Massachusetts Taxpayers Foundation

Bulletin

333 WASHINGTON STREET
BOSTON, MA 02108-5170
617-720-1000
FAX 617-720-0799

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State Faces Large Deficits in Both Fiscal 2008 and 2009: Threatens Rapid Depletion of State's Reserves

The state is facing a $500 million deficit in fiscal 2008 and the recently passed House budget for fiscal 2009 is at least $1 billion out of balance, creating a situation in which more than half of the state's reserves could be depleted in the next year without even accounting for a recession.

According to the latest Information Statement for the Commonwealth (April 16, 2008), the stabilization fund will have a projected balance of $2.12 billion at the end of fiscal 2008, compared to $2.335 billion at the close of fiscal 2007. An additional billion dollar draw in 2009 would leave slightly more than $1 billion in reserves.

Fiscal 2008

The final fiscal 2008 budget, after gubernatorial vetoes and overrides, included expenditures of $26.808 billion based on tax revenues of $19.825 billion and the use of $509 million in reserves (see Table 1).

Table 1: Fiscal 2008 Use of Reserves

	$ millions
Stabilization Fund	
Withdrawal	$240
Interest	$75
Health Care Security Trust Fund	
Withdrawal	$150
Interest	$44
Total	**$509**

Last October, the administration raised the revenue forecast by $400 million to $20.225 billion. Revenue collections through April have exceeded this revised forecast by another $702 million. Should May and June produce revenues at the benchmark, total tax receipts for fiscal 2008 will be $1.1 billion more than the forecast on which the budget was originally based.

According to the Foundationĝs analysis, despite this additional $1.1 billion in revenues the state will not be able to cover much, if any, of the $509 million initial draw on reserves, ending the year with an estimated $443 million deficit (see Table 2).

Table 2: Fiscal 2008 Overview

	$ millions
Initial Use of Reserves	($509)
Excess Revenue over Forecast	$1,100
Additional Obligations	($1,034)
Projected Deficit	**($443)**

Table 3 summarizes the more than $1 billion in additional spending or obligations that have consumed almost all of the $1.1 billion in revenues. Supplemental spending and estimated deficiencies total almost $750 million with the shortfall in lottery proceeds adding another $250 million.

Lottery shortfall: For the past two years proceeds from the state lottery have fallen short of the amount appropriated in lottery aid to cities and towns. The $119 million shortfall in fiscal 2007 was not funded in 2007. With an estimated shortfall of $124 million in 2008, the state has an unmet obligation of $243 million for the two years.

Supplemental spending: To date, six supplemental spending bills have been approved for fiscal 2008 totaling $168 million, principally for snow and ice removal and collective bargaining agreements. In mid-April, the administration filed a $268 million supplemental appropriation bill, including $153 million to cover increased enrollment in Commonwealth Care, $26 million for growing welfare caseloads, and another $13 million in snow and ice removal.

Table 3: Fiscal 2008 Additional Obligations

	$ millions
Lottery Shortfall	**$243**
FY07	$119
FY08 (estimated)	$124
Supplemental Spending	**$436**
Approved Supplemental Budgets	$168
Recently Filed Supplemental	$268
Estimated Final Deficiencies	**$305**
Commonwealth Care	$25
MassHealth	$50
Group Insurance Commission	$30
Agency Deficiencies	$200
MassHealth Deferral	**$150**
Shortfall in Revenue (May/June)	**$100**
Total	**$1,234**
Projected Reversions	*($200)*
Net	**$1,034**

Final Deficiencies: Beyond the supplemental spending for fiscal 2008, the Foundation estimates that an additional $300 million will be needed to fund various deficiencies. Health care accounts for $105 million, including $50 million for MassHealth, $30 million for the Group Insurance Commission, and another $25 million for Commonwealth Care. An additional $200 million in deficiencies is spread across state government.

MassHealth Deferral: An estimated $150 million in federal reimbursements under the MassHealth program may not be forthcoming due to concerns over the payment methodology.

Tax revenues: The Department of Revenue has said that the speedier processing of tax returns in April may have a $60-$70 million negative impact on May revenues. As the nation heads into a recession, the Foundation projects that tax collections in the final two months of fiscal 2008 will fall $100 million below the benchmark.

Reversions: On the positive side, as happens at the end of each year, there will be significant reversions of unspent appropriations into the state treasury, estimated at $200 million for fiscal 2008. The pressures on most major spending accounts are likely to result in a somewhat lower reversion amount than in normal years.

Despite the fact that we are nearing the end of this fiscal year, there remain several major variables that will determine the size of the fiscal 2008 deficit. An additional $216 million in federal reimbursements could be deferred; there could be wide swings in tax collections in May and June; the Legislature could approve additional supplemental spending. On balance the Foundation believes that the estimated $500 million deficit is more likely to be larger than smaller when the books are closed on fiscal 2008.

Fiscal 2009

The recently passed House budget for fiscal 2009, whose bottom line is virtually identical to the Governorôs proposal, is at least $1 billion out of balance. In addition to a planned draw of $500 million from the stabilization fund, the budget underfunds some major accounts and depends on revenue from changes in tax law that is not likely to be fully realized. Furthermore, the budgetôs tax forecast, while conservative by normal standards, does not take into account the impact of a national recession, which could create a larger hole than the $1 billion.

As shown in Table 4, the House budget underfunds two major health care accounts by a total of approximately $400 million. Commonwealth Care, which provides subsidies for lower income enrollees under health reform, is budgeted at $869 million in both the Governorôs and House budgets. According to the latest Information Statement, estimated expenditures have risen by $213 million to $1.082 billion. In addition, the MassHealth program is underfunded by an estimated $200 million. This health care spending is likely to receive 50 percent federal reimbursement, but it is also likely that Commonwealth Care will require more than $1.082 billion in 2009. The snow and ice account is funded at $20 million but for an average winter would require $70 million. A recession will put further pressure on caseload driven programs so there are undoubtedly other key accounts which will turn out to be underfunded.

Table 4: Structural Deficit
in Fiscal 2009 House Budget

	$ millions
Underfunding	**$463**
Commonwealth Care	$213
MassHealth	$200
Snow and Ice Removal	$50
Revenue Shortfalls	**$200**
Corporate Tax Increases	$100
DOR Revenue Enhancements	$100
Reserves	**$503**
Stabilization Fund Withdrawal	$412
Stabilization Fund Interest	$91
Total	**$1,166**

On the revenue front, the House budget counts on an additional $558 million from a variety of tax increases, based on the administrationôs estimates. The Foundation believes these estimates are overstated by at least $200 million, as discussed below. In addition, the $175 million estimate for the cigarette tax increase may well be overstated.

The Department of Revenue has estimated that the corporate tax increases will generate an additional $482 million when fully phased in, without accounting for any rate reduction, and $289 million in fiscal 2009. Given the complexities of corporate taxation, these are guesstimates at best, and neither DOR nor anyone else really knows how much will be derived from combined reporting. Furthermore, with a tax increase of this magnitude ï approximately 25 percent overall and a tripling or more for many corporations ï many employers will certainly decide to move some operations out of state in the years ahead. That will impact corporate tax collections as well as personal income and sales taxes.

Nevertheless, it is clear that the $289 million estimate for fiscal 2009 is overstated, probably by at least $100 million. Combined reporting represents a radical change in the way corporations are taxed in Massachusetts ï a far cry from closing ñloopholesò ï which will usher in years of litigation. DOR is seeking unprecedented discretionary authority ï greater than any other revenue department in the nation ï as part of combined reporting. Beyond the fundamental unfairness in what DOR is seeking, the more discretion that is given to DOR, the less revenue that will actually be collected in 2009 and the more that will end up in protracted litigation. The House version of the legislation, which provides clarity and predictability, will produce more revenue in fiscal 2009 than the Governorôs proposal which gives DOR unfettered discretion. The Senate bill improves on the Governorôs version but falls short of the House.

In addition to the corporate tax increases, the Governor has proposed and the House has adopted a series of tax changes euphemistically called ñrevenue enhancements.ò Even if all twelve changes are approved, it is questionable whether DOR will come close to achieving the $166 million estimate of additional revenues in fiscal 2009.

Aside from the question of revenues, the scope of these proposed changes deserves broader public review. For example, under ñEnhanced Compliance on Real Estate Sales,ò the administrationôs budget overview states this change would ñallow the Commissioner to require nonresident real property owners who sell or transfer property to make estimated payments on their liability by the closing date.ò In subsequent discussions, DOR has clearly stated its belief that this section applies to residents and nonresidents alike, extends beyond real estate transactions to other forms of income taxes, and provides the Commissioner with the authority to demand prepayment of estimated taxes before receipt of income, powers far exceeding the administrationôs description in the budget.

In conclusion, it is clear that a $1.5 billion draw on reserves over the next year will deplete the stateôs rainy day fund much too rapidly. In order to reduce the dependence on reserves, the final conference committee budget for 2009 needs to be several hundred million dollars less than the House budgetôs bottom line. The state must maintain sufficient reserves to help manage through an economic downturn.