Massachusetts Taxpayers Foundation

MTF

333 WASHINGTON STREET

BOSTON, MA 02108-5170

617-720-1000

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FY 2018 Fiscal Update

Heading toward the halfway mark in fiscal year (FY) 2018, the state's short-term fiscal outlook remains unclear. At this point in the fiscal year, the state budget appears to be in balance, with known spending needs largely offset by stronger than expected revenue collections.* However, several potential budget problems are lurking on the horizon while a change in revenue trends or a surge in capital gains collections could quickly eliminate any revenue surplus. This brief outlines the current fiscal situation and highlights issues to watch in the months ahead.

Background

FY 2018 began under difficult circumstances, with budget conferees reducing tax revenue estimates by $733 million from the amount assumed in both the House and Senate budgets to account for final FY 2017 tax revenue collections that fell $452 million short of benchmark. That revenue downgrade reduced spending by hundreds of millions of dollars in order to balance the budget:

Conference Budget Gap	
Tax revenue downgrade	-$733
Income tax offset	*$83*
Sales tax transfer offset	*$28*
Underfunded accounts	-$104
Total gap	**-$726**
Conference Budget Solutions	
MassHealth cuts	$387
Revenue offset	*-$164*
Other cuts	$219
Reversion/savings	$205
Non-tax revenue upgrades	$80
Total solutions	**$727**
Numbers in millions	

* While tax revenue is in excess of benchmark we do not yet know what share of these revenues are made up from the sale of capital assets. Should capital gains tax revenues exceed $1.169 billion, the additional amount is required by law to be deposited into the Stabilization Fund.

Even with the Conference Committee's revenue adjustments and spending reductions, it wasn't enough. The Administration made $193 million (net) in spending vetoes in order to account for a further $99 million tax revenue downgrade and $94 million in additional spending needs:

Governor Veto Gap	
Tax revenue downgrade	-$99
Underfunded accounts	-$94
Total gap	**-$193**
Veto Solutions	
MassHealth reforms and savings	$222
Revenue offset	*-$128*
Earmarks	$42
Other vetoes	$56
Total solutions	**$193**
Numbers in millions	

As the fiscal year began, the state was in balance only after both the Legislature and Administration significantly reduced revenues and spending from the original budgets passed earlier in the year.

Current Status

Because of tax revenue adjustments made in June and July, as well as tax provisions included in the budget signed by the Governor, the FY 2018 tax benchmark is far different from the amount agreed to during the Consensus Revenue process:

Consensus Revenue	**$27,072**
Conference/Veto Downgrade	($749)
Conference Tax Provisions	
Sales tax timing	$125
1099K	$20
EITC	$10
Online sales	$22
Life Sciences	$5
Veterans Tax Credit	($1)
Current Benchmark	**$26,504**
Numbers in millions	

To date, tax revenues have been slightly stronger than expected and stand $204 million over benchmark through the end of November – though recent history demonstrates that it is dangerous to assume that revenue trends through November will persist for the entire fiscal year. In addition, lottery net profits, which were expected to decline by $50 million, are ahead of last year's pace through October. Combined, these two revenue sources give the state a bit of a revenue cushion halfway through the year.

Unfortunately, unfunded spending needs will consume some, if not all, of these unanticipated revenues. Before ending formal sessions for the year, the House and Senate overrode $110 million of the Governor's spending vetoes. Since those vetoes were prompted by known spending requirements not funded in the budget, such as indigent legal defense, expected snow removal costs and family homelessness assessment, overriding those vetoes means that other resources must be identified to address these underfunded accounts.

A further $100 million spending gap exists, largely due to the state's MassHealth program.[†] In July, the Legislature rejected a set of MassHealth reforms proposed by the Governor and failed to offer an alternative plan for MassHealth. The Administration estimated that the proposed reforms would generate approximately $85 million in FY 2018 savings and those savings were assumed in the Governor's vetoes. Those reforms now seem unlikely to occur in time to generate savings this fiscal year. That fact, combined with other cost increases in the program as well as unanticipated costs in other areas of the budget create a budget shortfall.

For the present, the overall state budget appears in balance as better than expected revenues covered unbudgeted spending requirements:

Post Veto Spending Gap	
Overrides	-$109
MassHealth and other exposures	-$100
Total	***-$209***
Current Revenue Picture	
Tax revenue v. benchmark	$204
Lottery revenue	$40
Total	***$244***
Numbers in millions	

Outlook Going Forward

Looking ahead, several potential budget challenges bear watching.

Tax revenues. If the past few budgets are a guide, it is a mistake to assume that tax collection trends in the first half of the year will continue in the latter six months.

[†] In the Administration's September and December Information disclosure, the MassHealth shortfall was identified as $106 million and $56 million respectively.

Tax Collections v. Benchmark		
	Through November	Rest of Year
FY 2017	-$72	-$359
FY 2016	$73	-$381
FY 2015	-$9	$554
Numbers in millions		

The state's three largest revenue collection months are still to come and they will determine whether the state can end the fiscal year ahead of tax revenue projections – and the extent to which capital gains tax revenues are responsible for revenue growth. Federal tax reforms may also impact state tax collections positively in the short term with the state realizing a one-time bump in corporate tax collections if money that is repatriated for federal purposes is captured on estimated tax returns in the first half of calendar year 2018.

CHIP reauthorization. The Children's Health Insurance Program (CHIP) provides MassHealth benefits to 160,000 children in Massachusetts. Under the Affordable Care Act (ACA), Massachusetts receives federal reimbursement of more than 80 percent for these children – compared to 50 percent reimbursement for most other MassHealth members. Unfortunately, federal authorization for CHIP expired in September and no action has yet been taken to reauthorize the program. Without reauthorization, Massachusetts would lose as much as $110 million in federal revenue in FY 2018 and more than $250 million in FY 2019. Even if Congress does reauthorize the program, it is possible that current reimbursement rates will be reduced, creating a $40 – $50 million potential revenue shortfall this year.

CSR payments. This fall, President Trump eliminated federal Cost Sharing Reduction (CSR) payments to insurance carriers providing subsidized insurance through the ACA. In response to this decision, Governor Baker used $30 million from the state's Commonwealth Care Trust Fund to make up for the loss of these funds in 2017. It is unlikely that the state will continue to offset CSR payments in 2018, but the $30 million already used will need to be made up elsewhere in the budget.

Hurricane impact – due to the devastation of Hurricane Maria, many Puerto Rican residents have been forced to stay with friends. The number of families now staying in Massachusetts is unknown but some school districts are already dealing with an unexpected influx of students related to the disaster. In the aftermath of Hurricane Katrina, Massachusetts set aside funds to support the education, housing and other costs of refugees temporarily residing in the state. It is possible that a similar approach will be necessary to address the cost related to families displaced by Hurricane Maria.

Bottom line

For the first time since FY 2014, the Administration did not downgrade tax or other revenue assumptions at the end of the first quarter of the year. With no revenue downgrade and no midyear budget cuts to date, the state's budget is in slightly better shape at this point in the fiscal year than it had been at the same stage over the last few years. While this is a positive sign, stronger than expected revenues do not mean that the state has extra money to spend. Ongoing spending exposures are approximately $200 million and there is further budget risk related to CHIP reauthorization among other issues. Furthermore, disappointing tax collections over the next few months or collections that are heavy on capital gains could eliminate any tax revenue surplus for the budget.

Perhaps the most important thing for budget-makers to keep in mind as they manage the FY 2018 budget is the need to prepare for a chaotic FY 2019. As the Foundation laid out in our Consensus Revenue testimony, the FY 2019 budget plan will need to account for several scenarios in which the state could see sizeable revenue swings due to the outcomes from ballot questions raising and lowering taxes, to federal tax reform, the success of casinos, and to the emergence of a marijuana industry. Finishing FY 2018 with a budget surplus and depositing that surplus into the stabilization fund will be essential to managing the uncertainty of the next fiscal year.