



July 22, 2019

## **First Look at the Fiscal 2020 Conference Committee Report** *Conference Committee Agrees on \$43.6 Billion Spending Plan for FY20*

Massachusetts legislators released their compromise plan for the fiscal 2020 budget, authorizing \$43.6 billion in spending for the fiscal year that began July 1, 2019. The six-member budget conference committee reconciled the differences between the budget plans adopted by the House and Senate 21 days after the start of the new fiscal year.

Initial analysis of the conference committee report (CCR) suggests overly optimistic revenue assumptions of \$166 million and expected costs not included in the budget of \$168 million for a total gap of \$334 million. This total gap is partially offset by the inclusion of a \$90 million “necessary costs” reserve to address some of these anticipated costs.

In addition, the governor has several tools available to close this gap, including the assumed value of spending appropriations that will go unused, upward revisions to non-tax revenue estimates (e.g. fines, fees, and penalties), and exercising the governor’s line-item veto authority.

The five key takeaways from the conference committee report include:

1. The conference committee upgraded total tax revenue for fiscal 2020 by \$594 million and \$317 million in tax revenue available for the annual operating budget. MTF recommended upgrading total tax revenue by \$455 million, but after transfers and other adjustments this change would yield \$113 million in additional tax revenue for budget. These more aggressive assumptions add risk to the fiscal 2020 budget picture and raise the prospect of midyear budget cuts if the assumptions do not prove valid.

2. The CCR adds more than \$300 million, or about one percent, above spending levels approved in either the House or Senate budgets.
3. The CCR appropriates \$43.6 billion in spending, an increase of 4.1 percent over fiscal 2019 estimated spending.
4. The conference committee included two tax law changes, increasing expected revenue by approximately \$47 million. The new tax collection responsibility imposed on marketplace facilitators is expected to raise \$42 million while the cap on the life science tax credit is worth \$5 million.
5. The Governor’s vetoes are likely to focus on policy disagreements like differences over earmarks as non-veto solutions are available to offset overly optimistic revenue assumptions and underfunded accounts.

The Governor now has ten days to review the CCR and exercise his line-item veto authority. The Governor’s veto decisions are likely to be announced on or about August 1, 2019.

FY20 Gap Analysis	Net Impact
<b>Conference Committee Report</b>	
<b>Gaps</b>	
Tax-Related Settlements & Judgments	-100.0
Recreational Marijuana	-66.3
Underfunded Spending Accounts	-168.0
<u>Subtotal, Gaps</u>	<u>-334.3</u>
<b>Solves</b>	
Deficiency Reserve	90.0
Disregard Recreational Marijuana Risk	66.3
Downgrade Tax-Related S&J	50.0
Non-Tax Revenue Revisions	0.0
Reversion Assumption	150.0
Veto Exercise	0.0
<u>Subtotal, Solves</u>	<u>150.0</u>
<b>FY20 Projected Balance</b>	<b>22.0</b>

*Figures in \$ millions. Excludes minor funds.*

*Figure 1: Initial analysis of budget gaps and potential solves.*



## Budget Gaps

Failing to budget for unavoidable expenses or including overly ambitious revenue assumptions add risk to the budget and increase the likelihood of midyear budget cuts. While the conference committee increased revenue assumptions for fiscal 2020 to account for strong tax revenue collections in fiscal 2019, they did not revise estimates for tax revenue from the sale of recreational marijuana and tax-related settlements and judgments that now seem overly ambitious. These categories have underperformed expectations in fiscal 2019 yet were not modified by the conferees.

The CCR did not account for certain unavoidable expenses, likely requiring a supplemental appropriation later in the year to fully fund these programs. For example, the CCR assumes the Massachusetts Department of Transportation will spend approximately \$55 million on snow and ice clean up in fiscal 2020. The average cost of snow and ice clean up over the last five years, however, has been \$105 million.

In total, the CCR includes approximately \$168 million in unavoidable expenses as depicted in Figure 2.

<b>Unavoidable Expenses in FY20 Budget</b>	
	<u>CON</u>
Major Unavoidable Expenses	
Sheriffs and CPCS	65.3
Snow and Ice Control	50.0
State Employee Raise Reserve	26.4
Health & Human Services IT	14.6
DOC	11.8
<b>Subtotal, Unique Spending</b>	<b>168.0</b>

*Figures in \$ millions*

*Figure 2: Unavoidable Expenses in FY20 Budget.*

## Solutions

### *Disregard Recreational Marijuana Tax Risk*

In fiscal 2019, taxes on the sale of recreational marijuana were expected to generate \$63 million. Through May 2019, actual collections were just \$21 million. MTF recommended downgrading this estimate to \$66 million reflecting both continued growth in this



nascent industry and the relatively slow pace of its launch.<sup>1</sup> Budget managers could choose to disregard the risk associated with this revenue and revisit the issue later in the fiscal year.

#### *Downgrade Tax-Related Settlement and Judgment Revenue Estimate*

In fiscal 2019, tax-related settlement and judgment payments generated about \$50 million for the Commonwealth's coffers. The Governor's budget proposal in January assumed the same \$50 million would be received in fiscal 2020. The CCR assumes this source will generate \$100 million. Using the more conservative figure would reduce some of the risk associated with this unpredictable revenue source.

MTF has consistently recommended this revenue be credited to the Commonwealth Stabilization Fund, the state's "rainy day" fund, rather than being included as generally available revenue for the budget.

#### *Deficiency Reserve*

The underfunded accounts noted above are partially offset by a new deficiency reserve of \$90 million. After accounting for this reserve, there are approximately \$78 million in unbudgeted, unavoidable costs still to be addressed.

#### *Reversion Assumption*

During the annual budget development process, executive and legislative decision-makers agree on spending appropriations for the upcoming fiscal year. Some of these appropriations go unused each year for a variety of reasons. In Massachusetts, unused appropriations are known as "reversions".

In fiscal 2019, budget managers assumed reversions of \$150 million. While sizable, this amount is less than previous years in which the assumption ranged between \$175 million and \$225 million.

In the past, MTF has advised against assuming reversions in the budget development process because it reduces the margin for error. While reversions occur each year, it is also true some of the assumptions included in the budget will not prove valid, such as revenue collections that fall below expectations or entitlement spending in excess of the

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<sup>1</sup> [Letter to Budget Conferees on Fiscal 2020 Tax Estimates](#), Massachusetts Taxpayers Foundation, June 21, 2019.



estimate.<sup>2</sup> Assumed reversions add risk to the state budget picture and may trigger midyear budget cuts.

#### *Non-Tax Revenue*

Many of the estimates for non-tax revenue sources, such as revenue generated from the operating activities of state agencies in the form of fines, fees, and penalties, were projected in January and proposed as part of the Governor's budget proposal.

Considering more recent data available to the Executive Office for Administration & Finance, these estimates will be re-evaluated during the veto process.

#### *Veto Exercise*

The Governor may use his line-item veto authority to close any remaining gap between revenue and spending and to reject policies he deems unwise. As depicted above in Figure 1, the Governor likely does not need to veto to achieve balance. As a result, the Governor is likely to focus on spending items included in the budget he deems unwise, like certain earmarks. In similar circumstances last year, Governor Baker vetoed spending items worth a total of \$47 million.

For context, this amount is far below the veto tally of July 2017 when he vetoed \$320 million which was required to balance the budget.<sup>3</sup>

## **CCR Highlights**

#### *Tax Revenue Assumptions*

For the fourth straight year, conferees made significant revisions to the consensus tax revenue estimate agreed to in January by the Governor and Legislature. In fiscal 2017 and 2018, lawmakers were forced to significantly downgrade revenue assumptions in the wake of subpar tax collections. In fiscal 2019, strong tax collections supported an upgrade of \$668 million to the total tax revenue estimate and \$341 million available to budget after accounting for statutorily required transfers to the Massachusetts Bay Transportation Authority (MBTA), Massachusetts School Building Authority (MSBA), and the Commonwealth Stabilization Fund, the state's "rainy day" fund.

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<sup>2</sup> See [FY2019 Budget: Taking a Closer Look at Conference Committee](#), Massachusetts Taxpayers Foundation, June 26, 2018.

<sup>3</sup> See [An Initial Look at FY2018 Budget Vetoes](#), Massachusetts Taxpayers Foundation, July 18, 2017.



As MTF advised conferees in our letter of June 21, 2019, it is reasonable to re-evaluate the tax assumptions that underpin the budget development process.<sup>4</sup> It is also reasonable to take a cautious approach to tax revenue volatility rather than assuming certain revenue, such as above-trend corporate tax revenue collections, will continue in the future. We recommended upgrading total tax revenue by \$455 million, but after transfers and other adjustments this change would yield \$113 million in additional tax revenue available for the budget.

The conference committee took a more aggressive approach, upgrading total tax revenue by \$594 million and \$317 tax revenue available for the budget. These assumptions add risk to the fiscal 2020 budget picture and raise the prospect of midyear budget cuts if the assumptions do not prove valid.

#### *Tax Law Changes*

Consistent with the approach taken by the House of Representatives, the conference committee included only two tax law changes in their plan. So-called “marketplace facilitators” like Etsy and eBay will be required to collect and remit sales taxes on behalf of sellers who use such services. This change is expected to raise approximately \$42 million in sales tax revenue in fiscal 2020. The budget also assumes the Department of Revenue will enforce an administrative cap of \$20 million on life science tax credits. This change will yield \$5 million in additional tax revenue compared to the original estimate.

#### *Policy Sections*

The conference committee included 107 policy sections. As has been publicly reported, the committee included compromise language related to the purchasing of prescription drugs from manufacturers by MassHealth.<sup>5</sup> Other sections in the plan increase the salary of district attorneys, establish a new behavioral health trust fund to support ongoing efforts in that policy area, add or modify an array of reporting requirements for various state agencies and programs, require regional transit authorities to enter into agreements with the Department of Transportation related to data sharing and strategic planning, and create several new task forces or study groups to analyze various issues.

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<sup>4</sup> [Letter to Budget Conferees on Fiscal 2020 Tax Estimates](#), Massachusetts Taxpayers Foundation, June 21, 2019.

<sup>5</sup> For example, [Budget stalemate ends, plan ups spending](#), by Andy Metzger, *Commonwealth Magazine*, July 21, 2019.



## **Next Steps**

After being approved by the legislature, the budget will now head to Governor Charlie Baker's desk. He will have ten days to review the document and exercise his line-item veto authority over spending items he deems unwise or unaffordable. The budget will then return to the legislature for potential overrides.



<b>FY20 Tax Revenue Summary</b>	<b>GOV</b>	<b>HOU</b>	<b>SEN</b>	<b>CON</b>
<b>Consensus Tax Revenue</b>	29,299.0	29,299.0	29,299.0	29,892.5
<b>Tax Law Changes</b>				
<u>Already Enacted</u>				
Recreational Marijuana	132.5	132.5	132.5	132.5
Transient Accommodation/Room Occupancy Tax	27.5	27.5	27.5	27.5
<u>Subtotal, Already Enacted</u>	<u>160.0</u>	<u>160.0</u>	<u>160.0</u>	<u>160.0</u>
<u>Proposed Initiatives</u>				
Sales Tax Acceleration	306.0	0.0	0.0	0.0
Deeds/Climate Change	75.0	0.0	0.0	0.0
Sales Tax Marketplace	41.7	41.7	41.7	41.7
Opioid gross receipts tax	14.0	0.0	14.0	0.0
Vaping	6.0	0.0	12.0	0.0
Life Sciences	5.0	5.0	5.0	5.0
Withholding on non-resident property sales	4.0	0.0	4.0	0.0
Sales Tax Integrity	2.0	0.0	2.0	0.0
Stamp Smokeless Tobacco	0.0	0.0	0.0	0.0
<u>Subtotal, Proposed Initiatives</u>	<u>453.7</u>	<u>46.7</u>	<u>78.7</u>	<u>46.7</u>
<b>Other Tax Revenue</b>				
Tax-Related Settlements & Judgments	50.0	100.0	100.0	100.0
<b>Tax Transfers</b>				
Sports Wagering	35.0	0.0	0.0	0.0
<b><u>Total Tax Revenue Projection</u></b>	<b><u>29,997.7</u></b>	<b><u>29,605.7</u></b>	<b><u>29,637.7</u></b>	<b><u>30,199.2</u></b>

Figure 3: Tax Law Changes Considered in FY20 Budget Development. Figures in \$ millions.

Spending Comparison

<b>Appropriation Summary by Related Function</b>				<b>Figures in \$ millions.</b>
	<b><u>FY19 Spending</u></b>	<b><u>FY20 HOU</u></b>	<b><u>FY20 SEN</u></b>	<b><u>FY20 CON</u></b>
Administration & Finance	2,570.6	2,529.6	2,530.6	2,627.1
Education	8,641.6	9,010.6	9,027.2	9,116.5
Energy & Environmental Affairs	263.2	286.2	282.2	294.0
Health & Human Services	22,995.7	23,907.4	23,906.0	23,985.7
Housing & Economic Development	576.1	585.5	587.9	618.3
Labor & Workforce Development	59.0	73.0	72.5	75.8
Public Safety & Security	1,215.6	1,259.2	1,258.3	1,268.1
Technology Services & Security	36.3	36.3	41.3	37.5
Transportation	739.9	694.1	697.4	698.5
<b><i>subtotal</i></b>	<b><u>37,098.0</u></b>	<b><u>38,381.9</u></b>	<b><u>38,403.2</u></b>	<b><u>38,721.4</u></b>
All Other	4,771.9	4,861.5	4,859.8	4,869.0
<i>reversion assumption</i>				
<b><i>Total</i></b>	<b><u>41,869.9</u></b>	<b><u>43,243.4</u></b>	<b><u>43,263.0</u></b>	<b><u>43,590.4</u></b>

	CON vs FY19 Spend		CON vs HOU		CON vs SEN	
	\$ change	% change	\$ change	% change	\$ change	% change
Administration & Finance	56.5	2.2%	97.5	3.9%	96.5	3.8%
Education	474.9	5.5%	105.8	1.2%	89.3	1.0%
Energy & Environmental Affairs	30.8	11.7%	7.8	2.7%	11.8	4.2%
Health & Human Services	990.0	4.3%	78.4	0.3%	79.7	0.3%
Housing & Economic Development	42.2	7.3%	32.8	5.6%	30.4	5.2%
Labor & Workforce Development	16.8	28.4%	2.9	3.9%	3.3	4.6%
Public Safety & Security	52.5	4.3%	8.9	0.7%	9.8	0.8%
Technology Services & Security	1.2	3.3%	1.2	3.2%	-3.8	-9.2%
Transportation	-41.5	-5.6%	4.4	0.6%	1.1	0.2%
<b><i>subtotal</i></b>	<b><i>1,623.4</i></b>	<b><i>4.4%</i></b>	<b><i>339.5</i></b>	<b><i>0.9%</i></b>	<b><i>318.2</i></b>	<b><i>0.8%</i></b>
All Other	97.1	2.0%	7.5	0.2%	9.2	0.2%
<b><i>Total</i></b>	<b><i>1,720.5</i></b>	<b><i>4.1%</i></b>	<b><i>347.0</i></b>	<b><i>0.8%</i></b>	<b><i>327.5</i></b>	<b><i>0.8%</i></b>

Notes:

Data grouped by functional area (i.e., local aid appears as part of education)  
Amounts exclude MATF, pensions, chargeback spending, and interfund transfers  
Figures in \$ millions unless otherwise noted.