Massachusetts Taxpayers Foundation

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July 7, 2017

Initial Summary of FY 2018 Conference Budget

Today, the Legislature voted to enact a $40.2 billion budget for FY 2018. This year's budget reconciliation process was hampered by several major challenges – most notably the need to reduce expected tax revenues from the amount used in both the House and Senate plans.

Spending Comparison					
	FY 2018 House 1	FY 2018 House	FY 2018 Senate	FY 2018 Conference	Difference v. H1
Line item spending	$40,909.0	$40,830.0	$40,792.2	$40,407.6	-$501.4
Reversion assumption	$0.0	$0.0	$50.0	$205.0	$205.0
Off Budget	$4,300.6	$4,300.6	$4,300.8	$4,273.2	-$27.4
Total spending	$45,209.6	$45,130.6	$45,143.0	$44,885.8	-$323.8

The final budget compromise is a strong attempt to right the state's fiscal ship in FY 2018. However, by not including any MassHealth cost reforms proposed by the Governor, the budget does not address the state's most pressing long-term fiscal challenges.

This initial summary outlines the spending and revenue assumptions in this budget and highlights several notable policy provisions.

Tax revenue assumption

The conference budget uses an updated Consensus Tax Revenue number of $26.4 billion, $650 million less than the original tax estimate used in the House and Senate budgets.

Original Consensus revenue	$27,072
Conference reduction	-$733
Income tax rate impact	$83
Updated Consensus Revenue	$26,422

As the chart above shows, conferees reduced tax revenue by $733 million, but that number is offset by $83 million in tax revenue now expected from the income tax rate remaining at 5.1 percent. The original Consensus Revenue estimate assumed the rate would decrease to 5.05 percent in 2018. This new tax revenue assumption and growth rate falls within the range presented to budget-makers by the Foundation and other economists in early June, but still relies on year over year tax revenue growth of around 3 percent; a rate of growth that far exceeds the FY 2017 growth rate of 1.2 percent and may still prove to be overly optimistic.

Closing the Budget Gap

Reducing tax revenues by $733 million required budget makers to offset that amount through a combination of new revenues and spending reductions. In addition, lawmakers wisely chose to create a new $104 million reserve to support programs that are commonly underfunded in the budget. While these actions put the state in a much stronger fiscal position heading into the fiscal year, it means that the conferees had to address an $837 million budget gap and they employed a variety of measures to do so:

	FY 2018
Tax revenue reduction	***-$733***
Increase to underfunded accounts	-$104
Total gap	-$837
Tax Revennue Offsets	
Elimination of income tax reduction	$83
Reduced pre-budget transfers	$28
Spending Cuts	
MassHealth cuts (from H1)	$387
MassHealth revenue offset	-$164
Other cuts (from H1)	$219
Other Solutions	
Reversions/savings	$205
Increased assessment revenue	$20
Other revenue upgrades	$60
Solutions	***$837***

Most notable is the sizeable reduction in spending compared to earlier versions of the budget –$442 million in net cuts as well as a $205 million assumption of appropriated funds that will go unspent (reversions). A further $111 million came from other tax assumption changes. Because estimated sales tax revenues have been reduced from the Consensus Revenue estimate, associated transfers to the School Building Authority (SBA) and MBTA were also reduced by $27 million. The state's statutory income tax rate reduction is no longer assumed for January, saving an additional $83 million.

This budget takes a much different – and more fiscally responsible – approach to closing this $837 budget gap than compared to that used in FY 2017:

	FY 2018	FY 2017
Tax revenue downgrade	$733	$750
Amount set aside for underfunded accts	$104	$0
Reduction of stabilization transfer	$0	$206
Net spending cuts	$442	$197
Reversions	$205	$152

Conferees did not opt to reduce the $98 million Stabilization Fund deposit assumed in their budget as a means to close the budget gap as they did in FY 2017 when budget-makers eliminated an assumed $206 million deposit into the rainy day fund. Furthermore, the FY 2018 budget attempts to fully fund typically underfunded accounts and instead made $442 million in new spending reductions from other areas. In FY 2017, many of the "cuts" used to close the budget gap came in accounts that required supplemental funding later in the year. The one common approach to balance the budget in both this year's budget and FY2017 is the reliance on a substantial reversion assumption. While it is likely that at least $200 million in appropriated funds will go unexpended, relying on it at the start of the year limits financial flexibility in the months ahead.

Major Revenue Decisions

The biggest revenue decision facing conferees, aside from how to adjust total tax revenues, was how to address the employer assessment first proposed by the Governor. In June, Governor Baker proposed a reformulated assessment as a part of a larger package to reduce costs in MassHealth and the private insurance market and mitigate the impact of the assessment on employers by adjusting Unemployment Insurance (UI) rate schedules. Under the new assessment, the Employer Medical Assistance Contribution (EMAC) would be increased for all employers by $26 per employee, while a $750 EMAC would be paid for all employees receiving health care through MassHealth or ConnectorCare. This assessment is expected to generate $200 million in FY 2018. The conference report adopts the Governor's EMAC proposal as well as the UI schedule changes, but does not include any of the other insurance changes or MassHealth reforms.

The conference budget also includes $125 million in revenue from an accelerated sales tax remittance initiative. First put forth by the Governor, this policy has received strong criticism from impacted retailers and credit card companies due to a host of implementation and cost concerns. In light of that criticism, the conference budget requires the Commissioner of Revenue to certify that any sales tax acceleration can be implemented in a cost effective manner in the next twelve months. If that certification is not possible, the initiative will not go forward.

	House	Senate	Conference
Debit/credit income (1099K)	$20	$20	$20
Online Sales Tax	$30	$30	$30
EITC Change	$10	$10	$10
Temporary Accommodations	$0	$18	$0
Hotel Reseller	$0	$7	$0
Film Tax Restriction	$0	$14	$0
Trust Fund Sweep	$15	$0	$20
Race Horse Development Fund	$0	$15	$0

The conference report does not include several Senate tax provisions, such as the taxes on temporary accommodations, hotel resellers and limitations on the state's film tax credit.

Bottom Line

There are still many elements of the FY 2018 conference report that will take time to assess, such as the spending choices made and the implications of the 150 policy sections included in the budget. From an initial review, it appears that this budget significantly adjusted state spending to better align with the modest tax revenue growth. Another positive step taken by budget conferees is the move away from underfunding accounts in the initial budget only to require supplemental funding later in the year. This budget is balanced without reducing the $98.4 million Stabilization Fund deposit built into the original House and Senate budgets, another positive step.

However, a number of budget questions and concerns remain. It is unclear how lawmakers will effectuate $387 million in MassHealth cuts without adopting any of the MassHealth reforms proposed by the Governor. Without those reforms, the Governor has made it clear that he will not support the employer assessment and its $200 million in associated revenue. These, and other outstanding questions, will need to be answered in the coming week before a final assessment of the budget is possible.