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A Preview of the Fiscal Year 2019 Budget

The Fiscal Year (FY) 2019 budget year could be the most eventful in decades, with major changes in federal policy looming and ballot questions that could reshape state tax policy likely to appear on the November ballot. This year's budget will be written in a climate of uncertainty, and against a backdrop of ongoing fiscal challenges.

While recent revenue trends suggest that the state could end FY 2018 in a strong fiscal position, when enacted the FY 2018 budget was precariously balanced. It relied significantly on temporary revenue sources, including counting on 13 months of sales tax revenue rather than 12. And it has not yet fully-funded a number of accounts that everyone agrees will need to be funded (such as for removal of snow and ice from the roads). If strong revenue growth continues this year and into next year, the state could be in a position to reduce or end the practice of relying on temporary revenue and savings to balance the budget.

While there had been debate about whether the FY 2018 budget is currently balanced, the December revenue data—showing monthly tax revenue $527 million above the benchmark and year to date $728 million above the benchmark—suggests there will be adequate revenue to balance the budget. The debate about whether the budget was balanced was mostly a debate about currently underfunded accounts that will eventually need more funding. The Administration had projected a net of about $200 million of such deficiencies (after accounting for a $104 million reserve for such costs). This included $106 million[1] in net underfunded MassHealth costs and close to $200 million in other underfunded accounts. The Legislature had somewhat lower estimates. The December revenue numbers suggest, however, that there will be adequate revenue to fund these accounts. But the budget will likely still rely significantly on temporary measures to achieve balance.

To examine the fiscal context going into FY 2019, this preview begins with the reliance on temporary measures in FY 2018, examines projected revenue growth in FY 2019, and then looks at expected cost growth in FY 2019.

FY 2018 Temporary Measures

The FY 2018 budget relies on about $758 million in underfunded accounts and temporary revenues (see chart below). Some of these temporary revenues will be available again in FY 2019, so pose longer term problems rather than acute FY 2019 problems. For example, the FY 2018 budget relies on $200 million from a temporary assessment on employers to offset costs to the state when private sector employees use MassHealth rather than employer-provided health insurance. This assessment will continue through FY 2019 so the loss of revenue won't become an immediate problem until the FY 2020 budget. Other measures, such as assuming there will be $205 million in unspent balances in some accounts at the end of the budget year that can be used to fund other accounts ("assumed reversions"), appear to be becoming perennial strategies—and could be repeated in FY 2019.

While the Administration projects $106 million in net underfunded MassHealth costs, we do not include the MassHealth deficiency in the chart below because deficiency projections in that account often change considerably during the year. And we include one underfunding that the administration doesn't treat as a deficiency: the state retirees benefit trust payment.

While many of the temporary measures used in FY 2018 could be repeated in FY 2019, eight years into an economic recovery, budgets should not need to rely on these types of temporary measures to achieve balance.

Total Temporary Measures: $758 million

FY 2018 CURRENT RELIANCE ON TEMPORARY REVENUE AND UNDERFUNDED ACCOUNTS ($ millions)	
TEMPORARY TAX REVENUES	
Sales & room-occupancy tax daily remittance*	125
Cap life sciences credit program	5
SUBTOTAL	**130**
TEMPORARY NON-TAX REVENUES	
Employer health contribution	200
Assumed reversions of appropriations	205
SUBTOTAL	**405**
UNDERFUNDED ACCOUNTS	
State Retiree Benefits Trust	129
Emergency assistance (shelter)	10
Public counsel	64
Snow and ice appropriations	19
Sheriffs	45
Other accounts	60
Reserve for underfunded accounts	(104)
SUBTOTAL	**223**
TOTAL	**758**

*FY 2018 Current counts July 2018 sales taxes in FY 2018 but does not accelerate their collection.

FY 2019 Projected Revenue Growth

Tax Revenue

Each December the Legislature and Administration hold a revenue hearing at which forecasters project tax revenue growth for the coming fiscal year. At this year's hearing the state Department of Revenue (DOR) presented projections from Economy.com, Global Insight, and its own hybrid estimate. The

DOR Hybrid projects "actual" tax revenue growth of 3.4 percent—which would be $888 million. The "actual" growth rate is determined by calculating the baseline growth—growth due to economic trends—and adjusting that number to account for tax law changes and revenue initiatives (an offset of $219 million). This preview uses the state DOR projection, as it is the most official source available. It is, however, lower than estimates from a number of outside experts and it does not account for the December tax revenue data which shows receipts running $728 million above benchmark so far this year. A large share of that increase is higher estimated payments which likely reflects payments in December 2017 that would ordinarily be made in 2018. Therefore, we might see offsetting lower estimated payments in 2018. But withholding taxes are currently $164 million above benchmark and sales taxes are $46 million above benchmark. Those numbers are more likely to be reflecting actual economic trends rather than timing of payments. The DOR Hybrid estimate also doesn't account for effects of the recent federal tax law changes—which could affect state tax receipts in a number of ways. It is likely that this $888 million growth projection is a conservative estimate, and final FY 2019 tax revenue could substantially exceed this estimate—but there are a number of factors that make projecting 18 months into the future very perilous. And it is possible that if tax revenue does substantially exceed projections that a large share of the excess will be capital gains tax revenue, which is dedicated by law to the stabilization fund when receipts exceed roughly the level currently expected for FY 2018.

Other Revenue

Other state revenue sources are not likely to grow significantly or are already accounted for in our projections. While the state receives significant revenues from fees, that revenue is not projected to increase substantially. Revenue from the lottery is also not projected to grow substantially—and may decline. Federal Medicaid (MassHealth) reimbursements are likely to grow significantly, but we account for that in our calculation of health care costs (see below). We count health care cost growth as only the cost growth on the portion of health care spending ultimately paid by the state (that is total *state* spending, net of federal revenue). We treat the cost growth on the federal share as essentially cancelled out by the corresponding increased federal reimbursement.
This preview does not include the effects of potential federal cuts to Medicaid or CHIP, because it is impossible to give precise estimates of what might happen. If there are federal cuts to those programs, however, it would have a significant negative effect on the state budget.[2]

Total Projected Revenue Growth: $888 million

FY 2019 Estimated Cost of Providing Current Services

Only the Administration has access to the data needed to provide a reasonably precise estimate of FY 2019 costs to maintain current services. Such an estimate requires examining likely caseload levels for programs (particularly entitlement programs where all who are eligible have a legal right to the services); projected needs in specific areas (like child protective services); and inflation rates for different types of costs (health care inflation, for example, has historically been higher than overall inflation rates).

In some cases, that analysis will identify costs growing rapidly, and in other cases it will show maintenance costs declining (for example, in a strong economy when more people can find work, costs for some income support programs decline). A number of states publish data on the cost of maintaining current services into the next year. Doing so is generally considered a "best practice" in budgeting.[3] Massachusetts, however, doesn't do so.

Because such detailed data aren't publicly available, this budget preview uses broad estimates. We assume that most costs will grow at two percent, roughly the projected rate of inflation. While costs in some areas will grow at a higher rate and others at a lower rate, there is generally not a more reliable way to predict overall cost growth without access to detailed programmatic data. While there are some specific costs we could project with more certainty (and those are likely to grow at more than the rate of inflation), there are others that are not easy to project accurately, yet are likely to grow at less than the rate of inflation or decline. Thus it is likely more accurate to use one general adjustment for most of state government.

If the cost of most of the (non-health care) services state government provides and funds (everything other than health care) grows two percent from the current total of $25.45 billion, those costs will increase by $509 million in FY 2018.

We use a different cost growth estimate for health care.[4] The state's health care costs are a large share of the budget, they have typically grown faster than the rate of inflation and there is every reason to believe that trend will continue. It would allow for a more transparent and orderly budget process if the Administration were to publish a projection of costs for maintaining our current health care programs and policies after accounting for projected caseload and cost changes. Absent such an estimate, this brief assumes health care costs in the state budget will grow at the rate the state has adopted as a target for overall health care cost growth: 3.1 percent.[5] Since state health care spending (net of reimbursements from the federal government) is $9.6 billion, 3.1 percent growth will mean approximately $299 million in new health care costs in FY 2018. This estimate is likely low as health care costs have grown at a faster rate than this in recent years, but it is based on the most official source available.

Projected Increase in Cost of Providing Current Services: $808 million

Conclusion

It is likely that revenue growth in FY 2019 (above the current FY 2018 benchmark) will exceed cost growth. The estimates in this preview suggest revenue growth will exceed cost growth by $80 million. That would allow the state to reduce its reliance on temporary revenue and savings from this year's $758 million to $678 million in FY 2019. This estimate, however, assumes a conservative tax revenue growth projection. If the tax revenue continues to substantially exceed the benchmarks, revenue growth could exceed cost growth more substantially. On the other hand, costs—particularly for health care—could grow more rapidly than the estimated rates in this preview. And federal cuts could shift significant costs to the state. Nonetheless, continued strong revenue growth could present an opportunity for the Commonwealth to become less reliant on temporary measures.

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[1] Commonwealth of Massachusetts, Information Statement, September 27, 2017, page A-23.
[2] Nancy Wagman, "Partnership in Peril: Federal Funding at Risk for State Programs Relied on by Massachusetts Residents," Mass. Budget and Policy Center.

[3] Elizabeth McNichol, Iris J. Lav, Michael Leachman, "Better State Budget Planning Can Help Build Healthier Economies," Center on Budget and Policy Priorities.

[4] "Health care" for the purposes of this analysis refers to costs associated with MassHealth and various health reform initiatives, as well as the costs of the state employee health insurance administered through the Group Insurance Commission.

[5] Commonwealth of Massachusetts, Information Statement, September 27, 2017, page A-25.