

# Bulletin

June 30, 2016



## Initial Analysis of the FY 2017 Conference Report

The FY 2017 Conference Committee report released yesterday reconciles the House and Senate budgets while assuming \$750 million less in tax revenue than previous spending plans. This analysis outlines the Conference Committee plan for balancing the budget in light of reduced tax revenues and highlights areas of concern as we start the fiscal year. The Foundation will produce a more in-depth review of the Conference budget next week.

### Tax revenue reduction and gap closing

Since the end of May it has been clear that the tax revenue assumptions used for the FY 2017 budget were no longer tenable given recent events. In June, the Foundation and other participants in the consensus revenue process met with the administration and the House and Senate Committees on Ways and Means to reconsider FY 2017 tax revenue estimates in light of lower than projected recent tax revenue collections. From that meeting the administration identified a likely tax revenue shortfall of \$450 million to \$650 million. Following the turmoil caused by the recent Brexit vote, the administration upped the shortfall to between \$650 million and \$950 million.

	H2	House	Senate	Conference	Difference from H2
Tax Revenue	\$26,860.0	\$26,860.0	\$26,860.0	\$26,110.0	-\$750.0
Cap Gains Transfer	-\$206.0	-\$206.0	-\$206.0	\$0.0	\$206.0
Other tax impacts	\$0.0	\$0.0	\$0.0	\$80.0	\$80.0
Other revenues	\$17,249.0	\$17,246.5	\$17,270.7	\$17,264.1	\$15.1
<b>Total revenue</b>	<b>\$43,903.0</b>	<b>\$43,900.5</b>	<b>\$43,924.7</b>	<b>\$43,454.1</b>	<b>-\$448.9</b>
Line item spending	\$39,553.4	\$39,539.4	\$39,558.1	\$39,293.4	-\$260.0
Savings/Reversions	\$0.0	\$0.0	\$0.0	-\$151.5	-\$151.5
Other spending	\$4,346.8	\$4,352.8	\$4,357.6	\$4,303.0	-\$43.8
<b>Total spending</b>	<b>\$43,900.2</b>	<b>\$43,892.2</b>	<b>\$43,915.7</b>	<b>\$43,444.9</b>	<b>-\$470.7</b>

The Conference Committee elected to reduce the FY 2017 expected tax revenue figure by \$750 million and took several steps necessary to produce a budget that closed this gap:

Tax revenue reduction	<b>-750</b>
<b>Related tax revenue offsets</b>	
Reduction in cap gains to Stabilization Fund	206
Elimination of assumed income tax reduction	80
Reduced pre-budget transfers	59.8
<b>Spending Cuts</b>	
Cuts from H2 level	268.7
<i>MassHealth and other offsets</i>	-72
<b>Other solutions</b>	
Reversions/savings	151.5
Non-tax revenue upgrades	59.9
<b>Total solutions</b>	<b>753.9</b>

### ***Tax revenue offsets - \$347 million to close the gap***

The largest components of the gap closing approach comes directly from the projected tax revenue reduction. The Conference Committee budget decreased assumed capital gains revenues by \$206 million and eliminated the \$206 million Stabilization Fund transfer included in previous versions of the budget. While this means that the state is postponing a much-needed replenishment of the Stabilization Fund, it reduces the effective impact to the General Fund to \$544 million dollars.

In addition, the revised estimate of tax revenues impacts pre-budget transfers to the MBTA and the School Building Authority, whose funding is tied to overall sales tax revenues. Because sales tax growth will be less than initially projected, total transfers will be reduced by \$59.8 million from the proposed House and Senate budget levels.

Finally, because FY 2016 tax revenue growth is much slower than previously thought, it is unlikely that the next income tax reduction will be triggered. The personal income tax rate will remain at 5.1 percent for another year, which increases income tax revenues by \$80 million.

### ***Spending Cuts - \$260 million in cuts/\$190 million to close the gap***

The Conference Committee budget cuts \$260 million from the House 2 total spending level. The vast majority of cuts – approximately two-thirds – come from caseload-driven accounts, with the MassHealth program seeing the largest reduction. MassHealth is cut by \$140 million, resulting in a \$70 million net savings (federal revenue is similarly reduced by \$70 million). No changes were made to eligibility for these programs, so conferees are assuming a decrease in caseload or other savings. As the Foundation has noted earlier, the FY 2017 budget already assumes an aggressively low growth in MassHealth's caseload. Should the caseload reduction for MassHealth and other programs not occur, it will create budget risk later in the fiscal year. Compounding this problem is the Conferees' underfunding of family homelessness and indigent legal defense accounts by more than \$80 million.

### ***Other Solutions - \$200 million to close the gap***

The Conference Committee relies on \$210 million in other solutions, \$151.5 million of which comes from reversions, i.e., the practice of sweeping accounts where actual state spending will ultimately be less than the amounts appropriated in the budget and returning the money to the General Fund. Two thirds, \$100 million, of these reversions come from a provision requiring the administration to identify savings throughout the budget. Prior budgets have included similar language but for much smaller amounts. The Conference report also redirects \$51.5 million in debt service reversions, originally intended to support retiree health care liabilities, to the General Fund. Heavy reliance on reversions this early in the budget process is unusual.

Finally, the Conference budget assumes that non-tax revenue (such as the Lottery) will increase by \$60 million compared to initial assumptions.

### **Bottom line**

This year's budget Conference Committee faced plummeting tax revenue estimates and few good options. The Conferees are to be commended for producing an on-time budget based on a much more realistic revenue assumption; however, the solutions put forth in this budget still leave the state in a precarious financial position. The majority of the cuts come from reducing the assumed caseload for entitlement programs – meaning that if caseload exceeds present expectations, these savings will not materialize. Furthermore, the use of \$150 million in reversion savings now, leaves the state with fewer options to address unexpected costs or revenue shortfalls in the months ahead, taking away for FY2107 one of the key tools the Baker administration relied on to manage the budget gap in FY2016.