Massachusetts Taxpayers Foundation

News Release

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MTF Calls For Substantial Spending Cuts Now To Avoid Deeper Cuts Later

Warning of a fiscal meltdown, the Massachusetts Taxpayers Foundation called on Governor Patrick and legislative leaders to cut several hundred million dollars from the fiscal 2009 budget which the Legislature approved and sent to the Governor last week.

According to the Foundation's analysis, the budget is at least $1 billion out of balance (see Table 1) without accounting for two major risks:

- Ongoing negotiations with the federal government over the state's Medicaid waiver with hundreds of millions of dollars at stake;

- A potentially sharp drop in capital gains tax collections that accounted for almost $2 billion in revenues in fiscal 2008.

At the same time, the U.S. has entered an extended period of economic turbulence – a lengthy housing slump, volatile financial markets, a widespread credit crunch, skyrocketing energy costs, and declining consumer confidence – which poses an enormous threat to state finances.

Despite these extraordinary uncertainties, the House-Senate conference committee agreed on a final budget which was larger than that passed by either branch. With the budgets approved by the House and Senate each showing structural deficits of at least $1 billion, the wisest course for the conference committee would have been to produce a budget with a bottom line significantly less than that of either branch.[1] Instead, the final budget of $28.233 billion is $35 million more than the House proposal of $28.197 billion and $142 million more than the Senate version of $28.091 billion.[2]

For the past several months the state has been negotiating with the federal government over terms of a new Medicaid waiver which will determine the level of federal reimbursements for the state's health reform law. The negotiations have been extended beyond the July 1 deadline and the outcome is uncertain, but the potential impact on the state budget is enormous.

The state's over-reliance on volatile capital gains tax revenues makes the budget vulnerable to swings in the stock market. Capital gains tax collections dropped 70 percent in 2001 (from $1.16 billion to $337 million) and have grown dramatically since, reaching $1.62 billion in 2006 and more than $1.7 billion in 2007. While the Foundation does not anticipate anything close to the 70 percent drop in 2001, a decline of 25 percent would mean a loss of at least $400 million in

[1] See MTF's June 18, 2008 *Bulletin*, "Budget Conference Committee: Fiscal Perils Ahead."
[2] These totals do not include certain "off-budget" items.

fiscal 2009.

Table 1: Structural Deficit in Fiscal 2009 Budget
($ millions)

Underfunding	**$425**
Commonwealth Care	$75
MassHealth	$150
Collective Bargaining	$150
Snow and Ice Removal	$50
Revenue Shortfalls	**$200**
Corporate Tax Increases	$100
DOR Revenue Enhancements	$100
Reserves	**$401**
Stabilization Fund Withdrawal	$310
Stabilization Fund Interest	$91
Total	**$1,026**

A $1 billion shortfall in 2009 will deplete almost half of the state's stabilization reserves, which are estimated to total $2.1 billion when the books are closed on fiscal 2008. Bad news on the federal waiver and capital gains taxes will require a much larger draw on reserves, perhaps $1.5 billion, setting the stage for dramatic spending cuts in 2010.

The problem facing the state is clear – the current level of spending is unsustainable, and there is no plan to deal with the economic and fiscal challenges ahead. As difficult as it is to make large cuts in spending now, the consequences will be far greater if those cuts are delayed until later this year or next. For example, in 2002 the Legislature and Governor developed a comprehensive plan to address the fiscal crisis, including difficult spending cuts, which allowed the Commonwealth to survive better than many other states that postponed hard decisions.

As in 2002, the state needs to develop a multi-year fiscal plan, including the measured use of reserves, to cope with the economic storms buffeting the nation. Reducing the bottom line of the fiscal 2009 budget is an important first step.

Costly COLA

The Foundation calls on Governor Patrick to veto a fiscally irresponsible provision increasing the base for cost-of-living raises for state and teacher retirees by 33 percent, from $12,000 to $16,000. The cost of this enhanced benefit is huge – $1.1 billion in present value and $2.7 to $3.5 billion if paid over time. However, because the state does not have the funds to pay for this benefit, either presently or over time, the Legislature proposes to have the cost paid by taxpayers from 2024 to 2026. The state already faces a huge unfunded retiree health care liability which is beyond the means of state government to fund, now or for the foreseeable future.

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