Massachusetts Taxpayers Foundation

Bulletin

333 WASHINGTON STREET
BOSTON, MA 02108-5170
617-720-1000

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MTF

MTF's Analysis of FY 2017 Budget

The eventful final stages of the FY 2017 budget process are nearly complete. Last week, Governor Baker signed the Conference Committee budget after vetoing $267.1 million in spending and striking or proposing amendments to 60 budget sections. The Legislature has until the end of July to take up overrides of the Governor's vetoes at which point the FY 2017 budget will be finalized.

This brief examines the Governor's vetoes and considers the current state of the budget as the fiscal year begins.

Budget Spending after Vetoes

Tabulating spending in this year's budget is more complicated than usual. Both the Conference Committee and the Administration assume a sizeable amount of reversions – amounts appropriated that will ultimately go unspent and revert back to the General Fund. How these reversions are treated for spending purposes impacts assumed spending growth over FY 2016. FY 2017 spending growth is approximately 1.76 percent including reversions.

Table 1. FY 2017 Budget Spending

	FY 2016	Conference	Vetoes	Post Veto Spending growth	Gov Supp	FY 2017	Spending growth
Line item spending	$38,329.7	$39,293.4	-$267.1	1.82%	$274.0	$39,300.3	2.53%
Debt service reversions		-$51.6	$51.6			$0.0	
Other reversions		-$100.0	-$100.0			-$200.0	
Spending incl. reversion	*$38,329.7*	*$39,141.8*	*-$315.5*	*1.30%*	*$274.0*	*$39,100.3*	*2.01%*
Other spending	$4,053.7	$4,303.0		6.15%		$4,303.0	6.15%
Total Spending	***$42,383.4***	***$43,444.8***	***-$315.5***	***1.76%***	***$274.0***	***$43,403.3***	***2.41%***

Adding to the complexity is the filing by the Governor of an FY 2017 supplemental budget to address known deficiencies. This blueprint of ongoing budget deficiencies is very helpful, but it complicates the presentation of FY 2017 budget spending. If the proposed supplemental spending is considered, spending grows to 2.41% over

FY16. This level is low compared to prior years, but necessary given the substantial tax revenue downgrades to both FY 2016 and FY 2017.

Table 2. FY 2017 Tax Revenue Changes

	Consensus Revenue	Current
FY 2016 tax revenues	$25,751	$25,301
FY 2017 tax revenues	$26,860	$26,022
Growth assumptiuon	4.31%	2.85%

The state is likely to continue to face fiscal challenges in FY 2017, but a crucial first step toward meeting those challenges has been the Legislature and Administration's work to reduce budget spending growth to less than assumed tax revenue growth. It would be a major setback if veto overrides undid much of this work.

The Governor's Spending Vetoes

Governor Baker vetoed $267.1 million of budget spending in 303 separate line items. Given the sheer number of spending vetoes, it's difficult to easily categorize all of these reductions, but the chart below assigns them to several broad categories.

Table 3. FY 2017 Budget Vetoes

Category	Amount
Earmarks	
MassHealth	-29.5
Non-MassHealth earmarks	-51.6
H2 Policy vetoes	-53.4
Other MassHealth	-10
Updated projections	-26
New line items not in H2	-21.2
Non-executive branch 1%	-14.4
Non-line item veto	-3
Other	-58
Total	***-267.1***

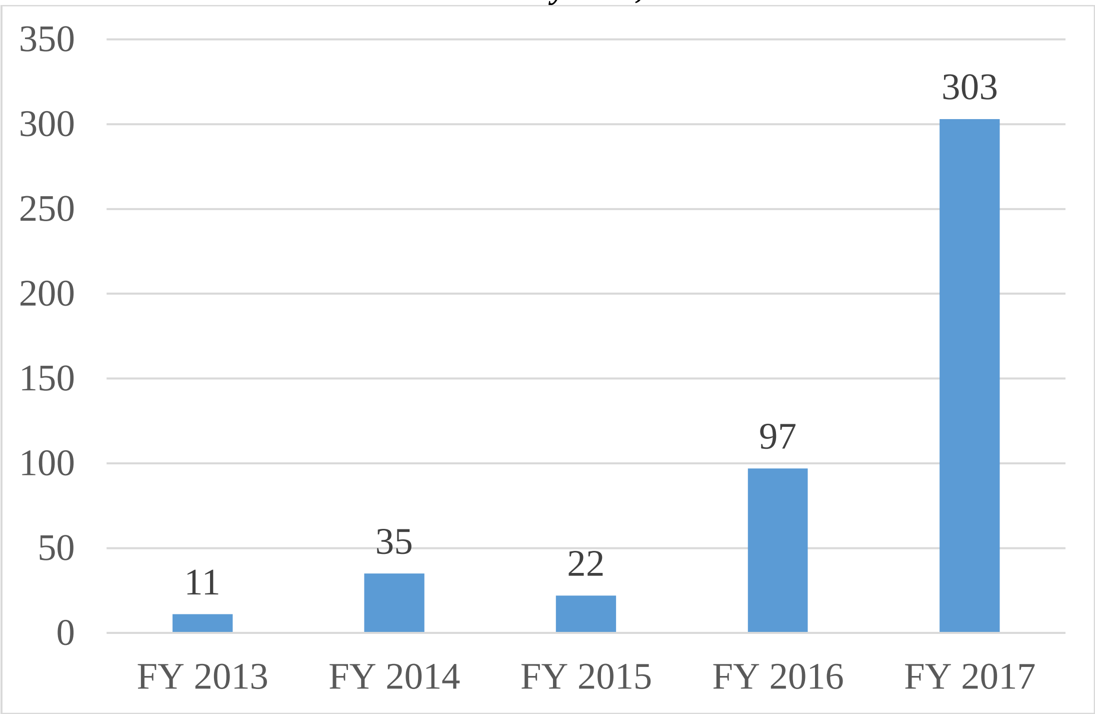
The vetoes avoided program eligibility restrictions, local aid, and budget priorities like substance abuse and child welfare, focusing instead on earmarks - spending appropriated for a specific program within a broader spending category. In total, 495 of the budget's 633 earmarks were eliminated or reduced. The Administration cuts $29.3 million in earmarks within MassHealth, the state's largest spending program, and another $51.6 million from other programs.

The Governor vetoes $53.4 million in spending related to the adoption of policies proposed in his original budget, but not adopted. The Governor cuts Group Insurance Commission (GIC) spending by $30 million and proposes generating that savings by applying the same premium contributions to all state employees. In addition, the Governor vetoes $23.4 million in cash assistance payments to low-income families that would be unnecessary if an eligibility change he had proposed was adopted.

All agencies that are not part of the executive branch, such as the Trial Court or the Secretary of State's office, saw their budgets reduced by one percent, generating a $14.4 million in savings. The Administration also cut $26 million to reflect more current projections for various accounts.

The 303 separate account vetoes far exceeds the number vetoed in any of the last five budgets and almost doubles the number of accounts vetoed by Governor Romney in FY 2007 when vetoes exceeded $500 million.

Table 4. Line Item Vetoes by Year, FY 2013 – FY 2017



The number of line items vetoed is notable for two reasons. First, it indicates that the Administration sought to spread these cuts among many individual accounts to lessen their impact. The average veto in FY 2017 is under $1 million – approximately half the amount of Governor Baker's FY 2016 vetoes. Second, it will be challenging for the Legislature to override all of the vetoes given the short time frame they have to do so. Last year, when formal sessions did not end until November, the Legislature overrode 85 percent of line item vetoes. To do so this year, would require three times the number of override votes by July 31st when formal sessions of the Legislature end.

Governor's Policy Vetoes and Amendments

In addition to spending vetoes, the Governor struck or proposed amendments to 60 sections – a substantially higher number than in the previous 5 budgets.

Table 5. Section Vetoes & Amendments by Year, FY 2013 – FY 2017

	Sections vetoed	Sections amended	Sections impacted
FY 2013	5	20	***25***
FY 2014	6	31	***37***
FY 2015	5	13	***18***
FY 2016	21	9	***30***
FY 2017	36	24	***60***

Several of these vetoed or amended sections have an impact on the state's finances. One amendment restores an FY 2017 contribution to the state's retiree health care costs to approximately $75 million, a figure that was included in all earlier versions of the budget but reduced to $25.8 million in Conference Committee. Another amendment makes optional what otherwise would have been a $15 million required contribution to the Health Safety Net.

Other notable veto actions include:

Proposed amendment to MBTA fare cap
The Conference Budget capped increases on MBTA fares at 7 percent every two years. Governor Baker's amendment would keep the aggregate cap at 7 percent while enabling individual types of fares to increase by more than this amount.

Veto of moratorium on municipal retiree health care premiums
The Governor vetoed an extension of a moratorium on municipalities increasing retiree health care premiums. Since Municipal Health Reform went into effect in 2011, municipalities have been prevented from adjusting retiree premium splits. If the Governor's veto stands this moratorium will end this year.

Proposed amendment to sick and vacation time reform task force
The Governor substituted the conference budget provision creating a task force on reforming state policies on sick and vacation time accrual with a 1,000 hour statutory cap on unused sick time credit, a proposal that he introduced as separate legislation.

Governor's Supplemental Budget

The Governor's veto message was accompanied by an FY 2017 supplemental budget that proposes $278.7 million in spending to address identified shortfalls in several accounts and new federally mandated spending. These spending exposures include indigent counsel services ($42 million), family shelter services ($28.5 million) and sheriff's offices ($28 million). More than $100 million of the total spending exposure is attributable to MassHealth ($112.7 million), the bulk of which is (approximately $100 million) related to new federal requirements for Hepatitis C coverage that will be offset by $102 million in new federal revenues. This exposure is unrelated to the $140 million MassHealth cut made in the Conference Committee and does not address the program's aggressive enrollment targets used in the FY 2017 budget. According to the Administration, net new spending for this supplemental budget will be $176.7 million.

These types of exposures would more typically be funded through supplemental spending bills filed later in the year when more information on actual program usage is available. However, while some of these estimates may change in the months ahead, identifying them now provides a more accurate assessment of the state's fiscal condition as the Legislature considers veto actions and helps mitigate budget problems should revenues decline further. It may also be an acknowledgement that actual revenues have more closely tracked projected revenues in recent years, leaving very little cushion to address supplemental spending or unbudgeted expenses that may arise.

Broader Fiscal Context

The Governor's vetoes and supplemental budget are best understood in the context of the fiscal challenges the state faces as FY 2017 begins. In order to avoid a third straight year of midyear budget cuts, the Administration has proposed a series of solutions to address a budget gap of close to $400 million at the start of the fiscal year.

Starting FY 2017 Gap

The Administration believes its vetoes and other solutions are necessary to close to the potential $400 million in budget exposures.

Table 6. FY 2017 Budget Gap

Initial FY 2017 Budget Gap	
ANF tax revenue downgrade	-88
Retiree Health Contribution Increase	-51.5
Trust revenue downgrade	-13
Non-tax revenue changes	-50
Deficient accounts	-278.6
Deficiency revenue offset	*101.6*
Initial ANF gap	***-379.5***

In addition to spending deficiencies, net of new revenue, addressed through the supplemental budget, the Administration also further reduced revenues from the Conference Budget. The Conference Committee assumed tax revenues would fall by $750 million from initial projections. The Governor's vetoes assume a decline of an additional $88 million ($838 million total decline) and slightly lower non-tax revenue.

The Governor restores the $76 million state contribution for retiree health care costs, included in earlier versions of the budget, from the Conference Committee contributions of $24.5 million, adding $51.5 million to the revenue shortfall. Failing to restore this contribution could be a red flag to bond rating agencies.

Administration's Budget Gap Closing Plan

In summary, the Administration identifies a host of solutions to close the gap outlined above, the biggest of which are line item vetoes.

Table 7. FY 2017 Budget Solutions

Administration Solutions	
Line item vetoes	264.1
Health Safety Net reduction	15
Other veto savings	8.6
Veto revenue offsets	*-28.3*
Supplemental budget solutions	11.6
Additional reduced allotments	100
Total solutions	***371***

In total, the Governor's veto actions generate $259.4 million to close the budget gap. The Administration closes the remaining gap by increasing the Conference assumption of savings from procurement and other initiatives from $100 million to $200 million and proposing several savings initiatives in the supplemental budget.

FY 2017 Final Steps

Before the budget is complete, the Legislature has the opportunity to override some or all of the Governor's vetoes. If history is a guide, the Legislature will override most of the Governor's spending vetoes. Since FY 2012, 90 percent of all vetoed spending has been overridden. If that trend holds for FY 2017, $240 million may be added back, further increasing the state's budget gap. Given the short time frame and the number of vetoes, the Legislature could be more discerning about which overrides to take up this year. As they make their override decisions, it's important to understand that each override increases the chances of the need for even more painful midyear budget cuts.

Table 8. Spending Vetoes & Overrides, FY 2012 – FY 2016

	Vetoes	Amount overriden
FY 2012	$0.0	$0.0
FY 2013	$32.1	$32.1
FY 2014	$435.4	$435.4
FY 2015	$16.1	$16.1
FY 2016	$162.8	$97.9
Total	***$646.4***	***$581.5***

In addition to overrides, it will be important to monitor several other possible risks as the fiscal year continues:

Reversion and tax settlement assumptions

The FY 2017 budget assumes that it will be possible to achieve $200 million in reversion savings through various ongoing initiatives. Expecting $200 million in reversions is not unrealistic – in three of the past five years, the state has easily met this mark – but it is not certain. More problematic is the fact that by assuming these reversions now, they will not be available to offset unexpected costs or revenue declines in the future.

Similarly, the budget relies on $125 million in settlement revenues which are unpredictable and have been declining in recent years. It is quite possible that the state will collect this $125 million in FY 2017, but it is risky to rely on that now, as opposed to using settlement revenues received to address other budget challenges later.

MassHealth

The FY 2017 MassHealth appropriation was based on member caseload growing at 2.7 percent. Meeting this caseload growth goal is key to controlling MassHealth growth. However, this enrollment growth figure may prove challenging – since FY 2010 MassHealth membership has grown by less than 3 percent only once. The inclusion of $112.7 million in MassHealth funding in the Governor's supplemental budget is mostly unrelated to enrollment exceeding projections, but there will be a large financial exposure if enrollment projections are too low. The FY 2017 budget also assumes $73.5 million in revenue related to federal approval of the state's next Medicaid waiver, which was recently submitted.

Tax revenue growth

The stock market volatility of the last few months has highlighted the feast or famine nature of capital gains revenues in our state budget. Budget makers will be hoping that tax numbers quickly rebound in FY 2017, but a continued decline remains a distinct possibility.