Massachusetts Taxpayers Foundation

News Release

333 WASHINGTON STREET
BOSTON, MA 02108-5170
617-720-1000

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MTF Forecast: Sluggish Growth in Tax Revenues Continues in 2018

Tax revenues will increase by $687 million, or 2.65 percent, to $26.64 billion in fiscal 2018[1], extending the trend of slow tax collection growth for another year, according to a new forecast released today by the Massachusetts Taxpayers Foundation (Table 1 and Figure 1). The Foundation estimates capital gains tax revenues of $1.38 billion which would exceed the FY 2018 statutory threshold by $200 million or more.

Table 1 – State Tax Revenues by Category
($ Millions)

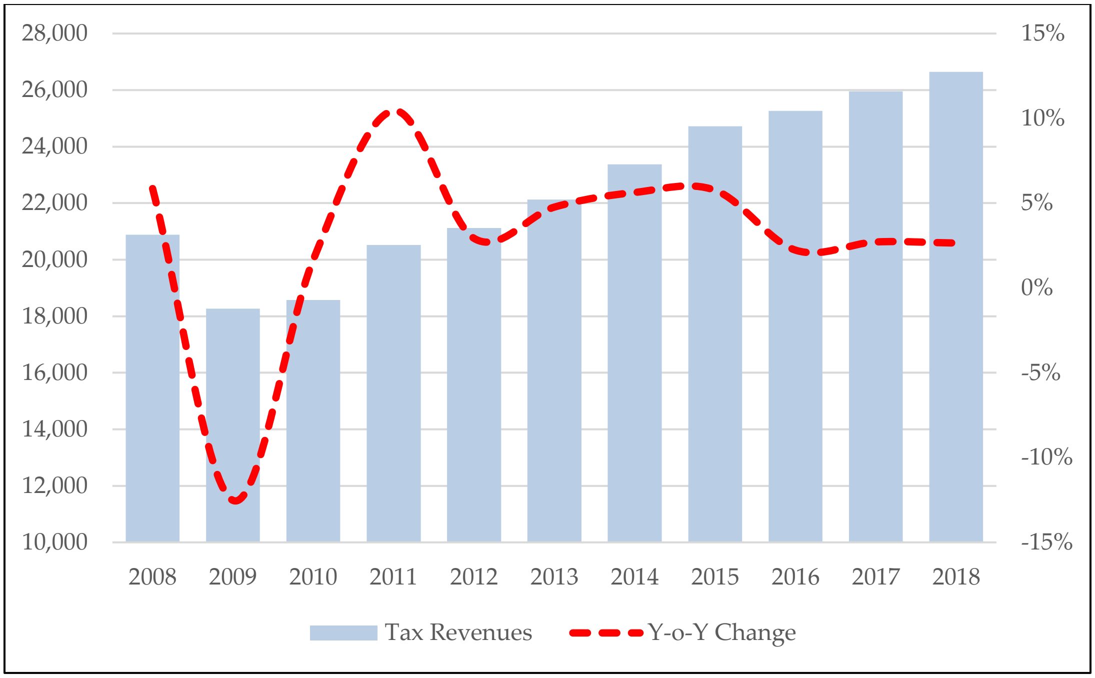
	FY 2016 Actual	FY 2017 Forecast	$ Change 17 vs. 16	% Change 17 vs. 16	FY 2018 Forecast	$ Change 18 vs. 17	$ Change 18 vs. 17
Withholding	11,424	11,762	338	2.96%	12,248	486	4.13%
Other Income	2,968	3,059	91	3.07%	2,998	-61	-2.01%
Sales	6,049	6,252	203	3.36%	6,455	203	3.24%
Corporate	2,532	2,564	32	1.27%	2,578	14	0.53%
Other Income	2,296	2,315	19	0.82%	2,361	46	1.99%
Total	**25,269**	**25,953**	**684**	**2.70%**	**26,640**	**687**	**2.65%**
Capital Gains	**1,416**	**1,430**			**1,377**		

For the current fiscal year, FY 2017, the Foundation projects tax revenues of $25.95 billion, or $100 million below the current benchmark of $26.056 billion representing an increase of $684 million, or 2.7 percent, over the $25.27 billion in taxes collected in fiscal 2016. This forecast includes capital gains tax revenues of $1.43 billion or $150 million above the $1.278 billion limit included in FY

[1] The Foundation does not include estimates of one-time corporate tax settlements in excess of $10 million in its revenue forecasts.

2017 budget language. As Figure 1 demonstrates, tax revenues continue to grow year over year but that rate of growth has slowed as we enter the eighth year of the economic recovery.

Figure 1 – State Tax Revenues, 2008 – 2016



Since last year's consensus revenue hearing in December, state tax revenues fell nearly $500 million below benchmark in the second half of FY 2016. Given that precipitous drop, the FY 2017 consensus revenue benchmark has twice been revised downward from $26.86 billion to the current $26.056 billion, representing a decline in the projected growth rate from 4.3 percent to 3.1 percent.

While the reasons driving this shortfall remain uncertain, what is clear is that there are no indicators suggesting that state tax revenues will grow at rates substantially higher than what we have experienced for the past 11 months. To the contrary, several recent developments, most noteworthy the United Kingdom's vote to leave the European Union and the uncertainty surrounding President-elect Trump's agenda, heighten our concerns.

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.

"The Foundation advises extreme caution over the next 18 months and urges lawmakers to exercise great restraint in building the budget. There are both longstanding causes for concern, such as a shrinking workforce and insufficient reserves in our Stabilization Fund, and many new ones – such as the lack of clarity on many policy positions from President-elect Trump and ominous signs of a global economic slowdown – that necessitate a conservative approach. Given our fragile fiscal state and our unpreparedness for a recession, our expectation is that these pressures will only grow in the coming year."

PREPARING FOR A NEWER NORMAL – UNCERTAINTY AND THE TRUMP AGENDA

Change is inevitable with any new president. However, this year it will be far more pronounced. The Trump campaign offered many promises and few details leaving enormous uncertainty about what changes are likely when the new president takes the oath of office in January. With Republicans controlling both houses of Congress, we can anticipate a marked departure from the policies of the past eight years.

For example, President-elect Trump has indicated that he wants to boost the nation's economy by doubling GDP growth to 4 percent annually. His stimulus package relies on tax cuts totaling nearly $4.4 trillion[2] – and $1 trillion in additional spending on infrastructure over the next decade. While it is predicted that these actions would initially expand the economy, the impact could be short-lived.

The country added 15 million jobs over the past six years and the national unemployment rate stands at 4.9 percent. This tight labor market leaves very little slack in the economy (defined as the amount of underutilized labor and capital resources). Therefore, rapid growth could drive up wage and inflation costs. This in turn would put pressure on the Federal Reserve to raise interest rates at an accelerated pace. If these policy costs are not offset by new revenues, the problem could be compounded. The $6 trillion added to the deficit will most likely drive interest rates even higher, which could curtail access to credit markets and lead to stagflation. Some economists are predicting that this sequence of events will lead to a U.S. recession in 2018.[3]

Of more immediate concern to Massachusetts are several other campaign promises that would reshape the state's economic environment. And again, while we wait to see what policy changes materialize, several of these proposals could have significant and immediate impacts on the state's fiscal health. Among them are:

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[2] Trump's $4.4 trillion tax plan uses dynamic scoring which assumes that tax cuts cause faster growth in collections.
[3] See for example, *Goldman Sees the Possibility of Stagflation under a Trump Presidency, Higher Inflation and Unemployment*, Julie Verhage, Bloomberg News, November 14, 2016 and Moody's Analytics *The Macroeconomic Consequences of Mr. Trump's Economic Policies*, Mark Zandi et al, June 2016.

- Repeal of the Affordable Care Act.
- Converting Medicaid to a block grant program or other changes that might impact the state's recently approved five-year CMS waiver agreement.
- Immigration reforms that could lead to further contraction of the workforce and
- Protectionist trade policies that would increase prices and/or lower demand for our manufacturing and professional services sectors.

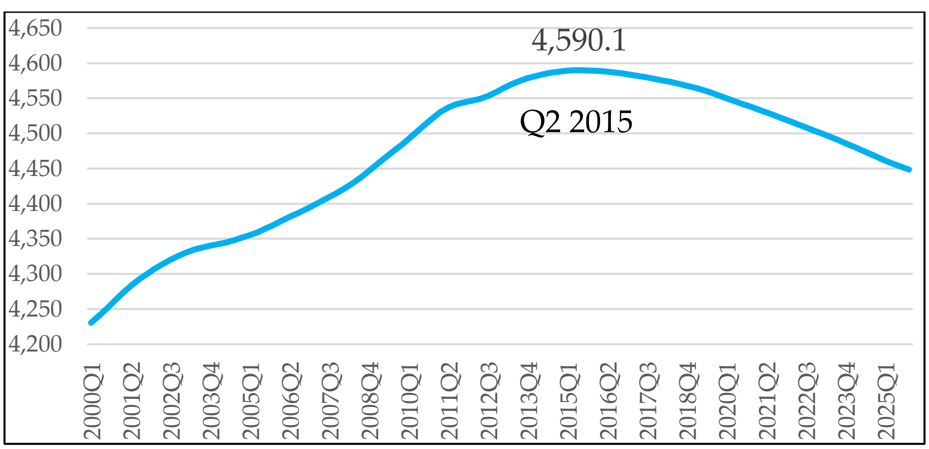
Any one of these changes could be enough to cause a significant economic downturn. In combination, they could have profound and long-lasting economic consequences placing the state in a more precarious fiscal situation.

The principle conclusion to draw is that revenue and budget decisions in FY 2018 must be mindful of the numerous external forces that could disrupt the Massachusetts economy.

MASSACHUSETTS' DEMOGRAPHICS CHALLENGES KICK IN, LIMIT ECONOMIC GROWTH

Over the past few years, MTF has forewarned that an aging population and a decline in the work-age population pose imminent challenges to the state's economy. Those challenges have materialized. In 2015 the number of Massachusetts residents between the ages of 16 and 64 peaked at 4.59 million (Figure 2). The declining workforce places severe constraints on future economic growth as businesses struggle to recruit workers.

Figure 2 – Massachusetts Population Age 16 – 64[4]
(in thousands)



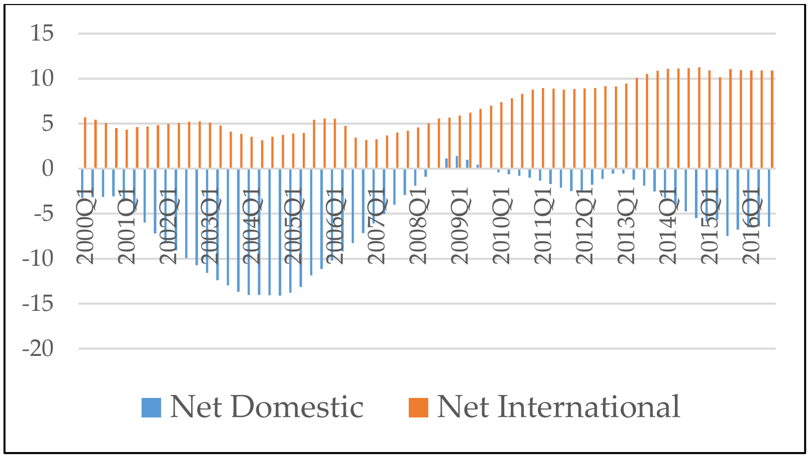
This problem could be made worse by changes to the country's immigration policy. Massachusetts has benefitted from an influx of highly-educated immigrants to sustain economic growth. Since 2000, the net international migration has averaged over 10,000 per year, more than

[4] Moody's Analytics, November 28, 2016.

offsetting the thousands of people who leave the state annually (Figure 3) by bringing new talent to the state.[5] Proposed immigration changes by the President-elect might limit a valuable source of workers to Massachusetts' businesses worsening the challenges to economic growth.

Figure 3 – Massachusetts Population – Net Domestic and International Migration[6]

(in thousands)



GLOBAL RISKS ESCALATE

While the U.S. economy continues to experience solid growth, the global economy is threatened by a series of risks that have intensified in recent months.

- The UK voted to leave the European Union in June sending the first shockwave through the global community.
- The outcome of the Italian reform referendum on December 4 could have far reaching implications that may lead to the resignation of Prime Minister Renzi, the ascendency of another populist movement in Europe, an Italian banking crisis that would likely spread across Europe, as well as the potential for a second withdrawal from the E.U.
- China's economy is slowing, the yuan is weakening causing currency outflows, and debt-fueled growth adds to the long-term challenges. The Economist Intelligence Unit expects China to experience a sharp economic slowdown in 2018.
- A strong dollar causes significant stress to emerging market non-bank borrowers, having accumulated $3.3 trillion in dollar based debt, as their economies slow and their currencies continue to weaken against the dollar according to the Bank of International Settlements. The higher the value of the dollar relative to other currencies, the more expensive it becomes to pay back the debt.

[5] Massachusetts ranks sixth in the nation in the number of H-1B visas allotted.
[6] Moody's Analytics, November 28, 2016.

- Russia and China each seek to extend their sphere of influence beyond their borders. This has created difficult challenges for neighboring states and may well lead to an escalation of regional and international tensions.
- In a major foreign policy speech during the campaign, President-elect Trump stated "We will no longer surrender this country or its people to the false song of globalism." He has criticized multilateral organizations and agreements including NATO and the TPP. The administration states that it will begin renegotiations on NAFTA within the first 100 days and could withdraw if the concessions are unacceptable. Whether these initiatives lead to trade wars or a more isolationist U.S. foreign policy, the impact will have profound consequences on global commerce and trade.

CONCLUSION - WARNING SIGNS ABOUND

The recovery has lasted seven years, the U.S. economy appears to be in excellent condition, job growth continues to be strong, and wages have finally begun to increase. But the warning signs are intensifying.

Massachusetts tax revenue growth slowed significantly in 2016 – a similar pattern to other states. The state's demographics have begun to impact businesses ability to grow. And these are but small matters.

The potential for a series of economic shocks has not been this high in recent years and Massachusetts is not prepared. The Brexit vote and the election of Trump represent two unanticipated events that portend a new nationalist trend in many countries that could lead to restrictions on commerce, a heightened focus on immigration reforms, and a reluctance to rely on multilateral institutions to quell disagreements.

Add in a potential national agenda that promises to reduce federal funding to states for numerous safety-net services, and Massachusetts could be faced with a catastrophic situation – stalled growth in tax revenues, declining federal funding, insufficient reserves to mitigate the budgetary impacts, and an economy that struggles to emerge from the next downturn due to high costs and even more challenging demographics.

It is time to conserve resources, vastly improve the management of state spending, and prepare for a transition where the state must increase its reliance on its own resources – that is the only prudent course given the number of local, national, and international uncertainties confronting us.

MASSACHUSETTS TAXPAYERS FOUNDATION

FISCAL YEAR FORECAST SUMMARY

MOODY'S ANALYTICS NATIONAL FORECAST								<<< History		Forecast >>>	
December 2016	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Personal Income (billions of current $)	12,498	10,593	10,128	11,570	11,906	12,814	13,197	14,370	14,389	14,821	15,246
% change	3.4	-15.2	-4.4	14.2	2.9	7.6	3.0	8.9	0.1	3.0	2.9
Employment (millions)	138.2	134.4	130.2	131.0	133.1	135.2	137.6	140.4	143.1	144.7	145.5
% change	0.6	-2.7	-3.1	0.6	1.6	1.6	1.7	2.1	1.9	1.1	0.5
Gross Domestic Product (billions of current $)	14,946	14,550	14,574	14,914	15,216	15,445	15,771	16,231	16,513	16,777	17,047
% change	1.5	-2.6	0.2	2.3	2.0	1.5	2.1	2.9	1.7	1.6	1.6
Unemployment Rate	5.0	7.6	9.8	9.3	8.5	7.8	6.8	5.7	5.0	5.2	5.2
CPI (% change)	3.7	1.0	-0.9	1.8	1.9	2.4	0.0	1.1	1.7	2.5	3.3
PPI (% change)	13.4	-12.6	7.5	10.6	-0.9	1.1	2.1	-1.3	3.3	2.8	3.7
Standard & Poor's 500 Index (% change*)	12.7	-17.3	-22.5	20.3	11.4	8.7	19.1	17.5	1.0	2.4	5.7

								<<< History		Forecast >>>	
MTF MASS. ECONOMIC FORECAST	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Gross State Product (billions of current $)	384	382	388	408	423	435	446	469	483	495	506
% change	4.2	-0.5	1.7	5.0	3.8	2.7	2.6	5.1	3.1	2.4	2.2
Personal Income (billions of current $)	329.2	333.5	340.4	358.0	371.7	382.5	391.6	414.6	433.4	442.9	456.9
% change	4.5	1.3	2.1	5.2	3.8	2.9	2.4	5.9	4.5	2.2	3.2
Total Employment (000s)	3,294	3,255	3,205	3,237	3,286	3,338	3,396	3,467	3,523	3,541	3,547
% change	1.0	-1.2	-1.5	1.0	1.5	1.6	1.7	2.1	1.6	0.5	0.2
Unemployment Rate	4.6	6.8	8.6	7.8	6.8	6.8	6.2	5.3	4.5	3.6	4.1

								<<< History		Forecast >>>	
MTF MASS. TAX FORECAST	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Income Tax (millions $)	12,498	10,593	10,128	11,570	11,906	12,814	13,197	14,370	14,389	14,821	15,246
% change	9.7	-15.2	-4.4	14.2	3.0	7.6	3.0	8.9	0.1	3.0	2.9
Sales Tax	4,088	3,870	4,626	4,909	5,061	5,161	5,495	5,782	6,043	6,252	6,455
% change	0.5	-5.3	19.5	6.1	3.1	2.0	6.5	5.2	4.5	3.5	3.2
Corporations Tax	2,547	2,100	2,120	2,222	2,316	2,259	2,507	2,414	2,525	2,564	2,578
% change	-3.4	-16.2	1.1	5.9	14.3	-2.5	11.0	-3.7	4.6	1.6	0.5
TOTAL TAXES**	20,908	18,272	18,576	20,517	21,121	22,111	23,371	24,731	25,270	25,953	26,640
% change	5.2	-12.4	1.7	10.6	3.8	4.7	5.7	5.8	2.2	2.7	2.6

* Percent change in index for prior calendar year.

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

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