Massachusetts Taxpayers Foundation

333 Washington Street | Suite 853 | Boston, MA 02108 | 617.720.1000
www.masstaxpayers.com

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One week after the October 7th Economic Roundtable and a day before the October 15th deadline established in Chapter 29 Section 5B of the M.G.L., the Baker Administration released its revised estimate of budgeted revenues for FY 2021. Following months of economic uncertainty and temporary budgets to keep the state operating, Administration and Finance (ANF) provided the Legislature with its revenue and spending proposals for their review and consideration. Notably, the Governor's revised plan projects a growth in overall spending of 3.8%, which is a higher growth rate than his original FY21 budget and is driven predominantly by growth in MassHealth, the state's Medicaid program.

ANF expects FY 2021 tax revenues to decline by $3.6 billion from the January benchmark of $31.15 billion upon which the governor's original budget was based. This 11.4 percent decline in revenues means that $27.59 billion in taxes revenues will be available for the FY21 budget. The remainder of available funds for this approximately $45 billion spending plan comes from various forms of federal assistance.

Withholding income tax and sales tax revenues would fall by $1.14 billion (7.9 percent) and $678 million (9.1 percent) respectively, and capital gains tax revenues are not projected to exceed the threshold that would require a transfer to the Stabilization Fund. Declines in revenues from motor fuels, room occupancy, and estates which reached a peak of $700 million in FY 2020, fall by $354 million or 14.7 percent (Table 1).

**Table 1 – ANF's Revised Tax Revenue Estimate for FY 2021**

| | **FY 21 H2** | **October 15** | **$** | **%** |
|---|---|---|---|---|
| **Income** | **17,909** | **15,867** | **-2,042** | **-11.4%** |
| Withholding | 14,423 | 13,282 | -1,141 | -7.9% |
| Non-withholding | | | | |
| Capital Gains | 1,590 | 1,210 | -380 | -23.9% |
| Other Non-withhold | 1,896 | 1,375 | -521 | -27.5% |
| **Sales** | **7,425** | **6,747** | **-678** | **-9.1%** |
| **Corporate** | **3,404** | **2,920** | **-485** | **-14.2%** |
| **Other Tax Revenues** | **2,413** | **2,059** | **-354** | **-14.7%** |
| **Total** | **31,151** | **27,592** | **-3,559** | **-11.4%** |

ANF's $27.59 billion estimate is on the conservative end of those projections made at last week's Economic Roundtable. While it is approximately $220 million higher than MTF's forecast of $27.272 and $450 million higher than the midpoint of the Department of Revenues forecast range derived from two models using differing scenarios, it is $160 million lower than the mid-point of the high and low estimates from the five presentations at the economic forum.

<u>Balancing the FY 2021 Budget</u>

The administration relies on variety of tools to help close the FY 2021 budget gap including a number of nonrecurring revenues that will not be available in future years:

- $422 million carried forward from FY 2020 ($390 in capital gains above the threshold and $32 million in other sources);
- $834 million in enhanced Federal Medical Assistance Percentages (FMAP) from a 6.2 percent federal increase for the first three quarters of FY 2021;
- $550 million from the federal government's Coronavirus Relief Fund that will be used principally to pay for budgeted public safety salaries for the first two quarters of FY 2021;
- A drawdown from the Stabilization Fund in an amount not to exceed $1.35 billion which would leave a balance of $2.2 billion for future needs (Table 2);
- $267 million from a proposal to accelerate sales tax revenues through a prepayment plan. If passed, the accelerated sales tax would provide an additional $59 million to the MBTA for FY 2021, offering some relief from the authority's operating budget challenges.

**Table 2 – FY 2021 Proposed Budget Solves**

| | |
|---|---|
| **Revenues** | |
| Capital Gains Above FY 20 Threshold | 390 |
| Other Balance Forwarded from FY 20 | 32 |
| Enhanced FMAP | 834 |
| Cornavirus Relief Fund | 550 |
| Stabilization Fund | 1,350 |
| Accelerated Sales Tax | 267 |
| Delay Charitable Deduction | 64 |
| Tax Settlements + | 58 |
| **Total** | **3,545** |
| **Other Savings** | |
| Refinance Debt Service | 140 |
| Low/Low Spending | 515 |
| **Total** | **655** |

MassHealth Drives Spending Hike

The newly proposed FY 2021 ANF budget increases total spending by approximately $1 billion over last January's release, a remarkable two percent hike over the pre-pandemic budget. The jump is due to a $1.6 billion increase in MassHealth costs – 10 percent more than in FY 2020. This is due in part to an eight percent spike or 140,000 new members joining the program since March that will most likely continue to grow. The enhanced federal medical assistance percentage (FMAP) adds 6.2 percent on top of current reimbursement rates, bringing the state's share of the increase to $536 million.

Other tools employed by the administration include debt refinancing for a savings of $140 million and utilization of the lower of the spending limit options included in the two interim budgets (the lower of FY 2020 GAA or original H.2) for savings of another $500 million. The administration increases its pension payment by $274 million to $3.1 billion, increases Chapter 70 school funding by $108 million or 2 percent, and level funds unrestricted municipal aid. Further, by delaying the implementation date for the charitable donation deduction the state saves $64 million in otherwise foregone revenue this year and $236 million next year.

The FY 2021 revised budget proposal is not as austere as some would have anticipated. The following line-items are actually increased:

- Pension payment by $274 million to $3.1 billion;
- Chapter 70 school funding by $108 million or 2 percent,
- Unrestricted municipal aid is level funded,
- Approximately $440 million in one-time funding for schools from federal CARES Act revenues that will help offset new pandemic-related costs.

Challenges Mount for FY 2022

FY22 is shaping up to be a more challenging year because the vast majority of the new revenues listed in Table 2 are not replicable in FY 2022.

The state will have to replace at least $3.5 billion in non-replicable revenues that bolster FY 2021 spending. In addition, corporate tax settlements that have been relatively low for years could further decline.

On the spending side, yearly hikes in non-discretionary spending for MassHealth, Chapter 70, and pensions typically grow by $1 billion. Factor in the cost increases to pay for the Student Opportunity Act reforms as well as annual inflationary costs and collective bargaining agreements that add hundreds of millions in costs, and the state will likely confront another multi-billion shortfall with fewer resources than in FY 2021.

The state will have to hope for further federal assistance, an economic rebound and strong tax revenue growth because the $2.2 billion remaining in the Stabilization or Rainy Day Fund is not sufficient to weather this storm.