



August 8, 2019

The \$3 Billion Stabilization Fund

Commonwealth's "Rainy Day" Fund Deposits Encouraging, But More Work Remains

The Commonwealth Stabilization Fund, the state's "rainy day" fund, is a critical component of the Commonwealth's financial structure. For example, amid the Great Recession in fiscal 2009, budgeted tax revenue plummeted by nearly \$2.7 billion compared to fiscal 2008. The Stabilization Fund was a key element of the response to the crisis, with nearly \$1.3 billion transferred from this reserve to support ongoing programs and projects that year. While budget cuts and other hard decisions were also required, these measures would have been more difficult without the Stabilization Fund.

The Stabilization Fund is on track to end fiscal 2019 with the largest nominal balance in history after the second consecutive year of strong tax collections. In order to prepare for the next economic downturn, however, there is more that must be done. This analysis summarizes the current status of the Stabilization Fund and recommends additional action steps.

Key Takeaways

- Based on current estimates, the Stabilization Fund will end fiscal 2019 with at least \$2.8 billion, the largest nominal balance in the fund's 32-year history.
- The Stabilization Fund's ending balance is likely to rise by at least \$814 million in FY19 over FY18, the largest annual increase in history.
- Adjusted for the size of the budget as measured by budgeted tax revenue (BTR), the Stabilization Fund will end the year with a balance equal to 10.1 percent of BTR, lower than the historical high of 12.7 percent in fiscal 2007.
- Under MTF's recommended framework for the fiscal 2019 surplus, the Commonwealth should deposit an additional \$289 million to the Stabilization Fund before closing the books on FY19, raising the balance to \$3.1 billion.



Stabilization Fund Summary

Stabilization Fund Summary	
	<u>Amount</u>
FY19 Beginning Balance	2,001.3
Inflows	
Capital Gains Transfer	848.4
Gaming Revenue	
MGM Springfield	5.8
Penalty Revenue (Encore and MGM)	3.6
Encore First Week	0.4
<i>Subtotal, Gaming Revenue</i>	<u>9.8</u>
Other Revenue	
Consolidated Net Surplus	?
Interest & Market Value	37.2
Abandoned Property	3.7
Lottery Withholding	0.3
<i>Subtotal, Other Revenue</i>	<u>41.2</u>
<u>Total, Inflows</u>	<u>899.4</u>
Outflows	
Capital Gains/Pension Transfer	42.4
Capital Gains/OPEB Transfer	42.4
<u>Total, Outflows</u>	<u>84.8</u>
Total, Expected Changes	814.5
Projected FY19 Ending Balance	2,815.8
MTF Recommended Additional Deposits	
Above-Trend Corporate Tax Revenue	240.4
Tax-Related Settlements & Judgments	48.8
<i>Subtotal, Add to Rainy Day Fund</i>	<u>289.2</u>
FY19 Ending Balance in MTF Framework	3,105.0

Figures in \$ millions.



Inflows

The Stabilization Fund is projected to receive \$899 million in inflows in fiscal 2019 including \$848 million per the Commonwealth's revenue volatility cap that transfers excess capital gains tax revenue to the "rainy day" fund. This deposit comes one year after highly volatile capital gains tax revenue added \$514 million to the Fund in fiscal 2018. Further expected deposits include approximately \$10 million in revenue from resort-style casinos in Massachusetts and \$41 million from a variety of other sources.¹

The revenue volatility cap also requires a portion of excess capital gains tax revenue be further transferred to the state pension fund and other post-employment benefits trust fund. Net of these outflows, approximately \$814 million will be deposited to the Stabilization Fund, the largest one-year net change in the fund's 32-year history. The resulting balance of \$2.8 billion will also be the largest nominal balance in the fund's history, surpassing the \$2.3 billion balance in the fund at the end of fiscal 2007.

Note that this calculation does not include any surplus remaining at the end of fiscal 2019. This amount, known as the Consolidated Net Surplus, is deposited in the Stabilization Fund. In fiscal 2018, this amount totaled \$209.3 million, though the amount varies considerably from year to year.

Comparing the Stabilization Fund Balance over Time

A nominal comparison of Stabilization Fund balances over time, however, does not account for the growth in the size of the Commonwealth's budget over the course of the Stabilization Fund's history.

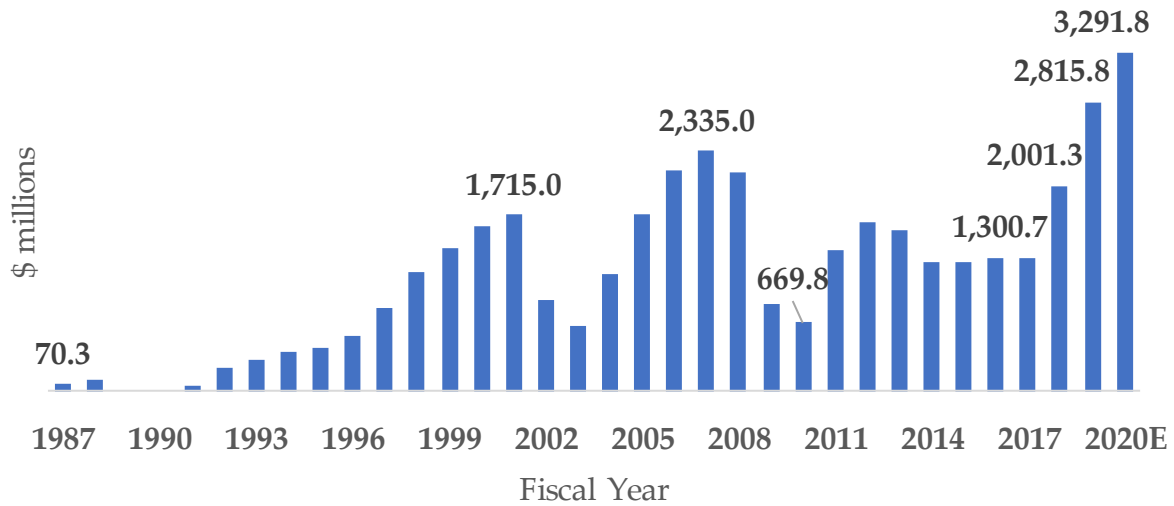
Further, given the expanded relationship between the state and federal government after the implementation of the Affordable Care Act (ACA) and other federal initiatives that reimburse the state for certain expenses and the manner in which the Commonwealth accounts for this revenue, use of total spending is a less useful point of comparison than in previous years.² Instead, it is more accurate to consider the Stabilization Fund as "reserved tax revenue" collected in one fiscal year but available for spending in a subsequent fiscal year.

¹ [*FY19 Surplus: A \\$500 Million Question*](#), Massachusetts Taxpayers Foundation, June 27, 2019

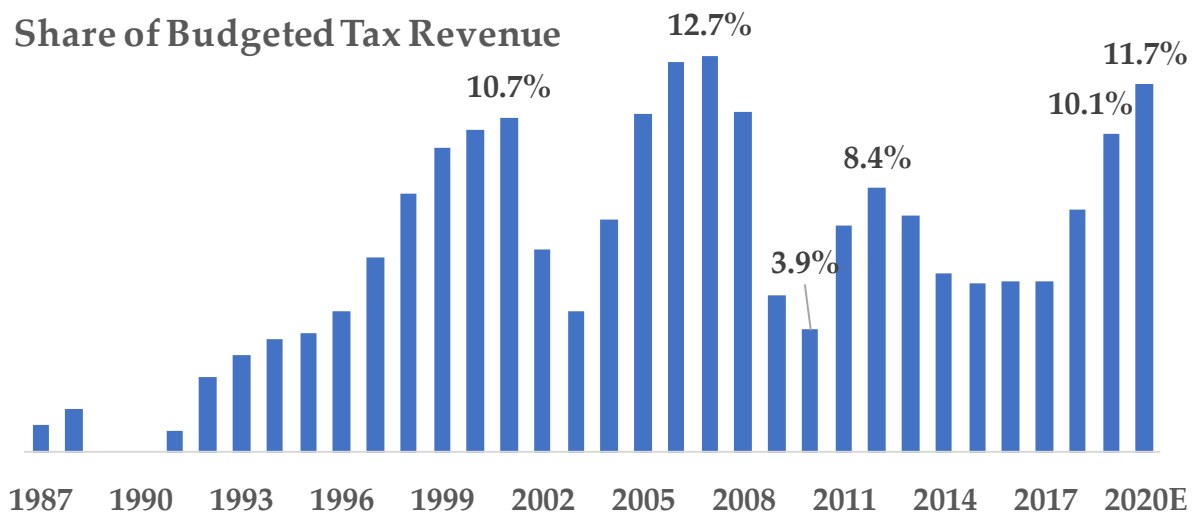
² This approach varies from MTF previous analyses. For further explanation, see [Statutory Basis Financial Report for Fiscal 2018, Commonwealth of Massachusetts, Page 11](#).



Stabilization Fund Ending Balance



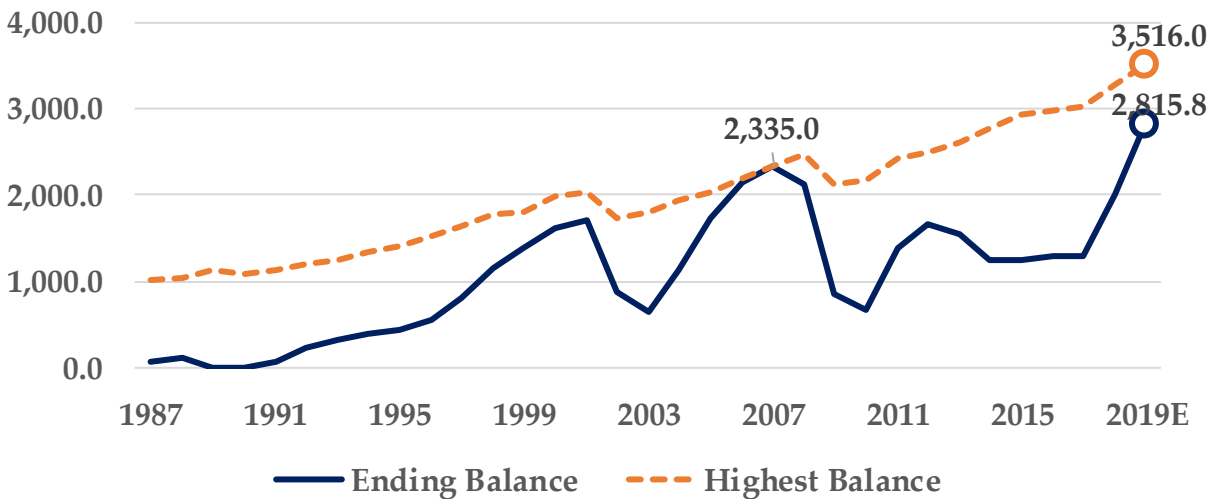
Stabilization Fund Balance as Share of Budgeted Tax Revenue



In this context, the Stabilization Fund reached its highest share of BTR in fiscal 2008 with 12.7 percent, or \$2.3 billion. A \$2.8 billion balance at the close of fiscal 2019 would represent 10.1 percent of BTR, the highest ratio since fiscal 2008 but still would leave the Commonwealth heavily dependent on other solutions, like budget cuts or tax increases, to weather an economic downturn.



Stabilization Fund Ending Balance vs Highest Balance



MTF Framework: Stabilization Fund

MTF previously outlined a framework for managing any fiscal 2019 surplus.³ This framework earmarks certain tax revenues to the Stabilization Fund, including the estimated amount of above-trend corporate tax revenue and the full value of tax-related settlements and judgments.⁴ Together, these would steer an additional \$289 million to the “rainy day” fund in fiscal 2019 and increase the Stabilization Fund ending balance to \$3.1 billion, or 11.2 percent of BTR. Encouragingly, this approach combined with currently budgeted deposits in fiscal 2020 would return the fund to its pre-recession high as a share of BTR at 12.7 percent, and more than \$3.5 billion by the end of fiscal 2020.

Conclusion

After two consecutive years of strong tax revenue growth, the Commonwealth is better positioned to weather the next economic downturn than in recent years, but more needs to be done to strengthen its position. Depositing nonrecurring revenues into reserves now will allow the Commonwealth to avoid the destabilizing and painful budget measures that will otherwise be required later.

³ [FY19 Surplus: A \\$500 Million Question](#), Massachusetts Taxpayers Foundation, June 27, 2019

⁴ Note that the above-trend corporate tax revenue calculation used fiscal 2019 actual collections through May and projections for June 2019. This calculation has not been updated for this analysis.

