MTF
Massachusetts Taxpayers Foundation

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

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MTF Analysis of FY 2024 Tax Revenue Shortfall & 9C Cuts

Earlier this week, the Healey administration announced a $1 billion tax revenue shortfall for FY 2024, downgrading the revenue benchmark from $40.41 billion to $39.41 billion. They also released a plan to solve the shortfall which includes approximately $375 million in net mid-year (9C) budget cuts. In total, 66 budget line-items were reduced by $545 million in gross spending. These cuts are accompanied by approximately $169 million in lost revenue, resulting in an estimated net impact of $375 million.

The announcement of the shortfall came the week after December revenues were released, which showed year-to-date tax collections falling behind benchmark by $769 million. This shortfall, combined with below benchmark revenues in Fiscal Year (FY) 2023 and the uncertainty regarding income surtax revenue has required the administration to adjust revenue expectations and pursue budget cuts to maintain a balanced budget in FY 2024. Additionally, the fiscal impacts of tax relief – while fully accounted for in the FY 2024 General Appropriations Act (GAA) – necessitate a further downward adjustment to the revenue benchmark.

FY 2024 Revenue Shortfall & Benchmark Adjustments

FY 2024 Original Benchmark	**$40,410**
Revenue Shortfall	**-$1,000**
Unanticipated Non-Tax Revenue	*$625*
Spending Reductions	*$378*
FY 2024 Revised Benchmark	**$39,410**
Tax Relief Adjustment	*($577)*
Conference Tax Relief Assumptions	*$580*
FY 2024 Cost of Tax Relief	*$0*
FY 2024 Benchmark w/ Tax Relief	**$38,833**

$ in millions

This brief explains the factors that have led to the state's current fiscal position and the tax revenue shortfall identified by the Healey administration. It then details the spending cuts and other solutions that are being implemented. Lastly, it ends with an analysis of the impact of these budget cuts on the FY 2025 budget development process.

Fiscal Background

As the Healey administration responds to the tax revenue shortfall and policymakers look ahead to the remainder of FY 2024, there are several important factors to keep in mind:

FY 2023 Revenue Shortfall

As recently reported by MTF, in FY 2023, state tax revenue collections fell dramatically; ultimately ending the year $846 million below benchmark, excluding surtax revenue. While the FY 2024 consensus tax revenue figure of $40.41 billion originally agreed to by administration and legislative budget leaders represented modest growth of 1.6 percent, the FY 2023 shortfall meant that non-surtax revenues in FY 2024 would now need to grow by 3.8 percent to meet expectations. This rate of growth far exceeded economic projections for the fiscal year, and placed the state in a more tenuous financial position heading into FY 2024.

FY 2024 Estimated & Required Rates of Revenue Growth

FY 2023 Revenue Benchmark	FY 2024 Revenue Benchmark	FY23 v. FY24 Estimated Growth
$39,769	$40,411	1.6%
FY 2023 Revenue Actuals[1]	**FY 2024 Revenue Benchmark**	**FY23 v. FY24 Required Growth**
$38,922	$40,411	3.8%

$ in millions

FY 2024 Revenue Collections to Date

State tax revenue collections for FY 2024 totaled $17.869 billion through December, $769 million (4.1 percent) below the year-to-date benchmark and $60 million (0.3 percent) ahead of FY 2023 collections.

FY 2024 Revenue Collections v. FY 2023 Actuals and FY 2024 Benchmarks

	FY 2023 YTD Actuals	FY 2024 YTD Actuals	FY 2024 v. FY 2023 YTD	FY 2024 YTD Benchmark	Year to Date v. BM
Withholding	$8,017	$8,524	$507	$8,506	$18
Non-Withholding	**$1,662**	**$1,562**	**-$100**	**$1,846**	**-$284**
Sales	$4,719	$4,662	-$57	$4,844	-$182
Corporate/Business	$1,947	$1,845	-$102	$1,984	-$139
Other	$1,464	$1,277	-$187	$1,460	-$183
Total	**$17,809**	**$17,869**	**$60**	**$18,640**	**-$769**

$ in millions

For the second consecutive month, collections for December fell short of both FY 2023 collections and expectations for FY 2024; with monthly collections in December coming in $82 million (2.1 percent) behind FY 2023 and $138 million (3.5 percent) below benchmark.

[1] FY 2023 revenue collections totaled $39.164 billion, of which $242 million was attributable to the income surtax and transferred to the Education and Transportation Trust Fund, established in the FY 2024 GAA (Chapter 28 of the Acts of 2023).

While state tax revenue collections have failed to meet benchmark in each of the first six months of FY 2024, this week's actions mark the first time that the administration has taken action to either reduce spending or adjust revenue expectations.

Income Surtax Revenue

As MTF has discussed in earlier reports, there is limited information available from the Department of Revenue regarding the impact of surtax revenue collections on withholding and non-withheld income tax collections to date. This lack of information makes it extremely challenging for policymakers to project future months' revenue collections and assess the resources that are available to support budgeted spending.

According to the process established in the FY 2024 General Appropriations Act (GAA) to collect, track, and spend surtax revenue, these resources may only be used to support education and transportation investments and are therefore set aside from any assessment of tax revenue available to support general budgeted spending.

To date, the only category of revenue in which collections in FY 2024 exceed benchmark is withholding income taxes; and the increase is marginal (0.2 percent). If even $18 million of withholding income is attributable to the surtax, those collections would be trailing benchmark as well.

Revenue Impacts of Tax Relief

The tax relief package signed into law by Governor Healey in September carries a fiscal impact of approximately $577 million in FY 2024, but was fully accounted for in the FY 2024 budget. However, while the costs of the package were covered, the FY 2024 tax revenue benchmark has not yet been adjusted to reflect its passage.

After taking into account the impact of tax relief, the FY 2024 revenue benchmark will receive a further downward adjustment from $39.410 billion to $38.833 billion.

FY 2024 Budget Spending Trends

The FY 2024 Conference Committee report sent to Governor Healey's desk included $56.2 billion in total spending; a $3.8 billion (7.3 percent) increase over the FY 2023 budget signed into law by Governor Baker, and nearly $1 billion greater than the FY 2024 budget proposal originally filed by the Healey administration.

FY 2024 Conference Committee Budget Spending

Category	Governor's Budget	House Budget	Senate Budget	Conference Budget	FY 2024 v. FY 2023
MassHealth	$19,817	$19,960	$19,929	$19,960	2.5%
Surtax Spending	$1,000	$1,000	$1,000	$1,000	--
All Other Line-Items	$34,465	$34,493	$35,022	$35,297	7.1%
Total Spending	**$55,282**	**$55,452**	**$55,951**	**$56,256**	**7.3%**

$ in millions

Of particular note, MassHealth spending in the FY 2024 budget grew by 2.5 percent, while non-surtax spending increased at a rate of 7.1 percent. This level of spending growth for non-MassHealth accounts is abnormal, and reflected the use of one-time resources to support budgeted spending, which were built up during two historic years of tax revenue gains. It also stands in stark contrast to expected revenue growth in FY 2024; which as aforementioned, was originally projected at 1.6 percent.

The Governor ultimately vetoed $276 million in spending ($205 million net) from the Conference Committee report, eliminating the budget's reliance on $205 million one-time resources from the Transitional Escrow Fund. However, the Legislature overrode $83 million of the Governor's vetoes, further contributing to the creation of a budgetary gap at the beginning of the fiscal year.

Governor's Budget Gap & 9C Action

Identified Budget Gap

As a result of the factors detailed above, the Healey administration announced the identification of a $1 billion tax revenue shortfall in FY 2024. To close this gap, the administration has identified $625 million in non-tax revenue solves and is cutting approximately $375 million in net spending across 66 different line items. The spending reductions put forward by the Governor fall into five categories: MassHealth, caseload savings, trust fund transfers, earmarks, administrative, and other.

Summary of Revenue Shortfall & Solutions

Identified Budget Gap	-$1,000
Solutions:	**$1,003**
Unanticipated Non-Tax Revenues	**$625**
General Fund Interest	*$378*
Revised Lottery Estimates	*$75*
Gaming Revenue Upgrades	*$15*
Departmental Revenues	*$158*
9C Spending Reductions (net)	**$378**
MassHealth	*$142*
Caseload Savings	*$63*
Trust Fund Transfers	*$58*
Earmark Reductions	*$21*
Administrative Reductions	*$5*
Other	*$89*

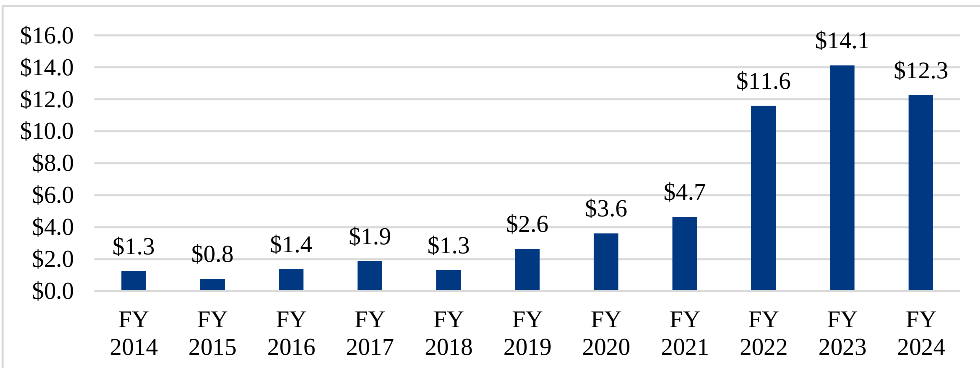
$ in millions

Non-Tax Revenue Solutions

To close $625 million of the $1 billion revenue shortfall, the administration has identified an array of non-tax revenue solutions that can be organized into four categories: General Fund interest, revised lottery estimates, gaming revenue upgrades, and departmental revenues.

- **Interest on the General Fund** ($378 million) – In FY 2023, interest on the state's General Fund generated approximately $427 million in revenue. This represented a staggering increase compared to FY 2022, during which $45 million in interest revenue was collected. This dramatic increase has been driven by growing monthly cash balances of the General Fund, which have contributed to additional investment earnings for the state.[2] The FY 2024 GAA reflected this recent increase, assuming that interest earnings on the General Fund would provide $200 million in revenue. Now, the administration is upping that revenue assumption by $378 million. This is consistent with interest revenue trends to date, which are averaging $42 million per month (July through November). Based on this, the state is on track to surpass $500 million in interest on the General Fund in FY 2024.

General Fund Cash Balances in July, FY 2014 – FY 2024 ($ in billions)



- **Revised Lottery Estimates** ($75 million) – The administration assumes that net profits from the Lottery will increase by $75 million over the current expectation of $1.2 billion.
- **Gaming Revenue Upgrade** ($15 million) – The FY 2024 GAA included a $240 million assumption for non-tax gaming revenues, and to close a portion of the $1 billion shortfall, the administration is increasing that estimate by $15 million. Year-to-date non-tax gaming revenues are running ahead of FY 2023 collections by a relatively small margin of $1.7 million.
- **Departmental Revenues** ($158 million) – A combination of unanticipated non-tax revenue collections from the Department of Mental Health, Secretary of State, and Departmental of Transitional Assistance contribute an additional $158 million towards closing the budgetary gap.

9C Spending Reductions

To close the remainder of the $1 billion tax revenue shortfall in FY 2024, Governor Healey implemented approximately $375 million (net) in mid-year spending cuts.

- **MassHealth** ($294 million gross/$142 million net) – Funding for the state's MassHealth program is reduced to reflect rate adjustments and updated forecasts regarding the implementation and utilization of certain programs. For example, lower than expected participation in the Medicare Savings Program has led to revised spending estimates, while planned managed care rate increases

[2] Cash deposits in the Commonwealth are managed by the State Treasurer and deposited into the Massachusetts Municipal Depository Trust (MMDT), the state's investment pool for governmental entities (https://emma.msrb.org/ER1328786.pdf).

have been adjusted downward. The gross spending cut of $294 million is offset by approximately $152 million in lost revenue, bringing the net impact to $142 million. The table below outlines the key factors driving the spending cut.

MassHealth Spending Cut Assumptions

Category	Gross Cut	Net Cut
Rate Adjustments	$68	$31
Updated Implementation & Utilization Forecasts	$226	$111
Totals	**$294**	**$142**

$ in millions

- **Caseload & Utilization Savings** ($78 million gross/$63 million net) – The Governor reduced funding for a number of state programs to account for updates to projected utilization rates, including a $40.4 million gross cut to Community Residential Services and a $13.6 million gross cut for Community Day and Work. Smaller spending reductions related to caseload updates include:
  - $2.6 million cut to home care services for older adults;
  - $2.3 million cut for elder protective services; and
  - $200K cut to transportation benefits for SNAP work program participants.

- **Trust Fund Transfers** ($58 million) – Transfers to three trust funds included in the FY 2024 GAA were cancelled as part of the Governor's 9C actions, including a $50 million appropriation to the Commonwealth Care Trust Fund, $6.2 million for the Massachusetts Transportation Trust Fund, and $5 million to the 21st Century Education Trust Fund. The 21st Century Education Trust Fund was created as part of the Student Opportunity Act to support department-led initiatives to address persistent gaps in student achievement, improve educational opportunities, and enhance classroom learning. In each of these cases, the administration notes that existing resources in the trust funds provide sufficient resources to cover program needs.

- **Earmark Reductions** ($21 million) – Nearly 500 earmarks funded across eight different line-items in the state budget were reduced to realize $21 million in savings in FY 2024. Predominantly local earmarks related to economic development, public safety, parks and recreation, and Councils on Aging were reduced by 50 percent. For context, this represents approximately 35 percent of all statewide, programmatic, and local earmarks included in the FY 2024 budget.

- **Administrative Reductions** ($5 million) – Across a variety of state agencies, funding was reduced to reflect the amount needed to support core operations and savings related to payroll. Agencies experiencing administration-related spending reductions include: the Office of Facilities Management, the Office of the Secretary of Administration and Finance, and the Office of the State House Superintendent.

- **Other** ($89 million) – To close the remaining balance of the revenue shortfall, $89 million in other spending reductions were implemented; impacting 26 line-items. Many of these cuts will be offset by unexpended funding carried forward from FY 2023 or available federal funding that had been previously been appropriated. The cuts include:

- $17.5 million to Transitional Aid to Families with Dependent Children (TAFDC) and Emergency Aid to the Elderly and Disabled Children (EAEDA), preventing a 10 percent increase in rate benefits that was planned to go into effect for the last quarter of the fiscal year.
- $12 million to Center-Based Child Care Rate Increases, from $35 million to $23 million. Approximately $7 million of this cut will be covered by unexpended funds carried forward from FY 2023.
- $7 million to State Supplemental to Supplemental Security Income, which is determined to be unnecessary to maintain current benefit levels.
- $4 million to the Massachusetts State Scholarship Program, to be covered by funds carried forward from FY 2023. In FY 2024, $181 million will remain available for the program.

Implications for FY 2025

By implementing these budget gap solutions and 9C cuts, the Healey administration has attempted to proactively close a $1 billion budgetary shortfall in FY 2024. However, while these measures improve the state's fiscal position heading into the second half of FY 2024, and create a more stable foundation upon which to build the FY 2025 budget, revenue collection trends will require further scrutiny and additional action could be necessary.

For example, at $39.41 billion, the revised FY 2024 benchmark represents 1.3 percent growth over FY 2023 collections (excluding surtax). While that is a more reasonable pace of growth compared to the 3.8 percent necessary to meet the original benchmark; it is worth noting that revenue collections are ahead of FY 2023 year to date collections by only 0.3 percent.

Furthermore, the budget gap and spending cuts announced this week highlight the need for spending trends to return to earth in FY 2025 and beyond. As policymakers begin to build the FY 2025 budget, spending growth must remain closely correlated with expected revenues. Based on the Consensus Revenue Agreement announced earlier this week, budget writers will be faced with crafting a budget for FY 2025 using an essentially flat revenue assumption; and this reality, combined with known spending obligations, such as payments to the state's Pension fund and implementation of the Student Opportunity Act, will leave little room for additional spending initiatives in the new fiscal year.