

## ECONOMIC LANDSCAPE FOR THE 2019 LEGISLATIVE SESSION

As the fiscal year (FY) 2019 legislative session prepares to open, a snapshot of the economic landscape in Georgia and the U.S. shows robust conditions. Job markets are very tight with unemployment low at less than 4 percent in both Georgia and the U.S. Job growth is sturdy in Georgia with non-farm employment growth averaging 2.1 percent year-over-year in the three months ending October 2018. This is well-above U.S. job market growth of 1.7 percent. Thus, Georgia's economy is creating significant job opportunities for the state and this is translating into growing incomes for Georgia's families.

Total personal income in Georgia grew 4.6 percent year over year in the most recent quarterly data; this compares to 4.3 percent in the U.S. This continues a long period in which total personal income in Georgia has grown generally in line with or exceeding the growth rate for U.S. total personal income. One ongoing concern has been that middle class workers have been left out of the economic recovery with stagnant wages that have not kept up with the pace of inflation. However, real (inflation adjusted) median household income in Georgia grew 4.3 percent in 2017 compared to 1.8 percent for the U.S. indicating middle class families have begun to share in the benefits of economic growth.

This robust economic growth has contributed to rapid growth in tax revenues. Through the first five months of FY 2019, Georgia's Department of Revenue has reported total tax revenue growth of 6.8 percent over the same period in FY 2018, which exceeds the 2.3 percent growth in general fund revenues required to achieve the existing

FY 2019 budget estimate. Revenue growth has been exceptional in the individual income tax, corporate income tax and general sales tax reflecting the underlying strong growth in the economy. This strong revenue growth, combined with the midterm adjustment is likely to lead to additional revenues available in the amended FY 2019 budget. Some additional revenue has already been appropriated for storm emergency and other purposes during the recent special session.

While this current snapshot is excellent, there are three key trends to keep in mind.

### **Federal fiscal policy has boosted U.S. and Georgia economic growth.**

The Tax Cut and Jobs Act, passed in late 2017, has boosted economic growth. Similarly, increased federal spending included in the two-year budget act, passed in early 2018, is also expected to provide stimulus. As shown in Figure 1, U.S. real gross domestic product soared over 4 percent in the second quarter of 2018 and posted a robust 3.5 percent growth rate in the third quarter. Growth in 2018 is expected to run at or above 3 percent for the year, well above the rate of growth for much of the Great Recession recovery and expansion period.

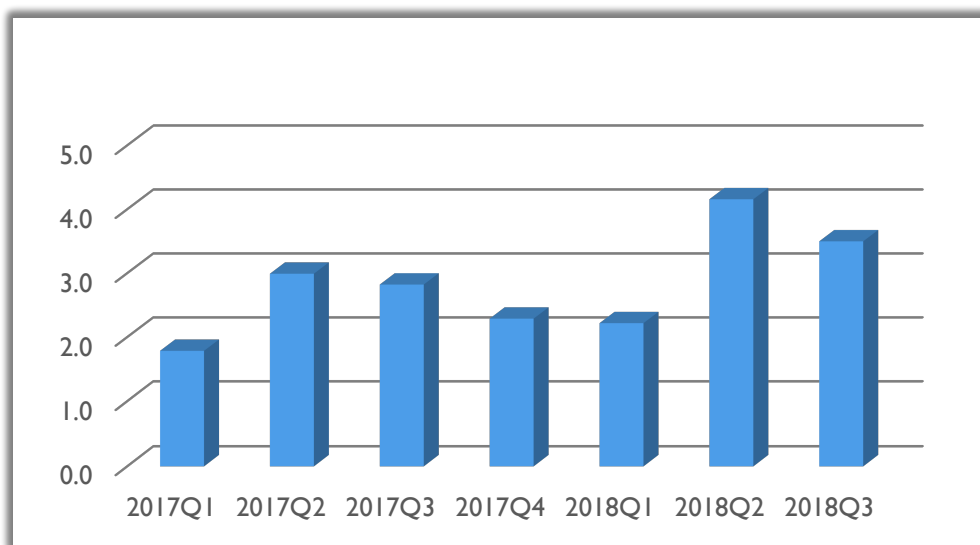
Initially, the increase in growth from federal tax and spending policy comes from greater spending power for households and more after-tax cash flow for businesses and investors. However, the stimulative effects will diminish over time and will weigh on growth prospects in late 2019 and 2020.

On the other hand, these lower tax rates policies can potentially spur long-term growth prospects

for the economy. This depends on these policies permanently increasing productivity by expanding investment by businesses and increasing the labor force

with incentives for more citizens to seek work. So far, the TCJA has not yet had a notable impact on labor force participation nor on business investment.

**Figure 1. U.S. Real GDP (% Change SAAR)**

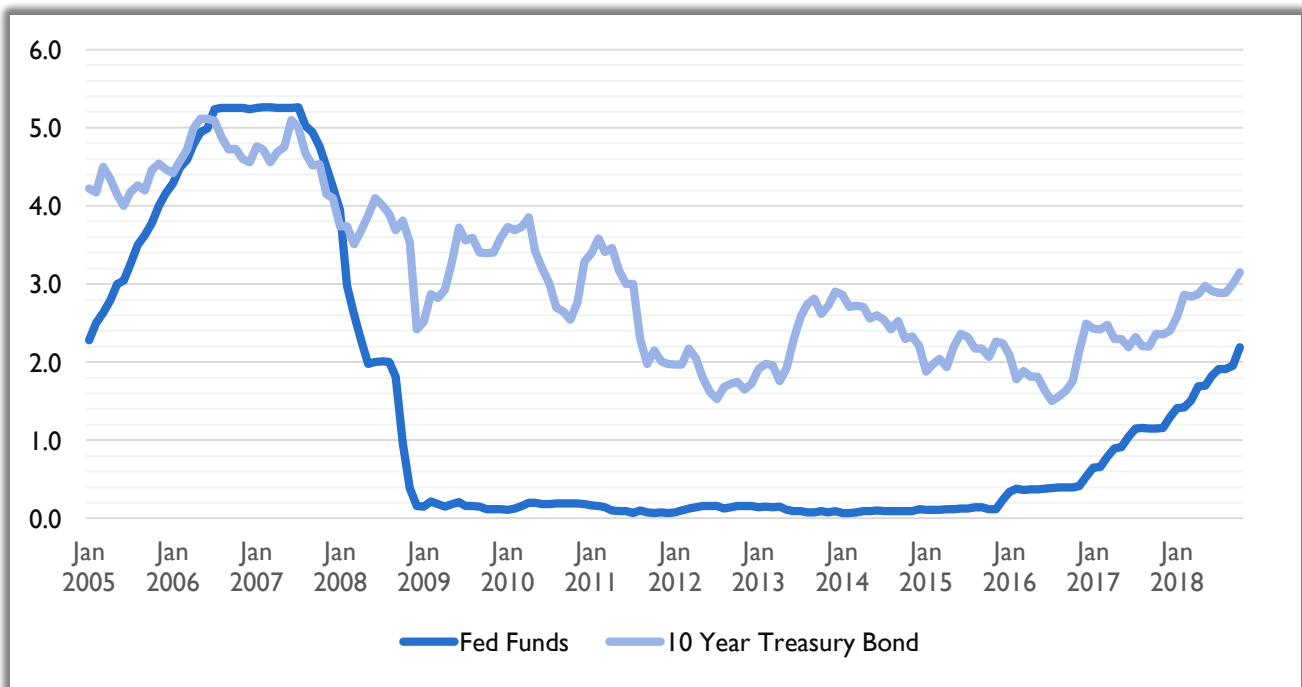


### **Interest rates are rising and could weigh on future growth.**

While fiscal policy has been expansionary, monetary policy has sought to slowly reduce the amount of accommodation in the financial system and move toward a neutral monetary policy. This is clearly seen in the steady increases in the state's rate of federal funds over the past two years as shown in Figure 2. Prior to the Great Recession, the federal funds rate reached as high as 5 percent. Following the Great Recession, monetary policy was highly accommodative and the federal funds rate was essentially at the zero lower bound for about five years. Rate increases began in late 2015 but have ramped up with improving job market conditions,

overall economic growth and soundness of the financial system. With fiscal policy stimulating growth, the Federal Reserve is expected to continue to slowly raise interest rates. In addition, the higher U.S. government's borrowing in order to finance increased federal budget deficits from the tax cuts is expected to add to upward pressure on interest rates. A higher interest rate environment is intended to prevent the economy from overheating and inflation from accelerating. It works through slowing down interest rate sensitive sectors such as housing and vehicle sales. In recent months, both housing and vehicle sales have softened a bit but are still near cyclical peaks indicating higher interest rates may be starting to have an impact on the real economy.

**Figure 2. Interest Rate Trends**

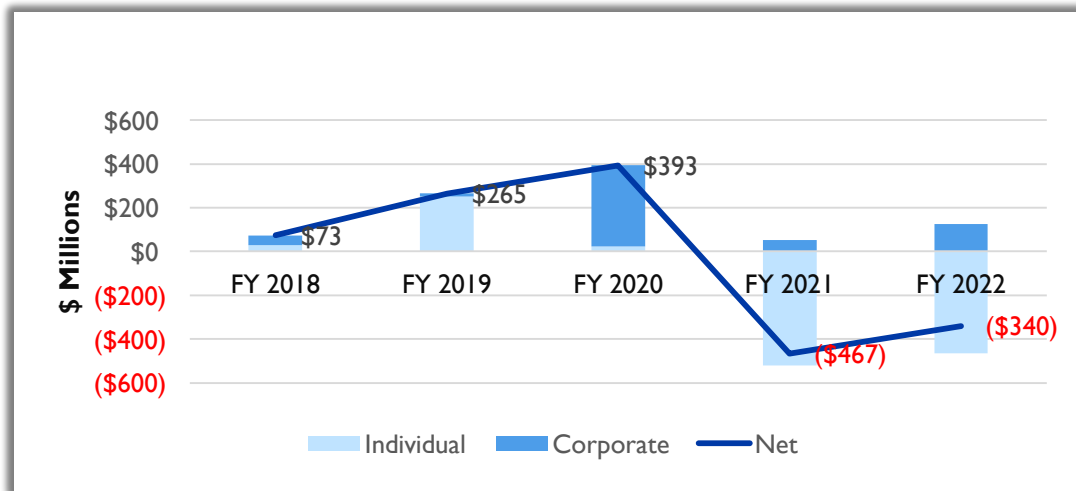


**Georgia's tax reform implementation is in process and will enhance revenues initially but significantly cut taxes in the medium term.**

Federal tax reform broadened the tax base (reduced or eliminated deductions) and lowered tax rates. Georgia's legislature passed HB 918, a tax reform strategy which adopted many of the federal rules on deductions and implements a three-phased approach to reducing tax liabilities. First, the standard deduction for tax payers that do not itemize deductions was doubled effective Jan. 1, 2018. Next, the top marginal tax rate on corporate and individual income tax will be reduced from 6.0 percent to 5.75 percent on Jan. 1, 2019. Third, this top marginal rate is scheduled to be reduced to 5.5 percent on Jan. 1, 2020 but this requires the General Assembly and the governor to ratify this reduction.

Figure 3 shows estimated changes in Georgia tax revenues assuming the final rate reduction is ratified due to the restructuring of Georgia's tax code from HB 918. These changes are additions to, or reductions from ongoing organic growth in revenues under the tax structure absent HB 918 modifications. As shown in Figure 3, the phase-in results in revenue enhancements during its first three fiscal years in effect. Once the final tax rate reduction is implemented, the new tax structure is expected to result in significant revenue decreases compared to the previous tax structure. The FY 2019 legislative session will consider a budget for FY 2019 and FY 2020, fiscal years during which tax reform is expected to add to revenue growth. However, budget writers will need to bear in mind the expected negative impact on revenue growth from the final phase of tax reform in FY 2021 in order to maintain appropriate budget flexibility.

**Figure 3. HB 918 – Revenue Impacts**



## About the Author

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**Ken Heaghney** is the director of the Fiscal Research Center. He also is Georgia's state economist, serving in this role since January 2005. As the state economist, Heaghney's primary responsibility is preparing forecasts of tax and fee revenues for use in budget planning. In addition, he is responsible for preparing estimates of revenue impacts of alternative tax policies. Other duties include communicating state economic trends and revenue performance to bond rating agencies, monitoring state revenue performance, and monitoring economic conditions and outlook. Prior to his appointment, Heaghney had extensive consulting experience working with business leaders on a wide range of economic problems and issues. Much of his consulting work was in the areas of pricing and revenue management. Heaghney holds a Ph.D. in economics from Rice University and a B.S. degree in business administration from the University of Missouri.

## About the Fiscal Research Center

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