



News Release

For Immediate Release

December 6, 2004



MTF Forecast: Rising Revenues in 2005 and 2006; Insufficient to Close Budgetary Imbalance

Over the next two fiscal years, state tax revenues will rise between four and five percent annually as a result of gradually improving economic conditions, according to a forecast released today by the Massachusetts Taxpayers Foundation. Capital gains receipts—which were in large measure responsible for a surge in tax collections that pushed fiscal 2004 revenues up by almost seven percent—are expected to shrink substantially in both fiscal 2005 and 2006, curbing the overall rate of growth.

MTF President Michael J. Widmer 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 revenue hearing at the State House today.

The Foundation estimates that tax revenues will total \$16.67 billion in fiscal 2005. MTF's forecast for 2005 is \$697 million higher than the \$15.97 billion estimate on which the 2005 budget is based and \$434 million higher than the revised forecast released by the Romney administration in October.

The state will collect \$17.37 billion of tax revenues in fiscal 2006, up \$703 million or 4.2 percent from projected

2005 taxes, according to the Foundation's forecast. MTF's estimate is \$333 million higher than the administration's 2006 forecast.

MTF State Forecast Summary

(\$, billions)

	Fiscal 2004	Fiscal 2005	Fiscal 2006
Tax receipts ¹	\$15.95	\$16.67	\$17.37
Personal income	\$259.1	\$271.9	\$284.7
Employment (000)	3,172	3,188	3,211

1. Including sales tax receipts dedicated to the MBTA and school building assistance.

Despite the improved tax outlook, balancing 2006 revenues and spending will remain a major challenge. Even with the Foundation's forecast of higher tax receipts, spending will exceed ongoing operating revenues by several hundred million dollars in fiscal 2005, and one-time resources used to fill this gap will need to be replaced with other funding sources or spending cuts in fiscal 2006. To compound the 2006 budget problem, spending growth will outpace revenue growth: Health care costs are expected to rise by as much as 10 percent, and other obligations and commitments in major areas such as debt service, Chapter 70 education aid, school construction and pensions will increase substantially as well. The resulting structural deficit in 2006 could well top \$500 million—before taking into account inflationary increases in the costs of other state programs that are likely to exceed \$200 million, or adding a single dollar to the budget for initiatives such as the planned expansion of early childhood education or restoring spending cuts.

“The improving revenue picture is good news, but the Commonwealth is trapped in a long-term fiscal squeeze,” said Mr. Widmer.

The Foundation’s forecast is predicated on a modest pace of improvement in the state economy, with job growth at less than half the rate for the nation. MTF projects that Massachusetts employment will rise by 16,000 jobs, or 0.5 percent, in fiscal 2005 and another 23,000, or 0.7 percent, in 2006.

Personal income taxes will rise \$254 million, or 2.9 percent, in 2005, as continued strength in withholding is offset by an almost \$300 million, or 50 percent decline, in long-term capital gains, according to the forecast. In 2006, personal income taxes will increase \$325 million, or 3.6 percent, with further erosion in capital gains receipts. Sales taxes are projected to rise \$172 million, or 4.6 percent, in 2005 and \$169 million, or 4.3 percent, in 2006. Corporate profits taxes will increase \$193 million, or 19.3 percent, in 2005, with a slower, although still strong, \$112 million, or 9.4 percent, gain in 2006.

The Foundation's Massachusetts projection is based upon the October 2004 national economic forecast from Global Insight, Inc., an economic forecasting firm. Under the forecast, the continuing national recovery will create job growth of 1.6 percent in fiscal 2005 and 1.5 percent in 2006, and an unemployment rate averaging 5.4 percent in both years. While incomes will be buoyed by the expanding work force, growth in consumer spending will slow. As the Federal Reserve tightens interest rates further, mortgage rates will trend higher, cooling the housing market. Growth in the stock market is expected to remain in the low single digits, with an increase of 1.9 percent in fiscal 2005 rising to 3.9 percent in 2006. The major risk to the national economic forecast comes from the potential for higher inflation—especially if energy prices remain elevated—which would trigger more aggressive tightening of interest rates by the Fed, leading to a weakening of consumer confidence and spending, and slower growth.

While the Foundation has used conservative assumptions in developing its forecast, capital gains remain a major area of uncertainty. For most of the past decade, the amount of annual capital gains realized by Massachusetts taxpayers has been closely tied to overall movements in the stock market. The unexpectedly strong performance in fiscal 2004 is a break from that earlier pattern, which may reflect investors’ decisions in 2003 to accelerate sales of assets in a market that finally appeared to be reversing direction. Or it may signal the existence of unrealized gains (despite the poor market performance since 2000) that can continue to be tapped in the future. For purposes of the tax forecast, MTF has assumed that the recent gains are largely one-time, coming on top of the realizations that would be normally expected.

As a result of recent financial reforms that dedicate a portion of annual tax collections for specific purposes, the amount of tax revenues actually available for appropriation in the 2006 budget will be significantly less than the forecasted total. After deducting sales tax revenues earmarked for the MBTA and school building assistance as well as the amounts required to meet the Commonwealth’s pension funding obligations, taxes available for appropriation in fiscal 2006 will total \$14.9 billion, up \$532 million, or 3.7 percent, from 2005. Should tax collections exceed the forecast, the state’s tax cap (which requires that annual tax revenue growth in excess of inflation plus 2.0 percent be deposited in the stabilization fund) will limit the amount of the additional revenues available for appropriation to an estimated \$232 million in 2005 and \$284 million in 2006. In fiscal 2004, tax revenues exceeded the cap by \$715 million.

The Massachusetts Taxpayers Foundation is an independent, nonprofit organization that conducts research on state and local taxes, government spending, and the economy. Founded in 1932, MTF ranks among the largest and most effective organizations of its kind in the country. The Foundation has won eight prestigious national awards in as many years for its work on business costs, capital spending, state finances, MBTA restructuring, state government reform, and health care.

MASSACHUSETTS TAXPAYERS FOUNDATION
FISCAL YEAR FORECAST SUMMARY

GLOBAL INSIGHT NATIONAL FORECAST

	<<< History			Forecast >>>		
OCTOBER 2004	2001	2002	2003	2004	2005	2006
Personal Income (billions of 2000 \$)	8,428	8,420	8,452	8,679	8,960	9,232
% change	3.9	-0.1	0.4	2.7	3.2	3.0
Employment (millions)	132.3	130.9	130.1	130.3	132.4	134.3
% change	1.3	-1.0	-0.6	0.2	1.6	1.5
Unemployment Rate	4.1	5.5	5.9	5.8	5.4	5.4
CPI (% change)	3.4	1.8	2.2	2.2	2.5	1.4
PPI (% change)	5.2	-3.8	3.3	4.8	5.4	-0.9
Federal Discount Rate	5.3	1.8	1.6	2.0	3.0	4.1
Prime Comm Rate	8.7	5.3	4.4	4.0	5.0	6.1
Standard & Poor's 500 Index (% change*)	-16.4	-16.5	-3.2	16.3	1.9	3.9

	<<< History			Forecast >>>		
MTF MASS. ECONOMIC FORECAST	2001	2002	2003	2004	2005	2006
Personal Income (billions of current \$)	247.2	249.3	250.3	259.1	271.9	284.7
% change	8.3	0.8	0.4	3.5	4.9	4.7
Personal Income (billions of 2000 \$)	241.7	238.6	235.5	239.5	246.3	253.5
% change	5.8	-1.3	-1.3	1.7	2.9	2.9
Total Employment (000s)	3,352	3,281	3,217	3,172	3,188	3,211
% change	2.3	-2.1	-1.9	-1.4	0.5	0.7
Unemployment Rate	2.9	4.7	5.6	5.5	5.9	6.4

	<<< History			Forecast >>>		
MTF MASS. TAX FORECAST	2001	2002	2003	2004	2005	2006
Income Tax (millions \$)	9,903	7,913	8,026	8,830	9,085	9,409
% change	9.5	-20.1	1.4	10.0	2.9	3.6
Sales Tax	3,756	3,696	3,708	3,749	3,922	4,091
% change	5.3	-1.6	0.3	1.1	4.6	4.3
Corporations Tax	945	587	799	998	1,190	1,302
% change	-6.3	-37.9	36.3	24.8	19.3	9.4
TOTAL TAXES**	16,730	14,290	14,964	15,953	16,665	17,368
% change	6.6	-14.6	4.7	6.6	4.5	4.2
TOTAL TAXES FOR BUDGET***	16,075	13,626	14,279	13,867	14,368	14,900
% change	2.5	-15.2	4.8	-2.9	3.6	3.7

* 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 and other tax receipts dedicated to the MBTA, school building construction, and pension funding, as well as amounts in excess of the state's tax cap, which are required to be deposited in the stabilization fund.