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MTF

MTF's Analysis of FY 2017 Midyear Budget Gap

Earlier in October, the Baker Administration identified an estimated midyear budget gap of $294 million. Today, Administration and Finance Secretary Lepore laid out the plan to close that gap and keep this year's budget in balance. This brief outlines the causes of the budget shortfall and reviews the solutions.

Understanding the Budget Gap

The $294 million budget gap announced on October 14th is comprised of two components:

- $175 million tax revenue downgrade; and
- $119 million in anticipated spending requirements not addressed in the original budget.

At first glance, the downgrade to tax revenue projections may seem unnecessary, as total collections through September stand just $11 million less than expected. However, these total collections mask two worrying trends that make the downward revision prudent. The state's sales tax has fallen short of expectations for nine consecutive months and FY 2017 sales tax growth to date is just 2.3 percent – well short of the 5.2 percent growth assumed in the original budget. If sales tax collections continue at this pace, it would mean a revenue shortfall of more than $200 million for the year. More generally, recent tax collections provide cause for caution. While September collections were strong, it marked only the second time in the last 8 months that collections exceeded benchmark. Given the reality of slow sales tax growth and the challenges created at the end of FY 2016 due to tax revenue shortfalls, the revision made by ANF makes sense.

The remainder of the gap is caused by $119 million in funding shortfalls:

- $57 million shortfall in the state's Committee for Public Counsel Services (CPCS) program, which provides legal defense for indigent clients;
- $30 million shortfall in the state's budget for snow and ice cleanup
- $24 million shortfall in emergency housing for homeless families (EA);
- $8 million shortfall in funding necessary for settlement

These funding shortfalls are not unexpected. As has historically been the case, CPCS and EA were substantially underfunded in the original budget. Both of these programs are entitlements and so additional funds will be necessary to serve those eligible. In the case of snow and ice and the state's settlement and judgment fund, final costs are less certain at this point, but in both cases supplemental funding is likely.

In total, the amount of this budget gap is approximately $60 million larger than the $231.6 million in budget vetoes overridden by the Legislature and in line with the level of resources the Administration projected at the start of the fiscal year.

Understanding the Budget Solutions

The Administration plans to close this budget gap without using 9C cuts, which is unique. This is the first time in more than ten years that a downward revision in projected revenues has not been accompanied by 9C cuts. Instead, the Administration is relying on budget solutions initially identified to close the FY 2016 budget:

Solution	Amount
MWRA & transportation trusts	$41
Legal settlement revenue	$20
Other trust funds	$84
Total	***$145***

Each of the solutions above were ultimately unnecessary in FY 2016 and can be used to offset this year's gap. The downside of using this $145 million now is that it is one-time in nature and does nothing to address the state's long-term budget deficit, limits the options should a larger deficit materialize later in this fiscal year and will have to be replaced by cuts or other revenues in FY 2018.

In addition to these one-time solutions, several other strategies are being employed to close the gap:

- $31 million in budget transfer savings. Because expected sales tax revenue has been reduced, required funding transfers tied to sales tax revenue (to the MBTA and the School Building Assistance program) are similarly reduced, thereby offsetting the impact of the revenue loss.
- $92 million in one-time federal revenues. The state is pursuing additional federal reimbursements for past MassHealth and other human service costs, which it expects to generate close to $100 million.
- $24 million in savings from a voluntary employee departure program. Recently, the Administration announced a Voluntary Separation Incentive Program for employees in which incentive payments are made to those choosing to leave state service with a savings goal of $24 million.

Assessing the Fiscal Condition in FY 2017

Since before the start of this fiscal year, it's been apparent that FY 2017 would pose a number of fiscal challenges; the recent revenue downgrade underlines that fact. Revising estimated tax revenues downward now, in spite of the fact that total collections are close to benchmark, is a vital step in ensuring that budget decisions are based on reasonable assumptions that reflect fiscal reality. Making cuts early in the fiscal year would have been another way to ensure the budget ends in balance, making the Administration's decision to not accompany the tax revision with 9C cuts rather unusual. While those cuts can still occur, they become less effective as a tool the longer they are delayed. The decision to avoid more drastic action is likely due to the relatively small size of the tax revenue downgrade and the fact that the first quarter of the fiscal year just ended.

In the months ahead, tax revenue trends and MassHealth enrollment will be key to the budget remaining in balance. September tax collections came in strong but it is too soon to tell whether this rebound signals a return to more positive revenue growth or just a temporary break in the poor collections that preceded. In addition, a small uptick in enrollment in MassHealth could have massive consequences for the budget given the size of the program, a concern highlighted by the Administration.