



December 6, 2016



## MTF's Analysis of Governor's 9C Cuts

Today, the Baker Administration announced \$97.9 million in midyear budget (9C) cuts.<sup>1</sup> These cuts come during a particularly challenging budget year in which revenues have been reduced by \$800 million already. Last month the Administration opted not to include 9C cuts as part of a series of solutions to close an estimated \$292 million midyear gap after September revenues rebounded and such cuts may have proven unnecessary. However, since that time, disappointing tax revenues and growing exposures have heightened the need for midyear spending reductions.

This brief provides background on the FY 2017 budget gap and summarizes the budget cuts announced today.

### **Background**

Three major factors have created a substantial midyear budget gap in FY 2017:

#### ***Known spending needs not accounted for in the signed budget***

The Conference Committee budget, that had to be reduced by more than \$600+ million because of a drop in projected tax revenue, underfunded several major caseload accounts – notably public defense services for indigent defendants and family homelessness services – by close to \$100 million. Underfunding these accounts in the original budget is not uncommon, but means that other revenue sources have to be found to cover the costs later in the year – a difficult task in a year with little revenue growth. While Governor Baker vetoed \$267 million from the Conference Report, \$231 million was overridden by the Legislature, creating a budget gap at the start of the fiscal year.

#### ***Sluggish tax revenues***

The poor revenue collections in the last months of FY 2016 that led Budget Conferees to sharply reduce tax revenue estimates during Conference Committee have continued to underperform in FY 2017. In light of this, Administration and Finance Secretary Kristen Lepore reduced expected tax revenues by \$175 million in October. Since then, October and November collections have fallen \$73 million short of the revised, lower benchmark. The Department of Revenue believes that this shortfall is overstated by approximately \$50 million due to timing issues related to DOR's new online customer interface, but collections remain poor.

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<sup>1</sup> Actual line item reductions total \$118.5 million, but are accompanied by \$20.7 million in lost revenue, making the combined impact \$98.7 million

### ***Unexpected MassHealth cost growth***

Spending growth in the MassHealth program adds to the budget challenges. According to the state's most recent disclosure to bond holders, spending is exceeding budget expectations by \$100 million. The Administration is working actively to manage this deficit, including \$30 million in 9C reductions made today, but MassHealth is an ongoing concern.

### ***October Budget Gap Action***

In response to the underfunding of certain accounts and the slow growth in revenues, the Administration identified a \$292 million budget gap in October and offered a series of solutions to close that gap.

<b>Solution</b>	<b>Amount</b>
Trust sweep revenue	\$125
Federal revenues not in budget	\$92
Reduced transfers tied to tax do	\$31
Employee separation savings	\$24
Legal settlement revenue	\$20
<b>Total</b>	<b>\$292</b>

The decision to not use 9C cuts as a part of that package was unexpected, but the Administration identified ways to address the immediate problem and gave the fiscal picture a chance to improve. Without any marked revenue improvement in November, the Administration now believes that midyear cuts are necessary.

### **Governor's 9C Action**

Secretary Lepore notified House and Senate Ways and Means Chairs of a further \$98 million spending shortfall requiring 9C cuts. This \$98 million, which is in addition to the \$292 million gap identified in October, includes the following cuts:

<b>Exposure</b>	<b>Amount</b>
Department of Corrections and Sheriffs	\$40
Collective Bargaining Agreements and other personnel costs	\$23
MassHealth spending and revenue	\$30
Department of Mental Health	\$5
<b>Total</b>	<b>\$98</b>

Many of these costs, including sheriff departments and other personnel costs were included in an FY 2017 supplemental budget filed by the Governor in July. Other exposures, such as the Department of Correction, had not previously been identified.

To close this gap, the \$98 million in net spending reductions were made to 139 budget line-items. Those reductions fall into the following three categories:

### ***Elimination of earmarks - \$53 million net (\$67 million gross)***

The 9C list eliminates \$67 million in budget earmarks. Due to revenue loss associated with the elimination of MassHealth earmarks, the net savings of earmark cuts is \$53 million. Notable earmark cuts include:

- \$9 million in net MassHealth money which include targeted funding for Disproportionate Share Hospitals and acute pediatric hospitals.
- \$7.6 million for Mass. Office of Travel and Tourism, or 87% of the total MOTT earmarks included in the budget.
- \$5.2 million for municipal grants.
- \$4.2 million for the Department of Conservation and Recreation.

It's not yet possible to know which specific earmarks have been affected, but the Governor's 9C cuts eliminate \$67 million or 48 percent of the \$139.1 million total funding for more than 600 million in earmarks that were included in the budget passed in July.

### ***Administrative reductions - \$19 million***

9C cuts also reduce by \$19 million spending for various administrative cost control efforts including layoffs, schedule restructuring, contract management and caseload savings. The payroll savings assumed in this amount are unrelated to the voluntary separation savings assumed in the Administration's October gap closing exercise. Administrative reductions include:

- \$5 million from the State Police
- \$3 million from Underground Storage Tank remediation
- \$2.4 million from the state's Rental Voucher Program
- \$1 million from the Department of Revenue

### ***Other savings - \$24 million***

Finally, the 9C cuts reduce by \$24 million spending for 22 small programs in their entirety, while providing alternate sources of funding or redesigning other programs. Eliminated budget items include:

- Big Data Innovation and Workforce Fund (\$2 million)
- Mass. Manufacturing Partnership (\$2 million)
- Mass. Technology Collaborative's Computer Science Education initiative (\$1.7 million)
- Gateway City English Language Learner grants \$1 million)

## **Where We Stand**

By implementing these 9C cuts, the Administration has proactively closed a \$390 million midyear budget shortfall (\$292 million in October and \$98 million today) putting the state in a stronger position to end the year in balance. However, major questions about the FY 2017 budget remain. Of the three major budget problems highlighted at the start of this brief, Administration actions have resolved the issue of known costs that were unaccounted for in the original budget, but MassHealth exposures remain. The extent of those exposures and the ongoing trend of lower than projected tax revenue collections will determine whether further action will be needed.