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*MTF*

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## **Analysis of Governor Baker's FY 2020 Budget**

Governor Baker released a spending plan that totals \$47.5 billion which includes both pre-budget transfers and line-item appropriations for fiscal year (FY) 2020. The proposal is noteworthy for the inclusion of several policy initiatives along with the introduction of new resources to pay for the increased spending. The Governor's operating budget is also noteworthy for the several investments included therein. The Governor's budget comes at a time of heightened state tax revenue volatility against a backdrop of global economic warning signs that will require close monitoring, and perhaps revising, over the months ahead.

### **The Basics**

The Governor's proposal recommends \$47.5 billion in spending, representing an increase of \$1.05 billion or 2.3 percent over the current FY 2019 budget. This spending is comprised of \$42.5 billion in line-item appropriations, and \$4.97 billion in pre-budget transfers to the state pension fund (\$2.84 billion), the MBTA (\$1.13 billion) the school building authority (\$970 million), and the Workforce Training Fund (\$25 million) (Table 1).



**Table 1 – H1 Budget Spending Summary (in millions)**

|                              | FY 2019       | FY 2020       |              |             |
|------------------------------|---------------|---------------|--------------|-------------|
|                              | Current       | GOV           | \$ Change    | % Change    |
| Line item spending           | 41,883        | 42,505        | 622          | 1.5%        |
| Off budget                   | 4,538         | 4,967         | 429          | 9.5%        |
| <i>Pensions</i>              | 2,609         | 2,842         | 234          | 9.0%        |
| <i>MBTA</i>                  | 1,042         | 1,130         | 88           | 8.4%        |
| <i>School Building Auth.</i> | 863           | 970           | 107          | 12.5%       |
| <i>Workforce Training</i>    | 25            | 25            | 1            | 2.0%        |
| <b>Total spending</b>        | <b>46,421</b> | <b>47,472</b> | <b>1,051</b> | <b>2.3%</b> |

## Revenues

The Governor’s budget relies on \$29.3 billion in tax revenue. This represents a 2.7 percent increase over FY 2019, a figure agreed to as part of the Consensus Revenue process. \$202 million of this amount is designated for deposit into the Stabilization Fund as above-threshold capital gains revenue.<sup>1</sup> The revenue benchmark assumes a reduction in the state income tax rate to 5.05 percent from 5.1 percent effective January 1, 2019 and a second rate reduction to 5.0 percent effective January 1, 2020 or midway through the FY 2020 budget. These two rate cuts are projected to reduce state income tax revenues by \$263 million in FY 2020.<sup>2</sup>

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<sup>1</sup> An additional \$11.4 million would be transferred to the State Retirement Benefits Trust Fund and \$11.4 million to the Commonwealth Pension Liability Fund.

<sup>2</sup> Should the income tax rate decline to 5.0 percent in January 2021, state tax deductions for charitable contribution would be reinstated beginning in January 2022, see [Chapter 186 of the Acts of 2002](#), Section 9.

**Table 2 – Revenue Sources Supporting FY 2020 (in millions)**

|  | FY 2019       | FY 2020       |              |             |
|--|---------------|---------------|--------------|-------------|
|  | Current       | GOV           | \$ Change    | % Change    |
| <b>Revenue Benchmark</b>                     | <b>28,529</b> | <b>29,299</b> | <b>770</b>   | <b>2.7%</b> |
| <i>Tax Settlements</i>                       | 125           | 50            | -75          |             |
| <i>Less Cap Gains Transfer</i>               | -488          | -225          | 263          |             |
| <b>New Revenue Sources</b>                   |               |               |              |             |
| <i>Sales Tax Acceleration</i>                |               | 306           | 306          |             |
| <i>Sales Tax on Marketplaces</i>             |               | 42            | 42           |             |
| <i>Opioid Gross Receipts Tax</i>             |               | 14            | 14           |             |
| <i>Excise Tax on Deeds</i>                   |               | 75            | 75           |             |
| <i>Sports Wagering</i>                       |               | 35            | 35           |             |
| <i>Marijuana (sales &amp; excise)</i>        | 63            | 133           | 70           |             |
| <i>Room Occupancy Modernization</i>          |               | 28            | 28           |             |
| <b>Revenue Initiatives (FY 2019)</b>         |               |               |              |             |
| <i>Employer Assessment</i>                   | 260           |               | -260         |             |
| <i>Repatriation</i>                          | 65            |               | -65          |             |
| <b>Federal Revenues</b>                      |               |               |              |             |
| <i>MassHealth Related</i>                    | 8,894         | 8,929         | 35           |             |
| <i>Other</i>                                 | 2,555         | 2,711         | 156          |             |
| <b>Departmental Revenues &amp; Transfers</b> |               |               |              |             |
|  | 6,687         | 7,581         | 894          |             |
| <b>Total</b>                                 | <b>46,690</b> | <b>48,978</b> | <b>2,288</b> | <b>4.9%</b> |

The Baker FY 2020 budget proposes several taxes and fees that would raise approximately \$630 million in new revenue, \$300 million of which would be one-time revenues from accelerated sales tax collections that the Baker administration has earmarked for education reform initiatives. (Table 2).

These new resources include both new tax initiatives and money from previously enacted tax increases that become effective in FY20:

- **Sales tax modernization (accelerated sales tax collections).** This proposal would reduce the amount of time between when a vendor collects sales, meals or room occupancy tax and remits the tax to the state. It comes on the heels of a proposal in the Governor’s budget last year to accelerate sales tax collection using a different

method that was not adopted. These requirements apply to businesses that have remitted more than \$100,000 in sales, meals, or room occupancy taxes in the previous year. It is projected to raise one-time revenues of \$306 million by collecting an additional three weeks of sales tax collections in FY20.

Of these \$306 million in one-time tax revenues, \$100 million would pay for college scholarships, \$50 million would be set aside for improvements in low-performing schools as determined by the Commissioner of Elementary and Secondary Education, \$30 million for investments in school safety, and \$20 million deposited into the Water Pollution Abatement Trust to fund water purification projects in schools. \$28.5 million would be deposited into the Stabilization Fund. The MBTA and MSBA would each receive a \$39 M transfer from this revenue.

- **Sales tax on marketplace facilitators.** This proposal would require online marketplace facilitators to collect and remit sales tax on behalf of vendors who sell products to Massachusetts customers on their platforms. It is expected to raise \$42 million in FY 2020.
- **A gross receipts tax on opioid manufacturers. This new tax imposed on** the sales of opioid products in Massachusetts is expected to raise \$14 million.
- **Deeds excise increase.** This provision raises excise taxes to \$3 per \$500 of real estate value from \$2 per \$500 of value and is projected to raise \$75 million in the first year and then \$137 million annually, which the administration would dedicate to the Global Warming Solutions Trust Fund for state and municipal investments in climate resiliency projects.

**Vaping and e-cigarettes** will now be subject to the same taxing regime as tobacco. These revenue proposals in the Governor's FY 2020 budget are in addition to tax changes previously adopted that take effect in 2019:

- The administration anticipates receipt of \$63 million in marijuana sales and excise tax revenues in FY 2019 and \$133 million in FY 2020.
- Short-term room occupancy rentals will be subject to the state's 5.7 percent rooms tax starting July 1, 2019 and cities and towns can add another 6 percent local excise

tax, with higher local option taxes available in Boston and Cape Cod. The state expects to raise \$28 million in FY 2020.

- A 0.63 percent payroll tax on the first \$128,400 of a worker's earnings collected from employers starting July 1, 2019. The revenues will be used to back the newly created Department of Family and Medical Leave (DFML) to provide paid family and medical leave for Massachusetts workers at an estimated cost of \$800 million per year;
- The sales tax holiday, now in statute as part of St. 2018, c.121 or the "grand bargain" law, suspends the 6.25 percent sales tax for one weekend in August and for the first time suspends meals taxes too... The tax holiday is estimated to cost the state \$39 million in FY 2020;
- Rental vehicles became subject to an additional \$2 fee starting January 1, 2019 to help pay the costs of municipal police training.

### Spending

A notable achievement in the Governor's spending plan is a sizeable reduction in the growth rate of MassHealth that has enabled the Governor's budget to increase spending in several other areas.

**Table 3 – Spending Highlights (in millions)**

|                                | FY 2019<br>Current | FY 2020 H1    | \$ Change    | % Change    |
|--------------------------------|--------------------|---------------|--------------|-------------|
| <b>Line item spending</b>      |                    |               |              |             |
| <i>MassHealth</i>              | 16,509             | 16,546        | 38           | 0.2%        |
| <i>Chapter 70</i>              | 4,908              | 5,108         | 200          | 4.1%        |
| <i>UGGA</i>                    | 1,099              | 1,129         | 30           | 2.7%        |
| <i>Caseload spending</i>       | 2,974              | 3,019         | 45           | 1.5%        |
| <i>Other</i>                   | 3,104              | 3,180         | 76           | 2.5%        |
| <i>Total Non-discretionary</i> | 28,593             | 28,982        | 389          | 1.4%        |
| <i>Discretionary</i>           | 13,288             | 13,777        | 489          | 3.7%        |
| <b>Total line item</b>         | 41,881             | 42,759        | 878          | 2.1%        |
| <b>Off-budget</b>              | 4,546              | 4,860         | 314          | 6.9%        |
| <b>Total spend</b>             | <b>46,427</b>      | <b>47,619</b> | <b>1,192</b> | <b>2.6%</b> |

*MassHealth*

Perhaps the single most noteworthy achievement in the Governor’s budget is that MassHealth spending grows by just \$38 million (0.2 percent), for a total spending level of \$16.55 billion. After accounting for federal reimbursements, net MassHealth spending is virtually flat from FY 2019. The savings are driven by reduced costs of prescription drugs and continued efforts to improve the eligibility system and program integrity.

**Table 4 - MassHealth Spending & Revenue, FY 2017 – FY 2020 (in millions)**

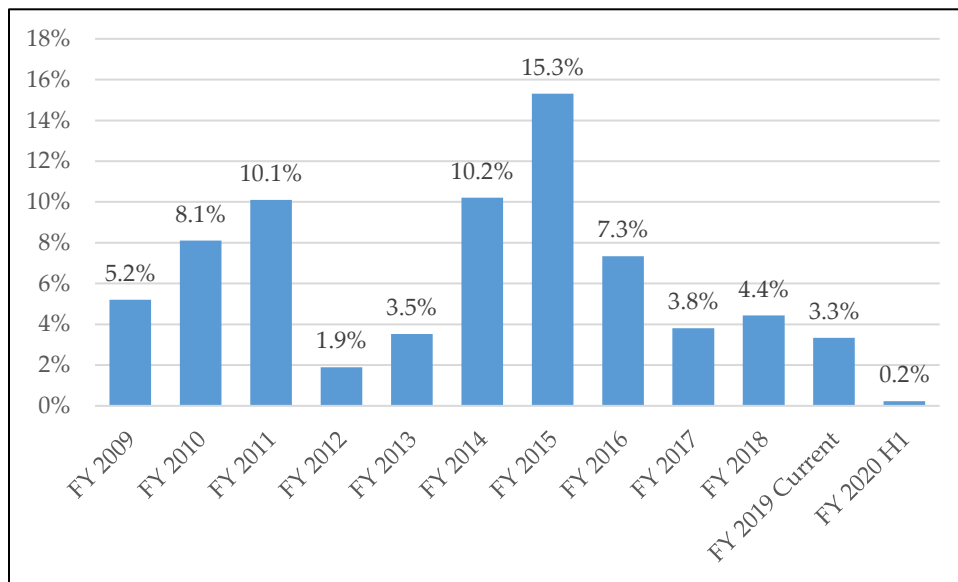
|                       | FY 2017<br>Final | FY 2018<br>Final | FY 2019<br>Current | FY 2020 H1 |
|-----------------------|------------------|------------------|--------------------|------------|
| MassHealth spending   | 15,298           | 15,976           | 16,509             | 16,546     |
| Percent Growth        | -0.3%            | 4.4%             | 3.3%               | 0.2%       |
| Federal Reimbursement | 8,537            | 8,817            | 8,896              | 8,938      |
| Net Cost              | 6,762            | 7,159            | 7,613              | 7,608      |
| Reimbursement Share   | 55.8%            | 55.2%            | 53.9%              | 54.0%      |

The Governor’s budget also includes provisions designed to reduce MassHealth’s pharmaceutical costs by providing new authority to negotiate drug pricing directly with

drug manufacturers. The administration estimates the savings could reach \$80 million in FY 2020.

The administration expects MassHealth enrollment of 1.86 million members in FY 2020 – 300,000 fewer than budgeted for in FY 2019. Caseloads are projected to increase by 0.6 percent from last year. This low level of enrollment and caseload growth is due to numerous program integrity measures that have been introduced to ensure member eligibility and record low-unemployment that may have resulted in more people being eligible for employer-sponsored insurance.

**Figure 1 – MassHealth Spending Growth, FY 2009 – FY 2020**



*Local aid*

This budget increases funding for the state’s two largest local aid programs, Chapter 70 education aid and Unrestricted General Government Aid (UGGA) by a combined \$230 million.

In Chapter 70, the Governor increases funding by \$200 million, substantially more than the \$119 million recommendation in last year’s budget. For the fourth consecutive year, the increase to Unrestricted General Government Aid is linked to the expected tax revenue growth rate of 2.7 percent; this increase works out to \$30 million (2.7 percent) in FY20. This increase is distributed based on a prorated basis in contrast to Chapter 70 aid which is subject to an annual formula.

**Table 5 – Chapter 70 & UGGA Funding, FY 2017 – FY 2020 (in millions)**

|           |              | FY 2017      | FY 2018      | FY 2019<br>Current | FY 2020 H1   |
|-----------|--------------|--------------|--------------|--------------------|--------------|
| 7061-0008 | <b>Ch 70</b> | <b>4,628</b> | <b>4,747</b> | <b>4,908</b>       | <b>5,108</b> |
|           | \$ Increase  | 116          | 119          | 161                | 200          |
|           | % Increase   | 2.6%         | 2.6%         | 3.4%               | 4.1%         |
| 1233-2350 | <b>UGGA</b>  | <b>1,022</b> | <b>1,062</b> | <b>1,099</b>       | <b>1,129</b> |
|           | \$ Increase  | 42           | 40           | 37                 | 30           |
|           | % Increase   | 4.3%         | 3.9%         | 3.5%               | 2.7%         |

The Governor’s budget raises Chapter 70 funding by \$200 million representing a 3.4 percent increase over FY 2019. Under separately filed legislation, the administration proposes a multi-year overhaul of the school funding formula that seeks to address rising health care costs as well as school districts facing costs from higher proportions of English language learners, children with special needs, and higher concentrations of poverty.

*Early education and higher education*

Early education is funded at \$657 million in the Governor’s budget, an increase of \$28 million (4.4 percent) over FY 2019. The University of Massachusetts system would receive an increase of \$39 million to \$563 million in FY 2020. State universities and community colleges would each see an increase of \$8 million over FY 2019.

As noted earlier, the Governor’s budget proposes using \$100 million from accelerated sales tax collections to fund college scholarships.

**Table 6 – Early Education & Higher Education, FY 2018 & FY 2019 (in millions)**

|                             | FY 2018<br>Final | FY 2019<br>Current | FY 2020 H1 | \$ Change | % Change |
|-----------------------------|------------------|--------------------|------------|-----------|----------|
| Early Education             | 586              | 629                | 657        | 28        | 4.4%     |
| University of Massachusetts | 514              | 524                | 563        | 39        | 7.5%     |
| State Universities          | 250              | 263                | 274        | 11        | 4.2%     |
| Community Colleges          | 275              | 286                | 294        | 8         | 2.7%     |



## Transportation

Transfers to support MassDOT operations in the Governor's 2020 budget includes \$105 million to fund snow and ice removal, for a net funding increase of \$31 million.

The Regional Transit Authorities (RTAs) would see their funding fall back to \$86 million following an \$8 million increase (10 percent) in FY 2019 (\$2 million of which was one-time funding). Further, the Secretary of Transportation would be authorized to establish RTA performance metrics and reporting requirements.

The MBTA receives a pre-budget transfer of \$1.13 billion, \$88 million more than in FY 2019, and a separate appropriation of \$127 million for operating costs, along with a \$60 million from the state's capital program for infrastructure investments. This is the third year that the additional contract assistance money has been allocated between operational and capital needs.

**Table 7 – Transportation Funding, FY 2018 – FY 2020 (in millions)**

|                              | <b>FY 2018<br/>Final</b> | <b>FY 2019<br/>Current</b> | <b>FY 2020 H1</b> | <b>\$ Change</b> | <b>% Change</b> |
|------------------------------|--------------------------|----------------------------|-------------------|------------------|-----------------|
| MassDOT & Snow and Ice       | 303                      | 359                        | 390               | 31               | 8.8%            |
| Regional Transit Authorities | 80                       | 88                         | 86                | -2               | -2.3%           |
| Merit Rating Board           | 9                        | 10                         | 10                | 0                | 0.0%            |
| MBTA Appropriations          | 127                      | 127                        | 127               | 0                | 0.0%            |
| MBTA Sales Tax               | 1,007                    | 1,042                      | 1,130             | 88               | 8.4%            |

## Other non-discretionary spending

The Governor's budget assumes the costs of the Group Insurance Commission will see a modest growth of 1 percent over FY 2019; while retiree health benefit costs shows modest growth of \$9 million, or 2 percent, the same rate as last year. Debt service costs will rise approximately \$80 million,

**Table 8 – Other Non-Discretionary programs, FY 2017 – FY 2020 (in millions)**

|                            | <b>FY 2018<br/>Final</b> | <b>FY 2019<br/>Current</b> | <b>FY 2020 H1</b> | <b>\$ Change</b> | <b>% Change</b> |
|----------------------------|--------------------------|----------------------------|-------------------|------------------|-----------------|
| Debt Service               | 2,614                    | 2,663                      | 2,744             | 81               | 3.0%            |
| Retiree Health Care        | 432                      | 441                        | 450               | 9                | 2.0%            |
| Group Insurance Commission | 1,683                    | 1,709                      | 1,726             | 17               | 1.0%            |

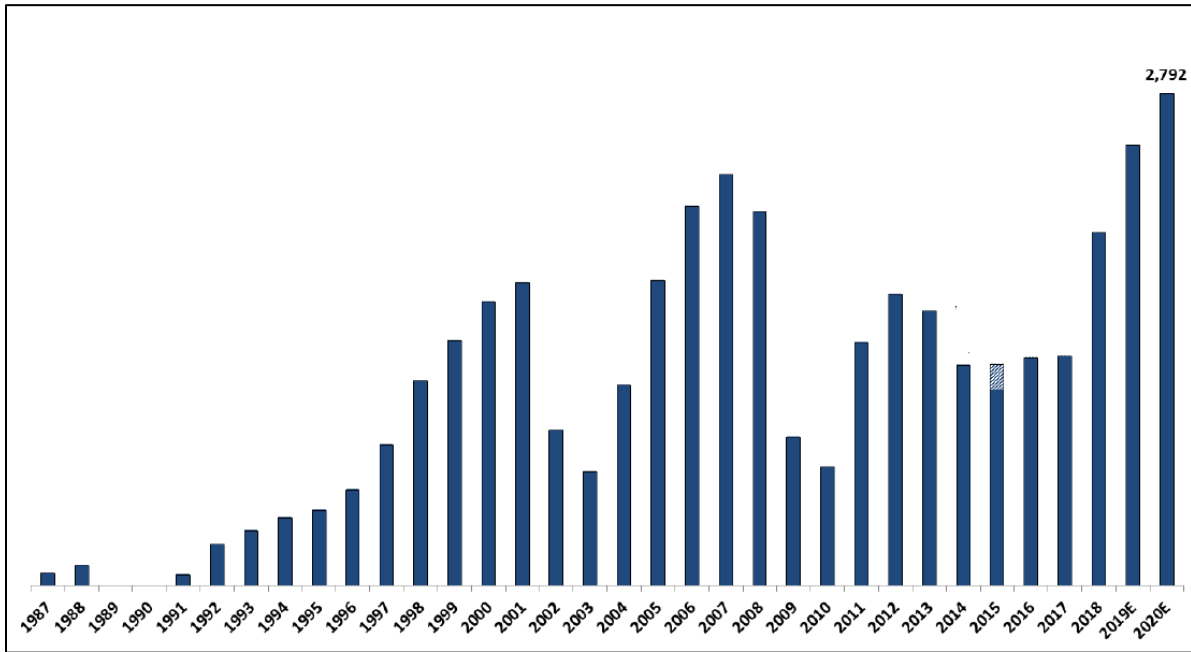
*Consolidated Net Surplus*

The Governor proposes evenly dividing up to \$20 million of any FY 2019 budget surplus between the state’s Life Sciences Investment Fund and the Community Preservation Trust Fund.

*Stabilization Fund Deposits and Balance*

According to the administration’s assumptions, the Stabilization Fund balance could approach \$2.8 billion by the end of FY 2020. This would represent approximately 6.5 percent of FY2020 budgeted spending and a remarkable achievement as the balance in FY20 would be more than double the \$1.3 billion balance in FY 2017. It is also a prudent move given the economic uncertainties surfacing in the Commonwealth, nationally and around the globe. This Stabilization Fund replenishment depends on the state collecting capital gains tax revenues of nearly \$650 million above established thresholds in FY 2019 and FY 2020, which may be a reach given recent revenue collection numbers.

**Figure 2 – Administration’s Stabilization Fund Balance Estimate for FY 2020<sup>3</sup>**



## Conclusion

Governor Baker’s FY 2020 budget is noteworthy for both its adherence to the sound budgetary practices that MTF has been championing for years and its inclusion of numerous policy changes to a degree we have not seen recently.

Several of these improvements to the Commonwealth’s fiscal health in recent years are important. First and foremost, the \$2 billion structural deficit that plagued the state in FY16 has been reduced to just \$28 million in FY2020. There is also reduced reliance on non-recurring revenues to balance the budget each year. At the same time, the balance in the state’s Stabilization Fund continues to grow and is projected to reach \$2.8 billion at the end of FY 2020. As MTF has highlighted for years, the state will be in a far better position to mitigate the impacts from the next inevitable economic downturn with a healthy balance in its reserve account.

Most importantly, the commitment to rein in MassHealth spending growth is a major achievement. By keeping gross increased spending to just 0.2 percent, again something

<sup>3</sup> Source: ANF Executive Summary, Governor Baker’s FY 2020 Budget

MTF has been advocating repeatedly, considerable resources are freed up for other spending priorities.

Finally, the Baker administration identifies and/or raises funding for the numerous new policy provisions that are included in H1. The administration's proposal to add \$200 million to Chapter 70 funding as part of its a multi-year overhaul of the school funding formula is an important commitment to improving educational outcomes and will contribute to what is expected to be a spirited debate. The Governor pays for these investments by an acceleration of sales tax payments. Similarly, H1 identifies new resources to increase funding for municipal investments in climate resilient infrastructure that is vital to addressing this growing problem, even if the source of revenues –higher deeds excise – proves to be unpopular.

In summary, there are a number of tax increases included in the Governor's budget that will meet with resistance. While reserving judgement on these proposals until we have had a chance to further study them, the alternative way to balance the budget is reducing spending in other areas to support these new priorities, or overhauling the way existing revenues are spent. In order for the Commonwealth to truly balance the budget, it must employ one of these methods, or a combination of them, to provide sufficient resources to pay for programmatic reforms or expansions, or capital investments, to continue on the path to fiscal health.