Massachusetts Taxpayers Foundation

MTF

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

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MTF's Analysis of the 2018 Revenue Forecast

The Secretary for Administration and Finance and the Chairs of House and Senate Ways and Means Committees have agreed to assume $27.072 billion in tax revenue in FY 2018. This amount represents 3.9 percent growth over expected FY 2017 revenues. While this level of projected growth is low compared to recent agreements, it exceeds both recent collection trends and the majority of revenue forecasts presented at the recent Consensus Revenue Hearing.

Tax revenue agreement in context

When compared to the revenue assumptions used in recent budgets, the FY 2018 agreement is relatively conservative – falling below 4 percent for the first time since FY 2014. However, revenue growth of 3.9 percent when compared to recent collection trends seems optimistic.

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Consensus Revenue Assumption	3.90%	4.90%	4.74%	4.31%	3.90%
Actual (not including tax settlements)	4.29%	7.72%	2.29%	*2.34%*	
** FY 2017 actual revenue growth through December*					

Year-over-year tax revenue growth fell well short of 3.9 percent in FY 2016 and is expected to do so again in FY 2017. Combined, actual collections in those two years fell short of budget estimates by more than $600 million.

The revenue growth agreement also falls on the high side of the revenue forecasts presented at the Consensus Revenue Hearing held on December 5th outlined in the chart below:

	2017 Projection	2018 % Growth	2018 Projection	2018 $ Growth	2018 Cap Gains	Cap Gains Above Threshold
BHI	$26,405	5.17%	$27,771	$1,366		
Economy.com (DOR Vendor)	$26,085	3.91%	$27,104	$1,019	$1,365	$197
CR Agreement	***$26,056***	***3.90%***	***$27,072***	***$1,016***	***$1,271***	***$103***
Alan Clayton Matthews	$26,296	3.69%	$27,267	$971	$1,423	$255
DOR Midpoint/Current	$26,056	3.46%	$26,957	$901		
Global Insight (DOR Vendor)	$25,979	3.20%	$26,810	$831	$1,188	$20
MTF	$25,953	2.65%	$26,640	$687	$1,380	$212

The consensus revenue agreement mirrors the Economy.com forecast, which also projects 3.9 percent tax revenue growth. In contrast, four of the other five vendors projected tax growth of 3.69 percent or less. The Foundation projected the lowest revenue growth for FY2018 at 2.65 percent in light of sluggish recent collections and heightened economic uncertainty.

The variance in the growth assumptions represents a relatively small revenue impact – revenues change by $26 million for each tenth of a percentage point difference – but speaks more broadly to differing economic outlooks and risk tolerance for the coming year. The higher the forecasted tax growth, the more optimistic the projection is regarding the national economy and improving state collections. Just as importantly, the higher the forecast, the greater the risk of a midyear budget gap should revenues fall short.

The Consensus Revenue agreement encompasses several other major budget items:

- Capital gains tax revenue – By law, capital gains revenue in excess of a sustainable threshold (approximately $1.168 billion in FY 2018) is set aside from the General Fund, which 90 percent of the excess going to the Stabilization Fund. This year's agreement assumes $1.271 billion in capital gains revenue, meaning that $103 million is not available for use in the budget.
- Pension funding – Every three years the Consensus Revenue agreement must settle on an actuarially sound pension funding schedule. Budget-makers have agreed to an adjusted schedule for FY 2018 in which the state's annual pension contribution will increase by 9 percent each year until 2036. Under this agreement, that will increase the pension contribution by $196 million over FY 2017 to $2.395 billion, the state stays on course to fully fund its pension obligations by 2036. In each of the last three years, the pension contribution increased by 10 percent annually.
- School Building Authority – the state's School Building Authority (SBA) receives one cent of the sales tax as a pre-budget transfer. The Consensus Revenue agreement assumes a $841 million transfer to the SBA in FY 2018.
- MBTA – the MBTA also receives a pre-budget transfer that is equal to the greater of:
    - The previous year's transfer after adjusting for inflation (capped at 3 percent growth); and
    - One penny of the sales tax plus $160 million.

  This year's agreement assumes an MBTA pre-budget transfer of $1.007 billion.

- Workforce Training – all Unemployment Insurance (UI) surcharges received by the state are set aside from the General Fund and dedicated to Workforce Training. The agreement estimates $22.9 million in FY 2018 UI surcharges.

The agreement also assumes that state revenue growth, and other factors, will be sufficient to trigger a reduction in the income tax rate from 5.1 percent to 5.05 percent in calendar year 2018.

Implications for the FY 2018 budget

The consensus revenue agreement becomes the cornerstone for the FY2018 budget: all budget makers will rely on an increase of just over $1 billion in tax revenue. From that $1 billion figure, up to 33.6% will be tabbed for reserves and the transfers described above, leaving $674.6 million for the operating budget. From this same tax revenue foundation, the Administration, House and Senate budgets will diverge in the spending and other revenue decisions necessary to craft a spending plan.

The Foundation estimates that, given this revenue agreement, the state faces a structural deficit of more than $800 million in FY 2018.

The decisions made to close that deficit in the coming months will influence whether or not the state can avoid a 4th consecutive round of midyear budget problems. The assumption of 3.9 percent tax revenue growth – compared to 4.31 percent at this time last year – indicates a more conservative approach to budgeting but given that tax revenue has grown by just 2.28 percent in FY 2016 and 2.34 percent to date in FY 2017, it remains to be seen if these budget assumptions are conservative enough.