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Ten Questions about the FY 2019 Budget: SWM Preview

The Senate Committee on Ways and Means will release its budget recommendations this week. To preview some of the most important issues that budget will address, MTF is revisiting ten key budget and policy questions that will impact the FY 2019 budget.

1. What is a reasonable tax revenue assumption?

	Governor	House
Consensus tax revenue	$27,594	$27,594
Tax settlements	$125	$125
Federal tax impact	$65	$65
Marijuana (sales & excise)	$63	$63
Temporary accommodations	$13	$0
Dairy tax credit	$0	-$2
Total tax revenue	$27,860	$27,845

Numbers in Millions

Despite the fact that revenues are surpassing projections, the SWM budget is likely to use very similar tax revenue assumptions to both previous spending plans. Each budget is committed to using January's consensus tax revenue estimate as its tax starting point, and it would be surprising if the SWM offers significantly different revenue estimates for tax revenues not included in the consensus estimate (such as tax settlements or revenues related to federal tax reform). While the Senate is unlikely to propose major tax policy or revenue changes, recent Senate budgets indicate that smaller tax changes are possible:

- *Temporary accommodations*: the House budget did not assume any budget revenues from pending legislation applying the state's lodging tax to temporary accommodations (like Airbnb) even though the Administration, House and Senate are in agreement that this issue should be addressed before the end of session. The version of the tax passed by the Senate in April also expands the lodging tax to hotel rooms booked through reselling companies, which is estimated to generate about $7 million in revenue per year. The SWM budget may include $12-$20M from expanded lodging taxes in their budget.

- *Film tax credit*: last year, the Senate adopted a budget amendment that would reduce the cost of the state's film tax credit by $14 million per year, thereby increasing tax revenues. The amendment created a $1 million cap on salaries eligible for the credit and increased the percentage of production spending required to take place in Massachusetts.

- *Flavored tobacco*: on several occasions, the Senate has adopted tax increases to flavored tobacco products, which increases state revenues by $7 million per year.

2. How will the FY 2019 budget account for looming tax revenue ballot questions?

	Governor	House
Explicit provisions to address ballot questions	No	No
Assumed FY 2018 Stabilization Fund deposit	$96	$96
Spending from FY 2018 surplus	$20	$10
Numbers in Millions		

MTF has written about the looming budget impact of two ballot questions that could be placed before voters in November. Neither the Governor's nor the House's budget included any specific provisions to account for possible revenue changes due to the ballot questions. However, both budgets do adhere to state policies that devote unexpected or unsustainable revenues to state reserves and avoid spending down any FY 2018 budget surplus. It is likely that the Senate will adopt a similar approach. One difference for the SWM budget is that April tax collections (the largest collection month) are known – the state is $809 million above benchmark with two months remaining. Like the Governor and the House, the best preparation the Senate budget can make for future revenue uncertainty is to ensure that any surplus at the end of FY 2018 is deposited into state reserves.

3. How will federal tax legislation impact the budget?

	Governor	House
Deemed repatriation revenue	$65	$65
Other federal tax provisions/assumptions	None	None
Numbers in Millions		

In both the Governor and the House's budgets, the FY 2019 impact of federal tax reform is limited to the assumption that the state will receive $65 million in corporate tax revenue in FY 2018 from the new federal repatriation of foreign profits requirement. It would be surprising if the SWM budget deviated from the revenue assumptions of the earlier spending plans. Following the lead of other states, the Senate could direct the Department of Revenue to do an analysis of the longer-term impacts of federal tax reform on Massachusetts revenues and different classes of taxpayers. Such an analysis would allow policy makers to make more accurate revenue adjustments and to understand how various federal provisions may impact residents and the state economy going forward. Massachusetts has not yet conducted this type of analysis.

4. Will the (relatively) strong economy continue and will state tax revenues catch-up?

Since MTF's initial budget preview was published, tax collections have continued to outpace FY 2018 benchmarks. This means that for the first time in three years, the revenue assumptions that underlie the budget remain reasonable as the Senate begins its budget deliberations. However, any conclusions about what recent revenue collections mean for FY 2019 are premature. As MTF noted recently, there are several plausible explanations for the recent strong revenue performance, including timing issues due to prepayment and a one-time surge in capital gains, and these explanations differ in terms of their implications for FY 2019. Until we know more about what is driving the revenue surge, lawmakers would be wise to avoid predicating spending on any surplus.

5. Will MassHealth reforms be included in the budget?

	Governor	House
MassHealth member transition	Yes	No
MassHealth pharmacy reforms*	Yes	No
MassHealth spending (millions)	$16,277	$16,500

**Gov. figure adjusted for related Connector spending*

The House did not include MassHealth reforms proposed by the Governor and it appears unlikely the SWM budget will incorporate these reforms. The Administration estimates that the reforms would save the state $60 million in FY 2019 and more than $100 million going forward. Both reforms have generated questions about likely impact on members and the likelihood of necessary federal approval. In order to address some of these concerns, the Foundation is suggesting that a bipartisan analysis of both reform proposals be completed in order to lay the groundwork for implementing these or other necessary reforms in the future. Failure to make meaningful progress on programmatic reforms would be yet another lost opportunity to rein in MassHealth costs.

6. Will the state revisit the Administration's FY 2018 accelerated sales tax proposal?

	Governor	House	Senate
Real time remittance policy	Yes - directs DOR to implement regulations over the next 3 years	No - strikes FY 2018 budget language empowering DOR to develop related regulations	No - strikes FY 2018 budget language empowering DOR to develop related regulations
Revenue gap from FY 2018 budget	Directs comptroller to move $125 million in FY 2020 sales tax revenue into FY 2019	Directs comptroller to move $125 million in FY 2020 sales tax revenue into FY 2020	Eliminates shift of $125 million in sales tax revenue from FY 2019 to FY 2018

The Senate unveiled its approach to the real time sales tax remittance policy and budget issues in its recent supplemental budget, making the three divergent approaches on this issue apparent. The Administration reintroduced a proposal to implement real time sales tax remittance for debit and credit card purchases again this year in spite of strong opposition last year due to a host of concerns related to cost, feasibility, and efficiency. Both the House and the Senate have rejected the real time remittance proposal – the House budget and the Senate supplemental budget strike the section that allowed DOR to pursue this idea from the FY 2018 budget.

The House and Senate differ in their methods for addressing the budget gap created by the advancing of FY2019 revenues to FY2018 related to the sales tax remittance proposal. The House would continue to shift $125 million in sales tax revenue from FY 2020 to FY 2019, while at the same time creating a commission to evaluate requiring some retailers to prepay sales tax. If implemented, sales tax prepayment would eliminate the need to continue to shift $125 million in sales tax revenue forward.

The Senate proposes to eliminate the shift of sales tax revenue from FY 2019 to FY 2018. This approach would reduce FY 2018 tax revenues by $125 million, but eliminate any related budget gaps in FY 2019 and thereafter. Given the current state of tax revenues, it makes sense to forego shifting FY 2019 tax revenue into FY 2018 while at the same time reducing the state's structural deficit.

7. **How will the budget balance short-term challenges with the need for long-term fiscal improvements?**

	Governor	House
One-time resources	$65	$65
Adherance to fiscal stability policies	Yes	Yes
Assumed Stabilization Fund deposit	$96	$96
Numbers in Millions		

Both the Governor's and the House's spending plans limit the use of one-time resources and adhere to the statutory requirement to dedicate one-time or unsustainable revenues (such as capital gains taxes or unclaimed property revenues) to state reserves. This is a positive step towards closing the structural gap and replenishing the Stabilization Fund and one that the Senate is likely to adopt.

The true test of lawmakers' ability to balance the state's short-term priorities with its long-term fiscal health will be how they handle the likely FY 2018 budget surplus and whether or not they take steps to begin FY 2019 with a balanced budget. For the first time in four years, the budget process is not occurring against the backdrop of major tax revenue shortfalls. A budget surplus to end FY 2018 would afford a rare but much needed opportunity for the state to make up lost ground in rebuilding state reserves. During the current recovery – now in its 9th year – the state has only once deposited more than $200 million into the Stabilization Fund ($709 million in FY 2011). In contrast, during the previous recovery which was half as long, the state deposited more than $400 million into the Stabilization Fund for three straight years. If the FY 2018 budget surplus persists, budget makers should not miss the opportunity to significantly increase the Stabilization Fund balance.

8. Will the FY 2019 budget continue to make progress on chronically underfunded accounts?

	Governor	House
Indigent legal defense	$236,938,646	$189,739,504
Family homelessness	$190,763,011	$181,107,614
Sheriffs	$626,715,238	$573,039,125
MassDOT (snow and ice)	$367,679,448	$323,109,448
Collective bargaining	$107,246,977	$47,216,876
	$1,529,343,320	***$1,314,212,567***

The House budget falls more than $200 million short of full funding for several major program areas and would require supplemental appropriations later in the fiscal year. If the Senate follows the House approach in underfunding, the FY 2019 budget is likely to begin with a significant budget deficit. The state's experiences over the last three fiscal years– when underfunding and sluggish revenues resulted in midyear budget cuts and contributed to a bond rating downgrade – provide budget makers with clear evidence as to the dangers of this practice. The FY 2018 budget provides a template for a more balanced and responsible approach. Before finalizing that budget, House and Senate budget conferees agreed to set aside $104 million to mitigate spending shortfalls.

9. What will the opening of two resort casinos means for the budget?

	Governor	House
Off budget	$16.2	$16.2
Local aid	$12.0	$12.0
MassDOT	$9.0	$9.0
Stabilization Fund	$6.0	$6.0
Chapter 70	$4.9	$5.5
Workforce Competiveness TF	$5.0	$0.0
Scholarships	$2.9	$0.0
Housing Choice	$2.7	$0.0
At-risk youth summer jobs	$0.7	$0.0
Local earmarls	$0.0	$2.7
Early educator workforce	$0.0	$8.5

Numbers in Millions

The House and the Governor's budget used the same assumption for resort casino revenue – $60 million – and the SWM budget will likely use the same figure. Less certain is how the SWM budget will use the budget. The chart above compares how the two previous spending plans divvied up the funds. The Administration devoted $5 million to the Workforce Competitiveness Trust Fund and a further $2.7 million to their Housing Choice initiative. The House set aside $8.5 million for a new program that connects early educators with community college training and $2.7 million for local earmarks. The SWM budget will also likely use $5 - $10 million in new gaming money to support a new Senate spending initiative.

10. What will recreational marijuana sales mean for the budget?

	Governor	House
General fund sales tax	$23.26	$23.26
Cannabis Control Commission	$7.59	$7.57
Cannabis and hemp oversight	$1.24	$1.24
Substance use prevention	$31.17	$31.18
Numbers in Millions		

The Governor and House relied on $63.26 million in recreational marijuana revenue and the SWM budget will likely follow-suit, although the SWM budget may opt to distribute the funds in a different way. The two earlier budgets are also almost identical in how marijuana excise revenues are used. The marijuana statute identifies several additional uses for excise tax revenues (including municipal police training and the Prevention and Wellness Trust Fund) providing the Senate with some flexibility as to how to allocate the revenues.