

## Fiscal Year 2010 Budget Preview

As Massachusetts begins the FY2010 budget process, the state faces a budget gap of more than \$3.1 billion. In other words, the taxes and other revenues the Commonwealth is expected to receive will fall short of the anticipated cost of maintaining current services by that amount. This estimate is likely a best-case scenario. It assumes that revenue does not fall any more than is currently anticipated and that inflationary and related cost increases in many areas of government would be only 2 percent. It does assume higher rates of growth for health care costs and other areas where the recession is leading to increasing demand for services.

This budget gap is the result of two factors:

1. The nation is in the middle of a recession that will likely prove to be the most severe since the Great Depression of the 1930s. Recessions create fiscal problems for states because tax revenues decline as incomes and spending in the private sector fall, and at the same time the demand for services increases as people lose their jobs and rely on the state's safety net.
2. The Commonwealth has created structural budget problems for itself as a consequence of enacting permanent tax cuts in the late 1990s in response to temporary budget surpluses.<sup>1</sup>

This *Budget Brief* focuses on the state's current fiscal crisis and estimates the size of the preliminary FY2010 budget gap.

### Identifying and Closing a Budget Gap

A budget is "structurally balanced" when ongoing revenues are sufficient to pay for expenses. If the budget is not structurally balanced and there is a deficit, the Governor and Legislature will have to cut spending or increase revenues. Revenue increases can be either permanent (such as a tax increase, an increase in fees, or a new ongoing source of federal revenue) or one-time (such as a withdrawal from the Stabilization Fund – the "Rainy Day Fund" – or a transfer from a non-budgeted fund or other reserves, or temporary aid from the federal government). Similarly, spending reductions can be permanent, or they can be temporary, such as postponing spending by pushing certain payments off into a future fiscal year.

### THE FISCAL YEAR 2010 BUDGET GAP

The budget gap entering Fiscal Year 2010 can be broken down into two major components: an initial structural gap carried forward from Fiscal Year 2009 and an expansion of that gap associated with anticipated changes in revenue and spending in FY2010.

#### Initial Fiscal Year 2009 Structural Gap

Fiscal Year 2009 currently has a structural deficit of more than \$2 billion. This total consists of a structural gap identified at the beginning of the year, as well as increases in the gap associated with declining revenue forecasts occurring throughout the year.

**July 2008:** Some of the FY 2009 structural gap existed at the beginning of the fiscal year when the Legislature passed a \$33.3 billion dollar budget that was paid for with \$32.8 billion in ongoing revenues, of which \$21.6 billion were tax revenues. To balance this budget, the Legislature approved the use of approximately \$538

<sup>1</sup> See Massachusetts Budget and Policy Center, "Substantial Surpluses to Dangerous Deficits: A Look at State Fiscal Policies from 1998 to 2008", January 14, 2009, available at [http://www.massbudget.org/documentsearch/findDocument?doc\\_id=638](http://www.massbudget.org/documentsearch/findDocument?doc_id=638).

million in “one-time” revenues, including more than \$400 million drawn from the state’s Stabilization Fund.<sup>2</sup>

**October 2008:** By the end of the first quarter of the fiscal year in October, the budget needed “re-balancing” due to an estimated additional budget gap of \$1.4 billion. The Administration projected that FY 2009 tax revenues would be \$1.1 billion less than originally forecast, and estimated that the cost of funding FY 2009 services would be \$321 million more than originally estimated. These increased costs were due to unanticipated

increases in caseloads for certain programs and other as-yet unbudgeted items such as costs for snow and ice removal.

To re-balance the budget, the Commonwealth relied on \$731 million in state savings from permanent spending cuts (primarily so-called 9C cuts). These cuts left a new structural gap of \$690 million on top of the previous structural gap of \$538 million. To fill this gap, the Commonwealth made another \$200 million withdrawal from the Stabilization Fund and identified approximately \$290 million in new – but temporary – revenues.<sup>3</sup> This re-balancing of the budget in the fall of 2008 did not completely eliminate the budget gap, leaving just over \$200 million in an unmet budget gap.<sup>4</sup>

**January 2009:** On January 13, the Governor announced that because of continued weakness in the economy, tax revenue estimates for FY 2009 were likely to be \$952 million less than as estimated in the preceding October. The Governor has not yet announced a plan to close this gap.

### Current FY 2009 Structural Gap

By the mid-point of FY 2009, given the \$538 million structural gap at the beginning of the year, an increased

<sup>3</sup> Some of the solutions to fill the gap came from the use of \$24 million transferred from certain mental health trusts, as well as \$98 million of funding from quasi-public agencies to maintain ongoing services, which may or may not be able to continue into the future. See “Summary of off-budget and voluntary contributions” at [http://www.mass.gov/?pageID=eoafterterminal&L=4&L0=Home&L1=Budget+Information&L2=FY2009+Budget+Information&L3=FY2009+Budget+Cut+Information&sid=Eeoaf&b=terminalcontent&f=fy2009\\_offbudvoluntary&csid=Eeoaf](http://www.mass.gov/?pageID=eoafterterminal&L=4&L0=Home&L1=Budget+Information&L2=FY2009+Budget+Information&L3=FY2009+Budget+Cut+Information&sid=Eeoaf&b=terminalcontent&f=fy2009_offbudvoluntary&csid=Eeoaf) (accessed January 12, 2009).

<sup>4</sup> Because the 9C cuts included reductions to the state’s Medicaid program (MassHealth), the Commonwealth would be receiving a lesser amount of federal revenue as reimbursement for state Medicaid spending. (Massachusetts, on average, receives a 50 percent reimbursement for every dollar spent on the Medicaid program.) This reduction of approximately \$122 million in Medicaid revenue was not fully accounted for in the fall budget “re-balancing.” In addition, the final budget plan passed by the Legislature fell \$80 million short of completely closing the \$1.4 billion gap identified by the Governor.

<b>Calculating the Fiscal Year 2010 Structural Gap</b>	
<b>(estimates in millions)</b>	
<b>Current FY 2009 Structural Gap</b>	
<b>July 2008</b>	
Transfer from Stabilization Fund	-401
Forgone Stabilization Fund deposit	-108
Other one-time revenue	-30
<b>July 2008 Structural Gap</b>	<b>-538</b>
<b>October 2008</b>	
Revenue shortfall	-1,100
New costs	-321
Spending reductions and other savings	731
<b>October 2008 Structural Gap</b>	<b>-690</b>
<b>January 2009</b>	
Revenue shortfall	-952
<b>January 2009 Structural Gap</b>	<b>-952</b>
<b>Total Current FY 2009 Structural Gap</b>	<b>-2,180</b>
<b>New Structural Gap in FY 2010</b>	
Spending estimates for FY 2010	-1,525
Revenue estimates for FY 2010	563
<b>Total New Structural Gap in FY 2010</b>	<b>-962</b>
<b>Projected FY 2010 Structural Gap</b>	
Current FY 2009 Structural Gap	-2,180
Total New Structural Gap in FY 2010	-962
<b>Total Projected FY 2010 Structural Gap</b>	<b>-3,142</b>

<sup>2</sup> See Massachusetts Budget and Policy Center, *Budget Monitor: The FY 2009 Conference Committee Budget*, July 11, 2008, available at [http://www.massbudget.org/file\\_storage/documents/FY09ConferenceMonitor%5B1%5D.pdf](http://www.massbudget.org/file_storage/documents/FY09ConferenceMonitor%5B1%5D.pdf).

structural gap of \$690 million identified in October and the recent news of an additional drop of more than \$952 million in revenues, the Commonwealth currently has a \$2.18 billion structural gap for FY 2009. Since the fiscal year is just more than half over, these estimates could change by the end of FY 2009.

## The Structural Gap in Fiscal Year 2010

### *Spending estimates for FY 2010*

In Fiscal Year 2010, we estimate that the Commonwealth would need to pass a budget of at least \$34.0 billion (\$1.52 billion more than the current FY 2009 budget) to maintain the current level of services being provided in Fiscal Year 2009, even after those services had been reduced in October. This is referred to as a “maintenance budget.” A maintenance budget is sometimes also referred to as a “current services” budget or a “level services” budget which estimates the cost of continuing into the next year the current year’s level of service, while adjusting for inflation and caseload changes assuming no policy shifts – department by department and program by program. A maintenance budget does not include any new programmatic expansions or contractions, and does not assume any policy changes affecting funding or service levels.<sup>5</sup> Maintenance budget estimates depend, of course, on the assumptions made about the inflation rate, and about caseload shifts.

The Commonwealth currently does not make public a true “maintenance budget” with accurate estimates of the costs of maintaining current service levels into the next fiscal year. This document would be an invaluable tool for understanding the budgetary process, as it would allow the public an opportunity to understand the true extent of proposed programmatic cuts or expansions

<sup>5</sup> There are a number of elements that are used to determine the FY 2009 maintenance budget. The FY 2010 maintenance estimates include any supplemental appropriations since the General Appropriations Act, funding reductions associated with the 9C cuts made in October, and projections for inflation and projections for caseload changes in the following year.

within each budget proposal. Because an official maintenance budget does not exist, this *Budget Brief* seeks to estimate FY2010 maintenance costs. The numbers below should be understood simply as estimates based on the limited data available.

### **Key components of the FY 2010 maintenance estimate**

In most instances, to make an FY 2010 maintenance budget estimate, we take current FY 2009 budget levels and increase them by an inflationary adjustment of 2 percent. This is likely to be a low estimate of a true maintenance increase. For those areas of the budget which constitute the state’s human services safety net, we also make an upward adjustment to account for the increased demand for services during a recession. For areas where we made special assumptions, our rationale for our maintenance budget estimate is described below:

#### *Health Care*

We estimate in a maintenance budget that health care costs would rise by approximately \$965 million. Health care inflation is typically substantially more than the general inflation rate, causing health care costs to rise faster than the rest of the Commonwealth’s budget.

Health care costs, particularly MassHealth and Commonwealth Care costs are also affected by caseload changes, and the demand for publicly-subsidized health care always increases during a recession. To adjust for these anticipated increases, we estimate that health care costs will increase by approximately 8 percent. It is important to note that the FY 2009 health care budget included more than \$60 million in certain one-time spending postponements. Although postponing costs in FY 2009 reduced that year’s budget, those postponed costs will now need to be paid in FY 2010.

Moreover, during the mid-year “re-balancing” of the FY 2009 budget and the implementation of 9C cuts, the Legislature counted on certain mental health trust funds to pay for the some of FY 2009 mental health costs. (We include mental health spending as part of total health care spending). The use of these trusts is a one-

time funding source totaling approximately \$24 million that is paying for ongoing services which would need to be made up in the FY 2010 budget.

#### *Human Services*

We estimate that a maintenance budget for human service costs would rise by \$178 million. Because the demand for human service safety net programs increases during a recession, we have estimated that in order to account for increases associated with inflation as well as caseload increases, human service programs would increase by 5 percent.

#### *Education (Chapter 70 education funding)*

We estimate that a maintenance budget for Chapter 70 education funding would increase by \$227 million, based on an assumption that the state would freeze implementation of its FY 2007 funding plan and ensure simply that each district would receive no less than it did in FY 2009 and that all districts would reach their FY 2010 foundation budget. Because some of the data needed to determine Chapter 70 costs – such as district by district enrollment – is not available, this is only an estimate. If on the other hand, the Commonwealth were to fully fund the fourth year of implementation of the revised Chapter 70 funding formula, funding in FY 2010 would likely be closer to \$300 million.

#### *School Building Assistance*

School building assistance will drop by \$61 million. The amount of money transferred to the School Modernization and Reconstruction Trust for the purposes of school building assistance is set in statute. In FY 2010, this amount will be 95 percent of 20 percent of tax revenue from regular and motor vehicle sales. The estimate for this total in FY 2010 is approximately \$641 million.

#### *Mass. Bay Transit Authority*

Funding for the Mass. Bay Transit Authority will drop by \$943,000. The amount of money transferred to the Massachusetts Bay Transportation Authority State and

Local Contribution Fund is set in statute as 20 percent of sales tax revenue, but there is an established floor for this contribution. The estimate for this total in FY 2010 is approximately \$767 million.

#### *Pensions*

Pension funding will increase by \$63 million. Because of a statutory change made in November 2008 (Chapter 377 of the Acts of 2008), there is a change in the schedule for funding the state pension system. The FY 2010 estimated pension total will be \$1.376 billion.

#### *Other*

All other spending would increase by approximately \$154 million. For other categories of spending, such as transportation, higher education, housing and economic development and law and public safety spending, we estimate that the average increase in costs to maintain current services will be 2 percent. We have estimated that debt services will remain constant.

#### ***Revenue estimates for FY 2010***

The most recent revenue estimates for FY 2010 suggest that there will be approximately \$19.53 billion in tax revenue available for the budget, a \$180 million baseline increase. We also estimate approximately \$7.27 billion in federal revenue, and \$2.47 billion in fees and other departmental revenues. Assuming that certain revenues transferred from non-budgeted trusts would stay constant, our total revenue estimate for FY 2010 is approximately \$31.22 billion. This is an increase of \$563 million over currently anticipated FY 2009 revenue.

#### **New Structural Gap in FY 2010**

With increased costs to maintain current spending of \$1.52 billion, and \$563 million in anticipated new revenue, the new structural gap anticipated for the FY 2010 budget is \$962 million.

## Total Structural Gap in FY 2010

The total estimated structural budget gap for FY 2010 is \$3.142 billion: \$2.180 billion carried forward from FY 2009 and the additional \$962 million created by FY 2010 revenues not keeping pace with expected costs.

## Options to Fill the FY 2010 Budget Gap

The Legislature is legally required to pass a balanced budget each fiscal year. In order to fill the gap presented by the FY 2010 budget, the Commonwealth will need either to reduce spending or increase revenues.

Spending options include the use of one-time spending reductions such as state worker furloughs or postponing certain costs into the next fiscal year. Spending options also include permanent spending cuts. Spending cuts could mean eliminating funding for services for certain vulnerable populations, limiting eligibility or benefits for human service programs, reducing education spending and other local aid, closing state-funded recreational areas, reducing the number of state employees staffing state agencies, or other state-funded services.

Revenue options to close the budget gap include the additional use of one-time revenue sources such as drawing from state reserve funds or trusts. The state's Stabilization Fund, for example, is now scheduled to have approximately \$1.7 billion at the end of FY 2009. Already the Commonwealth has withdrawn close to \$600 million from the fund to balance the FY 2009 budget, and has also forgone a required \$100 million deposit into the fund. Because this fiscal crisis is likely to last several years, it is important that spending from the Stabilization Fund be considered only after careful deliberation.

The Commonwealth could also hope for additional revenue from the federal government to fill its budget gap. It looks increasingly likely that such federal assistance will be a major part of Massachusetts' budget solution, but this would likely only be a temporary

solution. Finally, the Commonwealth could raise permanent revenues such as fees or taxes.