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News Release

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MTF Forecast: **Slowing Revenue Growth in 2006 and 2007 as Employment Outlook Remains Weak**

Tax revenues will increase roughly five percent per year in 2006 and 2007—down from the almost seven percent average pace of the last two years—as the state’s workforce continues to expand at less than half the national rate, according to a forecast released today by the Massachusetts Taxpayers Foundation.

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 fiscal 2006 tax revenues will total \$17.94 billion, \$850 million above 2005. MTF's forecast for fiscal 2006 is \$490 million higher than the \$17.45 billion estimate on which the 2006 budget is based and \$17 million less than the revised forecast released by the Romney administration in October.

The state will collect \$18.92 billion of tax revenues in fiscal 2007, \$977 million or 5.4 percent above projected 2006 taxes, according to the Foundation's forecast. MTF's estimate is \$239 million higher than the administration’s 2007 forecast.

MTF State Forecast Summary			
	(\$, billions)		
	Fiscal 2005	Fiscal 2006	Fiscal 2007
Tax revenues ¹	\$17.09	\$17.94	\$18.92
Personal income	\$277.4	\$291.6	\$308.9
Employment (000)	3,193	3,214	3,237

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

“While the tax outlook is modestly positive for 2007, weak employment growth will be a significant drag on both the state’s economy and the Commonwealth’s revenues,” said Mr. Widmer. “At the same time, largely unavoidable growth in health care and other costs will consume most, if not all, of the projected increase in tax revenues—before taking into account proposals for expanded health care coverage and other new spending initiatives that are now under consideration.”

The Foundation’s forecast is predicated on slow population and employment growth that will be only partially offset by wage increases. MTF projects that Massachusetts employment will rise at an annual rate of 0.7 percent over the next two years, adding only 21,000 jobs in fiscal 2006 and another 23,000 in 2007. The projected 2007 employment is 114,000 below the peak in 2001.

Personal income taxes will rise \$409 million, or 4.2 percent, in 2006, a slowing from the almost ten percent increase in 2005 that is largely attributable to less rapid growth in capital gains and other non-wage income, as

well as to the impacts of several tax cuts. The cuts include the first year of capital gains refunds as a result of the legislative response to the *Peterson* case, an “automatic” increase in the personal exemption for 2005 required by current law, and recently enacted cuts such as the one-time home heating fuel deduction and the motion picture tax credit. In 2007, personal income taxes will increase \$722 million, or 7.2 percent. Sales taxes are projected to rise \$134 million, or 3.5 percent, in 2006 and \$277 million, or 6.9 percent, in 2007. Corporate profits taxes—one of the most volatile revenue sources—will increase \$192 million, or 18.1 percent, in 2006, and then decline by \$119 million, or 9.5 percent, in 2007, as firms doing business in the state are affected by a projected nationwide drop in corporate profits.

Capital gains will remain an important source of revenues in 2006 and 2007—topping \$1 billion annually and accounting for more than 10 percent of income tax receipts. According to the forecast, capital gains revenues will grow between 10 and 15 percent per year in both 2006 and 2007, a pace that is roughly one-fifth the explosive rate of increase of the previous two years. Historically, capital gains has proven to be one of the most volatile tax sources; plummeting capital gains receipts were a major contributor to the almost 15 percent decline in tax revenues in 2002.

The Foundation's Massachusetts projection is based upon the November 2005 national economic forecast from Global Insight, Inc., an economic forecasting firm. Under the forecast, growth in the national economy will gradually ease as both the housing market and consumer spending cool. Although Hurricanes Katrina and Rita—and the resulting high energy costs—have dampened growth temporarily, that pause will be made up as reconstruction gets underway in the first half of calendar 2006. National job growth will maintain a relatively steady pace of 1.6 percent in fiscal 2006 and 1.5 percent in 2007, with an unemployment rate just under five percent in both years. Inflation risks will keep the Federal Reserve on its current path of incremental tightening. Growth in the stock market is expected to slow to seven percent in fiscal 2006, decelerating further to just over three percent in 2007.

While annual tax revenue growth of five to six percent is good news, it will do little to relieve the limited flexibility in the state budget. Based on the Foundation's analysis, even with the higher MTF forecast, the fiscal 2006 budget is at best barely in balance, due to the reliance on \$600 million of stabilization funds to support 2006 spending. In 2007, the forecasted increase in tax receipts will be fully offset by cost growth in health care, pensions, and debt service; prior commitments to increase spending for local education, school construction, and removal of the lottery cap; and inflation. Additional spending authorizations in 2006 and the potential impact of pending health care proposals in 2007 and beyond will only add to the budgetary pressures.

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 numerous prestigious national awards over the last decade 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 >>>	
NOVEMBER 2005	2002	2003	2004	2005	2006	2007
Personal Income (billions of 2000 \$)	8,419	8,446	8,647	8,960	9,203	9,595
% change	-0.1	0.3	2.4	3.6	2.7	4.3
Employment (millions)	130.9	130.1	130.5	132.6	134.6	136.7
% change	-1.0	-0.6	0.3	1.6	1.6	1.5
Unemployment Rate	5.5	5.9	5.8	5.3	4.9	4.8
CPI (% change)	1.8	2.2	2.2	3.0	3.6	1.6
PPI (% change)	-3.8	3.3	4.8	6.9	8.8	-2.1
Federal Discount Rate	1.8	1.6	2.0	3.2	5.1	5.8
Prime Commercial Rate	5.3	4.4	4.0	5.2	7.1	7.8
Standard & Poor's 500 Index (% change*)	-16.4	-16.5	-3.2	17.3	6.6	5.3

			<<< History		Forecast >>>	
MTF MASS. ECONOMIC FORECAST	2002	2003	2004	2005	2006	2007
Personal Income (billions of current \$)	249.2	251.1	262.2	277.4	291.6	308.9
% change	0.9	0.7	4.4	5.8	5.1	5.9
Personal Income (billions of 2000 \$)	238.5	235.9	240.9	248.3	253.6	263.1
% change	-1.2	-1.1	2.1	3.1	2.1	3.8
Total Employment (000s)	3,278	3,214	3,176	3,193	3,214	3,237
% change	-2.2	-2.0	-1.2	0.5	0.7	0.7
Unemployment Rate	4.7	5.7	5.6	4.8	4.6	4.6

			<<< History		Forecast >>>	
MTF MASS. TAX FORECAST	2002	2003	2004	2005	2006	2007
Income Tax (millions \$)	7,913	8,026	8,830	9,690	10,099	10,821
% change	-20.1	1.4	10.0	9.7	4.2	7.2
Sales Tax	3,696	3,708	3,749	3,886	4,021	4,298
% change	-1.6	0.3	1.1	3.7	3.5	6.9
Corporations Tax	587	799	998	1,063	1,255	1,135
% change	-37.9	36.3	24.8	6.5	18.1	-9.5
TOTAL TAXES**	14,290	14,964	15,953	17,087	17,940	18,917
% change	-14.6	4.7	6.6	7.1	5.0	5.4
TOTAL TAXES FOR BUDGET***	13,626	14,279	13,867	14,368	15,464	16,290
% change	-15.2	4.8	-2.9	3.6	7.6	5.3

* 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 and school building construction, tax revenues dedicated to pension funding, and net revenues in excess of permissible tax revenues.