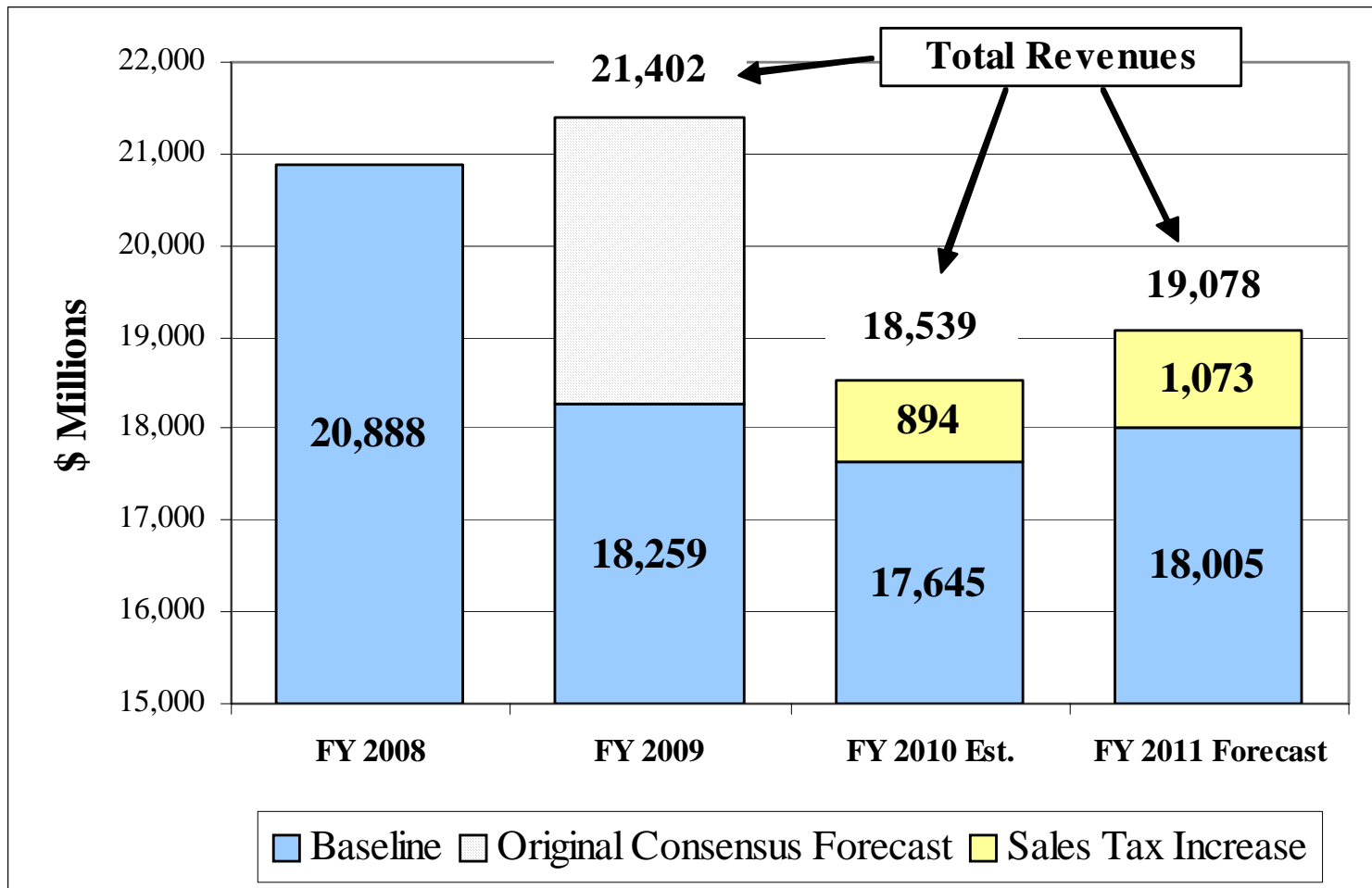




State Finances: Heading Over the Cliff?

Michael J. Widmer
September 14, 2010

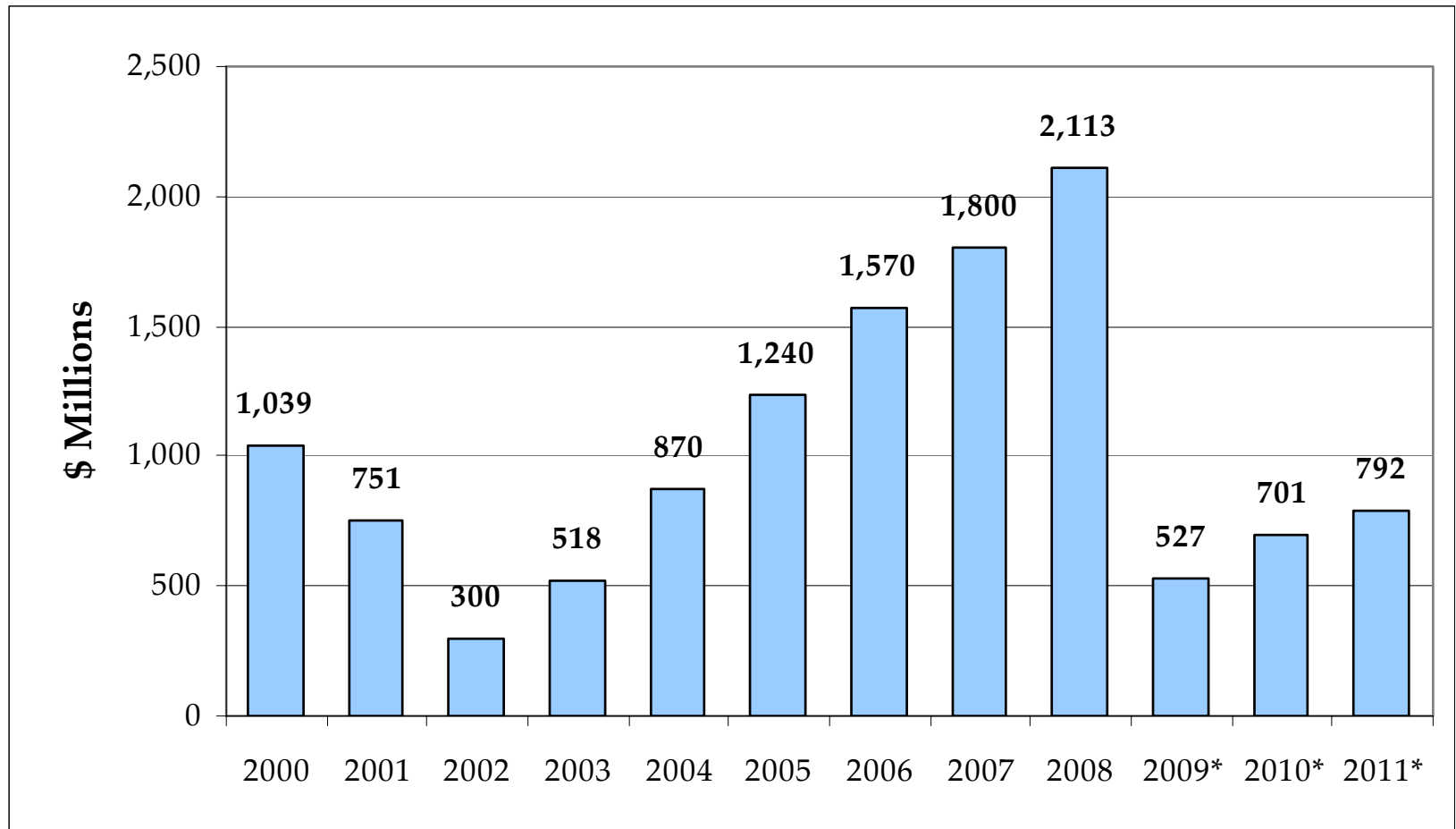
Dramatic Decline in State Tax Revenues



Historic Loss of Revenues

- Between fiscal 2008 and 2010, the state experienced the largest ever two-year decline in tax collections – baseline tax revenues dropped nearly 16 percent from \$20.9 billion to \$17.6 billion
- Even with last year's increase in the sales tax from 5 percent to 6.25 percent, 2010 tax revenues of \$18.54 billion were \$2.35 billion, or 11 percent, less than 2008
- Should fiscal 2012 revenues grow by 5 percent, total tax revenues of approximately \$20 billion would still be \$800 million below fiscal 2008

Volatility of Capital Gains Taxes

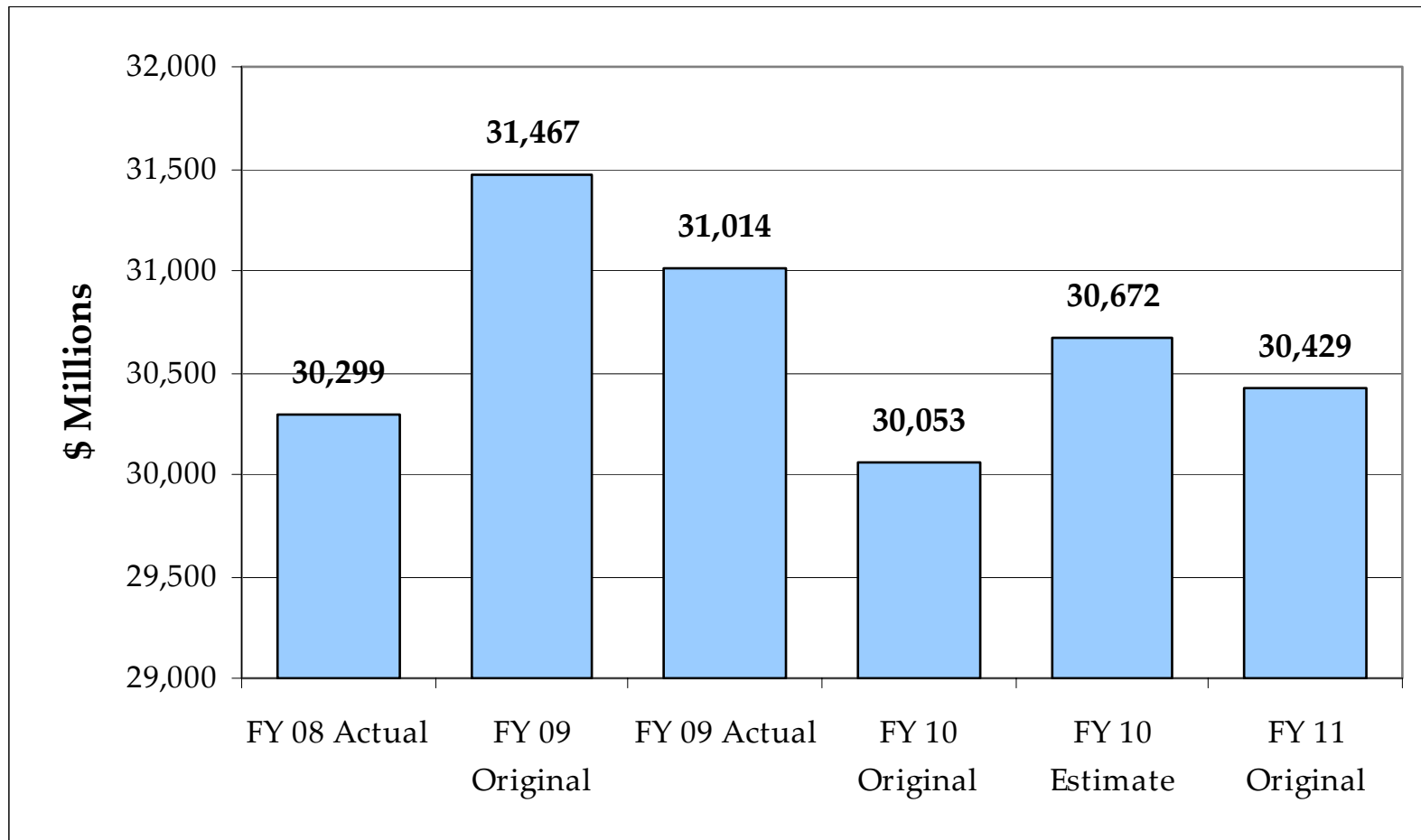


* Administration and Finance Estimates

Capital Gains Tax Reform Passed in the 2011 Budget

- Places a limit of \$1 billion on the use of capital gains tax revenues in the operating budget
 - 95 percent of excess deposited into rainy day fund
 - Remaining 5 percent used to fund state's OPEB obligations
- Advantages
 - Prevents reliance on exceedingly volatile source of revenues
 - Builds up stabilization fund during growth years
 - Limits spending cuts required in future economic recessions

State Spending – 2008-2011

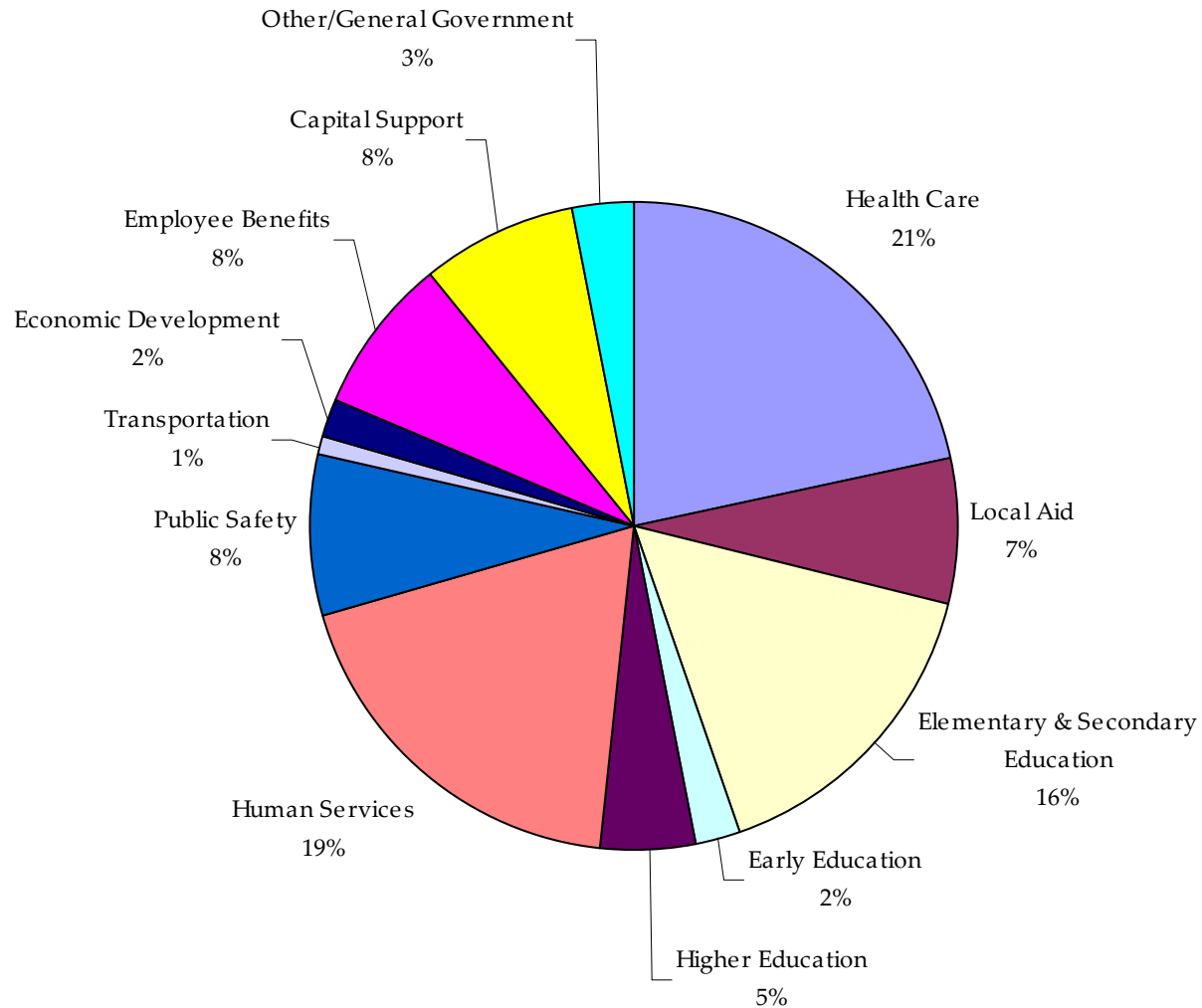


Spending Cuts Across State Government

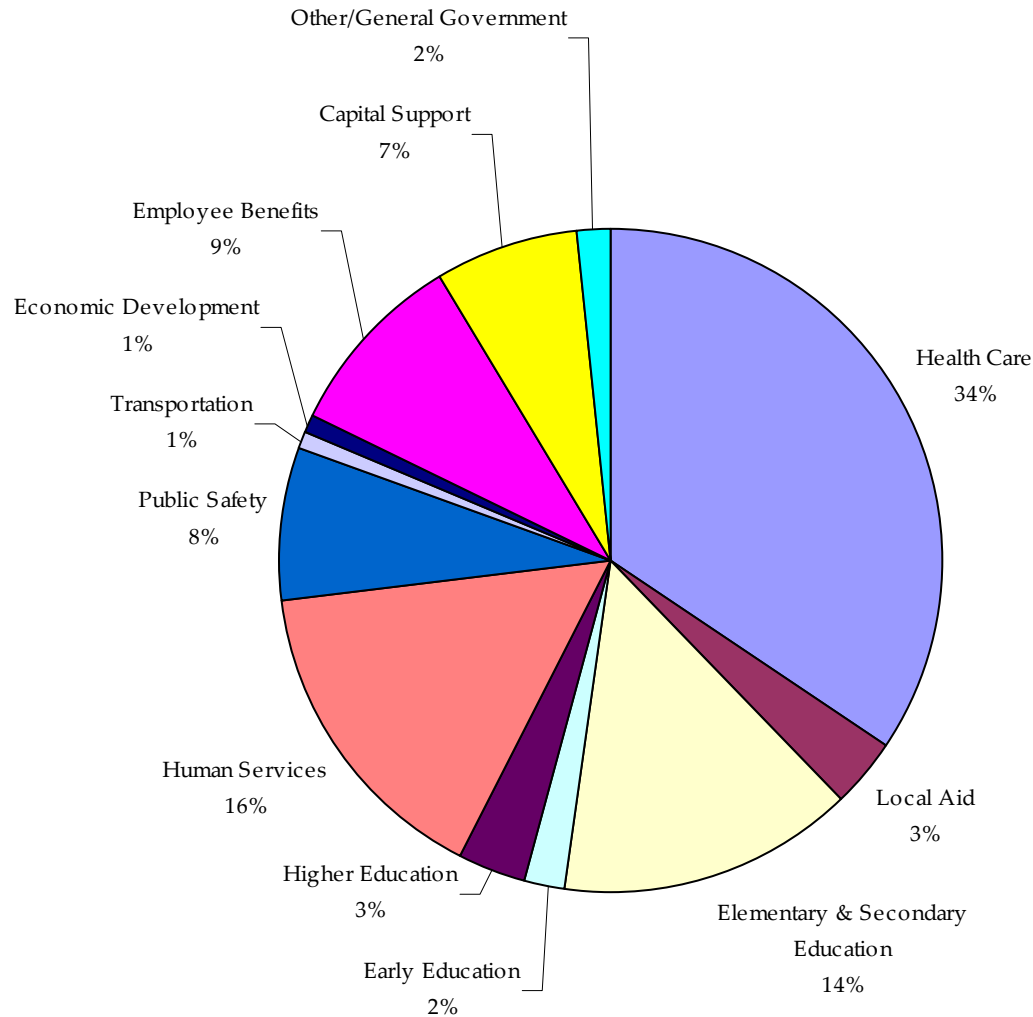
	FY 11 vs. FY 10	FY 11 vs. FY 09 Original
Medicaid	354	893
Employee/Retiree Health Care & Pensions	201	128
Total	555	1,022
Local Government Support*	(170)	(704)
Higher Education (including ARRA)*	(117)	(140)
Early Education	(16)	(85)
Human Services	(104)	(422)
Public Safety	(167)	(232)
Economic Development	(35)	(148)
Health Care Reform and other Health	(74)	(166)
General Government	(12)	(121)
Total	(694)	(2,018)

* Does not include allocation of \$204 million from Congress' recent extension of federal stimulus aid for all of FY 11

FY 2000 State Spending



FY 2010 State Spending



FY 11 Tax Revenues – Slow Growth; Cautions Remain

- Consensus forecast of \$19.08 billion, \$540 million more than fiscal 2010
 - \$180 million from extra 2 months of sales tax collections at 6.25% in fiscal 2011
 - Additional \$360 million is a 2% increase, which appears conservative given baseline growth of 5.3% in the April – June quarter
- However, August revenues fell \$70 million below benchmark after July revenues were \$78 million above
- National economy slowing
 - Unemployment remains stubbornly high; consumer confidence is falling; housing market is stalling; commercial real estate defaults are looming; severe state and local budget cuts are accelerating

2011 Budget Depends Heavily on One-Time Funds

(\$ Millions)

	2009	2010	2011 Original	2011 w/ Federal Aid*
Federal Stimulus	1,322	1,977	879	1,546
State Stabilization	1,390	169	106	106
Other	420	364	640	640
Total	3,132	2,510	1,625	2,292

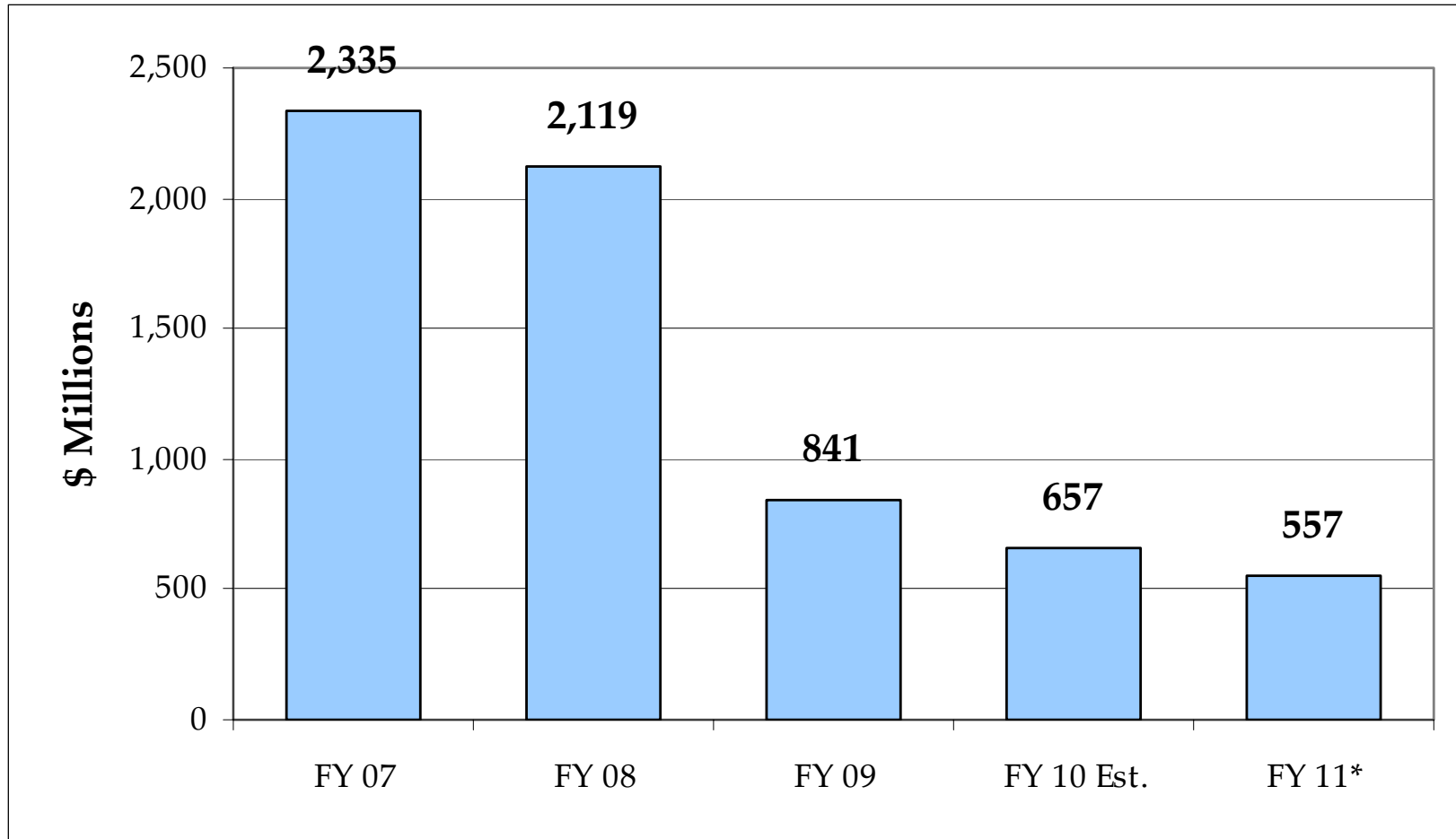
* Congress recently approved an extension of stimulus aid to cover all of FY 11, which will provide an additional \$463 million in Medicaid matching dollars (FMAP) and \$204 million in aid for education

One-Time Funds in 2011 Budget

(\$ Millions)

	2011 Original	2011 w/ Federal Aid
Federal Stimulus Aid (ARRA)		
State Fiscal Stabilization Funds	96	300
FMAP	690	690
FMAP II	0	463
Transitional Assistance for Needy Families	23	23
Medicare Part D Clawback	70	70
Subtotal	879	1,546
Other One-Time Funds		
Medicare Reimbursement	160	160
Debt Restructuring	300	300
State Stabilization Fund	106	106
State Land/Trust Funds	68	68
Transfers from Quasi-Public Agencies	17	17
Revenue Carry Forward	95	95
Subtotal	746	746
Total	1,625	2,292

Year End Stabilization Fund Balance



*Assumes no further draws in FY 11

Uncertainties in the 2011 Budget

- Estimated \$600 million budget shortfall largely driven by Medicaid increases
 - Net Medicaid cost ~ \$240 million
 - Emergency shelters, private counsel compensation also running deficiencies
- \$160 million Medicare reimbursement remains uncertain
- State would lose \$1 billion in revenues mid-year if Question 3 passes
- State likely to use most, if not all, of the additional federal stimulus aid to balance 2011 budget
 - This would add several hundred million dollars to the 2012 structural deficit

Fiscal 2012 Structural Deficit

(\$ Millions)

	2011 Original	2011 w/ Federal Aid
One-Time Funds in 2011 Budget	-1,625	-2,292
Spending on Obligatory Accounts*	-1,400	-1,400
5% Revenue Growth	1,000	1,000
Stabilization Fund	0	0
Federal Stimulus	0	0
Total	-2,025	-2,692

* Medicaid, Chapter 70 education aid, pensions, and debt service

FY 2012 – More Challenging than FY 2011

- Structural deficit at least \$2 billion; could top \$2.5 billion
- Virtually no more one-time funds to fill gap
- Severe cuts needed to balance budget
 - On top of multiple rounds over the past three years
 - Overall spending likely to decline from fiscal 2011
- Medicaid costs will continue to grow, squeezing other spending

November Ballot Questions

- Reduce sales tax from 6.25 to 3 percent
 - Annual loss of \$2.5 billion in revenues
- Repeal the sales tax on alcoholic beverages approved by the Legislature in 2009
 - Annual loss of \$100 million in revenues
- Both would take effect January 1, 2011

Revenue Loss From Question 3

(\$ Millions)

Fiscal 2011 (Feb. - June 2011)	1,000
Fiscal 2012	2,500

Fiscal 2012 Gap of ~ \$5 Billion if Question 3 Passes

(\$ Millions)

	2011 Original	2011 w/ Federal Aid
Fiscal 2012 Structural Deficit	-2,000	-2,700
Loss of Sales Tax Revenues	-2,500	-2,500
Fiscal 2012 Shortfall	-4,500	-5,200

Huge Spending Cuts Required to Close ~\$5 Billion Gap

- Depleted stabilization fund and no federal stimulus aid to fill shortfall
- Obligatory spending on five major accounts consumes almost half of state budget
- Would necessitate across-the-board cuts of 30% for most programs including human services, public safety, higher education and local aid

\$15.1 Billion of Obligatory Spending

Program	Total Spending*	Mandated Spending*
MassHealth	10,045	7,836
Chapter 70 Education Aid	3,926	3,657
Debt Service	2,039	2,039
MBTA	927	927
School Building Authority	644	644
Total	17,581	15,104

* Total and mandated spending based on 2011 budget with the exception of debt service which reflects 2012 obligations

Cuts of ~ 30% in “Discretionary” Spending

	2012 Structural Deficit	
	\$2 Billion	\$2.7 Billion
2011 Total Spending	32,000	32,000
Obligatory Spending	-15,104	-15,104
Balance of Budget	16,896	16,896
Cuts to 2012 Budget	-4,500	-5,200
Federal Revenue Loss	-300	-400
Total Cuts Required	-4,800	-5,600
Final Balance	12,096	11,296
Across-the-Board Cuts	28.4%	33.1%

Impact of 30% Cuts in 2012 Budget

Program	FY 11 Spending	Cut	Balance
Health Care	4,421	-1,326	3,095
MassHealth - Non-Obligatory	2,209	-663	1,546
Health Refrom and Other Care	967	-290	677
Employee & Retiree Health Benefits	1,245	-374	872
Local Government Support	1,665	-499	1,165
Non-Obligatory Education Aid	691	-207	484
Municipal Aid	974	-292	682
Other Education	1,456	-437	1,019
Early Education	505	-152	354
Higher Education	950	-285	665
Human Services	4,719	-1,416	3,304
Developmental Services	1,321	-396	925
Family Services	886	-266	620
Cash Assistance	767	-230	537
Mental Health	622	-187	435
Public Health	489	-147	342
Housing Support	273	-82	191
Senior Support	244	-73	171
Veteran Services	117	-35	82
Public Safety	2,222	-666	1,555
Corrections ¹	1,004	-301	703
Judiciary	731	-219	511
State Police	260	-78	182
District Attorneys	91	-27	64
Attorney General	38	-12	27
Crime Lab, Fire Services, and other Public Safety	97	-29	68
Transportation	213	-64	149
MassDOT Admin.	12	-4	9
Highways	83	-25	58
Regional Transit	59	-18	41
Registry	59	-18	41
Economic Development	286	-86	200
Business and Labor	97	-29	68
Div. of Industrial Accidents	20	-6	14
Workforce Training and Summer Jobs	22	-6	15
Tourism and Tourist Councils	4	-1	3
Commonwealth Zoo	4	-1	2
Environment and Energy	189	-57	132
Environmental Protection	45	-14	32
State Parks and Beaches	58	-17	41
Fisheries and Wildlife	21	-6	15
General Government	473	-142	331
Legislative Operations	51	-15	36
Department of Revenue	141	-42	99
State Lottery	82	-25	57
Employee Pensions	1,442	-433	1,009
TOTAL	16,896	-5,069	11,827

¹Includes Dept. of Corrections, Parole Board, and County Sheriffs