



Bulletin

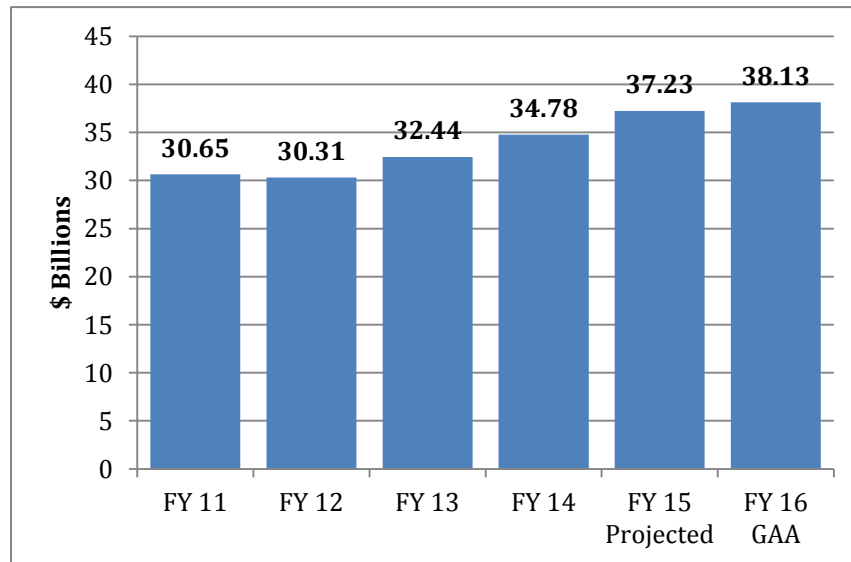
July 23, 2015

FY2016 Budget

Lawmakers enacted the final 2016 fiscal year budget of \$38.13 billion, \$60 million more than the Governor’s original proposal, after taking several weeks to iron out the differences between the branches in conference committee. Using the full ten days for review provided constitutionally, Governor Baker signed his first budget into law on July 17th after vetoing \$163 million in appropriations. These vetoes could still be subject to legislative overrides that would add to the bottom line for FY 2016.

Despite the vetoes, the 2016 budget bottom line remains virtually the same because there are both reduced appropriations and savings projections that are lower than originally anticipated. The early retirement incentive plan (ERIP) is expected to save \$46 million less than originally projected; \$84 million appropriated to the State Retirement Benefits Trust Fund (SRBTF) relies on unexpended funds from debt service accounts that may not materialize at the end of the year; and \$30 million in annual savings from executive branch secretariats proposed by the legislature was rejected by the Governor.

Figure 1 – State Spending for Fiscal Years FY 2011 – FY 2016¹



On the same day that Governor Baker released his 2016 budget vetoes, he also submitted his final deficiency budget for FY 2015. The Baker Administration’s plan proposes a total of \$358 million in additional spending to cover MassHealth expenses (\$203 million; \$101.5 million net),

¹ The budget totals do not include pre-budget transfers for pensions and the Workforce Training Fund, and dedicated sales tax revenues to the MBTA and the Massachusetts School Building Authority which total \$3.8 billion in FY 2016.

snow and ice removal (\$65 million), and \$28 million for substance abuse programs and an opioid action plan. If approved by the Legislature, total FY 2015 spending would reach \$37.23 billion or \$900 million less than the current FY 2016 budget. As a result, FY 2016 spending would be only a 2.4 percent year-over-year increase.

While there was general agreement on the budget numbers, the Conference Committee deliberations for the 2016 budget were more challenging than in recent years due to disagreements on a handful of policy issues. This caused the budget to be approximately three weeks overdue and required a \$5.5 billion interim budget to fund government operations until the issues could be resolved.

The House had sought an advisory opinion from the Supreme Judicial Court (SJC) as to whether or not the budget was a “money bill” as a result of its inclusion of the one-year postponement of the FAS 109 tax deduction and an expansion of a land conservation credit, among other provisions. Because money bills are constitutionally required to originate in the House, such a finding would allow the Senate to add tax provisions to its version of the budget. The SJC determined that the House budget was in fact a money bill and, as a result, the Senate’s proposed plan to increase the earned income tax credit (EITC) and personal exemptions and freeze the income tax rate at 5.15 percent were included in the Conference Committee negotiations.

In addition to this debate, the House budget included a five-year suspension of the Pacheco law as part of MBTA reforms. This provision proved controversial and kept conferees negotiating beyond the beginning of the fiscal year.

REVENUES

The 2016 budget is based on a consensus revenue estimate of \$25.48 billion. This figure includes capital gains tax revenues of \$1.38 billion, which is \$300 million greater than the statutory limit on capital gains funds that can be used in the operating budget. However, the 2016 budget departs from statute and suspends the deposit of the \$300 million to the state’s Stabilization Fund for the second consecutive year to help offset a substantial structural shortfall. There are two drawbacks to this decision: it relies on a one-time source to close a budget gap which will affect next year’s budget and diverts a contribution to the state’s Stabilization Fund, which the state should be replenishing during this period of economic recovery.

The budget relies on an additional \$350 million in one-time funds including a tax amnesty program (\$100 million), corporate tax settlements in excess of \$10 million (\$100 million), pushing MassHealth payments into the next fiscal year (\$116 million), and the delay of the FAS 109 tax deduction for yet another year (\$46 million).²

SPENDING

As noted above, the Governor vetoed \$163 million in FY 2016 appropriations to reduce exposures in the budget. They include:

² Note: The agreement to further delay the phase in by five years does not alter the \$46 million revenue savings to the state in FY 2016 as the delay was already assumed in the consensus revenue figure.

- a \$42 million reduction in ERIP reserve salary, pension contribution, non-payroll costs to reflect the lower number of state employee participants than projected. (4,500 state employees projected versus 2,750 actual);
- a \$5.25 million reduction in funding for UMass that was added by the Senate. The Governor’s veto restores the original figure of \$526.6 million proposed in House 1, which represents a \$7.5 million increase over FY 2015;
- reduced funding for Kindergarten Expansion Grants by \$17.6 million. That increase was included in the House’s budget;
- a \$7.4 million reduction in MassHealth fee-for-service payments;
- a \$5.3 million reduction in MassHealth nursing home rates;
- a reduction of \$2 million for the Department of Revenue tax administration, which represents \$6 million more than FY 15; and
- \$5.2 million less for Massachusetts Office of Trade and Tourism.

These vetoes underscore that the key story of the 2016 budget is the lack of financial flexibility to increase funding for many discretionary accounts. As shown in Table 1, non-discretionary spending on MassHealth, Chapter 70 local aid, pensions, debt service and dedicated sales tax revenues to the MBTA and the Massachusetts School Building Authority (MSBA), together with an increase in state contract assistance of \$64 million to the T, consume \$100 million more than the \$1 billion available in net new revenue and represents all of the total increase in spending. In other words, the growth in nondiscretionary spending leaves no revenue for any increases to discretionary line-items.

Table 1 – Distribution of \$1 Billion Increase in Spending in FY 2016

	FY 15		
	Projected	FY 16 GAA	Increase \$
Non-Discretionary Spending			
MassHealth	14,044	14,740	696
Chapter 70 Local Aid	4,401	4,514	113
Pensions	1,793	1,972	179
Debt Service	2,219	2,252	33
Dedicated Sales Tax Revenues:	1,743	1,789	46
MBTA	971	985	14
MSBA	772	804	32
Discretionary Spending			
MBTA Contract Assistance	123	187	64
Remainder of the Budget	16,806	16,685	-121
Total	41,129	42,139	1,010

RISKS TO THE FY 2016 BUDGET

Despite the cost controls and vetoes, the 2016 budget begins the fiscal year with a number of exposures that should be monitored carefully. For example, funding for private counsel compensation averaged \$137 million over the past five years, yet in FY 2016 this account is provided with only \$99 million. Similarly, snow and ice costs are underfunded and will require supplemental appropriations of \$25 million to \$30 million during the year if past history is any indicator. This figure could exceed \$80 million if we have a winter similar to last year's record snowfall. Further, the 2016 budget shortchanges by \$30 million the statutorily required transfer of 40 percent of the tobacco settlement funds to the State Retirement Benefits Trust Fund.

While the approximately \$100 million in potential shortfalls are minor at this point in the fiscal year, they need watching. When coupled with the additional \$25 million exposure from the anticipated foregone revenue from the sales tax holiday and potential legislative overrides to the \$163 million in vetoes, the gap begins to widen considerably. These numbers also assume that tax and departmental revenues will not be lower than expected. The state should carefully monitor these accounts to avoid the fiscal distress of FY 2015 that resulted in a \$1 billion gap half way through the budget year.

POLICY MATTERS

The FY 2016 final budget contained several policy measures, which were supported by MTF.

The Earned Income Tax Credit and FAS 109

In separate legislation, Governor Baker proposed a doubling of the EITC from 15 percent to 30 percent of the federal credit that would cost the state approximately \$80 million in FY 2016. To offset the loss to the state in fiscal 2016, the administration proposed the elimination of the state's film tax credit. ([Read](#) MTF's testimony in support of this approach.) The House opted not to include either provision in its budget proposal.

The Senate proposed a three-year phased in increase from 15 percent to 22.5 percent of the federal EITC. To cover these costs, the Senate proposed to freeze the state's income tax rate at the current 5.15 percent thereby overturning the current statute that allows for an incremental reduction in the tax rate to 5.0 percent when specific economic conditions are met.

The Senate's proposed income tax rate freeze was viewed by the House as a tax increase to which it was opposed, making it a critical topic of conference committee deliberations. The committee did not adopt the income tax rate freeze but agreed to increase the EITC from 15 percent to 23 percent. The change is effective beginning with the 2016 tax year meaning that the estimated fiscal impact of \$72 million to the state would not materialize until FY 2017.

Having rejected the elimination of the film tax credit and the income tax rate freeze, the conference committee sought a source of funds to pay for the EITC increase. In a surprise move, the committee chose to eliminate the FAS 109 tax deduction to generate \$76 million in new tax

revenues. However, because the consensus revenue figure already included the delay of FAS 109, no new revenue was generated for FY 2016.

This deduction was a key component of the 2008 corporate tax reforms and part of a carefully negotiated package. In addition to the tax benefits of the FAS 109 deduction, it was critical to mitigate the negative impact to corporate financial statements that otherwise would have resulted from adoption of combined reporting (see [joint letter](#) to the Governor to reinstate FAS 109).

After the full impact of the FAS 109 repeal was understood, and despite earlier public statements supporting its repeal, the Governor collaborated with the Speaker and Senate President to find a solution. The three leaders agreed to delay the FAS 109 deduction for five years from FY 2016 to FY 2021, to extend the amortization period from seven to 30 years, and to use the savings to pay for the EITC increase.

Change to Combined Reporting Avoided

Another tax change proposed by the Senate would have amended the combined reporting provisions to treat a business organized in U.S. territories and/or possessions as if organized in the United States rather than a foreign country. This change breaks with federal law and erodes the water's edge provision of combined reporting. The change, listed as a technical edit, survived the conference committee only to be vetoed by the Governor. The change was estimated to increase tax revenues by \$5 million, so the veto leaves a gap in that amount.

MBTA Reforms

The conference committee delivered a series of strong measures to reform the management and operations at the T including:

- the institution of a Fiscal Management and Control Board (FMCB) for a three-year term that can be extended to five years. The five-person board includes three members from the existing MassDOT board along with two appointees by the Governor;
- major procurement reforms that includes a three-year suspension of the so-called “Pacheco Law” thus allowing the FMCB to seek services competitively;
- a required firewall between the operating and capital budgets with separate sources of funding to prevent co-mingling of funds;
- a one-time independent fiscal audit of the MBTA;
- an audit team from the office of the Inspector General to oversee the MBTA operating and capital budgets to identify and report on waste or fraud; and
- an independent assessment of MBTA maintenance protocols, project selection criteria, and capital spending.

Other reform initiatives, such as approval of final and binding arbitration awards and changes to the MBTA pension board contained in the transportation bill (H3347), will be addressed after the Legislature's August recess.

Massachusetts Taxpayers Foundation - Fiscal 2016 Budget Summary

	FY 10 Final	FY 11 Final	FY 12 Final	FY 13 Final	FY 14 Final	FY 15 Projected	FY 16 Con Com	FY 16 GAA
Health Care	10,548	12,182	12,102	12,599	13,615	15,248	15,876	15,863
MassHealth	9,288	10,239	10,435	10,874	12,121	14,044	14,740	14,727
Connector	754	867	823	905	600	268	229	229
Trust Funds ¹	313	886	581	580	661	701	651	651
Other Health Care	193	190	262	240	232	235	256	255
Local Government Support	5,553	5,490	5,640	5,765	5,919	6,022	6,214	6,187
Chapter 70 Education Aid	4,042	4,014	4,108	4,186	4,303	4,401	4,514	4,514
Other K-12 Education Aid	492	501	517	571	602	585	622	602
Unrestricted Local Aid	965	925	927	927	948	973	1,007	1,007
Other Local Aid	54	50	89	81	67	63	70	64
Other Education	1,516	1,597	1,440	1,490	1,612	1,705	1,753	1,737
Early Education	512	515	507	499	524	544	568	563
Higher Education	1,004	1,082	933	990	1,088	1,161	1,185	1,174
Human Services	4,782	4,803	4,957	5,105	5,404	5,667	5,846	5,818
Developmental Services	1,322	1,358	1,402	1,441	1,553	1,715	1,847	1,847
Family Services	909	879	902	921	977	1,075	1,125	1,122
Cash Assistance	766	782	787	786	794	716	721	707
Mental Health	625	614	651	659	708	719	740	739
Public Health	490	491	517	522	560	601	549	543
Housing Support	311	320	337	406	420	427	427	423
Senior Support	253	247	240	240	253	271	283	283
Veteran Services	106	112	121	130	140	143	152	152
Public Safety	2,312	2,300	2,351	2,430	2,523	2,636	2,619	2,607
Corrections	689	543	569	579	591	607	610	608
Sheriffs	357	492	505	529	542	585	560	560
Judiciary	776	776	761	794	828	865	849	844
Police	271	270	285	293	310	308	326	322
District Attorneys	92	93	99	102	103	108	113	113
Attorney General	38	38	40	40	43	44	45	45
Other Public Protection	89	87	93	93	106	119	116	115
Transportation	974	1,197	1,143	1,191	1,423	1,614	1,632	1,627
MassDOT	136	195	180	162	272	471	368	365
Highways	9	53	0	56	0	0	0	0
Regional Transit	40	15	15	19	68	40	82	80
Registry	22	7	9	9	9	9	10	10
MBTA		927	939	947	1,074	1,094	1,172	1,172
Sales Tax Revenues	767	767	779	787	799	971	985	985
Discretionary Assistance	0	160	160	160	275	123	187	187
Economic Development	301	304	369	366	417	344	421	408
Business and Labor	96	105	146	167	197	117	179	170
Environment and Energy	205	199	223	199	220	227	241	238
Employee Benefits	2,837	3,014	3,170	3,207	3,445	3,981	4,123	4,123
GIC ²	1,088	1,175	1,278	1,240	1,395	1,683	1,726	1,726
State Retiree Benefits (OPEB)	372	397	414	415	420	505	425	425
Pensions	1,377	1,442	1,478	1,552	1,630	1,793	1,972	1,972
Capital Support	2,017	1,937	2,253	2,362	2,429	2,498	2,529	2,529
Debt Service	1,843	1,678	1,970	2,068	2,125	2,219	2,252	2,252
Contract Assistance	174	259	283	294	304	279	278	278
MA School Building Authority	591	644	678	669	729	772	804	804
Other/General Government	527	476	558	554	707	642	396	436
Total (Including Pre-Budget Transfers)	31,959	33,945	34,660	35,738	38,222	41,129	42,214	42,139

¹ Includes the Medical Assistance Trust Fund and the Delivery System Transformation Initiatives Trust Fund

² Includes health care costs for municipalities and authorities that reimburse the state