Massachusetts Taxpayers Foundation

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

# News Release

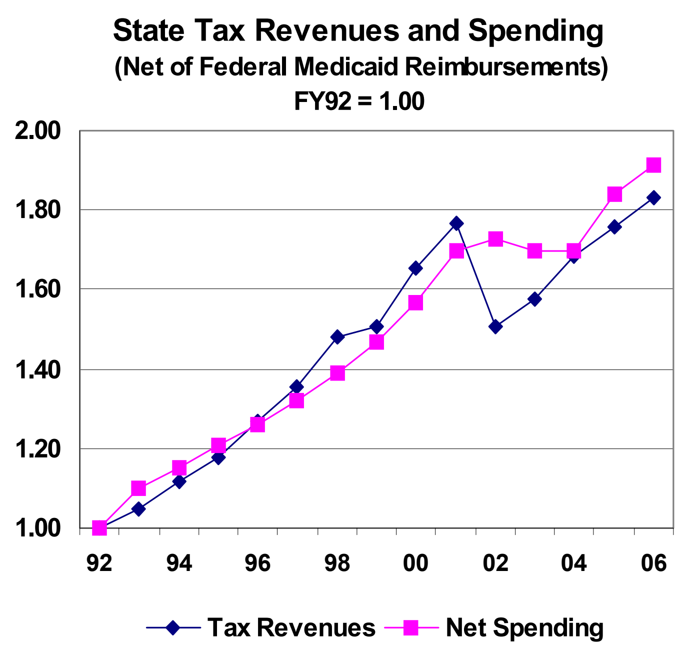
For Immediate Release

April 12, 2005

## MTF Report on State Finances: The Clash Between Expectations and Reality

Despite the widespread perception that improving revenues signal the end of the state's fiscal woes, the Commonwealth's ability to sustain its current commitments—much less take on major new ones— is sharply limited by a fundamental imbalance between spending growth in key areas and likely revenue growth for the foreseeable future, according to the Massachusetts Taxpayers Foundation's annual report on state finances released today.

"The widening disconnect between spending expectations and fiscal reality will only add to the difficulty in producing balanced state budgets over the next several years," said MTF President Michael J. Widmer. "While annual revenue growth is likely to be healthy, the expected performance is a far cry from the heady increases of the 1990s."




The report, *State Budget '05-'06: The Clash Between Expectations and Reality*, concludes that largely uncontrollable growth in spending for core programs is outpacing the revenue growth that can reasonably be expected to be generated by the state's economy and tax base over the long term, leaving next to nothing for restoring budget cuts, funding new initiatives, or cutting taxes.

According to the report, the Commonwealth faces a structural shortfall of almost $500 million in fiscal 2005 and more than $700 million in fiscal 2006. The gap in 2005 finances—largely the due to a heavy reliance on one-time resources—will widen in 2006 because of the mismatch between annual rates of revenue and spending growth. Expected annual revenue increases of roughly $700 million in both 2005 and 2006 are only slightly below the average growth over the last 25 years. At the same time, largely unavoidable increases in some of the biggest areas of state spending are requiring almost a billion dollars of additional expenditures each year, before considering the restoration of spending cuts, major new commitments such as early childhood education, or the unknown costs of proposals to expand health care. Given the structural forces driving these revenue and spending trends, the resulting "growth gap" will be extraordinarily difficult to resolve.

This new challenge will require extremely tight budgets for the foreseeable future, a reality that is reflected in Governor Romney's proposed budget for fiscal 2006. The Governor's budget recommends less than one percent growth in spending in the coming year and depends on one-time "savings" from a Medicaid accounting change and a third successive year of business tax increases to maintain balance.

The report identified four major spending areas that are contributing to the growth gap in the state budget:

- The escalating costs of health care for the poor, elderly and disabled, where the combination of federal mandates, rising costs and widespread support for expanded health care coverage leave few realistic options for controlling the rate of growth;

- The need for important capital investments, where debt service on the state's borrowing is in the short term contractually unavoidable and in the long term will have to rise even more rapidly if the state is to address its huge backlog of critical projects;

- The state's obligation to provide an adequate education to Massachusetts children, where there is extensive support (and a financial responsibility anchored in the state Constitution) for greater state funding, as well as the expensive new school building assistance program and a commitment by legislative leaders to expand early childhood education at an annual cost of up to $1 billion when fully implemented;

- The long-term costs of eliminating the state's huge unfunded pension liability, where staying on course to erase the liability by 2023—an imperative to maintain the Commonwealth's credit rating—requires annual spending increases greater than the rate of inflation for the next two decades.

According to the report, the state's spending priorities have been dramatically altered during the recent fiscal crisis, with rapid cost growth in areas such as health care offsetting deep cuts in other areas such as higher education and local aid. Even with the increases proposed in the Governor's budget, total 2006 spending will be below 2001 spending after adjusting for inflation. Apart from health care, debt service, and pensions, recommended 2006 spending in individual program areas will be lower than 2001 levels by margins ranging from substantial (up to 10 percent) to huge (30 percent or more). However, given the continuing financial pressures on the state budget, for the foreseeable future it will be difficult—if not impossible—to reshape significantly the spending priorities established during the crisis.

The Massachusetts Taxpayers Foundation is an independent, nonprofit organization that conducts research on state and local taxes, government spending, and the economy. Founded in 1932, MTF ranks among the largest and most effective organizations of its kind in the country. The Foundation has won eight prestigious national awards in recent years for its work on business costs, capital spending, state finances, MBTA restructuring, state government reform, and health care.

*****