expansion of the Earned Income Tax Credit, and capital gains tax revenues in excess of the threshold.

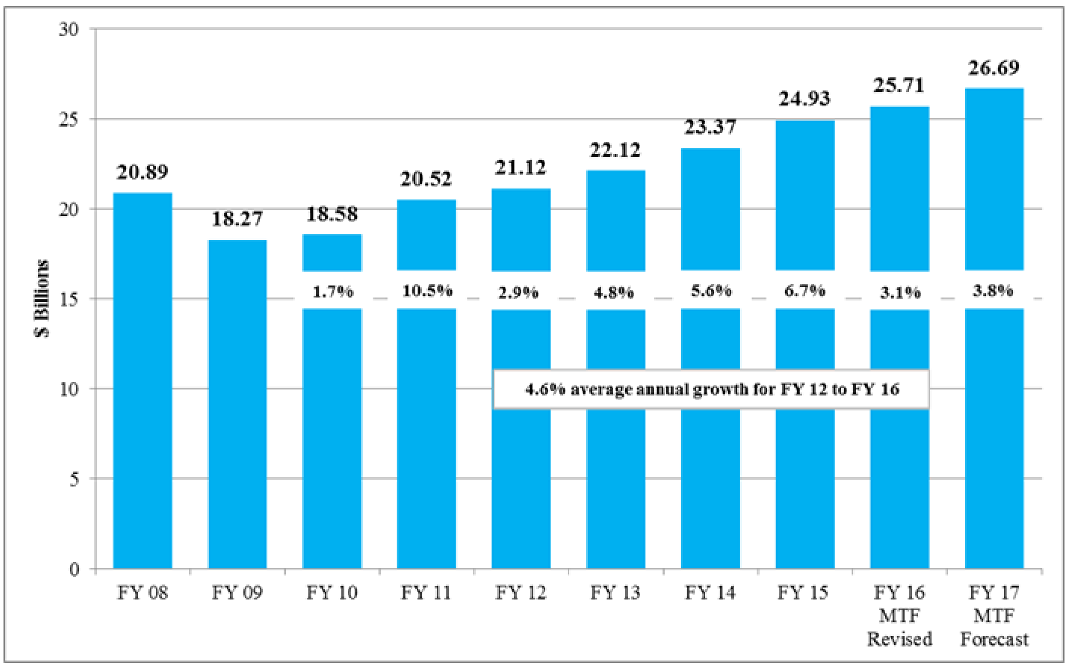
- Automatic income tax cut – the Foundation's forecast assumes that all conditions will be met to trigger an income tax rate reduction from 5.10 percent to 5.05 percent on January 1, 2017 due to continued economic growth and low inflation. The revenue impact of the fifth tax rate reduction in the last six years is estimated at $76 million in FY 2017.
- Expanded Earned Income Tax Credit (EITC) - the state's EITC will increase from 15 percent to 23 percent of the federal credit effective for tax years beginning January 1, 2016 after lawmakers adopted changes in 2015. The Department of Revenue's estimate of a $74 million reduction in tax revenues in FY 2017 is incorporated into the Foundation's forecast.
- Capital gains tax revenues- further complicating the FY 2017 budget challenges, the Foundation projects capital gains tax revenues of $1.42 billion in FY 2017 (down from $1.6 billion in FY 2016, Table 1). With an expected threshold of approximately $1.1 billion for the amount of capital gains tax revenues that can be used to support the budget, the $300 million in excess of the threshold would be transferred into the stabilization fund making it unavailable for operating expenses.

It is important to note that the Foundation does not include any estimates of one-time tax settlements and judgements in excess of $10 million in either the FY 2016 or FY 2017 forecasts other than the $14 million in actual settlements collected as of November 2015.

Eileen McAnneny, president of MTF, presented the Foundation's economic and revenue forecast to members of the House and Senate Ways and Means Committees and the Secretary of Administration and Finance at their annual consensus revenue hearing at the State House today.

"In a time of heightened economic uncertainty, caution is the only course. This entails replenishing the stabilization fund and balancing the budget without the use of one-time revenues. These actions are vital to prepare us for the heightened challenges to economic growth that we face due to demographic shifts in Massachusetts and the numerous economic and geopolitical global risks that escalate each day. Now is the time for fiscal restraint to prepare the state for the challenges it will likely face in the near term."

Figure 1 – State Tax Revenues, 2008 – 2017



Personal Income Taxes

The improvement in personal income tax revenues derives from gains in wages that will generate $609 million in additional withholding income tax in fiscal 2017, a 5.3 percent, increase over FY 2016. This increase will be partially offset by a decline of $186 million in capital gains tax revenues in FY 2017 from FY 2016 (Table 1).

The Foundation's economic forecast indicates a dramatic decline in job growth starting in 2018 and continuing for several years thereafter due largely to fewer working age people in the state. As the wave of baby boomers hit retirement age, the number of available workers in Massachusetts is forecasted to decline in 2018. This trend signals that the robust employment growth where Massachusetts averaged annual increases of 1.7 percent over the past five years is rapidly coming to an end.

With fewer workers, the Foundation estimates job growth of only 0.2 percent in FY 2017. Further, the Foundation expects the unemployment rate to fall to 4.5 percent – the lowest level since October 2001 – which suggests that Massachusetts is nearing full employment.

Personal incomes are expected to increase by 6.2 percent in 2017, up from 4.7 percent in 2016. This growth is driven by a 6.2 percent jump in average wages and salaries in 2017, compared to 4.6 percent in 2016.

Table 1 – State Tax Revenues by Category

($ millions)

	FY 15 Actual	MTF FY 16 Forecast	$ Change 16 vs 15	% Change 16 vs 15	MTF FY 17 Forecast	$ Change 17 vs 16	% Change 17 vs 16
Income Tax	14,448	14,760	312	2.2%	15,138	378	2.6%
Withholding	11,064	11,491	427	3.9%	12,100	609	5.3%
Capital Gains	1,669	1,603	-66	-4.0%	1,417	-186	-11.6%
Sales	5,774	6,097	323	5.6%	6,459	362	5.9%
Corporate and Business	2,561	2,602	41	1.6%	2,739	137	5.3%
All Other	2,148	2,253	105	4.9%	2,353	100	4.4%
Total	**24,931**	**25,712**	**781**	**3.1%**	**26,689**	**977**	**3.8%**
Old Total	**24,931**	**25,635**	**704**	**2.8%**	**26,421**	**786**	**3.1%**

Sales Taxes

The Foundation projects that sales taxes will grow by 5.9 percent to $6.46 billion in FY 2017, slightly more than the 5.6 percent increase in FY 2016 which is driven in part by an 11 percent increase in sales tax revenues for motor vehicles through the first five months of the fiscal year. Sales tax revenues since November 2013 have been buttressed by an agreement with Amazon to collect taxes on online purchases adding approximately $60 million in FY 2017 or nearly 1 percent of total sales tax revenues.

Corporate and Business Taxes

In Fiscal 2017, corporate and business taxes are projected to increase by $137 million to $2.74 billion, a 5.3 percent increase over 2016 driven by strong corporate profits. This projected growth rate far exceeds the growth in fiscal 2016, when corporate and business tax revenues are expected to increase by only $41 million or 1.6 percent from fiscal 2015; however much of the difference can be attributed to the vast swing in corporate tax settlements in excess of $10 million. In FY 2015, settlements totaled $141 million compared to just $14 million collected to date and incorporated in the Foundation's FY 2016 forecast.

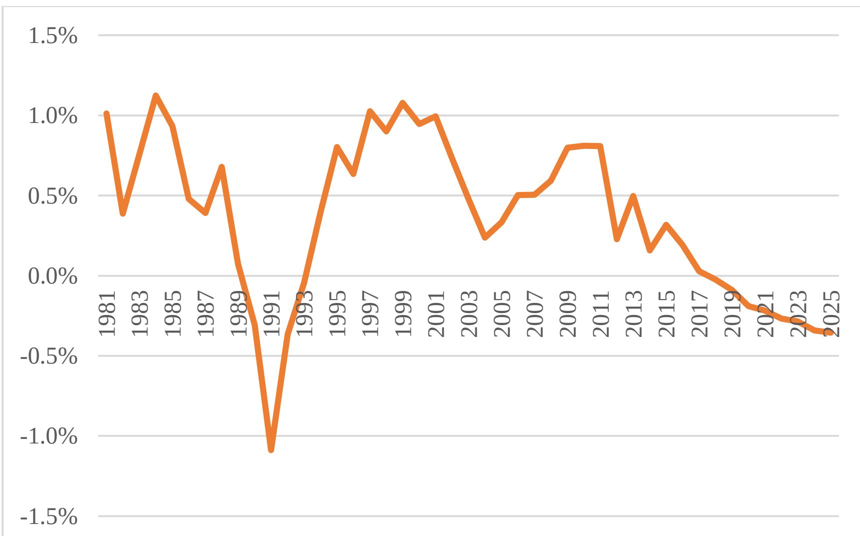
Short and Long-Tern Risks to the Massachusetts Economy

Workforce Demographics

Over the past few years, the Foundation has monitored the demographic changes the Commonwealth is experiencing and the economic challenges Massachusetts will confront as a result. Massachusetts' population is aging more rapidly than the rest of the U.S. It appears that these challenges will have a significant impact on Massachusetts' employment and, correspondingly, tax revenues over the next several years.

As shown in Figure 2, the forecast for the year-over-year change in the number of working aged people in Massachusetts – the population between the ages of 15 and 64 – shows a decline from +0.8 percent in 2011 to +0.03 percent in 2017 turning negative to -0.02 percent in 2018 and then continuing to fall. In other words, starting in 2018 the state will have fewer working aged residents.

Figure 2: Year-over-Year Change in MA Working Age Population (Aged 15 – 64)[1]

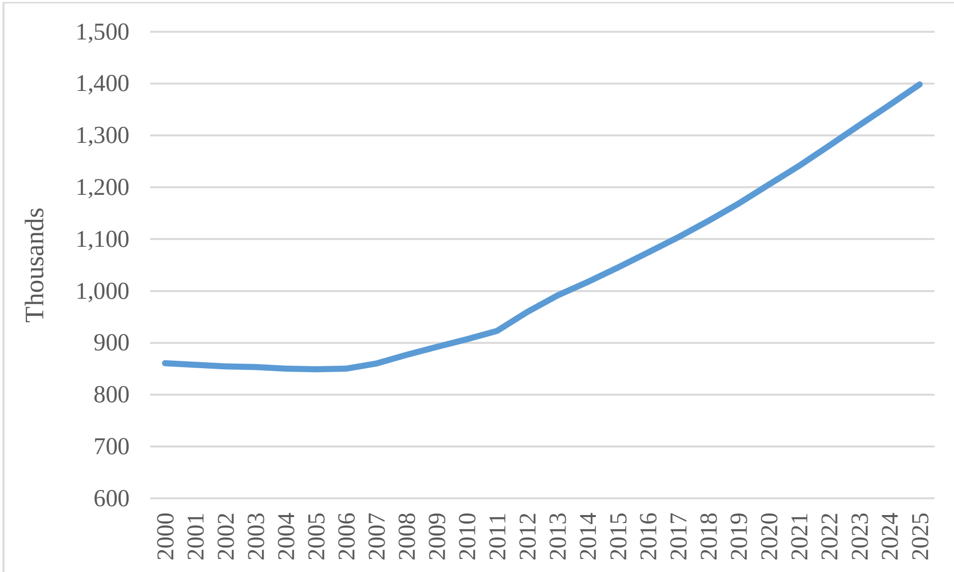


This decline has major implications for job growth and tax revenues. From mid-2011 through this November, Massachusetts and the U.S. experienced robust employment growth rates averaging 1.7 percent each year. The Foundation projects national job growth to continue at 1.5 percent through FY 2020 barring an economic downturn.

However, it is because of these demographic shifts that the Foundation's forecast shows only limited job growth in Massachusetts starting in FY 2017 and continuing at less than 0.2 percent over the next several years. Fewer workers will hamper economic growth and tax revenues as baby boomers withdraw from the workforce and reduce consumption.

[1] Moody's Analytics Forecast, November 9, 2015.

Figure 3 – Massachusetts Population Age 65+[2]



Additionally, Moody's Analytics projects the number of Massachusetts residents aged 65+ will increase by a third from 1.05 million in 2015 to 1.4 million by 2025. This increase will place higher demands on state sponsored safety net programs at a time when revenue growth is curtailed.

Global Risks

Although the U.S. economy continues to expand, the manufacturing and energy sectors are confronting negative growth, global risks have escalated, and warning signs of a global economic slowdown appear almost daily. Following seven years of economic recovery since the Great Recession amid a slackening global economy, it is an open question as to how much time the state has to prepare for the next economic downturn.

Europe remains on the brink of a deflationary trap with annual inflation pegged at 0.1 percent in 2015. The European Central Bank (ECB) recently extended its quantitative easing program until at least March 2017 to prop up economic growth in the EU that had recently slumped to 0.3 percent in the third quarter of 2015.

China's growth continues to slow as it grapples with enormous public and private debt exposures. The Chinese government is struggling to rebalance its economy from manufacturing to services as industrial production weakens. State Street Global Advisers expect China's GDP to fall to 6 percent in 2016, well below the country's 7 percent target.

[2] Moody's Analytics Forecast, November 9, 2015.

Japan, the world's third largest economy, continues to struggle to escape recession. South Korean exports – often referred to as the world's economic 'canary in the coal mine' – are substantially lower this year than last, further demonstrating a softening of the global economy.

Falling oil prices have created significant financial and political risks to several countries that rely on commodity exports. U.S. oil and gas companies are at an increased risk of default due to mounting debt costs as oil prices plummet to below $40 a barrel for the first time since 2009.

Global geopolitical risks have escalated over the past year. Continued hostilities in the Middle East create turmoil and uncertainty beyond their borders. Mounting tensions between Russia with its neighbors the Ukraine and Turkey, territorial disputes in the South China Sea, the growing refugee crisis, and the expansion of terrorist activities and threats each pose challenges to global economic growth in 2016.

Recommendations

Despite a robust recovery in employment over the past five years, the state has had to rely on ever increasing amounts of one-time revenues to balance its budget. Looking forward, as short and long-term risks mount, the state is ill prepared for the next economic downturn. As the Foundation concluded in its report on the Commonwealth Stabilization Fund:

> "Should another recession occur, it is likely that the state will have to rely on its own reserves to manage the impacts unlike the last fiscal crisis where the federal government provided the state with $4.7 billion in aid to mitigate the fiscal calamity."

Fiscal discipline and a cautious approach to spending are critical.

- The Foundation urges lawmakers to set aside one percent of budgeted tax revenues (approximately $270 million) as a pre-budget transfer to the stabilization fund.
- Further, all capital gains tax revenues above the statutory threshold should be deposited into the stabilization fund.
- Lawmakers should eliminate the use of one-time funds to support operational spending in FY 2017.

Equally as important, the state must emphasize the development of metrics, data measurement tools, and performance assessments as critical components of the budgetary decision making process. Given the resource constraints facing the Commonwealth, having a clear understanding of the need for investment, as well as the expected impact of a given program is essential for living within our means going forward.

MASSACHUSETTS TAXPAYERS FOUNDATION

FISCAL YEAR FORECAST SUMMARY

MOODY'S ANALYTICS NATIONAL FORECAST							<<< History		Forecast >>>	
December 2015	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Personal Income (billions of current $)	12,137	12,426	12,138	12,688	13,401	13,972	14,204	14,856	15,506	16,421
% change	3.4	2.4	-2.3	4.5	5.6	4.3	1.7	4.6	4.4	5.9
Employment (millions)	138.1	134.3	130.1	130.9	133.0	135.2	137.6	140.6	143.2	145.9
% change	0.6	-2.7	-3.1	0.6	1.6	1.6	1.8	2.1	1.9	1.9
Unemployment Rate	5.0	7.6	9.8	9.3	8.5	7.8	6.8	5.7	5.0	5.0
CPI (% change)	2.7	0.3	1.6	3.3	1.8	1.4	1.2	0.7	2.2	2.9
PPI (% change)	5.1	-5.4	6.9	7.7	0.0	0.7	-1.0	-4.5	3.6	4.2
Federal Discount Rate	5.2	1.6	0.5	0.8	0.8	0.8	0.8	0.8	0.8	1.5
Prime Commercial Rate	7.5	4.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	4.0
Standard & Poor's 500 Index (% change*)	12.7	-17.3	-22.5	20.3	11.4	8.7	19.1	17.5	6.8	2.4

							<<< History		Forecast >>>	
MTF MASS. ECONOMIC FORECAST	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Personal Income (billions of current $)	329.2	330.3	331.1	349.5	366.4	380.6	391.2	406.3	425.8	447.2
% change	4.5	0.3	0.3	5.5	4.8	3.9	2.8	3.8	4.8	5.0
Personal Income (billions of 2000 $)	270.4	264.3	260.6	270.2	274.0	275.8	282.8	289.3	303.2	317.5
% change	2.9	-2.3	-1.4	3.7	1.4	0.6	2.5	2.3	4.8	4.7
Total Employment (000s)	3,294	3,251	3,198	3,229	3,277	3,329	3,385	3,445	3,521	3,524
% change	1.0	-1.3	-1.7	1.0	1.5	1.6	1.7	1.8	2.2	0.1
Unemployment Rate	4.6	6.8	8.6	7.8	6.8	6.8	6.3	5.1	4.5	4.5

							<<< History		Forecast >>>	
MTF MASS. TAX FORECAST	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Income Tax (millions $)	12,498	10,593	10,128	11,570	11,906	12,814	13,197	14,448	14,760	15,138
% change	9.7	-15.2	-4.4	14.2	2.9	7.6	3.0	9.5	2.2	2.6
Sales Tax	4,088	3,870	4,626	4,909	5,061	5,161	5,495	5,782	6,097	6,459
% change	0.5	-5.3	19.5	6.1	3.1	2.0	6.5	5.2	5.4	5.9
Corporations Tax	2,547	2,100	2,120	2,222	2,316	2,259	2,507	2,414	2,602	2,739
% change	-3.4	-17.6	1.0	4.8	4.2	-2.5	11.0	-3.7	7.8	5.3
TOTAL TAXES**	20,908	18,272	18,576	20,517	21,121	22,111	23,371	24,931	25,712	26,689
% change	5.2	-12.6	1.7	10.4	2.9	4.7	5.7	6.7	3.1	3.8
TOTAL TAXES FOR BUDGET***	17,724	15,225	15,657	17,664	18,165	19,093	20,189	21,631	21,932	22,679
% change	4.3	-14.1	2.8	12.8	2.8	5.1	5.7	7.1	1.4	3.4

* Percent change in index for prior calendar year.

** Includes collections from other tax sources not detailed above.

*** Tax revenues available for appropriation in the budget exclude a portion of sales tax receipts dedicated to the MBTA, the Massachusetts School Building Authority, tax revenues dedicated to pension funding, and employer contributions to the Workforce Training Fund.

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