



July 18, 2018

### FY 2019 Budget: Initial Analysis of the Conference Report

Today, the House and Senate released the fiscal (FY) 2019 budget conference report, which will now go to Governor Baker for his review. The \$41.88 billion budget reconciles the House and Senate spending plans eighteen days after the start of the new fiscal year. The conference budget is most notable in its decision to increase assumed tax revenue by \$667.3 million over the amount agreed to as part of the consensus revenue process.

Chart 1. FY 2019 Budget Spending

|                       | Spending Comparison |                   |                   |                   |                   |                  |             |
|-----------------------|---------------------|-------------------|-------------------|-------------------|-------------------|------------------|-------------|
|                       | FY 2018 Current     | GOV               | House             | Senate            | Conference        | \$ Growth        | % Growth    |
| Line item spending    | \$40,572.7          | \$41,357.0        | \$41,515.2        | \$41,493.6        | \$41,883.3        | \$1,310.6        | 3.2%        |
| Pending supp          | \$300.0             |                   |                   |                   |                   |                  |             |
| Off Budget            | \$4,273.2           | \$4,526.9         | \$4,526.9         | \$4,526.9         | \$4,546.3         | \$273.1          | 6.4%        |
| <b>Total spending</b> | <b>\$45,145.9</b>   | <b>\$45,883.9</b> | <b>\$46,042.1</b> | <b>\$46,020.5</b> | <b>\$46,429.6</b> | <b>\$1,583.7</b> | <b>3.5%</b> |

Numbers in millions

In total, the conference budget includes \$368.1 million more in line-item spending than the House budget and \$389.7 million more than the Senate. This increase equates to a 3.2 percent increase in line-item spending over FY 2018 levels and a 3.5 percent increase when non-budget transfers to the pension fund, MBTA and school building authority are included.<sup>1</sup>

This initial summary provides an overview of major conference decisions related to revenue, spending and policy.

#### Revenue

For the third straight year, the budget conference committee makes a major revision to the consensus tax revenue figure agreed to in January. In FY 2017 and FY 2018 reductions were necessary to account for steep drops in revenue compared to expectations. In FY 2019 the situation is reversed. Tax collections in FY 2018 exceeded benchmark by approximately \$1.1 billion. In light of these strong collections, budget conferees elected to increase the FY 2019 tax revenue assumption by \$667.3 million to \$28.261 billion.

<sup>1</sup> MTF’s estimate of FY 2018 spending assumes \$300 million in non-deficiency spending in the final supplemental budget.

**Chart 2. FY 2019 Conference Committee Tax Revision**

|                                      | House           | Senate   |
|--------------------------------------|-----------------|----------|
| Total spending                       | \$41,515        | \$41,494 |
| Spending in common                   | \$41,211        |          |
| Unique spending                      | \$304           | \$282    |
| <b>Total House/Senate spending</b>   | <b>\$41,798</b> |          |
| <b><u>Conference spending</u></b>    |                 |          |
| Spending in House/Senate             | \$41,730        |          |
| New spending to address underfunding | \$153           |          |
| <b>Total conference spending</b>     | <b>\$41,883</b> |          |

*Numbers in millions*

As MTF advised in [our conference preview](#), while it is reasonable to reconsider the original FY 2019 tax revenue figures in light of strong tax collections, lawmakers should proceed with caution. The recent surge in collections is in part driven by federal tax changes and therefore much of the revenue, especially capital gains and other non-wage income taxes, is likely to be nonrecurring. Therefore, MTF suggested limiting any adjustment in FY 2019 to tax revenue sources not subject to volatility from year to year.

The conference committee report boosted assumed tax revenues by a significant amount - \$667.3 million – but assumes that \$300 million of this comes from above-threshold capital gains revenue which must be deposited into the Stabilization Fund and therefore is unavailable for operating expenses. After accounting for increased revenue transfers to both the MBTA and the School Building Authority (due to increases in expected sales tax revenue), the tax revenue upgrade leaves \$341 million available for budgetary spending. Until final tax numbers are released for the last fiscal year, it is difficult to gauge the fiscal risk of increasing spending by that amount, however the conference adjustment appears in line with expected above benchmark revenues for FY 2018.

In addition to determining whether or not to adjust total tax revenue, conferees were confronted with several other revenue decisions. First, there were several small revenue differences between the two budgets (including the Senate’s decision to include \$20 million in revenue related to hotel room resellers and taxation of temporary accommodations like those purchased through Airbnb). Second, several revenue assumptions included in earlier versions of the budget needed adjustment. For example, marijuana licensure has proceeded more slowly than anticipated and it is unlikely that the state will collect the \$125 million from tax and legal settlements relied upon in both budgets.

**Chart 3. Major Revenue Decisions in Conference**

|   | House | Senate | Conference |
|---|-------|--------|------------|
| Tax settlements                           | \$125 | \$125  | \$125      |
| Marijuana tax                             | \$63  | \$63   | \$63       |
| Racehorse development fund                | \$0   | \$16   | \$0        |
| Temporary accommodations                  | \$0   | \$13   | \$0        |
| Hotel resellers                           | \$0   | \$7    | \$0        |
| Benefit reimbursement to the General Fund | \$0   | \$10   | \$10       |

*Numbers in Millions*

Unfortunately, the conference budget does not reduce revenue assumptions for either tax settlements or marijuana revenue, which are unlikely to meet original projections.

**Spending**

The House and Senate budgets differed by just \$21.6 million in total spending, but that similarity masked more than \$500 million in different spending choices. In fact, unique spending in both budgets combined was approximately \$41.8 billion – an amount significantly higher than the revenues used by either the House or Senate. The decision to increase tax revenue available for the budget by \$341 million allowed the conferees to opt for the higher spending figure in almost all instances where there was a discrepancy and add \$153.1 million in new spending to offset otherwise underfunded accounts.

**Chart 4. FY 2019 Spending Comparison**

|                                      | House    | Senate          |
|--------------------------------------|----------|-----------------|
| Total spending                       | \$41,515 | \$41,494        |
| Spending in common                   |          | \$41,211        |
| Unique spending                      | \$304    | \$282           |
| <b>Total House/Senate spending</b>   |          | <b>\$41,798</b> |
| <b><u>Conference spending</u></b>    |          |                 |
| Spending in House/Senate             |          | \$41,730        |
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*Numbers in millions*

The conference report contains more than 800 earmarks that generally provide funding for local projects. The report also fully funds the programmatic spending priorities included in both budgets, such as additional early education spending in the House budget and increases for special education reimbursements and the Department of Children and Families programs in the Senate.

Several spending differences between the House and Senate were related to larger policy discussions. The chart below summarizes the resolution of some of those issues:

**Chart 5. FY 2019 Spending Related to Policy**

| Item                             | Issue  | Conference resolution   |
|----------------------------------|--|---|
| MBTA employees on capital budget | House budget included \$27M to support operating expenses for MBTA personnel the Senate & Governor proposed paying for on the capital budget.  | The conference budget allows the MBTA to move these employees onto capital and therefore does not include the additional \$27M. |
| MassHealth pharmacy savings      | Senate budget assumed \$80M in savings by giving EOHHS new powers to negotiate additional pharmacy rebates.  | The conference budget does not include the Senate's MassHealth pharmacy rebate proposal or assume the \$80 million in savings.  |
| Chapter 70 education aid         | Senate budget included ~\$20M to begin increasing formula funding for English language learners and additional relief for high contribution communities.   | The conference budget adopts the Senate approach.   |
| TAFDC changes                    | Both budgets proposed lifting the TAFDC "cap on kids", but the Senate implemented the change in FY 2019, includes additional funding for clothing allowances and allows some families to earn more while receiving benefits. | The conference budget adopts the Senate approach.   |

Both the House and Senate budgets underfunded several major accounts and the conference budget mitigates but does not eliminate this fiscal risk. The conference report does add \$153.1 million in new spending to mitigate underfunding, but it still falls more than \$70 million short of where it should be.

**Chart 6. Underfunded Accounts in FY 2019**

|                                | Governor               | House                  | Senate                 | Conference             | Difference from Gov  |
|--------------------------------|------------------------|------------------------|------------------------|------------------------|----------------------|
| Indigent defense               | \$236,938,646          | \$189,739,504          | \$193,250,115          | \$244,031,412          | \$7,092,766          |
| Family homelessness            | \$190,763,011          | \$181,107,614          | \$186,091,253          | \$193,745,706          | \$2,982,695          |
| Sheriffs                       | \$626,715,238          | \$573,039,125          | \$579,845,616          | \$623,752,476          | -\$2,962,762         |
| MassDot (snow and ice removal) | \$367,679,448          | \$323,109,448          | \$323,246,448          | \$358,546,448          | -\$9,133,000         |
| Collective bargaining          | \$107,246,977          | \$47,216,876           | \$47,216,876           | \$47,216,876           | -\$60,030,101        |
| Settlements and judgments      | \$10,000,000           | \$1,000,000            | \$1,000,000            | \$1,000,000            | -\$9,000,000         |
| <b>Total</b>                   | <b>\$1,529,343,320</b> | <b>\$1,314,212,567</b> | <b>\$1,329,650,308</b> | <b>\$1,467,292,918</b> | <b>-\$71,050,402</b> |

This underfunding continues to be problematic because the conference budget has much more optimistic tax revenue assumptions than either original spending plan. Essentially, the budget is relying on more revenue than originally expected, which creates new fiscal risk, without fully offsetting the fiscal risk presented by underfunding in the House and Senate budgets.

## Policy

The conference budget was tasked with resolving 274 different House and Senate policy sections. Even among policy sections included in both budgets, significant language differences often existed, requiring further negotiation.

*Chart 7. Outside Section Summary*

|                      | Not adopted | Adopted in some form |
|----------------------|-------------|----------------------|
| House only sections  | 39          | 34                   |
| Senate only sections | 118         | 44                   |
| House & Senate       | 1           | 38                   |

The Senate budget included many more policy sections than the House; therefore, more Senate-only policy sections were included in the conference budget, but more than 100 Senate-only sections were held in conference. The chart below summarizes the outcome of several major policy proposals:

*Chart 8. Resolution of Major Policy Proposals*

| Issue                                      | Proposed by | Conference   |
|--|-------------|--------------|
| EITC increase                              | Both        | Included     |
| TAFDC cap on kids                          | Both        | Included     |
| State Police audit                         | House       | Included     |
| Dairy farmer tax credit                    | House       | Included     |
| Conservation tax credit                    | House       | Not included |
| Charter school growth cap                  | Senate      | Not included |
| CPA dedicated funding increase             | Senate      | Not included |
| EMAC double jeopardy                       | Senate      | Not included |
| EMAC hardship exemption                    | Senate      | Included     |
| Higher education notification requirements | Senate      | Not included |
| Municipal police training surcharge        | Senate      | Not included |
| County deeds fee increase                  | Senate      | Not included |
| Sports betting commission                  | Senate      | Not included |
| GIC membership change                      | Senate      | Not included |
| Immigration cooperation restrictions       | Senate      | Not included |
| Tax expenditure review                     | Senate      | Included     |
| Pharmacy rebates                           | Senate      | Not included |

In addition to the policy sections listed above, the conference report strikes from the FY 2018 budget all sections related to the Administration's real time sales tax collection proposal (you can read more about the problems with this proposal [here](#)). By eliminating these sections, the budget also solves the long-term fiscal problem created in last year's budget by shifting \$125 million in tax revenue forward to account for savings assumed from the original proposal.

## **Bottom line**

The FY 2019 conference budget appears to make a defensible upgrade to initial tax revenue assumptions based on current information. That upgrade allows the budget to include almost all spending priorities in both the House and Senate budget while also dedicating \$150 million to address otherwise underfunded programs.

Still, this budget does not fully address some of the fiscal risks in earlier spending plans because it continues to use several unrealistic revenue assumptions and underfund programs by approximately \$70 million. These risk factors, and the upward revision to tax revenue expectations, could pose challenges in the year ahead.