Massachusetts Taxpayers Foundation

333 Washington Street
Boston, MA 02108-5170
617-720-1000
Fax 617-720-0799

News Release

For Immediate Release January 18, 2001

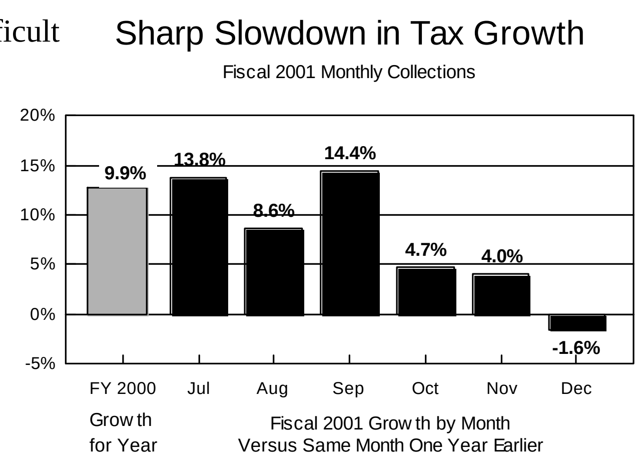
MTF Report on State Spending: The Perfect Storm

With tax collections weakening precipitously, achieving a balanced state budget for fiscal 2002 is likely to be the most difficult financial challenge in a decade, according to the annual analysis of state spending released today by the Massachusetts Taxpayers Foundation.

The report, entitled *State Budget 01: The Perfect Storm*, highlighted three major trends which are converging to dramatically change the state's fiscal landscape:

- a sharp drop in the rate of growth of tax revenues in recent months amid widespread signs of a slowing economy;
- the phasing in of the Governor's $1.2 billion income tax cut approved by the voters, as well as another $600 million of previously approved tax cuts, over the next four fiscal years;
- rapidly escalating health care costs, which account for almost one-quarter of the state's $22 billion budget, as well as other nondiscretionary items.

"The sharp decline in revenues will make it very difficult to produce a balanced budget in fiscal 2002 while funding important priorities," said MTF President Michael J. Widmer.



While the Commonwealth will almost certainly end fiscal 2001 with a moderate surplus, the outlook for 2002 and beyond is much more problematic, the report said. In sharp contrast to the fiscal plenty of recent years -- with booming revenues, generous across-the-board spending increases and huge surpluses -- the state is now facing the prospect of much tighter finances over the next several years.

According to the report, the recent abrupt slowdown in tax revenue growth has radically altered the state's fiscal outlook. Although tax receipts were up 12.5 percent in the first three months of fiscal 2001 -- continuing the remarkable double-digit pace of base revenue growth (before cuts) of the last four years -- growth slowed to 4.7 percent in October, 4.0 percent in November and actually declined 1.6 percent in December. This full quarter of much slower tax growth is clearly tied to a weakening national and state economy, spelling the end of dramatic increases in tax receipts and the likely onset of an extended period of more sluggish revenue performance.

At the same time, annual tax revenues will be reduced by $1.8 billion, or 11.5 percent, over the next four fiscal years as a result of cutting the income tax rate to 5.0 percent and other previously enacted tax reductions. In fiscal 2002, these cuts will lower state revenues by more than $700 million, including $400 million from reducing the income tax rate.

Tax Cuts Phasing in Through Fiscal 2004
Cumulative Annual Reductions in Millions

	FY 2001	FY 2002	FY 2003	FY 2004
Cut income tax to 5%	$160	$540	$960	$1,180
Charitable deduction	0	165	165	165
Prior cuts				
Capital gains tax reform	100	200	200	200
Cut income tax to 5.85%	75	75	75	75
Dependent deduction	15	70	95	95
Elderly property tax relief	10	30	50	50
Other	20	30	35	35
Total	$380	$1,110	$1,580	$1,800

Based on these revenue trends, the report concluded that spending growth will have to be seriously curtailed over the next several years. Even if revenues rebound slightly to 4.5 percent growth in the second half of this fiscal year and 2002, spending increases in 2002 would have to be limited to $600 million, or about 2.5 percent, over fiscal 2001 appropriations (including an assumed $200 million Medicaid deficiency appropriation). If revenue growth (before tax cuts) improved to a 6.0 percent rate in 2002, available spending growth would still be only $800 million, or about 3.5 percent, over 2001. Annual spending increases in recent years have been in the six to seven percent range.

Considered on their own, these sharply lower rates of spending growth would require tough choices among the state's many competing budget priorities. However, the third major fiscal trend identified in the report -- large unavoidable cost increases in health care and other nondiscretionary programs --will dramatically compound future fiscal pressures.

Based on the Foundation's analysis, the state is likely to face additional nondiscretionary costs totaling $800 million or more in 2002, including:

Fiscal 2002 Revenue / Spending Scenarios

	Base Tax Growth in 2002	
	4.5 Percent	**6.0 Percent**
2001 structural surplus	$460	$460
2002 tax growth		
Base tax growth	750	1,000
Tax cuts phasing in	-790	-800
Tax growth after cuts	-40	200
Nontax revenue growth	160	160
Total 2002 revenue increase	$580	$820
Percent of 2001 spending	2.5%	3.5%

- at least $425 million for Medicaid and employee health benefits, as the state struggles with double-digit premium increases, shaky provider finances, and significantly expanded entitlements, including expensive new prescription drug benefits;

- $150 million for the costs of supporting the Commonwealth's capital program, including debt service on capital bonds, contract assistance for projects such as Route 3 North, and capital aid to independent authorities and local governments;

- $150 million for education aid in order to sustain school spending at the levels deemed adequate under the education reform law after taking into account inflation and enrollment growth;

- $50 million for the state costs of school building construction projects that have already been authorized for 2002; and

- at least $50 million for pension funding, the costs of recent court settlements, and other unavoidable items.

It is striking that these nondiscretionary programs would consume all of the budgetary growth in 2002, exceeding the $600 million spending increase under the first revenue scenario by $200 million -- which would need to be financed with cuts in discretionary programs -- and equaling the $800 million spending increase under the second scenario.

Earlier discussions of the affordability of the Governor's tax cut were based on the assumption of slightly slower revenue growth -- to the range of eight percent, for example -- but not on the rapid deceleration seen in the last few months. The report noted that revenues could improve in the second half of fiscal 2001, putting the state back on a more manageable spending path. However, the recent change in revenue performance reaffirms the logic of the Foundation's alternative proposal to cut the income tax to 5 percent, which would have tied the pace of cuts to the rate of growth in the economy rather than a fixed three-year schedule.

The Massachusetts Taxpayers Foundation is an independent, nonprofit organization which conducts research on state and local taxes, government spending, and the economy. Founded in 1932, MTF ranks among the largest and most effective organizations of its kind in the country. The Foundation has won five prestigious national awards in as many years for its work on capital spending, business costs, management of state budget surpluses, and reform of the MBTA.

****