For Immediate Release January 21, 2004

MTF Report on State Spending: The Long Road Back

The fiscal 2005 state budget will require a fourth year of significant spending cuts to help close a $1.1 to $1.4 billion budget gap, according to the Massachusetts Taxpayers Foundation's annual report on state spending released today.

The report, *State Budget '04: The Long Road Back*, warns that despite the improving economic picture the Commonwealth has not yet resolved the huge mismatch between spending and revenues that has plagued the state's finances since 2001. The "perfect storm" of forces identified by the Foundation three years ago will continue to buffet the state's finances at least through fiscal 2005, making further spending cuts inevitable and precluding any expansion or restoration of programs that is not offset by reductions in other areas.

"Achieving a balanced 2005 budget will be all the more difficult given the series of tough actions that have already been taken over the last three years—almost $3 billion of spending cuts, major tax increases on individuals and businesses, and fee hikes in excess of the costs of service," said MTF President Michael J. Widmer. "While a modest use of reserves to address the 2005 shortfall is in order, relying heavily on one-time resources and other measures that push the problem onto future taxpayers will only prolong the crisis."

Fiscal 2005 Balance
($, Millions)

Revenue	
Consensus tax forecast	$15,801
Less: Sales tax dedicated to MBTA	-684
Nontax revenue	8,649
Total	23,766
Spending	25,124
Revenue minus spending	**-1,358**
Added taxes using MTF forecast	290
Adjusted revenue minus spending	**-1,068**

According to the report, the continuing shortfalls are being driven by a powerful combination of fiscal forces that include:

- A state tax base seriously reduced by the collapse of capital gains and the dot.com bubble, and further eroded by the ill-timed income tax rate cut approved by the voters in 2000;

- A modest rate of recovery in the state economy, with annual revenue growth less than half the pace of the boom years;

- Double-digit growth in the costs of Medicaid and other health care obligations, a major increase in pension appropriations due to stock market losses, expanded benefits, and prior funding cuts, and a surge in debt service costs;

- The use of up to $900 million of one-time revenues in 2004, including almost $500 million of nonrecurring federal fiscal relief and $145 million for pension obligations that are being met with the transfer of the Hynes Convention Center.

Based on the Foundation's analysis, the spending required in 2005 to sustain the state's programs and services at 2004 levels would total $25.1 billion, an increase of $1.9 billion or 8.4 percent. Assumed in this total are spending increases of $795 million or 12 percent for Medicaid, $530 million or 77 percent for pension costs, $230 million or 14 percent for debt service, $81 million or 10 percent for employee health benefits, $50 million or 1.6 percent for education aid, and $250 million or 2.5 percent for inflation.

Using the Foundation's tax forecast and taking into account federal reimbursements on the higher level of Medicaid spending, 2005 revenues will fall short of required expenditures by $1.07 billion. The estimated shortfall rises to $1.36 billion using the lower consensus tax forecast recently agreed upon by the administration and Legislature.

The report cited agreement on the tax forecast and the 2005 pension appropriation as positive steps in meeting the fiscal 2005 budget challenge. Another positive element is the state's reserves—approximately $500 million in the stabilization fund and $400 million in the tobacco settlement reserves after accounting for the withdrawals authorized in 2004.

The Commonwealth will continue to face lean times well beyond 2005, according to the report. There is little sign that the rampant growth in health care costs will abate in the next few years. And while the state economy will continue to improve—though at a slower pace than the nation—only a portion of the resulting revenue growth will be available for spending. Under the stringent new state tax cap adopted in 2003, annual increases in tax collections that may be used for the budget are limited to the rate of inflation in state and local government spending plus two percent. Amounts in excess of the cap will first be used to replenish reserves. Given these realities, there is little prospect for significant expansion or restoration of prior spending cuts for the foreseeable future.

Although there are a long list of reforms the Commonwealth should undertake—such as improving management of the courts, eliminating pension abuses, and easing the anti-competitive "Pacheco" law—those measures will produce only modest savings over time, and almost none in the short term.

The Massachusetts Taxpayers Foundation is an independent, nonprofit organization that conducts research on state and local taxes, government spending, and the economy. Founded in 1932, MTF ranks among the largest and most effective organizations of its kind in the country. The Foundation has won eight prestigious national awards in recent years for its work on business costs, capital spending, state finances, MBTA restructuring, state government reform, and health care.

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