

Bulletin

September 6, 2001

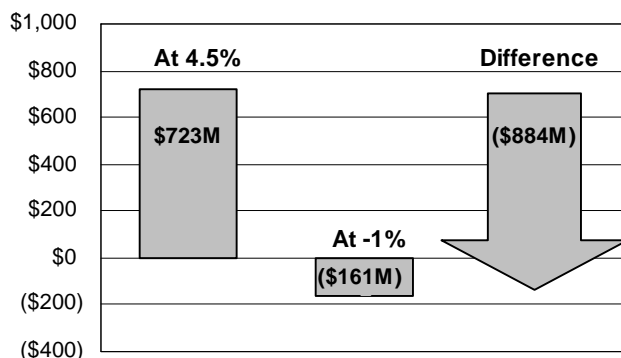
Budget Stalemate, Declining Revenues Pose Serious Risks

The news of declining revenues through the first two months of fiscal 2002 -- a one percent decrease after adjusting for the phase-in of the income tax rate cut -- highlights the urgency of the state's fiscal situation. Not only is the 2002 budget woefully overdue, but both the House and Senate versions of this year's spending plan are out of balance even before factoring in the latest bad revenue news. On top of all this, lawmakers have so far failed to take the actions needed to close out fiscal 2001 -- which ended more than two months ago -- leaving the use of a surplus of more than \$500 million in limbo and jeopardizing the state's ability to meet key financial reporting deadlines.

As House and Senate conferees continue to wrangle over the 2002 budget, tax collections to date are falling seriously short of the 4.5 percent rate of baseline growth assumed in both branches' budgets. Although the recent trend in receipts could turn around in the coming months, extrapolating the current performance to the entire year raises the sobering specter of a potential revenue shortfall of as much as \$900 million for 2002 (see accompanying chart).

The final compromise budget for this fiscal year -- whenever it may be resolved -- is already virtually guaranteed to be out of balance, before taking into account the recent poor revenue collections, because of underfunding and other problematic elements in the budgets adopted by each branch (as well as in the spending plan proposed by

Fiscal 2002 Base Revenue Growth
(\$, Millions)



* Base revenue growth of 4.5 percent is assumed in the House and Senate versions of the FY02 budget. The \$884 million total is the difference between that growth and the 1% decline in base revenue growth in the first two months extrapolated to the entire fiscal year.

the Governor). Both the House and Senate underfunded Medicaid and other non-discretionary programs by more than \$150 million. Other proposals to cut pension funding and draw down tobacco settlement dollars further jeopardize the fiscal outlook

In a July 16 *News Release*, the Foundation called on the Legislature to set aside up to \$300 million of the 2001 surplus to help balance the budgets in fiscal 2002 and 2003, the years that will feel the greatest impact of the income tax cuts approved by the voters last

year.¹ Over the next two years, the state will have to accommodate more than \$1 billion of tax cuts, while simultaneously coping with slower economic and revenue growth that has already forced budget cutbacks in other states. Given this ominous fiscal picture, which is only reinforced by the recent poor revenue performance, the \$300 million proposed by MTF is the minimum that should be reserved for this purpose. While the amounts proposed in the Legislature -- \$100 million by the Senate and \$150 million by the House -- are a step in the right direction, they are clearly inadequate. The House also sets unnecessarily restrictive conditions on the spending of the \$150 million.

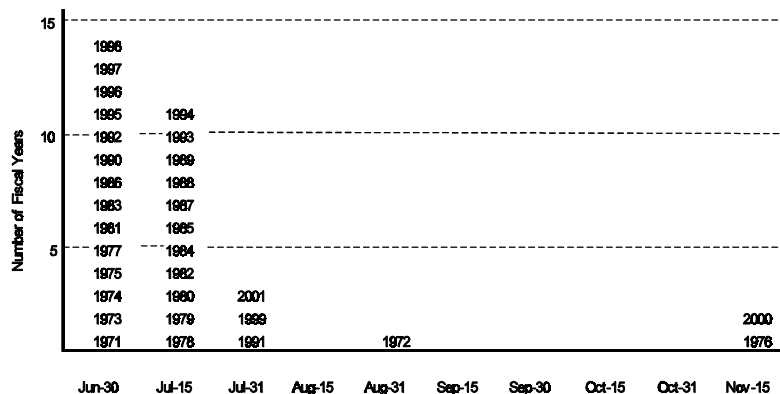
The pace of budget deliberations on Beacon Hill stands in striking contrast to the state's new financial realities. The fiscal threats of which the Foundation has repeatedly warned are no longer on the horizon, but instead are beating at the front door.

Fiscal 2002 Budget

As the Foundation previously reported,² the budgets of both the House and the Senate are unbalanced with spending totals of more than \$23 billion, an increase of over six percent from 2001. Like the Governor's House 1 proposal, each branch's budget underfunds Medicaid and other nondiscretionary programs and relies on a variety of questionable initiatives and assumptions to appear balanced. While the spending totals of the two budgets are only \$90 million apart, this similarity masks tremendous differences in areas such as the use of tobacco dollars, the distribution of education aid, pension funding, and how to finance the Clean Elections law approved by the voters three years ago.

With the new fiscal year now in its tenth week, there has been no apparent headway by the conference committee convened to resolve the differences

Date of Enactment of Annual Budget by Legislature
Since Fiscal 1971



between the two legislative versions of the 2002 budget. During the interim, state operations have been sustained through a series of two-week stop-gap spending authorizations.

While modest tardiness of a week or two in approving a budget for the new fiscal year is relatively common, this year's delay of over two months is extreme. The Legislature's approval of the state budget has lagged beyond August 31 in only two prior years since 1971 (see above chart). Even in the depths of the state's fiscal crisis at the beginning of the last decade, lawmakers were able to conclude their budget deliberations before July 31. Taking an even longer perspective, legislative budget enactment has been delayed beyond the end of July in only four previous years in the last five decades.

¹ See the Foundation's July 16 *Release*, "MTF Proposal: Use 2001 Surplus to Balance 2002 and 2003."

² "MTF Analysis: An Unbalanced Fiscal 2002 Budget," June 26, 2001.

Fiscal 2001 Surplus

The House and Senate only last week approved their respective versions of the "final deficiency" for fiscal 2001, which ended on June 30. The final deficiency makes appropriations for accounts that were underfunded for the year as well as certain authorizations that would carry over into fiscal 2002. In the House bill, these amounts total \$222 million, compared to \$187 million in the Senate (see accompanying table).

The final deficiency also includes decisions on how the 2001 surplus will be used. The Senate is proposing to spend essentially all of the approximately \$550 million surplus,³ with major shares dedicated to capital and health care. The House, on the other hand, earmarks only \$350 million of the surplus, mostly for capital.

Under both proposals, any remaining surplus revenues would be allocated between capital reserves and the state's rainy day fund. The differences between the two branches' recommendations must now be reconciled by a conference committee.

While the positive initiative to raise the cap on the state's rainy day fund is included in both the House and Senate bills, it is unfortunate that neither branch has supported the fiscal reforms of the regional transit authorities -- including abolishing budgeting in arrears - - that were recommended by the Blue Ribbon Commission on Regional Transit Authority Financing. With this omission, the Legislature is missing a major opportunity for reform that will be difficult to afford in the years ahead.

³ Assuming reversions (unspent appropriations) for the year of \$250 million.

Proposed Final Legislative Action for Fiscal 2001 (\$, Millions)

	House	Senate
Deficiencies and other appropriations	\$222	\$187
Chapter 90 local road grants	50	50
Uses of surplus		
Reserve for FY02-03	100	150
Capital		
Capital needs investment trust	100	48
Housing	80	60
Other	73	65
FY02 children/seniors health care*	--	83
Uncompensated care	--	44
New family leave program	--	70
Total proposed uses of surplus	353	521
Grand Total	\$625	\$758

* Proposed transfer from general fund to children and seniors health care

According to state finance law, the comptroller must officially certify the amount of the 2001 surplus -- and issue the final statutory financial report for the fiscal year -- by October 31.⁴ If action on the final deficiency is delayed much beyond the first week in September, it will become administratively impractical to meet this deadline, potentially resulting in a failure to issue timely financial reports. Such a breakdown in the state's financial practices would reflect badly on the Commonwealth's hard-earned reputation for fiscal stability and would be noted by credit raters on Wall Street.

⁴ An earlier August 31 deadline applies only to any unpaid bills for agency program costs during the prior fiscal year, which must be processed for payment within two months of the end of the fiscal year (and up to two weeks later at the discretion of the state budget director). If that deadline is not met, any appropriations previously encumbered (earmarked) to pay the bills are released to be counted as surplus in the final tally for the year.