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Bulletin

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State Fiscal Crisis – No End in Sight

Despite the Governor's plan to address a $1 billion fiscal 2010 deficit, the state still faces a several hundred million dollar shortfall for 2010 and a gaping $3 billion structural deficit for 2011.

The unprecedented collapse in state tax revenues has put the Governor and Legislature in an extraordinarily difficult position, and Massachusetts has handled its fiscal problems better than many other states. Nevertheless, there are two serious shortcomings with the administration's approach to balancing the 2010 budget.

First, the administration has not addressed the full dimensions of the 2010 deficit which it has estimated to be at least a billion dollars, with the possibility it will grow larger over the course of the year. Even with the Governor's actions, the Foundation projects a $300 - $500 million shortfall in the 2010 budget.

Second, the administration's plan relies much too heavily on one-time solutions that further deplete the rapidly disappearing state and federal reserves and create an even larger deficit in fiscal 2011. The heavy dependence on one-time monies results in significant part from the Governor's decision to exclude direct local aid from his principal of "shared sacrifice" in closing the 2010 deficit. The Foundation estimates that the projected fiscal 2011 structural deficit is at least $3 billion, which will require spending cuts of the magnitude of 2010.

Furthermore, there is a risk that tax revenues could fall below the new benchmark. The administration's revised fiscal 2010 forecast of $18.28 billion in tax collections is consistent with the Foundation's latest forecast. Nevertheless, baseline tax collections, which exclude the effects of tax changes such as the increase in the sales tax, are off 10 percent for the first five months of fiscal 2010. In order to meet the new target, collections for the last seven months of fiscal 2010 will have to equal baseline revenues for the same period of fiscal 2009, even while the Massachusetts economy continues to shed jobs.[1]

The administration's estimate of the fiscal 2010 budget deficit is $1.175 billion (Information Statement of October 29, 2009). This includes two parts – a $600 million shortfall in tax revenues and $575 million in underfunded accounts. Because $300 - $350 million of the underfunding is for Medicaid which is eligible for federal reimbursements, the net deficiency is in the range of $400 million.

On October 29, the administration proposed spending cuts and one-time revenues to deal with the $600 million problem. However, the administration believes that it can manage the $575 million in underfunded accounts through a combination of squeezing spending across state government, using surpluses in some accounts to cover expenses in deficient accounts, and making cuts in programs such as Medicaid and the Group Insurance Commission.

[1] October and November tax collections were a combined $37 million above the revised benchmark, an infinitesimal sum in the context of the $11.1 billion the state needs to collect over the next seven months to meet the 2010 benchmark.

There are several reasons why it is unlikely that the administration can close a $575 million shortfall without a deficiency budget of several hundred million dollars later this year.

A key element in the administration's budget-balancing plan, as it was in fiscal 2009, is the ability to cover deficiencies in some accounts by transferring surpluses from other accounts (limited to 5 percent of an appropriation within a secretariat). The Legislature granted this power to the Governor last year but has denied his request this time.

A second problem is the large Medicaid shortfall which is driven by increased costs for a range of services as well as higher estimates of utilization and enrollment. The administration's plan addresses only $70 million of the deficit of at least $300 million, after reversing its proposal to curtail some benefits including adult dental and day habitation programs and to increase co-pays for a range of services.

The administration has limited ability to change Medicaid eligibility because of "maintenance of effort" requirements accompanying the federal stimulus dollars. Two-thirds of the $70 million in "savings" is achieved by delaying pay for performance payments to acute hospitals and physicians until fiscal 2011. Providers have already borne a heavy burden of Medicaid cuts during the fiscal crisis. Hospitals alone have had to absorb more than $150 million of reductions in Medicaid rates and delayed payments in 2009 and 2010. In addition, a more than $50 million shortfall in the Health Safety Net Trust Fund in fiscal 2010 will have to be picked up by hospitals, many of which are in difficult financial straits.

As a result, even under the best of circumstances, there will need to be a Medicaid supplemental budget of approximately $240 million ($100 million in state spending) this year.

The Group Insurance Commission is also struggling with an estimated deficit of $35 million. In response, the GIC raised co-pays for a range of services and set higher deductibles of $250 for individual plans and $750 for families to take effect February 1, 2010. Nevertheless, even with these changes there will be at least a $15 million deficit this year and an expected increase of 10 to 15 percent in premiums next year, adding over $100 million to 2011 expenditures.

The administration estimates that other underfunded accounts total $200 million, ranging from emergency shelters for veterans and families and other caseload-driven accounts to compensation for private counsel services (public defenders). The latter is funded at $125 million in 2010 compared to an average of $160 million for the past three years. Given the severity of the recession and the demand on public services, the $200 million estimate will likely turn out to be understated.

Governor's Plan

The Governor's October 29 plan combined $250 million of one-time funds with $237 million in executive branch spending cuts and $115 million in other cuts requiring legislative approval. The plan also included $30 million in additional spending for the Medical Security Trust Fund, reducing total savings from cuts to $320 million (Table 1).

The $237 million in executive branch spending reductions includes $202 million in direct cuts and $35 million in estimated savings from layoffs of roughly 1,500 state workers. Of the $200 million, cuts in human services programs account for approximately $80 million, including cash assistance for children whose parents are disabled and receive Social Security ($23.8 million), programs for family stabilization, foster care and adoption ($5.8 million), closing access to child care services for 20,000 wait-listed children of homeless families ($11.6 million), aid for the homeless ($2.7 million), residential services for adults with developmental disabilities ($4.9 million), and adult mental health services ($7.1 million).

As part of his plan, the Governor requested authority to cut $75 million from the budgets of the Legislature, constitutional offices, the judiciary, sheriffs and district attorneys. The Governor also sought legislative approval to cut targeted local aid payments by $16 million and reduce $24 million in funding for short-term borrowing costs that are substantially lower than had been projected.

The administration decided not to include cuts in direct categorical aid to cities and towns in its request for expanded 9C authority, instead cutting accounts like special education reimbursements and regional school transportation. The Governor's approach places an inequitable burden on a minority of local communities and will require deeper local aid cuts in fiscal 2011. It also necessitates further cuts in an array of human services programs that are already experiencing a disproportionate share of several rounds of budget cuts.

Table 1 – Governor's Spending Cuts ($ Millions)

Executive Branch 9C Cuts and Layoffs	237
Legislative Authorization Required	
Expanded 9C Authority	75
Short-Term Debt Service	24
Quinn / PILOT	16
Sub-Total	**352**
Transfer to Medical Security Trust Fund	-30
Total Reduction in Spending	**322**

Legislative Response

The Legislature's response to the Governor's proposal has created an even larger hole in the 2010 budget. In addition to denying the Governor the authority to transfer monies within secretariats, the Legislature's actions reduced the administration's proposal by approximately $120 million (Table 2).

Specifically, the Legislature rejected the Governor's request for 9C authority to cut spending by $75 million as well as $11 million for PILOT (payments in lieu of taxes) and $5 million for the Quinn bill. The Legislature also overrode $24 million in gubernatorial vetoes, including $18 million in funding for the Legislature, thereby reducing by $24 million the amount to be transferred from the state stabilization fund.

The Legislature did approve the Governor's request to transfer $30 million to the Medical Security Trust Fund as part of a broader plan to address the large deficit in this program which provides health insurance for unemployed workers. While appropriate, this transfer adds another $30 million to the 2010 deficit.

In sum, the combination of gubernatorial and legislative actions has reduced the 2010 deficit by approximately $450 million, leaving a gap of several hundred million dollars.

Table 2 – Legislative Supplemental Bill Adds $120 Million to the Deficit ($ Millions)

	Governor	Legislature	Difference
Executive Branch 9C Cuts and Layoffs	237		
Legislative Authorization Required			
Expanded 9C Authority	75	0	-75
Short-Term Debt Service	24	24	
Quinn / PILOT	16	0	-16
Subtotal	**352**	**261**	**-91**
Transfer to Medical Security Trust Fund	-30	-30	
Total Reduction in Spending	**322**	**231**	**-91**
Executive Branch One-Time Solutions			
ARRA Funds to Replace Higher Ed Cuts	62		
DOR Tax Settlements	50		
Reduced Payments to SBA	27		
Surplus Land	9		
Legislative Authorization Required			
State Stabilization Fund	60	36	-24
Tax Amnesty	20	20	
Smart Growth Trust Fund	15	11	-4
DOR Tax Changes and Other Revenue	10	7	-3
Total One-Time Solutions	**253**	**222**	**-31**
Total Plan	**575**	**453**	**-122**

The Governor's initial response to the Legislature's actions was to say that the administration would have to identify an additional $120 million in cuts in the executive branch. However, in a surprise Friday afternoon announcement on December 4 the Governor said the $120 million gap would be closed through the combination of an $82 million one-time tax settlement and the $37 million in tax collections in October and November that exceeded the revised lower benchmark.

He also announced he was filing a supplemental $42 million budget for homeless shelters and backed off changes in the Medicaid program which would have saved approximately $30 million. The Governor did not identify the source of the $70 million for the shelters and Medicaid.

There are several problems with the Governor's actions:

- Enhanced spending will add to the large deficit still facing the state in 2010.

- The additional use of one-time money will increase the already enormous fiscal 2011 structural deficit and require larger cuts in the 2011 budget.

- Counting on an additional $37 million in over-benchmark tax collections – in the wake of a total of $5.2 billion in reduced tax estimates through fiscal 2009 and 2010 – is fiscally shortsighted.

Use of One-Time Solutions

A major flaw in the Governor's original plan, exacerbated by his subsequent actions, is its heavy dependence on one-time solutions, which leaves the state with fewer options later this fiscal year and results in an even larger budget deficit for fiscal 2011.

The Governor initially proposed the use of $250 million in one-time funds but the Legislature reduced that amount by $30 million. The administration's subsequent announcement that it would rely on a one-time tax settlement of $82 million raises the use of additional one-time funds to $300 million (Table 3). This adds, dollar-for-dollar, to the 2011 structural deficit.

Of particular concern is the dependence on another $36 million in state stabilization ("rainy day") reserves and $62 million in federal stimulus dollars. The $36 million – an end of year fiscal 2009 "surplus" – needs to be placed in the context of the fact that the state drew down its reserves by an astonishing $1.4 billion in 2009.

The use of $62 million of federal stimulus aid to replace $62 million of state funds for higher education in 2010 will produce even larger cuts in higher education in 2011. Higher education appropriations of $960 million in fiscal 2010 were already propped up by $162 million in federal stimulus aid which will disappear in fiscal 2011, setting the stage for potential cuts of $200 million or more.

Table 3 – Half of Governor's Plan Uses One-Time Funds ($ Millions)

State Stabilization Fund	36
ARRA Funds	62
DOR Tax Settlements	132
DOR Tax Changes and Other Revenues	7
Reduced Payments to SBA	27
Tax Amnesty	20
Smart Growth Funds	11
Surplus Land	9
Total	**304**

The additional reliance on one-time solutions so early in the fiscal year (the 2010 budget already counted on $2 billion in federal stimulus dollars and state reserves) places the state in a vulnerable position when it confronts a likely deficit later in the year. At that point, the state will have nowhere to turn except one-time revenues, setting the stage for even deeper cuts in fiscal 2011.

Fiscal 2011 Structural Deficit

Even assuming the beginning of an economic recovery in 2010, the state faces a structural deficit of approximately $3 billion in fiscal 2011, as shown in Table 4. Estimated increased revenues of $700 million are offset by $2.25 billion in one-time sources in the fiscal 2010 budget plus $1.5 billion of additional spending required for increases in largely non-discretionary accounts and a small allowance for inflation. Any further use of one-time funds in fiscal 2010 will simply add to the $3 billion deficit while leaving less money available to close that deficit.

Table 4 – Fiscal 2011 Structural Deficit ($ Millions)

One-Time Funds in FY 10	-2,250
Maintenance Budget	-1,500
Growth in Revenues at 3%	550
Additional Sales Tax Revenues - Full Year	150
Structural Deficit	**-3,050**

Revenues should begin growing again in fiscal 2011, albeit at a modest rate.[2] Factoring in a full year of the sales tax increase and an estimated 3 percent growth in baseline revenues, state tax collections would increase by roughly $700 million.

A "maintenance budget" would require an estimated $1.5 billion in additional spending in fiscal 2011, driven largely by non-discretionary increases for Medicaid, pensions, Chapter 70 education aid, debt service, the Group Insurance Commission, human services caseloads, and wage increases for state workers.

Even if the state avoids further use of one-time funds in fiscal 2010 – an unlikely scenario – lawmakers have a maximum of $1 billion available to close the $3 billion gap (Table 5). Using any more than $300 million from the balance of $575 million in the state's stabilization fund would risk the Commonwealth's credit rating and drive up the costs of borrowing.

The state will receive its last installments of federal stimulus funds in fiscal 2011 – $611 million of FMAP funds and $100 million of federal fiscal stabilization aid for education. The $100 million, like the state's stabilization reserves, could be used in 2010.

Table 5 – Use of State Reserves and Federal Stimulus Dollars

	Available	FY 09	FY 10	Remaining
FMAP	2,760	-869	-1,280	611
Federal Fiscal Stabilization	994	-484	-410	100
State Stabilization Fund	2,188	-1,389	-274	575
Total	**5,942**	**-2,742**	**-1,964**	**1,286**
Cumulative Usage		**-46%**	**-79%**	**21%**

With limited revenue growth and reserves nearly exhausted, the state will need to depend heavily on further spending reductions to balance the fiscal 2011 budget. The cuts are likely to be on a scale of those included in the 2010 budget. However, the consequences will be more serious because for many programs this will be the third, fourth, or even fifth round of cuts since the onset of the fiscal crisis.

[2] The Foundation will release a new revenue forecast for fiscal 2011 on December 16, 2009.

BUDGET SUMMARY[1]

($ Millions)	FY07 Spending	FY08 Spending	FY09 GAA	FY09 Estimate	FY 10 GAA	FY 10 Post 9C Cuts
Investment in Children	**6,580.4**	**6,885.7**	**7,234.3**	**7,151.4**	**7,013.4**	**6,952.4**
Education Local Aid [4]	4,023.5	4,278.2	4,546.8	4,505.4	4,471.1	4,440.3
Higher Education [4]	1,110.1	1,081.6	1,090.5	1,085.6	1,067.6	1,066.3
Services to Children	785.6	817.2	842.3	832.1	785.3	777.2
Youth Services	154.1	158.4	164.6	160.9	152.1	147.7
Child Care Services	507.1	550.3	590.1	567.3	537.3	520.8
Criminal Justice and Law Enforcement	**2,165.4**	**2,324.0**	**2,316.3**	**2,318.5**	**2,031.9**	**2,241.5**
Corrections [6]	950.8	1,060.5	1,047.2	1,060.1	881.5	1,093.8
Judiciary	789.7	822.9	824.6	818.9	752.9	756.1
Police	295.5	298.3	298.7	297.4	265.6	259.4
DAs	93.2	101.5	102.2	99.2	92.6	92.6
Attorney General	36.3	40.8	43.6	43.1	39.3	39.5
Local Government	**1,515.3**	**1,517.2**	**1,523.2**	**1,370.6**	**1,052.7**	**1,051.8**
Assistance to the Poor	**9,832.0**	**10,896.7**	**11,501.0**	**11,389.9**	**11,347.3**	**11,347.3**
Medicaid/Other Health Care [2]	8,698.8	9,711.2	10,274.0	10,179.5	10,160.3	10,191.4
Cash/Housing Asst.	856.6	893.7	930.9	922.1	925.9	901.9
Elderly	276.7	291.9	296.1	288.3	261.1	254.0
Assistance to the Sick and Disabled	**2,359.5**	**2,450.9**	**2,543.0**	**2,505.7**	**2,407.5**	**2,382.7**
Mental Retardation	1,191.4	1,235.9	1,271.9	1,265.9	1,262.6	1,254.8
Mental Health	657.1	671.5	685.4	667.4	644.1	634.0
Public Health	511.0	543.4	585.7	572.5	500.8	493.8
Transportation	**306.3**	**281.4**	**185.5**	**288.2**	**214.4**	**202.1**
Regional Transit [5]	51.7	58.3	57.9	57.9	59.2	59.2
Highways	193.9	161.7	61.0	166.9	98.6	91.3
Registry	60.7	61.4	66.6	63.4	56.6	51.5
Economic Development	**519.4**	**519.5**	**435.9**	**369.0**	**319.3**	**296.0**
Business and Labor	285.2	295.3	198.7	148.5	118.7	106.4
Environment	234.2	224.2	237.3	220.5	200.6	189.7
Central Costs	**4,658.7**	**4,670.0**	**4,888.7**	**4,759.6**	**4,921.3**	**4,896.4**
Employee Benefits [3]	2,380.0	2,630.8	2,789.7	2,663.0	2,823.2	2,822.5
Debt Service	2,278.7	2,039.2	2,099.1	2,096.6	2,098.1	2,073.9
Other	**985.8**	**1,063.0**	**1,072.8**	**1,023.1**	**867.5**	**842.0**
Total	**$28,922.9**	**$30,608.4**	**$31,700.8**	**$31,176.1**	**$30,175.3**	**$30,212.1**

1 Amounts are adjusted to include certain "off-budget" authorizations, primarily for health care and pensions, and to exclude MBTA, school building assistance, convention center, mosquito control and certain other expenditures moved off-budgetin recent years.

2 Combines MassHealth accounts with related "off-budget" funds, such as the Commonwealth Care Trust Fund (including the Health Safety Net Trust Fund) and the Essential Community Provider Trust.

3 Does not include workers' compensation and unemployment insurance which are budgeted in agency accounts. Includes $52 million pension reconciliation and $100 million extension of pension payments in FY 09.

4 Includes $330 million of federal stimulus funds in FY 10.

5 Includes $15 million earmarked from sales tax revenues in FY 10.

6 Includes $217 million for county sheriffs passed into law after the FY 10 GAA.