

News Release

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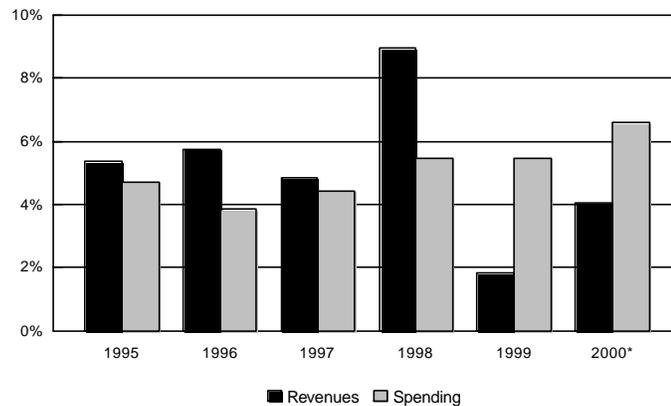
MTF Report on State Spending: Expectations Soar, But Hard Landing Ahead

Due to recent major income tax cuts and rapid growth in spending, the state is entering a period of much tighter budgeting -- and difficult trade-offs among priorities -- the Massachusetts Taxpayers Foundation reported in its annual analysis of state spending released today. Despite the new financial reality, expectations for additional spending and further tax cuts continue to soar even as the state faces a renewal of largely unavoidable cost growth in Medicaid, pensions and the other "budget busters" and a persistent challenge in financing its critical capital needs.

"The structural excess of revenues over spending that generated large surpluses in recent years has largely been eliminated," said MTF President Michael J. Widmer. "With the cost of meeting the state's existing commitments swelling and roughly \$500 million of previous tax cuts still phasing in, the state should be leery of taking on any major new obligations."

The report, entitled *State Budget '00: Expectations Soar, But Hard Landing Ahead*, lauds the Legislature and administration for its wise use of surpluses and for the important steps adopted in the 2000 budget to strengthen the state's long-term fiscal health and economic climate, including comprehensive reform of MBTA finances, a positive approach to using tobacco monies, added operating funds to preserve existing capital facilities, and a series of tax reforms such as the elimination of the onerous "pay-to-play" provision and an extension of the investment tax credit. However, the report warns that preserving the state's fiscal accomplishments will be difficult given unrealistic expectations about what the state can afford.

Growth in Revenues and Spending
Annual Percent Change



* 2000 spending growth based upon initial appropriation amount.

Over the last two years, the Commonwealth has undertake a series of major income tax cuts that in combination with previously authorized cuts reduce revenues by almost \$1.7 billion, a dramatic 11 percent reduction in the state's tax revenues. Approximately \$550 million of these cuts will be phased in beyond 2000.

At the same time, state spending has grown significantly -- almost 20 percent since 1997, according to the report. In an apples-to-apples comparison of initial appropriations, the 2000 budget is up 6.6 percent. With over \$100 million of major savings in pensions and welfare, the underlying increase is actually even larger. The growth in 2000 spending is a hefty \$1.4 billion or 7.2 percent after adjusting for these items.

| State Tax Cuts | |
|---|----------------|
| Annual Savings in Millions | |
| Tax Cuts Since 1998 | |
| Double personal exemption | \$492 |
| Cut income tax to 5.75 percent | 274 |
| Interest/dividend tax cut | 250 |
| Dependent deductions | 73 |
| Elderly property tax relief | 55 |
| Other | <u>197</u> |
| Subtotal | 1,341 |
| Continued Phase in of Previously Enacted Cuts | 317 |
| Total Annual Savings | \$1,658 |

The combination of tax cuts and additional expenditures has brought revenues and spending into alignment, eliminating the structural surplus that generated \$1.2 billion of excess revenues in 1998. The state's operating surplus was about \$550 million in 1999, and the 2000 budget is tightly balanced at best.

Looking forward, the Commonwealth faces a daunting list of unavoidable cost increases, with much of the impetus for additional spending in the former budget busters:

- C Health care expenditures have begun to accelerate, with expanded entitlement programs and a national trend of rising medical costs.
- C Pension costs are likely to grow substantially as a result of a new analysis of the size of the unfunded pension liability.
- C Although the state's commitment to dramatically increase education aid over seven years concludes in 2000, at least \$100 million of additional annual state funding will be required to sustain the reform program.
- C With intense demands to complete a long list of important capital priorities and the enormous challenges of financing the Central Artery project, the cost of supporting the Commonwealth's capital program—debt service on capital bonds and special Artery notes, as well as capital assistance to independent authorities and local governments—will continue to increase significantly.
- C Even with the financial reforms adopted in the 2000 budget, state assistance to the MBTA will grow by 16 percent in 2001 and increase at the same rate as sales tax revenues in subsequent years.

C In a multitude of other programs ranging from special education to housing to elder care, the state faces mounting pressure for new spending.

The Foundation also noted several important vulnerabilities to future revenue growth. Even as the national economy continues its expansion, the state's extremely tight labor market is likely to become an increasing drag on our economic progress. Job growth has already slowed, although that trend has not yet translated into slower revenues. While the growth in the state's underlying tax revenue base has been strong—exceeding the rate of increase of personal income—that growth appears to be closely linked to the stock market. A sustained downturn in the market could have a dramatic effect on tax receipts. So too would two proposed ballot questions—to reduce the income tax rate to five percent and to provide an income tax credit for tolls and auto excise taxes—with a combined revenue impact of over \$1.5 billion.

Founded in 1932, the Massachusetts Taxpayers Foundation is an independent, nonprofit organization which conducts research and policy analysis on state and local taxes, government spending and the economy. Dedicated to the public interest, MTF ranks as one of the largest and most effective organizations of its kind in the country. The Foundation has won four national awards in as many years for its work on capital spending, business costs, and managing the state's budget surpluses.

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