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Analysis: Fiscal 2020 Budget Vetoes

Baker Does Not Veto Spending Items, Returns Nine Policy Sections with Amendment

Governor Charlie Baker signed his fifth General Appropriations Act (GAA) on Wednesday, July 31, 2019, giving his approval to $43.6 billion in spending appropriations. While choosing not to exercise his veto authority to reduce spending, the Governor did veto line-item language in 7 spending accounts and returned 9 of the 108 policy sections to the legislature for further review.

This analysis provides a high-level overview of the fiscal 2020 GAA, assesses potential risks in the budget going forward, and summarizes the Governor's proposed amendments.

Key Takeaways

- As articulated in MTF's analysis of the conference committee report, the Governor's decision not to veto any spending items is not surprising but is still striking as it is the first time he has chosen not to do so.
- Education funding, particularly regarding Chapter 70, is the centerpiece of the budget with a $268 million increase, or 5.5 percent over fiscal 2019 spending.
- In light of robust June 2019 tax collections, MTF now views the fiscal 2020 tax revenue assumptions as reasonable, anticipating $406 million and 1.4 percent growth over fiscal 2019.
- The GAA includes concerning risks such as overly optimistic revenue assumptions and underfunded accounts, especially in the context of robust tax collections in recent years. These items will require careful monitoring throughout the fiscal year.

Spending Vetoes

Governor Baker did not veto any spending items in the fiscal 2020 GAA. Per MTF's analysis of the Conference Committee Report (CCR), the budget was essentially in balance in conjunction with other available tools, such as assuming some appropriations would go unspent (i.e. reversions).[1]

Spending Veto Summary	
Fiscal Year	Amount
2016	162.8
2017	267.1
2018	320.2
2019	48.9
2020	0.0

Figures in $ millions.

Nonetheless, the fact that there are no spending vetoes is striking in comparison to previous years when Governor Baker vetoed hundreds of millions of dollars in appropriations.

Spending Highlights

Education funding, particularly regarding Chapter 70, is the centerpiece of the budget with a $268 million increase, or 5.5 percent over fiscal 2019 spending. This amount is $68 million higher than proposed in the Governor's budget. Other major education increases compared to fiscal 2019 include support for high need special education students of $26 million or 8 percent, charter school reimbursements of $25 million or approximately 28 percent, and a $7 million or 10 percent increase for regional school transportation costs.

Other major new spending initiatives were included in policy areas such as health and human services, housing, and energy and environmental affairs.

Reconciling the Numbers on Total Spending

With his signature, the Governor approved $43.6 billion in spending appropriations. This total differs from the publicly reported total spending figure of $43.3 billion in several ways, as depicted in Figure 2.

Published total spending includes expected costs not included in the GAA (as further described below) and other spending authorized or anticipated to be authorized in other legislation, such as spending appropriations carried over from fiscal 2019.

[1] First Look at the Fiscal 2020 Conference Committee Report, Massachusetts Taxpayers Foundation, July 22, 2019.

The spending total also includes an assumption that $150 million of the $43.6 billion in appropriations will go unused during the fiscal year. As MTF noted previously, use of this assumption during the budget development process is a risky practice that reduces the Commonwealth's margin for error and makes midyear budget cuts more likely if fiscal pressures arise.[2]

FY20 Spending Calculation	Amount
Total Spending Appropriations	43,589.9
MTF-Identified Spending Exposures	170.4
Less "Necessary Costs" Reserve	-90.0
Subtotal, Net Spending Exposures	80.4
Other Authorized Spending	281.9
Total Authorized Spending	43,952.2
Reversion Assumption	-150.0
Exclude MATF	-481.3
Total Estimated Spending Excluding MATF	**43,321.0**

$ Figures in $ Millions.

Figure 2: FY20 Spending Calculation

The total estimated spending figure also excludes payments made through the Medical Assistance Trust Fund (MATF).

Fiscal Context

Tax Revenue Assumptions in the GAA

Fiscal 2019 tax collections were $1.1 billion above the estimate used to forecast tax revenue in fiscal 2020, justifying changes to the tax assumptions that underpinned the budget development process.

In conference committee negotiations, legislators revised the fiscal 2020 tax revenue estimate to $30.1 billion, an increase of $594 million over the consensus tax revenue (CTR) agreement reached on December 31, 2018 and $406 million, or 1.4 percent more than fiscal 2019 actual tax collections. These figures exclude tax-related settlements and judgments.

[2] First Look at the Fiscal 2020 Conference Committee Report, Massachusetts Taxpayers Foundation, July 22, 2019.

Under these assumptions, the Commonwealth will transfer $1.1 billion to the Massachusetts Bay Transportation Authority (MBTA) and $954 million to the Massachusetts School Building Authority (MSBA), increases of $60 million over fiscal 2019 for each entity and $23 million above their expectations related to CTR.

Further, estimated capital gains tax collections will total $1.7 billion, or $455 million over the Commonwealth's revenue volatility cap threshold which will be transferred to the Stabilization Fund, the state's "rainy day" fund, under these assumptions. This represents an additional $235 million transfer to the Stabilization Fund compared to CTR estimates and will put the Stabilization Fund balance at approximately $3.3 billion by the end of fiscal 2020.

On June 21, 2019, MTF sent a letter to conferees recommending a package of revisions to the fiscal 2020 tax revenue assumptions. In sum, these changes would have added $455 million to total tax revenue and an additional $113 million to tax revenue available for the budget compared to CTR.[3] As noted at the time, MTF's analysis was based on fiscal 2019 tax collections through May 2019 plus the *estimated* amount for June 2019. Using the full year *actual* collections announced by the Department of Revenue on July 29, 2019, a similar analysis produces approximately $652 million in total tax revenue and $301 million in additional tax revenue available for the budget. These estimates are essentially the same as those included by the legislature in the final budget.[4]

The GAA includes additional tax revenue from four tax law changes, including:

- $133 million from the sale of recreational marijuana
- $42 million from extending the sales tax to so-called "marketplace facilitators", e-commerce platforms like eBay and Esty which will now be required to collect sales taxes
- $28 million as a result of the previously adopted room occupancy tax reform to include short-term rentals (e.g. AirBnB)
- $5 million from imposing an administrative cap on the Life Science Tax Credit at $20 million instead of its statutory limit of $25 million

[3] Massachusetts Taxpayers Foundation letter to conferees, Massachusetts Taxpayers Foundation, June 21, 2019.

[4] As of July 30, 2019, publicly available data is insufficient to replicate the MTF analysis from June. Figures should be viewed as approximations.

In total, these tax changes are calculated to add approximately $207 million in new tax revenue in fiscal 2020. The GAA excludes several tax law changes that had been proposed by the Governor and included in the Senate budget, including a new gross receipts tax on the of opioids in Massachusetts, extending the cigarette tax to e-cigarettes and vaping supplies, requiring income tax withholding on non-resident property sales, and a package of measures designed to prevent sales tax fraud.

Tax Watch Areas

Recreational Marijuana

Fiscal 2019 was the first year the Commonwealth generated tax revenue associated with the sale of recreational marijuana. Consumers pay both the regular retail sales tax plus the marijuana excise tax on all such purchases. Though originally expected to bring in $63 million, a slower than anticipated launch of the nascent industry generated approximately $22 million in fiscal 2019.

Despite this shortfall, the GAA assumes $133 million in recreational marijuana revenue in fiscal 2020. While this estimate may have made sense in the context of the $63 million figure for fiscal 2019, it is overly optimistic considering more current information. MTF recommended reducing this estimate to $66 million.

FY20 Tax Watch Areas			
Estimated Risks	MTF	GAA	Variance
Recreational Marijuana	66.3	132.5	66.3
Tax-Related Settlements and Judgments	0.0	50.0	50.0
Total, Estimated Risks	**66.3**	**182.5**	**116.3**
Offsets			
Corporate Income Tax	2,577.3	2,456.9	-120.4
Total Tax Exposures	**2,643.6**	**2,639.4**	**-4.2**
Total Tax Revenue (Including Tax-Related S&J)		**30,149.2**	
Risks compared to Total Tax Revenue		0.0%	

Figures in $ millions.

Figure 3: FY20 Tax Watch Areas

Tax-Related Settlements and Judgments

Disputes between taxpayers and the Department of Revenue occasionally require litigation to resolve. For such resolutions concerning amounts less than $10 million each, the payment amount is simply recorded as regular tax revenue in the relevant tax category. Amounts greater than $10 million each, usually associated with corporate taxes, are tracked and estimated separately for budgeting purposes.

In the past, these large tax settlements have generated considerable revenue for the Commonwealth. In fiscal 2016, for example, these payments totaled $155 million. Since that time, however, such payments have declined substantially as the corporate tax code has been clarified to improve compliance. Tax-related settlements and judgments generated $58 million in fiscal 2017, just $11 million in fiscal 2018 from only one case, and $49 million from just two cases in fiscal 2019.

MTF has previously recommended reviving a policy that credited these payments to the Stabilization Fund.[5] Adopted in calendar year 2011, this law triggered deposits of $375 million in fiscal 2012, $95 million in fiscal 2013, and $414 million in fiscal 2014, though the fiscal 2014 transfer was later withdrawn, resulting in no net deposit in 2014. In total, the policy steered approximately $470 million to the Stabilization Fund.

In 2014, the law was changed to subject these transfers to a threshold equal to the average settlement and judgments revenue for the previous five years.[6] Since this change was implemented, no settlement and judgment revenue has been deposited to the Stabilization Fund.

MTF reiterated this recommendation to the conference committee but it was not adopted. The conference committee assumed tax settlements would generate $100 million in tax revenue available for the budget in fiscal 2020. The Governor revised this figure to $50 million, but still relies on it to support spending.

<u>Offset: Corporate Tax Revenue</u>

Fiscal 2019 corporate income tax collections totaled $2.9 billion, an increase of $535 million, or an incredible 22.4 percent over fiscal 2018 actuals. This is the largest year-over-year increase since the initial rebound from the Great Recession in fiscal 2011. While some of this growth is the result of a strong economy, a portion is from provisions of the federal Tax Cut and Jobs Act of 2017 (TCJA) that expanded the

[5] M.G.L. Section 29, Section 2H was amended by the Acts of 2011, Chapter 68, Section 37.

[6] M.G.L. Section 29, Section 2H was further amended by the Acts of 2014, Chapter 165, Section 47.

corporate tax base, perhaps by as much as 12 percent.[7] Additionally, a further provision of TCJA deemed certain foreign income held by corporations as repatriated subjecting it to federal tax with implications for the Massachusetts corporate tax base. The fiscal 2019 estimates assumed repatriation would generate an additional $65 million in one-time tax revenue. The estimate of this revenue surge may have been too conservative, though a full tabulation of the impact has not been completed to date.

These factors make forecasting fiscal 2020 corporate tax revenue more challenging than previous years. MTF advised legislators that above-trend corporate tax collections should not be relied on in fiscal 2020. The GAA assumes corporate tax collections will decline by 12.3 percent in fiscal 2020 to $2.5 billion. MTF applauds policymakers for this cautious approach toward corporate tax collections is reasonable and praiseworthy. It may also buffer tax collections from other tax risks as previously described.

Exposures in the FY20 Budget

The GAA includes budget exposures totaling $200 million, including approximately $30 million in overly optimistic revenue assumptions and $170 million in underfunded spending accounts, though these items were partially offset by the inclusion of a "necessary costs" reserve of $90 million.

Notably, the "necessary costs" reserve is only available to several spending accounts identified in the budget. Other items, such as collectively bargained state employee raises, legal aid for the indigent provided by the Committee for Public Counsel Services (CPCS), and the Department of Correction (DOC) are not eligible for support from the "necessary costs" reserve.

In context, approximately $110 million in exposures amid a $43.6 billion budget is manageable throughout the fiscal year. Unanticipated delays in hiring or ramping up new programs, unexpected revenue, or a host of other factors that are difficult to predict but likely to occur are more than enough to offset exposures of this amount.

[7] The Impact of Federal Tax Reform on State Corporate Income Taxes, State Tax Research Institute (STRI), March 2018.

FY20 Budget Exposures		
	Amount	Reserve?
Overly Optimistic Revenue Assumptions		
Chapter 58	-21.8	NO
Unclaimed Bottle Deposits	-7.7	NO
Total, Overly Optimistic Revenue	-29.5	
Underfunded Spending Accounts		
Snow and Ice	-50.0	YES
Sheriffs	-40.9	YES
Collective Bargaining	-26.4	NO
CPCS	-15.0	NO
HHS IT	-14.6	PARTIAL
DOC	-13.6	NO
Settlements and Judgments	-9.0	YES
HRD	-0.9	NO
Total, Underfunded Spending Accounts	-170.4	
Total, Budget Exposures	**-199.9**	
"Necessary Costs" Reserve	90.0	
Total, Budget Exposures with Offset	**-109.9**	

Figures in $ millions.

More broadly, however, the continued presence of budget exposures is concerning given the strong tax revenue growth of recent years. If the Commonwealth is unable to budget for all likely expenses in good times, it will be challenging to do so during difficult times.

Policy Vetoes

The Governor vetoed line item language in seven spending accounts and nine policy sections, including:

- A MassDOT study of using state-owned property near transit stations as a staging area for "micro-mobility devices", like electric scooters
- A report on the staff and initiatives pursued by the Executive Office of Energy and Environmental Affairs related to environmental justice
- A report establishing a commission to study transferring ownership of the Willett Pond dam in Norwood to the Department of Conservation and Recreation (DCR)

- A report on staffing levels at DCR
- A requirement that prioritizes skating rink time scheduling at DCR skating rinks that conflicts with language in another line item
- A requirement that could be interpreted to allow the Disability Law Center, Inc. to investigate the physical environment of Department of Correction (DOC) facilities in violation of federal regulations
- A requirement that DOC collect employment data on former participants in the prison industries and farm services program after their release.

Baker Policy Vetoes and Amendments					
	2016	2017	2018	2019	2020
Conference sections	213	200	150	110	108
Sections vetoed	21	36	9	0	0
Sections amended	9	23	25	19	9

Further, the Governor returned nine policy sections with amendment, including:

- Four related to the procurement of offshore wind energy,
- One addressing a drafting error that inadvertently included the sales tax on meals in the upcoming sales tax holiday,
- One that rejects a temporary moratorium on deer hunting in the Blue Hills Reservation,
- And three related to other technical items.

Conclusion

The fiscal 2020 GAA increases spending by $1.1 billion, or 2.8 percent, compared to fiscal 2019. These increases are affordable in fiscal 2020 as a result of strong tax collections produced by a strong economy, a host of new revenue sources such as gaming revenue, extending the room occupancy tax to short-term rentals, the sale of recreational marijuana, and expanding the sales tax to apply to "marketplace facilitators" like eBay and Etsy.

As always, careful stewardship will be required to manage the identified risks in the budget during the fiscal year and maintain a balanced, sustainable approach to the Commonwealth's finances.