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# News Release

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## *FY 2022 Tax Revenue Forecast*

FY 2022 tax revenues are projected to rise to $29.73 billion, a $1.54 billion or 5.5 percent increase from the most recent FY 2021 projection of $28.19 billion. The Massachusetts Taxpayers Foundation FY 2022 forecast is $1.68 billion more than the Baker administration's revised FY 2021 revenue benchmark of $28.05 billion announced Friday, December 11, representing a 6.0 percent year-over-year increase.

This improved fiscal outlook is based on MTF's projections that withholding income tax will jump by $522 million (3.9 percent) and sales tax revenues by $484 million (7.1 percent), in FY 2022. MTF estimates that corporate taxes will grow by $133 million and the catch-all category of "other tax revenues" will increase by $297 million, or 15 percent, driven largely by rebounds in motor fuels and room occupancy taxes (Table 1).

**Table 1 – State Tax Revenues by Category**

($ Millions)

| | | | | FY 22 vs FY 21 | | |
|---|---|---|---|---|---|---|
| | **FY 19** | **FY 20** | **FY 21** | **FY 22** | **$ Change** | **% Change** |
| **Income** | | | | | | |
| Withholding | 13,208 | 13,736 | 13,381 | 13,903 | 522 | 3.9% |
| Non-withholding | | | | | | |
| Capital Gains | 2,060 | 1,659 | 1,313 | 1,389 | 76 | 5.8% |
| Other Non-withholding | 1,858 | 1,993 | 1,536 | 1,567 | 31 | 2.0% |
| **Sales** | 6,842 | 6,846 | 6,818 | 7,302 | 484 | 7.1% |
| **Corporate** | 3,347 | 2,948 | 3,159 | 3,291 | 133 | 4.2% |
| **Other Tax Revenues** | 2,518 | 2,487 | 1,978 | 2,275 | 297 | 15.0% |
| **Total** | **29,834** | **29,670** | **28,186** | **29,728** | **1,542** | **5.5%** |

“While the FY22 forecast represents an improved fiscal outlook from the dark, early days of the pandemic that influenced our FY21 revenue projections, we are still not out of the woods. All the optimistic assumptions concerning vaccine distribution, efficacy and inoculation rates and the ensuing speedy economy recovery upon which this forecast is based must materialize for the FY 22 revenue projection to be realized. Given the unprecedented level of uncertainty the pandemic has prompted, we would still urge a conservative approach to budgeting” cautioned Eileen McAnneny, President of MTF.

Longer-term, McAnneny noted that “lawmakers need to be paying close attention to fundamental shifts in the economy that could have significant budgetary implications. Zoom meetings, telework, telehealth, remote learning, food delivery services – all have changed the way people communicate and socialize. Whether or not these potentially seismic changes persist post-pandemic will dictate how the state’s economy evolves and their future impact on tax revenues.”

**FY 2022 ASSUMPTIONS / RISKS – ABUNDANT UNCERTAINTY**

MTF’s FY 2022 forecast makes assumptions in four key areas, one of which is based on the baseline scenario used by Moody’s Analytics, which warrant further explanation. What follows is a more descriptive summary of these four topics and updated information where appropriate.

**1. Rate of Vaccination**

MTF assumes that vaccines are widely distributed in Massachusetts this spring and that a large majority of residents both here and across the U.S. are vaccinated by the summer. If 70 percent of the population is inoculated against COVID-19 by then, which is what MTF’s forecast assumes, people should have sufficient confidence to reengage socially and economically for the first time in 15-18 months, sparking growth in the state’s economy and an upsurge in tax revenues. In order for the United States to achieve these inoculations levels, the distribution of the vaccine must go smoothly, the public health infrastructure for vaccinating must work, the efficacy of the vaccine must remain high and the population must sufficiently trust in the safety of the process to get vaccinated.

2. **Uncertainty surrounding Federal Relief Package**

MTF's forecast assumes that there will be a $1.5 trillion relief/stimulus package enacted in the first quarter of 2021 "with the bulk in unemployment insurance and stimulus checks to individuals and aid to small businesses along with airlines. The package is expected to also include aid to state and local governments."[1]

The status of a relief package remains uncertain, but indications are that the package could total $908 billion, substantially less than the figure Moody's Analytics assumes. The latest news from Washington suggests that Congress might enact two separate aid packages. One would address the two points of contention – $160 billion in financial aid to state and local governments and liability protections for businesses to protect against coronavirus-related lawsuits. The other would provide $748 billion in extended UI benefits, small business assistance and money for health-care providers, among other forms of relief. Should Congress not act before the end of this legislative session, it is difficult to handicap the chances of a major relief initiative next year with control of the Senate in 2021 still unknown. The absence of sufficient federal funds would have direct impacts on the Commonwealth's and its municipalities' budgets, and could also prolong the recession by slowing the recovery if the purchasing power of individuals and small businesses dries up due to the expiration of federal assistance programs.

3. **Labor Market Struggles**

Massachusetts faces three challenges to the growth of its labor force: (1) a shrinking labor pool (2) high unemployment rates and (3) the uncertainty surrounding continued relief for the non-traditional workforce.

The pandemic appears to have accelerated the state's demographic trend of a declining number of work-aged people. Prior to the pandemic, when, Massachusetts had record-low unemployment, our workforce was contracting due to older workers exiting the work force and an insufficient number of work-age people to backfill those openings. The pandemic has accelerated this trend, helping to push 228,000 people from the Massachusetts labor force since January, which shrunk from 3.84 million to 3.61 million in October.[2]

[1] Moody's Analytics, Baseline Scenario Narrative for November 2020. MTF's FY 2022 econometric model relies in part on data from Moody's Analytics.
[2] *Civilian Labor Force in Massachusetts*, FRED, Federal Reserve Bank of St. Louis, Updated November 20, 2020.

Massachusetts continues to suffer from higher unemployment than the nation as a whole. Massachusetts has a 7.4 percent unemployment rate and there are approximately 345,000 fewer people employed in November than there were in February before the pandemic. The state has recovered half of lost jobs since February, but employment growth has slowed considerably, and the state is not projected to return to the 3.7 million employed in February 2020 until late 2024.[3]

Additionally, members of the gig economy, i.e. independent contractors, self-employed individuals and other non-traditional workers have suffered greatly during the pandemic. There were 403,891 continued claims under the Pandemic Unemployment Assistance (PUA) program as of November 21 for people who are ineligible for traditional unemployment insurance benefits. There were another 175,774 claims under the Pandemic Emergency Unemployment Compensation (PEUC) program that extends benefits for an additional 13 weeks after people have exhausted those initial UI benefits.[4] The PUA and PEUC programs expire before year's end. If these programs are not extended, more than a half-million people could see their incomes dissipate.

These labor market hurdles – getting people back to work, especially those who could lose their UI benefits in less than two weeks – could constrain economic growth and limit the size of the tax revenue recovery.

**4. Nature of the Economic Recovery**

Economic reengagement in the short-term depends greatly on containing the virus and the success of the vaccine roll-out. Should there be hiccups that delay widespread inoculation, it will impact the timing of the recovery.

Longer-term, the lasting effects of the pandemic will vary greatly by sector. Some sectors, such as professional services, have transitioned to new working models that yield similar or improved productivity at lower costs, improving the profit margin for many companies.

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[3] Moody's Analytics forecast, December 8, 2020.
[4] *Unemployment Insurance Weekly Claims*, U.S. Department of Labor, December 10, 2020.

Businesses have substituted virtual meetings for travel and conferences with a growing mindfulness of reduced costs and time. Remote work, stress tested for nine months, has proven to be more productive than first thought. As a result, many employers have stated a preference to pare down office space to reduce costs. While there will be a return to work in the office – many companies have expressed a growing acceptance of hybrid work models and new emphasis on remote work to reduce expenses and expand pools of talent.

Should these changed practices be widely and permanently adopted, there could be profound implications, both good and bad, for the Massachusetts economy. Take remote working as an example. On the one hand, remote working could enable companies to attract the best and brightest from a global talent pool. On the other, Massachusetts' highly educated workforce, our economic differentiator, could choose to relocate to lower-cost or more attractive jurisdictions, taking their taxable salaries and purchasing power with them.

Other sectors, such as travel, accommodations, and tourism that have been hard-hit by the pandemic, face a more uncertain economic future. They will struggle to recover should businesses permanently reduce travel budgets, employees continue to work remotely, and tourists seek vacation destinations closer to home. These changes will likely reduce their customer base and intensify competition.

Even higher education could be impacted, should fewer out-of-state and international students enroll in Massachusetts schools or the costs become unaffordable for a growing swath of the population. Some institutions that were already experiencing fiscal challenges before the pandemic could see a further decline in net revenue due to these additional barriers to enrollment growth. This is especially true for those institutions with a percentage of international students.

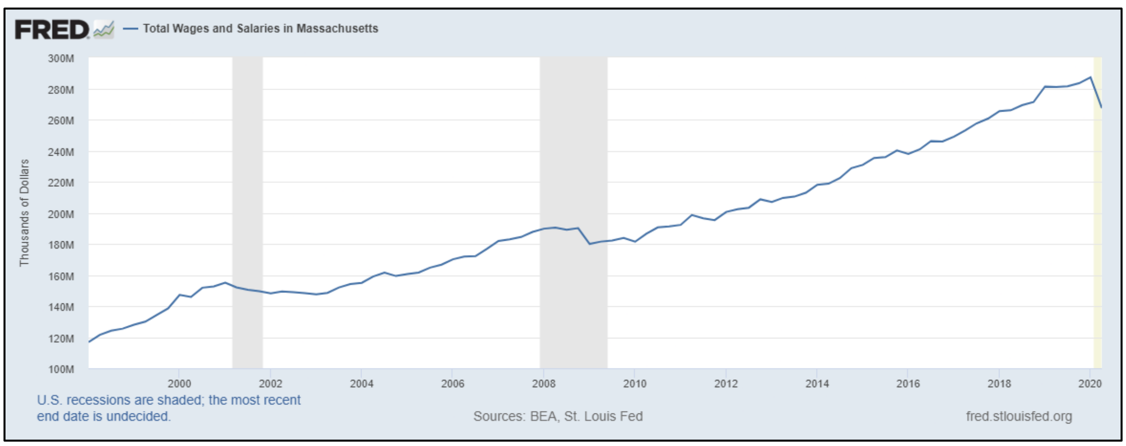
In other words, the pandemic has inflicted permanent and structural changes to the economy that we are only beginning to understand and appreciate. The flood of federal dollars into the Massachusetts economy to date has masked the consequences of these changes. How these changes affect the state's recovery and tax revenues on a go-forward basis will not fully emerge until the recovery is well underway.

## FY 2021 Tax Revenues Fare Better than Expected – So Far

MTF revised its FY 2021 forecast from ANF's October revised revenue benchmark of $27.6 billion due to stronger than expected withholding income tax and sales revenues through the first five months of the fiscal year. The revised revenue figure of $28.2 billion is $135 million greater than ANF's revised benchmark of $28.05 billion.[5]

In the fourth quarter of FY 2020, the state experienced a loss of 600,000 jobs and a steep decline in wages and salaries. In that three-month period, wages and salaries plummeted by $19.8 billion, falling to $267.4 billion from $287.2 billion.[6] Given this 6.9 percent decline in wages and salaries, one would expect a correlating loss of $500 million to $600 million in withholding income tax revenues, but that did not happen. Instead, in the fourth quarter of FY 2020, withholding tax revenues increased by $92 million, or 2.9 percent, over year-over-year.

**Figure 1 - Total Wages and Salaries in Massachusetts, 1998 - 2020**




In FY 2021, despite 346,000 fewer people working, withholding income taxes have increased by $246 million, or 4.6 percent, through November compared to November 2019.

Clearly, this spring's $3 trillion federal relief package offset anticipated tax losses, adding hundreds of millions in withholding income tax revenues from enhanced unemployment insurance benefits. A range of other federal relief programs, such as the $1,200 stimulus

[5] The Baker administration's revised base tax estimate of $28.051 billion does not include $339 million in tax adjustments from an accelerated sales tax ($267 million), a one-year delay in charitable deductions ($64 million), tax settlements ($50 million) and $7 million in other initiatives.

[6] *Total Wages and Salaries in Massachusetts*, FRED, Federal Reserve Bank of St. Louis, Updated September 2020.

checks to tax filers from the IRS, helped to boost sales tax revenues for goods by 8.4 percent and motor vehicle excise by 10 percent through the first five months of the current fiscal year.[7]

However, the state faces mounting risks in the remaining six months.

The pandemic has surged to startling heights, reaching a seven-day national average of over 200,000 daily cases – 4.7 times the rate at the time of the last economic forum in October.[8] The spike in new cases, deaths, and hospitalizations, overwhelming hospitals across the country, is forcing cities and states to roll back reopening plans, causing greater economic damage to businesses and workers.

As COVID-19 surges and economies close down, a federal relief package has become all the more critical. The size of the package currently being considered in Washington - $908 billion is $600 billion less than anticipated in this forecast and one-third that of the previous package and may be insufficient to mitigate the economic impacts.

As noted earlier, if unemployment insurance programs are not extended, it could pose a major problem for the nearly 580,000 people receiving UI funds from the two federal relief programs (PUA and PEUC) set to expire December 26, 2020.

Absent another relief package to bridge the period from now until the economic recovery begins in earnest, the trajectory of the recovery could change and take a longer and slower course than previously anticipated.

[7] Eligibility extends to $99,000 for single filers and $198,000 for joint filers but the payment amount is reduced by $5 for each $100 above the $75,000/$150,000 thresholds.

[8] The seven-day average of new cases in Massachusetts now exceeds 4,500 or nearly 8-times the rate at the last economic forum on October 7.