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After the Miracle: A History and Analysis of the Massachusetts Fiscal Crisis: Being a Drama in Five Acts, with an Implied Invitation to the Reader to Participate in the Crafting of the Final Act

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FOREWORD

This report by a quartet of Fellows of the McCormack Institute was born out of frustration...out of the same frustration that has angered the Massachusetts body politic and confounded their elected representatives. Pooling backgrounds and experience in public finance, economics and political science, this quartet has looked at the state's fiscal problem from the perspectives of economic analysis, budgetary analysis and political analysis.

Our basic purpose in this paper is not to prescribe a definitive short-term solution for the state's ills -- we are confident that this will soon be done in time enough to avoid serious cash shortfalls and continuing fiscal chaos. Neither are we so presumptuous as to believe that our suggestions for longer-term decision-making and policy changes can be implemented before a new Administration takes charge in January 1991. Our intent has simply been to lay out the background and consequences of the state's fiscal policies over the last few years, to analyze the political implications of the public's views on current economic and budgetary issues, to suggest the kind of state strategies that can assist in operating in the near term within a framework of limited state revenue growth, and to suggest that specific provisions be included in any deficit funding authorization to prevent recurrence of past fiscal mismanagement. We also support certain initiatives incorporated by the legislature in the Budget Control and Reform Act of 1989. We wish particularly to acknowledge our intensive use of Massachusetts Taxpayer Foundation publications, including the periodic forecasts from its econometric model, and extend our thanks to William Guenther, President of Massinsight, for authorizing our use of recent Massinsight polls and to Dan Breen of the State Department of Revenue for updates of state tax revenue collection data.

Finally this paper would not have seen the light of day without the prodigious efforts of Pat Mullen, Madeleine Pidgeon and Ruth Finn in preparing the manuscript and distributing the final product.

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Executive Summary

"After the Miracle" documents the factors that have shaped the recent political debate in Massachusetts and are likely to determine continuing economic and fiscal conditions in Massachusetts in the near future. The paper indicates that 1990 may begin a decade of real limits for Massachusetts. The economy has stagnated and the next two years will be a period of deep economic uncertainty. It is also clear that a resurgence, like that of the boom period of the eighties, is unlikely to be replicated.

The 1980's was a period when state-local spending in Massachusetts, propelled by the infusion of double-digit tax revenue yields, increased by about 72% (from $10.8 billion to $18.6 billion), an average rise of 9% each year. State spending excluding direct local aid distributions between the 1981 and 1989 fiscal years increased from $4.8 billion to $9.6 billion, or by over 12% on average per year. As a result, the state share of state-local spending increased from 45% to 52% of the total. By contrast, spending by cities and towns climbed by only 50% (from $6 billion to $9 billion) during this same period, or by 6% on average per year.

The study shows that currently eight major cost centers dominate the state's spending priorities. They are like giant termites, eating away at a revenue stream with limited growth potential. If their total allocation over the current fiscal year had not been essentially level-funded (on the basis of proposed major policy and program changes), they would have added more than one billion dollars to the Governor's recommended budget for the 1991 fiscal year. Even as submitted, the $8.039 billion in budgetary requests for seven major cost centers, excluding pensions, is $2.0 billion over actual expenditures for these same purposes just four years ago, a jump of over 34%. The major cost centers account for 68% of the Governor's entire budget submission for next year as compared with 62% of total spending in the 1989 fiscal year. Estimated spending for all purposes other than the major cost centers, on the other hand, will be about 13% below actual expenditures for these same purposes two years ago.

Some of the specific conclusions of the study are:

1. On the so-called statutory or budgetary accounting basis, the state ended the 1989 fiscal year with a deficit of $466 million and a cash shortfall of $305 million; for fiscal 1990, the deficit is currently estimated at $1 billion and the cash shortfall at between $800 and $900 million. In the 1987 and 1988 fiscal years the state was able to avert budgetary deficits only by dipping into and finally exhausting prior-year balances and available reserves. Clearly the Commonwealth of Massachusetts has failed to live within its means over the past few years.
2. However, if the condition of the state's finances is measured according to generally-accepted accounting principles (GAAP), which is a modified accrual basis of accounting defined by the Government Accounting Standards Board, the State Comptroller reports a more grim picture. On a GAAP basis (excluding capital project funds), the real deficit for the most recently-audited fiscal year of 1989 has shot above the billion-dollar mark.
3. Although debates over the root causes of the state's fiscal crisis may be likened to "chicken-and-egg" controversies, what is factually certain is that state spending (exclusive of direct local aid distributions) doubled during the eighties, reflecting extraordinary expansion of state programs and expenses, and despite the warnings of independent observers that double-digit revenue expansion had come to an abrupt halt by mid-1988.

4. The public's general attitudes toward state taxes, spending, waste and inefficiency have maintained a remarkable constancy over the past three decades as indicated in periodic polls that reveal an angry citizenry, filled with mistrust and deeply concerned about the state's economic, fiscal and service problems.

Recommendations

Even if all tax and/or spending ballot petitions fail in November 1990, the Commonwealth of Massachusetts faces in the near term at least the necessity for operating within a framework of very limited growth in resources. This means that every available strategy must be aimed at:

1. Reviewing and updating all state agency and institutional missions to reflect current realities on state revenues.
2. Re-ordering state priorities through a comprehensive evaluation process that clearly separates needs from desires, and subjects every spending item to the criteria of state affordability, costs versus benefits, and other relevant measures of effectiveness and efficiency.
3. Instituting, where applicable, an organizational and programmatic sunset policy.
4. Restructuring, reorganization and system changes that will improve control and containment of operating costs, and strengthen the state's financial planning and management capacities.
5. Restoring aborted state efforts in long-range economic, physical and social planning by re-establishing and institutionalizing a Governor's Office of Strategic Planning through appropriate legislation.
6. Instituting a moratorium on new policy initiatives and program expansions that will remain in effect until the Commonwealth's annual state revenue collections exceed the state's consumer price index.

7. Assuring that any deficit funding bill to cover the 1990 budgetary shortfall should contain specific provisions to prevent recurrence of the fiscal mismanagement of the past four years, including:
   a) A requirement that the Governor's annual budget (House No.1) and the appropriation recommendations of the Ways and Means Committees provide data on operating results of the past three fiscal years on the so-called GAAP basis.
   b) A requirement that House No. 1, the Governor's proposed budget, include spending and revenue estimates for two years beyond the year to which the budget applies, including a statement of the assumptions underlying such estimates so that the legislature and public will be advised of the estimated out-year cost implications of budget proposals.
   c) New controls on the use of continuing appropriations.
   d) Restrictions on borrowing for current operations and maintenance expenses and on use of available bond funds for current purposes.
8. Restricting the use of non-recurring, one-shot revenues for budget balancing, practices that cover up deficits that subsequently become more and more difficult to resolve and are symptoms of the state's inability to deal with persistent budget problems. Such questionable practices include:
   a) Withdrawals of cash from reserves such as the state's pension reserve funds.
   b) Changing payment schedules to defer the payment of bills until next year.
   c) Refinancing bond issues to free up cash reserves required by the current term of the original bonds.
   d) Accelerating tax payments by changing filing rules to require larger initial payment.
   e) Diverting unemployment insurance funds to re-employment and job placement programs.

f) Diverting Lottery Fund receipts to state purposes.

g) Using the proceeds from asset sales for current operating purposes.

9. Instituting fiscal planning and management reforms recommended in the Report of the Governor's Task Force on Fiscal Management including:

   a) Reorganization of the Administration and Finance Secretariat into four major functions reporting directly to the Secretary and with the State Comptroller included in the core financial group as part of an intensive effort to strengthen financial operations, institute more effective priority-setting, and expedite cost forecasting and expense control.

   b) Establishment of a joint executive-legislative revenue forecasting mechanism with an adequate professionally-trained, experienced staff.

   c) Rebuilding the state's depleted Stabilization Fund and adopting prudent criteria for drawing on Fund balances.

   d) Reorganization of the state's badly-dispersed responsibilities for health care into a consolidated health care agency that can focus on health care strategies, their financing and implementation and that would manage state-owned health facilities and the state's rate-setting role.

INTRODUCTION

THE ECONOMIC BACKGROUND

The Massachusetts Miracle: Boom Period, 1980-87. The unusually strong growth that the Massachusetts economy experienced from 1980-87, evidenced by low unemployment and high personal income, resulted from both a fortuitous series of favorable events and the historical development of the New England region, which provided the economy with a unique opportunity for expansion. The initial impetus came from the federal military buildup, beginning in the late 1970s, and accelerating through the first half of the 1980s. During this period, orders for defense goods tripled, and Massachusetts received more than double the national average of prime contracts awarded by the U.S. Department of Defense. At the same time, the demand for minicomputers accelerated, benefiting the computer companies in this region that had a dominant position in the market.

As the surge in the computer and defense industries was slowing, the financial services segment of the state economy began its own boom. The stock and bond bull markets, financial product innovation, and deregulation of the financial markets all combined to create an enormous increase in the demand for financial services. Growth in medical services and in research and development and large increases in revenue flowing into the colleges and universities also bolstered the region's economy.

In 1980, for example, the office vacancy rate in the Greater Boston area was just 1.0%. Throughout the 1970s little new private construction had occurred because of the generally weak economic environment. However, the expansions in the defense, computer, financial services, medical services, and education industries all combined to generate an enormous demand for office space, resulting in an unprecedented construction boom.

The Way We Were: Remember the Seventies. During the 1970s employment growth in Massachusetts was substantially slower than the average growth for the United States. From the first quarter of 1970 to the fourth quarter of 1979, nonagricultural employment in the United States increased by 27.0%; in Massachusetts, by 19.1%. As a result of this relatively slower rise in employment and a higher unemployment rate than in the nation, average wage rates in Massachusetts were below those of the other industrialized regions of the nation.

The unemployment rate in Massachusetts in 1975 was 11.2% on average compared with the national average rate of 8.3%. Moreover, from 1971-77 the average unemployment rate in Massachusetts was 1.25 percentage points higher than the national rate. This relatively high unemployment in Massachusetts had a clear impact on keeping wages below national averages.

In the early 1970s, average hourly earnings in the manufacturing sector were about 5.0% lower in Massachusetts than for the nation as a whole. By 1975 manufacturing wages were 7.5% lower, and by 1980 they were about 10.0% lower. Currently, this measure of wages is about 3.0% higher in the state than on a national basis.

As a result of the forces described herein, employment in Massachusetts grew more rapidly during most of the 1980s. The unemployment rate dropped well below the national average and below the commonly accepted level of full employment. As a consequence, wage rates in Massachusetts increased faster than comparable national figures. The average wage rate in Massachusetts is now above the national average.

The Miracle Subsides: Post-Boom Period, 1988-.

Economic growth has cooled off considerably since 1988. The downturn has shown up particularly in construction, real estate, financial and manufacturing sectors.

Since the Massachusetts and the New England economies have a number of locational and cost disadvantages relative to other regions of the United States, other special and positive factors are required if the Massachusetts economy is to match national growth rates. With the strength of many of the forces that propelled the Massachusetts economy during the boom period subsiding, the concern now is whether the region's economy will slip back into the sub-par growth track that persisted through the 1970s.

Unemployment is on the rise. In 1989 employment in Massachusetts declined for the first time in 7 years due mainly to a 10.1% decrease in construction employment. Moreover, in February, 1990, the state's unemployment rate rose to 5.3%, equal to the national average for the first time since August, 1981. Increasing unemployment claims have also significantly reduced the balances in the unemployment compensation trust fund.

Recent trends in personal income substantiate the prediction of a slowdown economy. Massachusetts personal income during the 3rd quarter of 1989 increased by 7.8% over the comparable period in 1988. This was below the average U.S. increase of 8.7% and tied Massachusetts with Rhode Island as the poorest income performer among the New England states.

It now appears that the Massachusetts economy will grow slightly more slowly than the national economy in 1990. However, there are enough positive factors at work in the Massachusetts economy to stimulate growth in 1991 and beyond at a rate that at least matches the national average growth rate. The decline in the dollar's exchange rate should continue to aid the export-oriented Massachusetts economy. The computer software industry and the medical service and research industries, with their unique propensity for creativity and adaptability, should continue to expand. Finally, the decline in defense spending, particularly for high technology weapons, should be more gradual during the 1990s than it was in the 1970s. (See Appendix for details on the most recent Massachusetts economic forecast.)

THE FISCAL BACKGROUND

Overview of State/Local Finances. Between the 1981 and 1989 fiscal years, state-local spending in Massachusetts, propelled by the infusion of double-digit tax revenue yields, increased by about 72% (from $10.8 billion to $18.6 billion), an average rise of 9% each year. During this period, however, there was a significant shift in both the proportions of total spending and rates of spending as between the Commonwealth and its municipal subdivisions. If spending is measured by where the money is spent and the service provided, state spending excluding direct local aid distributions doubled between the 1981 and 1989 fiscal years (from $4.8 billion to $9.6 billion), or by over 12% on average per year. As a result, the state share of state-local spending increased from 45% to 52% of the total. Even after adjusting for inflation, the "real" increase in state spending amounted to 35%.

By contrast, spending by cities and towns climbed by only 50% (from $6 billion to $9 billion) during this same period, or by 6% on average per year, and the local segment of total state-local spending declined from 55% of the total to 48%. These trends clearly indicate the extraordinary expansion of programs, services and expenditures at the state level as compared with the relatively modest rise in spending by cities and towns.

The lion's share of state-local revenues and receipts ($8.8 billion or 47% of the total) is raised from a variety of state-levied taxes, mainly broad-based taxes on income (23% of the total), sales (11%) and businesses (over 4%); about $4 billion, or roughly 22% of the total, is raised from taxes levied by cities and towns on property; another 10% is in the form of federal assistance; and the remaining 20% comes from state and local fees, service charges and other forms of nontax revenue in addition to limited yields from selectively authorized locally-levied excise taxes.

Over the past 9 years (FY81-90), state tax revenues, fueled by unprecedented economic growth and aggressive collection of delinquent taxes, will have increased by an estimated 121%, from $4.2 billion to $9.3 billion, an average of 13% a year.

(Table 1) The rate of increase in local property tax revenues during this same period, on the other hand, slowed down appreciably, from $3.3 billion in the 1981 fiscal year to an estimated $4.2 billion in the 1990 fiscal year, indicating an increase of only 27%, or an average of 3% a year. This resulted from property tax limitation endorsed by the voters in November 1980 and enacted the following year, and expanded local aid distributions from a booming state economy that produced unprecedented collections of broadly-based state taxes.

The most dramatic change in revenues, however, has been in the broad state area of departmental receipts and nontax revenues (fees, fines, assessments, interest earnings, licenses and permits, etc.) that either go into the state treasury or are retained by agencies and spent without appropriation, plus such legally restricted revenues as state lottery proceeds, that are distributed without appropriation to cities and towns. These revenues and receipts have skyrocketed to an estimated $1.5 billion in the 1991 fiscal year (12% of total state revenues and double the proportion of state revenues in the 1981 fiscal year).

A major stimulus for the dramatic increase in nontax revenues at the state level has come from the realization that Massachusetts has lagged behind other states in cultivating nontax revenue opportunities and from expanded legislative authorization for agency retention without appropriation of nontax revenues that they generate for their own spending, thereby providing greater incentives for revenue-raising creativity.

Moreover, there have been parallel initiatives at the municipal level to bring fees and service charges more into line with rising costs, efforts that have raised the proportion of local revenues from such locally-raised receipts from 3.8% of all local revenues in the 1981 fiscal year to about 16% of the total in 1990.

TABLE 1

STATE TAX REVENUES

FY 1985-1991

(in millions of dollars)

	Actual					Estimated		% Change
	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91	FY 85-91
Income	$3,159.0	$3,628.5	$3,995.6	$3,984.7	$4,286.7	$4,985.8	$4,800.0*	+51.9
Sales	1,438.5	1,710.2	1,865.8	2,021.1	2,084.0	1,990.0	2,100.0	+46.0
Business Corp.	667.4	802.6	814.1	771.8	887.1	865.0	820.0	+22.9
Motor Fuels	283.1	288.6	297.4	305.5	306.9	308.0	310.0	+ 9.5
Cigarettes	174.8	173.3	170.6	168.5	158.6	153.0	140.0	-19.9
Insurance	163.7	191.8	220.6	241.2	301.6**	317.5**	275.0	+68.0
Estate & Inheritance	153.6	210.7	223.1	254.7	258.6	255.0	280.0	+82.3
Banks	138.3	193.4	229.1	219.1	223.5	170.0	200.0	+44.6
Alcoholic Beverages	83.2	80.3	80.3	78.0	75.8	72.0	73.0	-12.3
All Other	150.7	208.9	205.7	230.4	233.9	204.5	220.5	+46.3
Totals	$6,412.3	$7,488.3	$8,102.3	$8,275.0	$8,816.7	$9,320.8	$9,220.0	+43.8%
% Change Over Prior Yr.	-	+16.8%	+ 8.2%	+ 2.1%	+ 6.5%	+ 5.7%	- 1.1%	

Source: State Department of Revenue.

* Includes $445.8 million estimated from temporary income tax increase of 15% dedicated to funding prior year deficit and medicaid payments.

** Including fees collected by Division of Insurance related to high-risk insurance, first classified as taxes in FY 1988.

The present paper -- a detailed analysis of the decline and fall of the Commonweath's fiscal condition -- is staged in five acts: Act 1, describing major events in coping with an unanticipated revenue deficit in the 1988 fiscal year and the unfortunate budgetary consequences of over-optimistic revenue predictions for fiscal 1989; Act 2, examining in considerable detail the disastrous effects during the 1990 fiscal year of continuing Administration denial that state spending was not at the heart of the fiscal problems and of the risky assumption that state revenue collections would rebound; Act 3, probing the new realities of the proposed budget for the 1991 fiscal year and of the political stalemate that seems to defy resolution of the current year's budget gap, and the validity of revenue estimates for fiscal 1991 in light of continuing state tax collection erosion; Act 4, describing major initiative petitions that may be on the ballot in November 1990 and the potential fiscal impact if they are approved by a voter majority; and Act 5, conclusions and recommendations, as yet unfinished.

ACT 1: DETERIORATING STATE FINANCES

The current fiscal year of 1990 will mark the fourth straight year that the Commonwealth has annually spent more than it has received in current revenues and coincides with an end of the "Massachusetts Miracle". From small budgetary surpluses in the 1987 and 1988 fiscal years, due mainly to the use of available prior year fund balances, the excess of annual spending over available revenues escalated to over $400 million in fiscal 1989 and a cash shortfall of $305 million, while the budgetary deficit for the current fiscal year (as of May 5, 1990) is now estimated at $1 billion. The Secretary of Administration and Finance recently estimated a cash shortfall as of June 30, 1990 of between $800 and $900 million.

Scene 1: Let the Good Times Roll, FY88. The fiscal crisis took dramatic shape during the 1988 fiscal year when actual tax revenue collections were about $360 million below original estimates, indicating revenue growth of only 2.1% over tax revenues of the prior year. This extraordinary revenue deficit, which occurred in the final quarter of the fiscal year, was due mainly to lower than anticipated income taxes and corporate taxes. Disappointing yields of income taxes were caused by accelerated taxpayer sales of stocks and properties to avoid paying higher federal capital gains taxes, a phenomenon that affected the 1987 fiscal year positively and the 1988 fiscal year negatively, while corporate tax collections fell below estimates because of changes in the federal tax code, conversions of large businesses to so-called Subchapter S status (this reduced revenues by about $45 million), and the avoidance of state corporate taxes by offsetting profits made in Massachusetts with losses incurred elsewhere because of an Appellate Tax Board ruling that upheld a provision of Massachusetts law, a ruling that was confirmed by the Supreme Judicial Court. This resulted in substantial corporate tax refunds.

To balance the budget for the 1988 fiscal year, the Governor and Legislature were forced to liquidate an estimated $575 million of reserves set aside in continuing appropriation accounts for planned authorized spending, to increase nontax revenues substantially, to resort to an assortment of interfund transfers, and to make extensive use of borrowed funds for current operating purposes, a dubious fiscal practice, all to the tune of over $450 million, as documented below:

(1) Legislative shifting of $185 million from current appropriations to bond financing for the repair of state buildings, highway construction and reconstruction grants to cities and towns;

(2) Increasing nontax revenues by $99 million through aggressive pursuit of available federal reimbursements and accelerated payment of debts owed the Commonwealth, and by applying $45 million of federal highway reimbursements to operating rather than capital expenses;

(3) Reducing proposed spending by $97 million, over half of which came from additional accounts payable reversions;

(4) Eliminating $32 million in continuing appropriations from the 1988 fiscal year that would otherwise have been spent in fiscal 1989;

(5) Transferring $27 million from surplus appropriations that were to have been deposited in the state's pension reserve to appropriations for non-pension purposes;

(6) Using $12 million from unexpended bond proceeds for current operations;

(7) Appropriating about $6 million from the state's Special Revenue Funds instead of from the General Fund.

As a result of the above actions, which were considered non-recurring events, the Commonwealth ended the 1988 fiscal year under the so-called statutory or budgetary accounting basis[1] with a slight operating surplus of just over $78 million

[1]Under this basis of accounting, tax receipts and departmental revenue are recorded on a cash basis, but federal reimbursements receivable on expenditures already made are handled on a limited revenue accrual basis, while expenditures are recorded on a cash basis except that encumbrances on expiring and continuing appropriations are included in expenditures as are outstanding advances at end of the year to state agencies.

in its three major operating funds. Under the so-called GAAP basis of accounting[2], however, the Commonwealth ended the 1988 fiscal year with an operating deficit of $885.4 million in all governmental funds of the Commonwealth, excluding fiduciary accounts and enterprise funds. Moreover, after exhausting over $575 million in reserves for continuing appropriations (carrying forward such huge appropriation amounts is hardly considered sound fiscal policy), only $3.8 million was left as the undesignated surplus balance at the beginning of the 1990 fiscal year.

Scene 2: Ominous Warnings, FY89. The Commonwealth's fiscal condition worsened during the subsequent 1989 fiscal year despite the complete liquidation of the state's "rainy-day" Stabilization Fund and despite some tax growth recovery in which tax revenues increased by a more normal 6.5% over the prior year. Under the statutory basis of accounting, the state ended the fiscal year 1989 with a staggering deficit of $466 million.

This operating deficit was due mainly to the fact that total expenditures of $12.171 billion in fiscal 1989, including net spending of continuing (prior year) appropriations, authorized off-budget spending of retained revenues and Lottery Fund distributions to cities and towns, were based on highly dubious revenue projections, despite warnings by the Massachusetts Taxpayer Foundation and several legislators over the growing spending-revenue gap.

At the core of the 1989 fiscal year problem was the original prediction that total revenue would grow by about $600 million over the 1988 fiscal year. The factors affecting tax revenues in the prior year were primarily not related to the economy and were not expected to recur. Therefore tax revenue forecasters counted on the continuing strength of the economy. When slower economic growth clearly indicated lower than expected tax revenues during the 1989 fiscal year, state officials were forced to reduce their original estimates by $402 million, from a total

[2]GAAP is a modified accrual system used for all revenues and expenses and defined by standards issued by the Governmental Accounting Standards Board.

of $9.172 billion to $8.769 billion, the final reduction being made on May 10, 1989, with most of the spending year completed. Actual tax revenue collections of $8.849 billion for the 1989 fiscal year were slightly above the revised total estimate, but $323 million below original tax revenue estimates. Collections of the state's sales taxes on general sales, meals and motor vehicles were a disappointing $218 million below their original estimates, while income tax collections were $185 million under budget predictions.

It should also be noted that the Commonwealth launched a series of tax-related initiatives, including several one-shot revenue approaches, to help bridge the growing gap between revenues and expenses:

(1) Authorizing 481 additional positions in the State Department of Revenue to strengthen that agency's tax collection enforcement capacity;

(2) Legislation improving the linkages between the state's personal income tax laws and the federal tax code and eliminating the sales tax exemption for cigarette sales;

(3) Legislation dealing with factors responsible for lower-than-estimated corporate excise taxes in the prior year;

(4) Executive action diverting the entire balance of over $112 million in the state's Stabilization Fund to ease the impending revenue shortfall;

(5) Legislation approving administrative initiatives for tax revenue enhancement; allocating part of a scheduled increase in state unemployment taxes to a reemployment/job placement fund; and changing the filing rules for estimated corporate tax payments so that larger initial payments would be required.

One of the unanticipated consequences of the sizable year-end operating deficit in the 1989 fiscal year was an unprecedented cash flow crisis. This forced the State Treasurer to defer until early July the payments for certain expenditures, including a payment of $305 million in local Chapter 70 education aid due on June

30th of the prior fiscal year. To expedite payment of deferred 1989 bills and provide sufficient operating cash for temporary expense needs, the State Treasurer issued $1.1 billion in short-term notes. Moreover, to cover the operating deficit of the prior year, the Legislature authorized the issuance of deficit funding notes to a total of $475 million, the proceeds of which could be used for a period not exceeding one year. The notes were repayable by January 31, 1991.

In addition, with the revelation that the Commonwealth had an extraordinary accumulation of unpaid bills for Medicaid, mainly to nursing homes and hospitals, the Legislature also authorized borrowings and direct expenditures up to $488 million in general obligation notes to cover payments for Medicaid services provided in the years before the 1990 fiscal year: to settle bills for the 1985-88 fiscal years with nursing homes and hospitals, including retroactive rate adjustments; and for Medicaid payments to be made in fiscal 1989.

To meet the debt service requirements on both the deficit funding notes and the Medicaid-related notes and to finance an estimated $72 million in direct Medicaid expenditures, the Legislature imposed additional taxes on certain types of personal income (mainly salaries and wages) by raising the tax rates on these income categories from 5% to 5.375% for the 1989 tax year and from 5% to 5.75% for the 1990 tax year. The net effect of this revenue measure was a 15% additional tax increase on applicable income for an 18-month period ending on December 31, 1990. Two trust funds were set up to receive the dedicated proceeds of these additional income taxes and of investment earnings thereon from which debt service is being paid on the deficit funding bonds and the Medicaid-related notes.

Despite the legislative debate over borrowing to cover both an operating deficit and an accumulation of unpaid bills for Medicaid and over the income tax bill of 15%, the expectations were that the state's fiscal problem would constitute a brief one-act play.

ACT 2: ALICE IN BUDGET LAND, FY90

Scene 1: House No. 1 -- Continuing Denial, Waning Optimism. When the Governor announced in his State of the State Address (January 5, 1989): "Some say that we have this problem because we're spending too much. That's baloney.", most of the audience of legislators and invited guests broke out into great applause.

He was stubbornly insisting that spending was not the problem and soon reconfirmed this belief in his spending proposals and revenue predictions for the 1990 fiscal year (House No. 1). His budget requests had all the earmarks of "Alice in Budget Land". Apparently disregarding the continuing slowdown in the state's economy and the spiraling costs of several fixed charges and "budget busters," the Governor submitted a spending program for FY1990 amounting to $13.5 billion, which called for new taxes amounting to $604 million and bore the ironic catch-phrase, "Meeting the Challenge". This budget was based on projected tax revenue growth of over $650 million, or 7.4% above the prior year.

Faced thereafter with heightened concern over the fact that actual tax receipts were lagging substantially behind original estimates and that actual revenues could not sustain the state's record-breaking spending proposals, the Legislature and Governor entered into a "cat and mouse" game of vetoes, withholdings of expenditures and allotments, and unsuccessful tax proposals, behavior that has dominated the state's political dialogue over the past nine months. Although the current debate over state fiscal issues is more muted and somewhat less acrimonious, a budget/tax consensus continues to elude the legislative leadership.

Scene 2: Political Pingpong. The first climax in the fiscal scenario for the current year was the Legislature's passage of the annual appropriations act of FY1990 on July 13, 1989, providing a total spending program of $12.3 billion. Legislative action reflected resistance to propsed spending increases and additional tax proposals. By July 1989, it was clear that the revenue estimates used by the Legislature in crafting this fiscal 1990 budget were overly optimistic. As a result, arguing that this legislatively-enacted spending program for FY1990 had under-funded several critical budget components while overestimating tax receipts, the Governor reduced authorized spending by about $490 million, vetoing about $273 million in appropriations (including $100 million for local aid), vetoing budgetary language that reduced alleged under-funding by $25 million and indicated his withholding of another $192 million of appropriations, including an additional $110 million for local aid.

Subsequently, when the Legislature overrode the Governor's veto of the $100 million of local aid, the Governor retaliated by also withholding the allotment expenditure for this $100 million of local aid. The net result of these actions was that by August, 1989, appropriations for the 1990 fiscal year had been cut back to $12.127 billion, taking into account the $309 million in allotment expenditure withheld by the Governor.

By November 1989, however, based on preliminary estimates of the State Comptroller, the Massachusetts Taxpayers Foundation had raised the estimated total of authorized spending for the 1990 fiscal year to $12.7 billion, indicating a spending rate in excess of appropriations and had projected a year-end operating deficit of over $600 million.

Major factors explaining a higher predicted rate of spending than authorized in the annual appropriations act included: (1) authorization of certain prior-year appropriations for continuing use, (2) expanded utilization of off-budget spending of agency-retained revenues, (3) substantial Lottery Fund distributions to cities and towns. By November 1989, it was estimated that over $400 million would be required in additional appropriations for the 1990 fiscal year, over half of which would go for Medicaid ($173 million) and for group insurance ($70 million).

In November 1989, the Executive Office for Administration and Finance (EOAF), conceding that spending was running about $808 million above authorizations, revised its expenditure estimates for the 1990 fiscal year to a total of

$12.763 billion, including an estimated $416 million in expenditures from the Medical Assistance Liability Fund. If expenses financed from the temporary income tax increase were excluded, the new spending total was $12.347 billion.

Uncertainty over how much would be spent in the 1990 fiscal year soon spilled over to the revenue side of the budget. Excluding the Governor's tax proposals to cover an estimated budget gap of $800 million, the original revenue estimates accompanying the proposed spending programs for FY1990 totalled $12.901 billion, including an estimated $9.520 billion in tax revenues. Tax growth had been forecast at 7.4%, an estimate that would have exceeded even the prior-year prediction.

A series of downward revisions in revenue estimates was initiated by EOAF as an emergency response to the rapid erosion in state tax collections. These adjustments reduced initial revenue estimates by $565 million or to $12.136 billion -- a $170 million reduction on August 15th and a further reduction on November 6th, when EOAF adopted downward estimates of the Revenue Advisory Board (RAB). RAB's most recent advisory had lowered its prior revenue estimates by another $220 million, indicating that 1990 tax receipts would increase by only $58 million, or by a meager 0.7% over the prior year. EOAF made one further adjustment in spending, lowering its earlier estimate as to the amount of additional appropriations that would be required -- from $423 million down to $326 million. By the end of November, 1989, there seems to have been a general consensus that if the November 6th revenue estimates were met and $309 million of appropriations through withholding allotment would not be spent, the Commonwealth faced a budgetary shortfall for the 1990 fiscal year of $721 million.

To deal with the extraordinary gap between estimated revenues and expenditures in FY1990, the Governor on October 12, 1989 submitted a legislative package designed to produce a net increase of $123.3 million in FY90 revenues and an increase in budgetary savings of $10.8 million, for a total of $134.1 million. The Governor also reiterated his support for tax initiatives he had filed in January 1989 and added several new revenue-enhancement proposals to cover the budgetary shortfall. These included the use of $40 million in state higher education trust funds (accumulated largely from student fees) and $46 million from state recovery of part of unclaimed bottle deposits. Moreover, the Governor cut further into authorized spending for FY1990 by withholding additional allotments totalling $153.6 million, reflecting an estimated across-the-board reduction of 5% in discretionary spending by state agencies under executive jurisdiction, including human service program cuts of $72 million and higher education cuts of $26 million.

In the wake of the downward revenue estimate revisions by the Revenue Advisory Board early in November 1989, the House Ways and Means Committee reported out a modified version of the Governor's legislative package totalling $401.1 million that was designed to reduce spending by about $150 million and achieve savings by policy changes and reorganizations and by raising additional nontax revenues, but resisting efforts to raise taxes. Among the major spending cuts were 5% reductions in most state agencies, including the judiciary and higher education. The principal cost-saving and nontax revenue measures included reductions reflecting Medicaid restructuring, capping emergency welfare assistance, higher business payments for health insurance, revenues from unclaimed bottle deposits, higher tuition for out-of-state university students, new Registry of Motor Vehicle fees and tapping college trust funds for certain expenses of higher education employees.

<u>Scene 3: Waiting for Godot.</u> Final legislative action on state appropriations for FY1990 was taken by the Legislature on December 28th and signed by the Governor as the Budget Control and Reform Act of 1989 (Chapter 653) on January 4, 1990, six months after the fiscal year had begun. After selective item vetoes and budgetary language disapprovals by the Governor, this belated legislation left the Commonwealth with an unresolved budgetary shortfall originally estimated at $504 million.

Several efforts to close part or all of the gap with additional taxes in the House of Representatives during the December 1989 - January 1990 period failed to win majority support. Hope that the state's tax revenue trends might turn around, thereby easing the current crisis, continues to wane as the state economy shows few signs of re-ignition. Actual collection of state taxes over the first nine months of the 1990 fiscal year (through March 1990) are 1.8% lower than for the same period in the prior year. On April 9, 1990, the Governor's Revenue Advisory Board, whose revised estimate had been that tax collections would increase by 0.7% over the prior year, revised its estimate by projecting a decline of 1.9% for FY1990 over FY1989. Corporate income tax revenues fell by over $113 million or by 17% during the first nine months of the 1990 fiscal year over the same period in the prior year because of lower corporate earnings. Although personal income tax collections during the first three-quarters of FY1990 were up by 5.4% over the same period in FY1989, sales tax revenues by contrast, were down by 5%. (See following table)

MASS. TAX REVENUE COLLECTIONS
July 1988-March 1989 vs July 1989-March 1990
(000's of dollars)

Tax Revenue Source	First 9 Months FY1989	First 9 Months, FY1990	% Change
Income	$ 2,891,024	$ 3,047,158	+ 5.4%
Sales	1,551,028	1,473,387	- 5.0
Corporate Business	677,679	564,349	-17.0
All Other	1,097,011	1,017,001	- 7.3
Total	$ 6,216,742	$ 6,101,895	- 1.8%

Source: State Department of Revenue.

Two-thirds of the current fiscal year have passed and the issue of resolving the budget shortfall of $1 billion is back in the hands of the House Committee on Ways and Means. One trial balloon floated by the Governor, to cover the shortfall by reducing the Chapter 70 school aid payment due to cities and towns on June 30th by $500 million, seems to have been deflated by the subsequent discovery that this move would have extraordinarily uneven impacts on municipalities, especially cities and towns whose shares of local aid come largely from Chapter 70. It should also be noted that the huge municipal revenue deficit for FY90 that would result from such action would have to be made up by cities and towns in the 1991 fiscal year, thereby doubling their municipal revenue shortfall to $1 billion.

This would not only have had devastating results for next year's municipal budgets but would fly in the face of the fact that cities and towns had taken extraordinary steps to offset large unanticipated losses of local aid -- virtually using up all available free cash reserves built up over the last three or four years, cutting more deeply into proposed spending and adopting local revenue enhancement measures to cover the $233 million in local aid shortfalls they had sustained through gubernatorial vetoes and withholdings in the 1990 fiscal year after they had determined their local spending programs and after the fiscal year had begun.

Particularly disturbing, however, is the conclusion of a recent analysis of projected municipal revenues and expenditures for the current 1990 fiscal year by the State Division of Local Services. This identifies the estimated budgetary gaps or revenues in excess of estimated spending and calculates these gaps or excesses as percentages of the prior year (FY89) budgets for 341 of the state's 351 cities and towns. Although almost all of them will have achieved balanced budgets this year as required by law through a combination of local revenue increases, spending reductions and heavy use of free cash and other reserves, the analysis found that municipal budgets are burdened with a structural budgetary gap of almost $400 million, equivalent to 4.5% of their total spending, and that this gap "is likely to persist and grow in future years without a change in the way local government is financed."[3]

Whether the Legislature will resolve the current fiscal impasse with deficit borrowing, further budget reductions, additional permanent or temporary taxes, or a combination thereof, remains to be seen. What should not be overlooked in the search for alternative remedies is that the temporary income tax increase of 15%

[3]City and Town, vol. 3, No. 4 (Dec. 1989), monthly publication of State Division of Local Services. Of the 341 cities and towns examined, 311 or over 90% of the total showed projected gaps of spending in excess of revenues. Of this latter group, 108 had gaps estimated at 6% or above their prior year budgets.

expires on December 31, 1990. Extending its imposition for one year would yield about $600 million, a substantial proportion of the amount needed to fund the 1990 deficit. Temporary borrowing to cover the budget deficit might also be paid back over a longer period, i.e., 5 years, thereby providing the breathing spell required for tax revenue growth to return to normal.

ACT 3: FISCAL REALITY AND POLITICAL PARALYSIS

Scene 1: A "Disgrace" or "Fundamental Reform". House No. 1, the Governor's proposed budget for the next fiscal year, was a curious contradiction of deeply-felt personal anger and re-awakened fiscal reality. Deeming his submitted budget "a disgrace which will do incalculable harm not only to the most vulnerable among us, but also to the ability of our cities and towns to educate our children, to protect public safety and to maintain safe streets and roads," the Governor's message admits "that a fundamental reform of our most expensive obligations is necessary" and indicates that his budget "restructures and streamlines state government and brings under control the fixed costs which have driven up spending so rapidly in the past five years."

Although the specific proposals for restructuring and streamlining are limited by and large to the consolidation of police forces at the state level, the closing or consolidation of several state facilities (mainly hospitals), the elimination of some branch offices in every state agency and reorganization of the Executive Office itself, the budget message urges that the budget process applied to the 1991 spending program "should become a permanent part of state budget making" in which all state spending, service by service, program by program, department by department" is "examined and ranked." Most important, perhaps, is the acknowledgement in the budget message that this budget "used as its focus for decision-making the fiscal limit of currently authorized revenue."

According to Table 2, the Governor's total spending program for the 1991 fiscal year amounts to $12.888 billion, of which $12.103 billion represents recommended appropriations, $498 million consists of off-budget spending of retained revenues and other restricted revenues, and $306 million is in lottery fund

TABLE 2

EXPENDITURES FOR MAJOR COST CENTERS AND "BUDGET BUSTERS"

FY 1987-1991
(in millions)

	Actual			Estimated		% Change
	1987	1988	1989	1990	1991	1987-91
Local Aid*	$ 2,197.6	$ 2,416.2	$ 2,527.0	$ 2,584.9	$ 2,490.7	+ 13.3%
Medicaid	1,204.8	1,523.2	1,523.0	2,129.8	2,079.4	+ 72.6
Debt Service**	661.9	714.5	749.1	874.6	993.0	+ 50.0
Public Assistance	760.5	830.0	899.9	996.5	922.8***	+ 21.3
Pensions	22.4	29.1	662.1	684.0	725.2	+ 313.7
Higher Education	708.4	757.2	668.4	714.4	665.2****	- 6.1
Group Insurance	240.5	281.8	341.4	446.3	506.6	+ 110.6
MBTA	219.3	248.6	277.5	325.7	376.2	+ 71.5
All Other	4,845.3	4,915.4	4,749.8	4,410.0	4,129.0	- 14.8
Total	$10,860.7	$11,716.0	$12,640.9	$13,166.2	$12,888.1	+ 18.7%
Total for 7 Major Cost Centers & Budget Busters Excluding Pensions	$ 5,993.0	$ 6,771.5	$ 7,229.0	$ 8,072.2	$ 8,033.9	+ 34.1%

Source: Reconstructed data from Table in House No. 1, FY 1991, p. IV - 5.

* For unrestricted and categorized direct aid, but excluding debt service on state-subsidized school buildings.

** Including debt service on school building construction.

*** Including proposed elimination of state SSI payments.

**** Much of the $20.5 million reduction over prior year spending for campus operations will be offset by planned increases of resident tuition by about 12% and by full-cost tuition for non-residents. Note also that reductions over prior year include $23.6 million for scholarships to students attending private or out-of-state institutions and selective contractual arrangements with private schools of veterinary medicine and engineering.

distributions. Estimated revenues and other sources of revenues for 1991 total $12.894 billion, leaving a miniscule undesignated fund balance of $6 million and an estimated budget surplus at the end of 1991 of $2.1 million. The spending requests for the next fiscal year are estimated at 2% below the estimated total expenditures for the current year.

The tax revenue estimates of $9.220 billion underlying the proposed spending program are the initial figures put forth by the Governor's Revenue Advisory Board. The RAB originally forecast tax revenue growth for the 1991 fiscal year of $345 million or 3.9% over the official 1990 tax revenue estimates. On April 9, 1990, however, the RAB, after downgrading its prediction of current year tax collections, lowered its projections for next year by $560 million or 6% over the earlier January estimate. In estimating that tax revenues for FY1991 would total $8.661 billion, the RAB was restating tax collections to grow by only $16 million over FY1990. As a result, House No. 1 is out of balance even before the new fiscal year begins.

The initial FY1991 projections for sales tax revenues in House No. 1 indicated that sales tax collections, reflecting an expectation of moderate recovery of the state economy, would rebound and increase by 5.5% next year. This would be a rather sharp upturn since actual sales tax collections for the first nine months of 1990 fiscal year are down by 5% over the same period of FY1989 and after only a 3% rise in the prior year. Sales tax collections throughout the Northeast have been rising between 3% and 5% in the past two years and there may be factors other than a temporary economic slowdown that could keep the upward trend below the 5% growth level.

Unanticipated demographic factors and consumer behavior, including higher rates of savings, may be the new driving forces behind sales tax yields. Much of the sales tax is tied to housing-related and motor vehicle consumer spending. Accompanying the stagnant housing market, which has stifled the sale of big-ticket consumer equipment and furnishings, is the "graying" of the Northeast market and its concentration of mature households whose needs and desires for consumer durables may have been largely satisfied. The concern in Massachusetts is that the turnaround in sales tax revenues may not occur for 18 months, not until the 1992 fiscal year rather than next year. In New Jersey, the sales tax estimate for the coming fiscal year is 3%; in Connecticut, 5%.

If there is a new note of reality in the bottom-line of House No. 1 that keeps spending within prudent assumptions about revenue projections, the budget message also includes a so-called "current services" budget that would increase the no-tax budget by $1.4 billion, thereby revealing a certain reluctance to face the music. The Governor's budget message does concede that unless the state's eight major cost centers, several of which are becoming popularly known as "budget busters," are brought under control, they will soon overwhelm the state's available resources and seriously threaten the financing of basic services.

These cost centers consist mainly of entitlement programs providing medical assistance to low-income groups, including the elderly and disabled (Medicaid), income maintenance or cash assistance to the poor (Public Assistance), and Local Aid (unrestricted and categorical direct assistance to cities and towns), plus so-called fixed charges for employee/retiree group insurance, debt service, pensions, and MBTA subsidies (contract assistance and debt service). In a separate category is higher education because of the access of its institutions to over $600 million a year in trust funds from student fees and various campus operations and in federal grants (which may be spent without appropriation) and because of the authorization since the 1989 fiscal year that campuses may spend increases in tuition without appropriation. For the 1990 and 1991 fiscal years, such retained tuition increases total $22.8 million.

The figures in Table 2 clearly show how the eight major cost centers dominate the state's spending priorities. They are like termites, eating away at a revenue stream with limited growth potential. If their total allocation over the current fiscal year had not been essentially level-funded on the basis of proposed major policy and program changes, they would have added more than one billion dollars to the Governor's 1991 fiscal year recommended budget. Even as submitted, the $8.039 billion in budgetary requests for the seven major cost centers, excluding pensions, are $2.0 billion over actual expenditures for these same purposes just four years ago, a jump of over 34% (an average increase of 8.5% each year). The major cost centers account for 68% of the Governor's entire budget submission for next year as compared with 62% of total spending in the 1989 fiscal year. By contrast, estimated spending for all purposes other than the major cost centers will be about 13% below actual expenditures for these same purposes two years ago.

Excluding pensions, which increased by over 300% over the past four years because of a long-delayed policy shift from a pay-as-you-go pension system to a fully-funded system, Medicaid, group insurance, MBTA contract assistance and debt service, and the state's debt service are the cost centers that continue to press the state budget despite service reductions, program redesign and special efforts to control costs.

Medicaid. The Medicaid budget for the next fiscal year, providing health care to low-income families, children, the disabled and the elderly, now exceeds $2 billion and has climbed by almost 73% over four years ago, indicating an average annual increase of about 18%. The Chairman of the House Ways and Means Committee recently estimated that the Medicaid budget, unless current trends were drastically checked, could reach $15 billion by 1997. Moreover, next year's Medicaid budget assumes that over $700 million in reductions, requiring legislative changes and waivers of federal regulations, will be achieved through management savings, program restructuring, long-term care revisions, rate adjustments, eligibility redefinition and benefit amendments.

It remains to be seen whether these proposed fundamental changes, proposed and rejected by the Legislature in the past, can offset such cost-driving factors as federal restrictions on program revisions, growing welfare case loads and their impact on automatic eligibility for Medicaid, the steadily-increasing proportion of Medicaid cases who are elderly (the long-term care component of Medicaid spending is now over one billion dollars), expanding demand for health care, escalating health care costs and unanticipated federal policy decisions. Moreover, even if such changes are enacted, there is skepticism whether the level of savings projected will be attained. In fact, the Medicaid program is caught up in a seriously-flawed overall health financing and delivery system that requires basic reform, reform that eliminates and reduces unnecessary or marginal procedures, that reorganizes the delivery of health services, that shifts the emphasis from treatment to prevention and public health-related measures, and that eliminates the dispersion of overlapping health roles within the state government itself.

Debt Service. As for debt service, its total cost exceeds one billion dollars a year if the state's contingency obligations for the Massachusetts Convention Center Authority and the Massachusetts Bay Transportation Authority are included in the debt service calculation. (Excluded from this estimate is state-guaranteed debt issued by local housing authorities and higher education building authorities.) Several administrative and legislative initiatives have been launched to slow down the upward trend of debt service. The Administration imposed capital spending limits of $925 million during each year of the 1989-91 fiscal period. The Budget Control and Reform Act of 1989 added several limitations: (1) a ceiling of $6.8 billion on the total amount of outstanding general obligation bonds, with an annual allowable increase of 5% on this ceiling, and (2) a requirement that annual debt service may not exceed 10% of the state budget.

These are hardly onerous borrowing limitations. Subject to these limits, the Commonwealth can tap $6.8 billion in authorized but unused general obligations. Since current debt service is 8% of the total state budget and $300 - $400 million in debt service will be reduced by debt maturing in each of the next five years, the 10%

limitation would merely stabilize the debt service spending rate, not reduce it gradually. Moreover, other issues of capital spending, several cited in a recent debt analysis of the Massachusetts Taxpayers Foundation, have apparently not yet been addressed:

1. Should certain previously authorized but unissued debt be expunged because of updated and revised priorities of capital needs and wants, priorities that should now emphasize mandated projects, capital maintenance of bridges, roads and buildings, and projects that clearly contribute to economic growth?
2. Is an annual capital spending program with a scale and complexity of $925 million realistic based on the past track record of capital project initiation and completion?
3. Do major capital planning and spending agencies (the State Division of Capital Planning and State Department of Public Works) have the administrative and technical capacities to oversee a capital spending program totalling almost $1 billion a year?
4. Does the Commonwealth need a new process of long-range planning based on realistic estimates of economic growth, state revenues and expenses to serve as the framework for future capital spending proposals?
5. Is adequate attention being given to the state's portfolio of capital assets so that systematic sale or other disposition of surplus state-owned properties can be used as financing sources for newly-acquired assets?

Group Insurance. The state's Group Insurance Program for active state employees and about 42,000 retirees, like Medicaid, has been battered by skyrocketing health care costs. With an estimated cost for the next fiscal year exceeding $500 million (more than double the 1987 cost), it is the 7th highest spending component and the fastest growing expense item in the state budget. Although several provisions of the Budget Control and Reform Act of 1989 are designed to make group insurance more cost-effective and equitable by adding new employer-employee cost-sharing arrangements under which the state will only pay 90% of all premiums, this change plus an estimated work force reduction of over 9% in two years and cost reductions anticipated in future collective bargaining agreements are not likely to curb future double-digit increases in group health insurance, increases that have averaged 27.5% annually over the past four years. Not only has total enrollment increased by an average rate of 4% over the past 6 years, but the changing pattern of more family enrollees and more elderly members, requiring more expensive care, have also contributed to rising costs.

Recent surveys of private employer health-plan costs concluded that efforts to control costs through cost-sharing with employees had little or no effects on cost-containment. Health plan cost increases are due mainly to the widening availability of expensive medical technology, the increasing number of catastrophic health claims and higher costs of outpatient care.

<u>MBTA Subsidies.</u> The principal strategy for curbing rapid annual increases in state contractual assistance and debt service for the Massachusetts Bay Transportation Authority (MBTA), which have gone up by 71.5% in four years (an average increase of almost 18% per year as compared with an average annual increase of under 6% in MBTA direct operating costs), is contained in several provisions of the Budget Control and Reform Act of 1989. These provisions require a revenue-recovery ratio of 33-1/3% (indicating some future increases in rider fares and related revenues), limit capital spending to $300 million a year, impose a 10% sharing of health insurance coverage by employees, and mandate a plan for implementing forward-funding of the MBTA instead of retroactive-funding. The upward trend in MBTA subsidy by the Commonwealth has been due to limited increases in MBTA revenues (only 2-3%), lower federal assistance for mass transportation and the Proposition 2-1/2 limitation on local assessments for the MBTA.

Since the initiatives mandated in the Budget Control and Reform Act of 1989 are clearly not enough to slow down significantly the rise in the state's MBTA subsidies, new legislative efforts are planned to reduce MBTA spending further and to generate additional MBTA revenues, efforts that are estimated to total $3.5 - $5.2 million. These include caps on tort claims against the MBTA and tort interest payments, eliminating double-dipping of workmen's compensation by MBTA employees receiving disability pensions for the same injuries and authorizing the MBTA to enter the New England Power Pool, thereby reducing energy costs. It should be noted, however, that the latter savings and increased revenues would reduce the state's subsidy by less than 1-1/2%.

Public Assistance. Between the 1987 and 1990 fiscal years, expenditures for public assistance -- Aid to families with Dependent Children (AFDC), General Relief (GR) and the state supplement to federal Supplemental Security Income (SSI) -- increased by 31%, or by about 8% per year. The increases were attributable mainly to cost-of-living allowance adjustments and improved benefits to welfare recipients, at a time when the number of welfare cases was not rising significantly. Faced with welfare caseload increases that had taken an unexpected sharp rise over the prior year (the number of families receiving AFDC showed an increase of 10% in December, 1989 over December, 1988; the number of General Relief cases jumped by 15% in this same period), state budget-makers took drastic action in preparing the public assistance estimates for FY1991, omitting planned cost-of-living increases for welfare recipients, eliminating state supplements for recipients of federal Supplementary Security Income (SSI) benefits, requiring strict adherence to federal eligibility categories and guidelines for benefits and calling for more strict management control over Emergency Assistance eligibility determination. The proposed elimination of state SSI supplements, estimated at $110 million for some 115,000 elderly, disabled and blind recipients and the major revisions in Medicaid, generating an estimated reduction of $700 million, have stimulated the most vocal and widespread opposition of advocacy groups.

Local Aid: End of a State-Local Partnership? Since 1981, when Proposition 2-1/2 imposed strict limits on local property tax increases, thereby ending automatic annual property tax increases to cope with higher local expenses, local aid from the Commonwealth has emerged as a critical issue of both state and local finance. Between the 1981 and 1989 fiscal years, the Commonwealth made good on commitments to cushion the adverse impacts of property tax limitation through more generous distributions of local aid, particularly direct local aid (unrestricted and earmarked assistance, reimbursements, grants, etc.), which rose by an average of 11% a year. This was the same period, of course, in which total state spending increased each year by a similar 11%, indicating the relatively high priority that the Governor and Legislature were giving to local government services -- schools, fire and police protection, refuse collection and disposal, libraries, etc.

Local aid cutbacks began with the 1989 fiscal year when $120 million was cut out of appropriations for local aid: the Governor vetoed $91 million in unrestricted aid and withheld $29 million in grants earmarked for grants to lower-spending school districts. As a result, the net total of $3 billion finally authorized for direct local aid in the 1989 fiscal year was just about 5% over prior year expenditures for this same purpose.

The Governor's budget for 1990 had originally recommended $3.2 billion for local aid, an ostensible increase of 6.8% over FY1989, but broke with the policy in effect since 1984 of sharing 40% of anticipated tax revenue growth with cities and towns. Additional estimated aid of $206 million was $40 million below what cities and towns would have received if the 40% sharing policy had been honored. However, the Legislature reduced the Governor's local aid back to the FY89 funding level of $3 billion. Not reckoning that the Governor would subsequently veto or withhold another $233 million of local aid, cities and towns had used the level-funded local aid approved by the Legislature as the basis for planning their own FY90 budgets.

Thus the local aid cuts accounted for 47% of the $491 million of proposed 1990 spending vetoed or withheld by the Governor. Some $210 million of the local aid reductions came from Chapter 70 school aid. The net result was that the $2.8 billion finally authorized in local aid for the 1990 fiscal year was less than actually spent for this same purpose. Aside from the local aid spending cuts, the lottery distribution for cities and towns was down by $20 million from the original estimate of $306 million.

Not only did cities and towns take the "big hit" in overall 1990 state budget cuts, but the major reductions in local aid were in so-called "unrestricted aid," the state's basic revenue-sharing program. Finally, the Commonwealth added insult to injury by not apportioning the aid reductions proportionately. The Governor's veto took smaller shares of local aid away from those cities and towns receiving a larger share of state funds under the equalizing distribution formula, generating a court suit that challenged the reduction formula used by the state.[4]

For the 1991 fiscal year, the cities and towns are being asked to bear less pain than they did in the 1990 fiscal year although the threat of an additional $500 million cut in Chapter 70 aid for education hangs over them like a Damoclean Sword. Proposed local aid of $2.695 billion for FY91 is $86 million below estimated local aid expenditures for the current year. About $50 million of the reduction are in unrestricted school aid under Chapter 70 and Additional Assistance.

There are available offsets to the above losses, assuming that local governments accept opportunities for expense savings and revenue expansions contained in certain provisions of the Budget Control and Reform Act of 1989,

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[4]This suit, <u>Brookline et al. v. Dukakis et al</u>. (Suffolk Superior Court No. 89-4416), is by 118 cities and towns and various municipal officials who not only charge that the apportionment reduction formula is inconsistent with various statutes, but challenge the Governor's use of Section 9C, Chapter 29, G.L. to reduce by $210 million the allotment of funds appropriated by the Legislature for local aid, claiming that this law is unconstitutional, and if constitutional, is inapplicable to local aid appropriations. Plaintiffs in this suit also challenge the constitutionality of a provision in the FY1990 budget limiting the use of certain state lottery receipts to local aid and further claim that the state's FY1990 budget violates balanced budget requirements. They seek injunctive relief recovering the $210 million to be released for distribution.

opportunities that could generate over $125 million for the 1991 fiscal year. One section of this law allows cities and towns to have their property taxes paid on a quarterly basis (on the first of August, November, February and May), thereby reducing interest costs for notes issued in anticipation of taxes and increasing investment income. Total savings from this change are estimated at between $40 million and $50 million. There will be some increased costs for local collector and assessor administrative requirements.

Another provision allows cities and towns, effective July 1, 1990, to tax in the current fiscal year new construction and improvements occurring during the first half of the 1990 calendar year. Its purpose is to reduce the delay taking place between the legal assesssment date of January 1 and June 30, end of the fiscal year. If adopted statewide, this provision could produce an estimated one-time bonanza of $62 million in additional property tax capacity, resulting from accelerating the new growth in the levy limit and compounding this new growth at the annual rate of 2-1/2% under tax limitation.

Other provisions would (1) allow the Registry of Motor Vehicles to deny drivers' licenses and registration renewals to persons failing to pay delinquent local motor vehicle excise taxes -- this could yield an additional $8 million to $12 million in local revenue statewide; (2) extend cost-sharing of health insurance by municipal employees enrolled in Health Maintenance Organizations, with annual municipal savings estimated at $8 million.

Additional legislation enacted in 1989 would ease annual municipal debt service payments in the future by lengthening the terms of borrowing for certain municipal purposes -- from 10 to 20 years for borrowing to remodel, reconstruct or make extraordinary repairs to municipal buildings; from 5 to 15 years for borrowing to purchase departmental equipment -- by allowing the first payment on a municipal borrowing to be made any time during the next fiscal year, and by allowing level debt service payments for debt excluded from a municipality's levy limit and for debt incurred by municipal operations funded under the enterprise accounting system.

Finally, if the Legislature and Governor implement major recommendations in the final report of the Governor's Task Force on Local Finance to expand local revenue-raising potential, including several modifications of Proposition 2-1/2 limitation provisions, cities and towns could benefit by over $150 million in FY1991 -- $92 million from increasing the annually allowed increase in the property tax levy from 2-1/2% of prior year collections plus new growth (the current limit on annual increases) to an index measuring the prices that state and local governments pay for goods and services so that inflation can be factored into the limit; $15 million by exempting principal and interest on newly-issued debt from the property tax limit, subject to approval by a two-thirds vote of the local legislative body and to voter approval; and $18 million by including in the calculation of the local property tax limit all improvements to existing property, thereby expanding the current narrow definition that restricts the addition of major improvements to those which increase the value of residential property by 50% or more and all other properties by at least $100,000.

If enacted, these recommendations on tax levy limits are estimated to generate over $260 million in additional property tax revenues, equivalent to about 6% of the state's total property tax levy during the current year.[5]

Higher Education. State-appropriated spending for higher education reached its peak in the 1988 fiscal year with a total state outlay of $757.2 million. This peak culminated an unbroken 5-year string of program expansion and enrichment, staffing increases, faculty salary improvement, and scholarship enhancement. Between the 1984 and 1988 fiscal years, state appropriations for higher education grew by 64%, or by 16% a year on average. (See Table 3.) Among the factors

[5]See p. 92-95, Report of the Governor's Task Force on Local Finance (January 1990).

TABLE 3
HIGHER EDUCATION EXPENDITURES
FY 1984-85 AND 1988-91
(in millions of dollars)

	Actual				Estimated		% Change	
	FY 84	FY 85	FY 88	FY 89	FY 90	FY 91	FY 85-91	FY 88-91
Campus Operations*	$425.6	$510.1	$664.4	$650.1**	$609.4****	$591.4****	+ 39.0	- 11.0
Scholarships	33.6	48.9	77.4	***	84.7***	61.1	+ 81.8	- 21.0
Board of Regents	2.6	11.5	15.4	18.4	20.3	12.7*****	+388.5	- 17.5
Totals	$461.8	$570.5	$757.2	$668.5	$714.4	$665.2	+ 44.0	- 12.1%

Sources: Reports of Mass. Taxpayers Foundation and House No. 1, FY 1991.

* Excluding expenditures from trust funds and federal grants.

** Includes retained tuition increase revenues of $10 million.

*** $84 million appropriation in FY1988 for spending in FY1989.

**** Includes retained tuition increase revenues of $2.8 million.

***** Most of reduction from proposed elimination of $3.8 million for contract with Tufts School of Veterinary Medicine, $429,000 from collaborative engineering programs with three private universities and $180,000 from elimination of the Northeast Consortium, outreach programs to disadvantaged students with strong potential for college.

explaining the 56% increase in expenditures for campus operations during this period was the rise by almost 1800 positions, or 14%, in total campus staff and significant increases in faculty salaries that raised them from below the national average in 1983 to a national ranking of fifth by 1988.

The upward trend in higher education spending came to an abrupt halt at the halfway point of FY88, however, when the Board of Regents, forced along with other state agencies to cut back planned authorized spending to affect unanticipated shortfalls of state tax revenue collections, reduced spending by $20 million. But only about $5 million of this overall reduction had to come from campus budgets since the Regents were able to revert about $15 million from unspent scholarship reserves.

Despite the growing realization in 1988 that deteriorating state finances could adversely affect state allocations for higher education, the Governor's budget proposals for fiscal 1989 did not forecast significant contraction of campus operations. The original total appropriation for the campuses was $638 million, about $2.3 million below the total actually spent in the prior fiscal year. The Board of Regents had estimated, however, that the Governor's budget recommendations were $20 million under what was necessary to maintain the spending level of FY1988. In authorizing campuses to retain about $8 million in new revenue from the 8.5% tuition increase for the 1988-89 academic year, the Board of Regents moved to close some of the gap in available resources.

This minor problem took on more serious proportions, however, when a new Administration directive ordered that $16 million more in planned spending for higher education revert to the General Fund, thereby reducing available authorizations by almost 3%. The campus effects of these spending cuts were mainly in reductions of part-time instructional staff. The impact of these budget cuts on students came in the closing out of some course sections and an estimated decrease in enrollment of about 2,000, a slight decline in enrollment from 189,000 to 187,000.

Significant "downsizing" of higher education really took hold in the 1989 fiscal year and persisted into FY1990 as the Governor and Legislature were forced to take drastic steps to curb spending plans in the face of rapidly declining tax revenues. In July 1989 higher education lost $39.3 million through gubernatorial vetoes and withholding of allotments. Subsequently the Board of Regents reduced authorized appropriations by an additional $25 million in the middle of the 1989 fall semester, thereby raising the total reduction in proposed spending for the 1990 fiscal year from the level approved by the Legislature during the summer of 1989 by a total of $64.3 million, of which $52.7 million had come from campus budgets. These cuts were partially offset by increases in tuition and fees in 1990. The consequences were felt mainly in staff reductions amounting to about 6%.

Overall spending for campus operations from state appropriations and retained tuition increases in the current 1990 fiscal year (excluding trust funds and federal grants) is estimated to total $609.4 million, or 8% below actual expenditures two years ago. As tuition increases retained by the campuses for spending without appropriation have increased, from about $10 million in the 1989 fiscal year to an estimated $22.8 million in both the 1990 and 1991 fiscal years, they have partially mitigated the negative impact of lower state appropriations.

It should also be noted that higher education has access to sizable amounts of off-budget revenues in the form of trust funds and federal grants that may be spent without appropriation. These include over $500 million in trust funds from student fees and income from a variety of campus operations such as bookstores, parking facilities, etc. and over $100 million in federal grants. These off-budget revenues have grown dramatically. Trust fund revenues for higher education increased four times more rapidly between the 1987 and 1989 years, for example, than state appropriations for higher education, and higher fees have been used as an offsetting source of revenue to cover state appropriation shortfalls. As a result state budget allocations for higher education have declined significantly from 58% of total spending for higher education in FY1987 to 54% in FY 1989 and to an estimated 51% in FY1991.

While Table 3 indicates that the Governor's proposed budget for campus operations in FY1991 would be about 9% below estimated total spending for FY1989, the budget message notes that the $20.5 million reduction below available authorizations for the current 1990 fiscal year can be largely offset by accelerated implementation of the Board of Regents timetable to bring tuition of resident students up to 30% of costs for state colleges and universities and up to 25% of costs for community colleges, and to bring tuition of non-resident students up to 100% of actual costs. This would require a 12% tuition rise in resident tuition and an increase in non-resident tuitions to their proposed maximum during this year and next as required by the Budget Control and Reform Act of 1989.

ACT 4: OUT OF THE FRYING PAN AND INTO THE FIRE -- THE INITIATIVE PETITIONS

Several initiative petitions have been circulated for collection of voter signatures which could be on the ballot in November of 1990. Two principal petitions would have enormous impacts on the state's finances. Several other petitions by the Massachusetts Organization of State Engineers and Scientists (MOSES) and the Massachusetts Municipal Association (MMA) would have important but less significant impacts on state tax and fiscal policy.[6] This chapter briefly outlines the scope of each of the two major ballot questions and estimates its consequences for state revenue.

The Initiative Petition Process

The initiative petition process -- guaranteed by the state's constitution -- is an important part of the state's democratic heritage. It ensures that the people may always have the final word in how they will be governed.

There are some restrictions on what can go to the ballot. Judicial salaries, review of judicial decisions, actual appropriation of dollars (which is specifically reserved to the General Court), and basic freedoms and rights such as those contained in the state constitution's Declaration of Rights are among the subjects not eligible for the initiative process.

The initiative process varies, depending on whether the petition is for a law or a constitutional amendment. In the early stages, however, the process is similar. In

[6]Several MOSES petitions would limit residential real property tax rates, lower the sales tax rate and extend it to certain business services, make major realignments in state tax policy and make adjustments in the state's income and sales taxes. The MMA petitions would require 40% of the state's major tax revenues to be distributed to cities and towns and would authorize revision of the local aid distribution formula by the Secretary of Administration and Finance with the advice and consent of the Local Government Advisory Board.

both cases the petition is drafted and submitted to the Attorney General with the signatures of ten residents of Massachusetts who have been certified by their city or town as registered voters. Petitions must be filed with the Attorney General not later than the first Wednesday in August.

The Attorney General reviews each petition filed to ensure that it meets the constitutional requirements -- that it does not contain "excluded matter", and that it is not substantially similar to a petition circulated or appearing on the ballot in the preceding two biennial elections. Having determined the petition to be proper, the Attorney General then prepares a fair and concise summary (which will appear on the petition form itself) and files it with the Secretary of the Commonwealth. The constitution provides that the Attorney General may not submit the petitions to the Secretary prior to the first Wednesday in September. There is, however, no date by which the Attorney General must make his determination (which can be very important to the sponsors who need time to collect the required signatures).

Once the Secretary of State has the petitions, they are processed and petition forms are printed containing the summary prepared by the Attorney General, the names and addresses of the first ten signers, and spaces for additional voter signatures. This usually takes a week to ten days. The sponsors are notified that the forms are available and the signature gathering begins.

Sponsors must file not less than 50,525 certified voter signatures with the Secretary of State on or before the first Wednesday in December or the petition is no longer active. Not more than 25% of the signatures may come from any one county.

Once filed with the required number of certified signatures, the petition is forwarded by the Secretary of State to the Clerk of the House of Representatives where it is processed in a manner quite similar to other bills filed for consideration by the General Court. Eventually it is assigned to a committee for a public hearing and report. In the case of initiative petitions, the constitution requires written committee reports -- majority and minority (if any) -- signed by the committee members.

Process for a Law

In the case of a petition for a law, the petition must be enacted in the precise form in which it was submitted not later than the first Wednesday in May. The vote in the Legislature must be by roll call. If the petition is amended in any way, or if it is not enacted by that time, the first ten signers may then file with the Secretary of the Commonwealth between the first Wednesday in June and the first Wednesday in July, additional certified voter signatures equalling one-half of one percent of the vote cast for Governor in the most recent election, 8421 in 1989.

Once these additional signatures are filed, the proposed law must appear on the ballot and, if approved by a majority of the votes cast -- and at least 30% of the total number of voters -- it becomes law.

Incidentally, between the first Wednesday in May and the first Wednesday in June, a majority of the first ten signers, with the certification of the Attorney General, may make perfecting amendments to the petition provided they do not affect its substance.

Two initiative petitions which could have significant impact on Massachusetts are described below. (We have borrowed liberally from the analyses prepared by the Massachusetts Taxpayers Foundation on these petitions.)

The Fee and Tax Reduction Petition of Citizens for Limited Taxation (CLT) and the Mass High Technology Council.

Overview. This petition reduces the rate of the income tax, rolls back fees and charges and freezes all other taxes at current rates. The intent, apparently, is to repeal or repay tax and fee increases adopted during the last year, discourage future fee increases and generally prohibit any tax increase above rates in effect a year ago.

Revenue Impact. The petition reduces the state tax on income subject to the 1989-90 surtax to 4.25%, effective January 1, 1991, and to 4.625% for 1992. The rate reductions would apply for eighteen months. The intent is to recapture over a 2-year period the 15% tax increase enacted in July, 1989, which was designed to cover the cost of borrowing for financing the 1989 deficit and accumulated Medicaid bills.

All state tax rates in effect as of January 1, 1991 would be rolled back to those in effect on August 2, 1989 unless rates in effect on January 1, 1991, yielded less revenue. (There are 36 citations including taxes on bazaars and raffles, boxing and racing.)

In addition, all state agency and public authority fees and charges would be rolled back to rates in effect on June 30, 1988. Included would be increases in all state fees, MBTA fares, MWRA sewer and water rates, Massport landing fees, Turnpike tunnel fees, among others. Virtually any future increase in state fees or charges, including fees and charges levied by authorities, must be determined by the Secretary of Administration and Finance and approved by the Legislature, which essentially delegated its fee-setting power to state agencies. Fees must not exceed the cost of administering the service or producing and processing the application for a permit of license. (Registry of Motor Vehicles, fees imposed by fees, Boards of Registration and all revenue bond authority fees now exceed such costs.) Rates of tuition or fees in higher education and fees for the administration of state courts would be exempt. No increase in any fee after the effective date of this act will apply to anyone aged 65 or over.

The rollback of public authority fees, their linkages to the cost of service, regulation, registration, license permits, or other public functions, and the requirement that they be approved by the Legislature will almost certainly be challenged in court.

The proposed law would also provide that beginning in the 1991 tax year, all laws relating to state taxes would revert to their August 2, 1989 status or to their status as of the effective date of the new law, whichever resulted in less tax revenue.

Fiscal Impact. Preliminary estimates by the Massachusetts Taxpayers Foundation indicate that the income tax reduction will affect tax collections in fiscal years 1991, 1992 and 1993 while the impact of the fee reductions depends on subsequent actions by the General Court. The following estimates include only revenues lost from possible reduction of Registry of Motor Vehicle fees; the total impact on fees will be significantly higher. The peak of revenue loss as shown in the table that follows would occur in the 1992 fiscal year, with a total estimated loss of $846 million in income tax revenue and Registry fees and charges.

Estimated Revenue Loss	FY 1991	FY 1992	FY 1993	Total
(in millions)	$356	$846	$368	$1,570

An Act to Invest in Massachusetts' Future Sponsored by the Tax Equity Alliance of Massachusetts (TEAM)

Overview. The general intent of the TEAM proposal is to provide modest tax relief to low and middle income taxpayers, while increasing income and sales taxes on so-called "wealth" and business services, and allocating the additional revenues to education, police and fire protection, environmental needs, "safe roads" and "basic human needs". It would also establish a broadly representative commission to examine government efficiency and ethics, require cuts in state spending on consultants, enact a taxpayer bill of rights and require corporations to disclose to the public their state tax returns. TEAM is a coalition consisting mainly of public employee unions and human service advocacy groups.

Tax Changes. The Team proposal extends the sales tax to the following services: services to buildings, computer and data processing, management and consulting services, credit and collection, blueprinting, commercial art and graphics, stenographic, personnel, supply, research and development, engineering, architectural and surveying, accounting (except individual tax preparation), auditing and bookkeeping, detective services, and interior design.

For small businesses and individuals, a $5,000 (corporate) or $500 (individual) maximum tax deduction would be allowed to compensate for sales tax payments.

The proposal also increases the tax rate on capital gains from 5% to 7% (except for sale of a principal residence which would remain at 5%) and doubles the current income tax exemptions for senior citizens and for child care.

Revenue Allocation. The net increase in revenue from the TEAM legislation would be dedicated to a special "Invest in Massachusetts' Future Fund" and used for designated purposes. However, the purposes are so broad that nearly the entire state budget and all local budgets would qualify. Eligible functions include education, health, welfare, housing, highways, police and fire protection. Perhaps the most stringent limit on the use of the additional funds is that they provide services only to residents of the Commonwealth. Fund revenues and expenditures would be audited annually by the State Auditor.

Expenditures in fiscal 1992 for state consultants must be at least 25% below fiscal 1989 costs. (This would apply only to consultants paid from the General Fund, thus excluding highway consultant costs) Any cut in services because of this limitation is restricted. In other words, state employees must be used instead of consultants.

Other Elements of TEAM Proposal. -- Establishes a task force on ethics and efficiency in government consisting of 33 members representing numerous designated interests; the committee would examine efficiency as well as ethics in government.

--Creates a taxpayer bill of rights enumerating various taxpayer and tax collector rights and responsibilities and procedures for implementing them.

--Requires all banks, insurance companies and publicly traded corporations filing tax returns in Massachusetts to report information from those returns to the Secretary of State each year.

Fiscal Impact. The estimated net annual revenue increases are summarized below in millions of dollars:

Estimated Net Revenue Increase	FY1991	FY1992	FY1993	Total
(in millions)	$402	$409	$418	$1,229

Poll Findings on Initiative Petitions

Two Massinsight polls, taken in October, 1989 and February, 1990, showed the following results concerning the ballot questions listed below:

1) "In addition to races for Governor and Senator, the people of Massachusetts will have to vote on a number of referendum questions this year. I'm going to read you brief descriptions of two of these questions and I'd like you to tell me whether you strongly favor, somewhat favor, somewhat oppose or strongly oppose each one.

A referendum sponsored by Barbara Anderson and Citizens for Limited Taxation that would roll back all the tax and fee increases levied recently. The effect would be to return the tax increase even if services have to be cut."

	Feb. 1990		Oct. 1989	
Strongly favor	19%		27%	
Somewhat favor	21%	>40%	19%	>46%
Somewhat oppose	23%		19%	
Strongly oppose	27%	>50%	28%	>47%
(Not sure)	19%		6%	

2) A referendum sponsored by the Tax Equity Alliance of Massachusetts to increase business taxes and use the revenue to maintain or improve services.

	Feb. 1990		Oct. 1989	
Strongly favor	33%		28%	
Somewhat favor	29%	>62%	24%	>52%
Somewhat oppose	10%		16%	
Strongly oppose	21%	>31%	28%	>44%
(Not sure)	7%		4%	

A more recent poll of a sample likely to vote in November 1990, conducted by the Becker Institute for business clients late in March, 1990, indicated that the two main tax ballot questions were still virtually in a "dead heat". This poll showed that the CLT tax rollback petition was endorsed by 51% with 41% in opposition. It should be noted, however, that support for the TEAM tax proposal was 54% with 41% in opposition. The margin of error for this poll is plus or minus 3-5%. What is particularly revealing, however, is that 64% of the respondents stated that they would reluctantly support a tax increase to maintain services for those needing them, although 29% remained opposed to any tax increase under any circumstances.

If, as we have suggested in Chapter III, the current fiscal impasse is likely to be fixed at least temporarily through a combination of deficit borrowing, budget reductions and permanent or temporary taxes, and the general public does not experience extensive service cuts while being directly affected by tax increases, this would sustain their persistent belief that they do not receive commensurate value for their tax dollars and could generate greater support for the CLT tax rollback petition. If, on the other hand, the Legislature only partially resolves the fiscal crisis or fails to resolve it all, widespread service cuts would be felt in advance of the November 1990 election and this could turn the ride in favor of the TEAM petition.

ACT 5: CONCLUSIONS AND RECOMMENDATIONS

Conclusions

1. Since the most recent economic and tax forecast for 1992 expects employment and income in Massachusetts to grow at rates below the national averages, spending decisions by state and local government in the next few years will be shaped by modest revenue growth (5 - 5.5%) that is closer to inflationary trends rather than the double-digit yields of the mid-eighties.

2. The Commonwealth of Massachusetts has failed to live within its means over the past few years.

3. On the so-called statutory or budgetary accounting basis, the state ended the 1989 fiscal year with a deficit of $466 million and a cash shortfall of $305 million; for fiscal 1990 the deficit is currently estimated at $1 billion and the cash shortfall at between $800 and $900 million. In the 1987 and 1988 fiscal years the state was able to avert budgetary deficits only by dipping into and finally exhausting prior-year balances and available reserves.

4. However, if the condition of the state's finances is measured according to generally-accepted accounting principles (GAAP), which is a modified accrual basis of accounting defined by the Government Accounting Standards Board, the State Comptroller reports a more grim picture, as summarized below. On a GAAP basis (excluding capital project funds), the real deficit for the most recently-audited fiscal year of 1989 has shot above the billion-dollar mark.

Fiscal Year	GAAP Surplus (Deficit)* (in millions)	GAAP Surplus (Deficit)** (in millions)
1987	($183.6)	$103.6
1988	($885.4)	($722.7)
1989	($637.9)	($1,002.0)

Source: Preliminary Official Statement (March 12, 1990) accompanying $360 million bond issue.
* Including capitol project funds.
** Excluding capitol project funds.

5. The state's credit rating (lowest long-term bond rating among 41 states assessed by Standard & Poor's) was adversely affected by last-resort borrowing of up to $475 million to balance the books for the 1989 fiscal year and by almost an equal amount of current expense borrowing to finance an accumulation of unpaid Medicaid-related bills, and the state's unfavorable bond rating will persist when the Legislature adopts a final solution to fund most of the projected budgetary deficit of $1 billion for fiscal 1990.

6. Although debates over the root causes of the state's fiscal crisis may be likened to "chicken-and-egg" controversies, what is factually certain is that state spending (exclusive of direct local aid distributions) doubled from $6 billion to $12 billion during the eighties (an average increase of 12% a year), reflecting extraordinary expansion of state programs and expenses, and despite the warnings of independent observers that double-digit revenue expansion had come to an abrupt halt by mid-1988. The revenue shortfalls were interpreted as forecasting aberrations and as temporary non-recurring events.

7. There is little doubt that the Legislature will resolve the current impasse over 1990 finances with a combination of deficit borrowing, further budget reductions, additional permanent or temporary taxes and that the revenue mix will include, among other components, extension and/or modification of the temporary income tax increase of 15% on wages and salaries which expires on December 31,

1990, as recommended by the House Chairman of the Committee on Taxation.

8. The Governor's proposed budget for the 1991 fiscal year, totalling $12.9 billion and about 2% below estimated total spending for fiscal 1990, although a curious contradiction of deeply-felt personal anger and re-awakened fiscal reality, departs sharply from initial optimism about an early economic turnaround by using as its focus for budget-making "the fiscal limit of currently authorized revenue".

9. That the Legislature will make significant changes in the Governor's budget priorities for 1991 is widely acknowledged as debate rages over the relative importance of income maintenance, health, education, local aid, housing, the environment, etc. and the competing demands of advocates on behalf of service beneficiaries and service providers.

10. Although the initial revenue assumptions behind the Governor's budget for the 1991 fiscal year projected tax revenue growth of only 3.9%, tax collections over the first nine months of the fiscal 1990 have fallen far short of tax revenue estimates, reflecting unanticipated declines in corporate and sales taxes, and requiring sharp downward revision of the original tax revenue forecast for fiscal 1991 even before the fiscal year begins.

11. Eight major cost centers, including several "budget busters", are like termites, eating away at a state revenue stream with limited growth potential, and unless brought under control, will threaten the ability of the Commonwealth to finance basic services.

a. Medicaid -- It remains to be seen whether $700 million in recommended budget reductions in Medicaid for the 1991 fiscal year will be achieved in the face of such cost-driving factors as federal restrictions on program changes, the impact on Medicaid eligibility of growing welfare case loads, expanding demand for health care, escalating health care costs and unanticipated federal policy decisions, and in the face of the reality that similar changes have been proposed in the past and have failed to secure legislative approval.

b. Debt Service -- There is greater administrative and legislative awareness that the upward trend in debt service, now in excess of one billion dollars a year, must be slowed down, as reflected in newly-imposed capital spending limits, ceilings on the total amount of outstanding general obligation bonds, and caps on debt service as a percentage of the state budget, but the new limits are hardly onerous and, at best, will merely stabilize not gradually reduce future debt service requirements.

c. Group Insurance -- Despite several provisions of the Budget Control and Reform Act of 1989 to make group insurance for employees and retirees more cost-effective and equitable, the new cost-sharing arrangement plus work force declines and cost reductions to be achieved through future collective bargaining agreements are not likely to curb double-digit annual increases in this fastest-growing budget item. Health plan cost increases are due mainly to the widening availability of expensive medical technology, the increasing number of catastrophic health claims and higher costs of outpatient care, factors that counteract cost-containment measures.

d. M.B.T.A. Subsidies -- Strategies for slowing the average annual increase of almost 18% over the past four years in MBTA subsidies (estimated at $376 million for fiscal 1991) contained in the recent Budget Control and Reform Act -- requiring a revenue-recovery ratio of 33 1/3%, limiting capital spending to $300 million a year, requiring 10% sharing of health insurance coverage by employees -- and in additional legislative initiatives to reduce MBTA spending further and to generate additional MBTA revenues are likely to have only minimal downward effects on the rapidly rising trend of state support, indicating that more comprehensive and radical cost-saving measures are required.

e. Public Assistance -- Recent upward trends in the case loads of Aid to

Families with Dependent Children (AFDC), General Relief (GR) and Supplemental Security Income (SSI) may well offset savings achieved or expected from reforms already instituted or to be implemented, e.g. shifting qualifying disabled recipients of GR to SSI, eliminating GR benefits for aliens and ex-offenders, ending emergency relief program benefits for full-time high school students, and terminating state supplements to federal SSI benefits. The impact on the proposed 1991 Public Assistance budget of rising homelessness and unemployment is a question mark that could completely nullify any budget gains from welfare office consolidation, trimming of administrative staffs and omission of cost-of-living benefits.

f. Local Aid -- Events of the past two years -- substantial local aid appropriation reductions, vetoes and withholdings; failure of the Administration to honor its stated policy of sharing 40% of anticipated state tax revenue growth with cities and towns; disproportionate apportionment of local aid reductions; municipal suits against the Governor and other responsible state officials over constitutionality of the apportionment reduction formula, the impoundment of appropriated local aid, limits on the use of certain state lottery receipts for local aid and violation of the state's balanced budget requirements; and the Governor's threat to reduce Chapter 70 aid for education by $500 million as a major solution for closing the 1990 budget gap -- have shattered the relatively strong and healthy state-local partnership developed during the eighties.

g. Higher Education -- Since the proposed state budget for campus operations in the 1991 fiscal year will be about 9% below estimated total spending for FY1989, public higher education institutions are engaged in serious reviews of alternative opportunities for program, department and college consolidation, elimination of duplicating activity, and program elimination, in order to preserve and enhance their basic institutional missions.

12. The public's general attitudes toward state taxes, spending, waste and inefficiency have maintained a remarkable constancy over the past three decades as indicated in periodic polls that reveal an angry citizenry, filled with mistrust and deeply concerned about the state's economic, fiscal and service problems.

13. While polls show greater public resentment than those of the past, an important difference is the more recent tendency to turn to the intitiative petition mechanism for venting public frustrations.

14. Although the debate between advocates for the two principal initiative petitions may seem to indicate basic ideological conflict, from another perspective the CLT petition represents the claim that the current incumbents of elective office, whose behavior is responsible for the fiscal crisis, should not be rewarded with additional tax funds, while the TEAM petition makes a case for maintaining a reasonable level of current state services and achieving some tax reform, but conceding that its 5% increase in tax revenues will of itself not resolve a fiscal problem that has escalated above the $2 billion mark.

Recommendations

Even if all tax or spending ballot petitions fail in November 1990, the Commonwealth of Massachusetts faces in the near term at least the necessity for operating within a framework of very limited growth in resources. This means that every available strategy must be used for:

1. Reviewing and updating all state agency and institutional missions to reflect current realities on state revenues;

2. Re-ordering state priorities through a comprehensive evaluation process that clearly separates needs from desires and subjects every spending item to the criteria of state affordability, costs versus benefits, and other relevant measures of

effectiveness and efficiency;

3. Instituting, where applicable, an organizational and program sunsetting policy;

4. Restructuring, reorganization and system changes that will improve control and containment of operating costs, and strengthen the state's financial planning and management capacities;

5. Restoring aborted state efforts in long-range economic, physical and social planning by re-establishing and institutionalizing a Governor's Office of Strategic Planning through appropriate legislation;

6. Instituting a moratorium on new policy initiatives and program expansions that will remain in effect until the Commonwealth's annual state revenue collections exceed the state's consumer price index.

7. Any deficit funding bill to cover the 1990 budgetary shortfall should contain specific provisions to prevent recurrence of the fiscal mismanagement of the past four years:

a) A requirement that the Governor's annual budget (House No. 1) and the appropriation recommendations of the Ways and Means Committees provide data on operating results of the past three fiscal years on the so-called GAAP basis;

b) A requirement that House No. 1, the Governor's proposed budget, include spending and revenue estimates for two years beyond the year to which the budget applies, including a statement of the assumptions underlying such estimates so that the Legislature and public will be advised of the estimated out-year cost implications of budget proposals;

c) New controls on the use of continuing appropriations;

d) Restrictions on borrowing for current operations and maintenance expenses and on use of available bond funds for current purposes;

8. Limitations should be placed on the use of non-recurring, one-shot revenues

for budget balancing, practices that cover up deficits that subsequently become more and more difficult to resolve and are symptoms of the state's inability to deal with persistent budget problems:

a) Withdrawals of cash from such reserves as the state's pension reserve funds,

b) Changing payment schedules to defer the payment of bills until next year,

c) Refinancing bond issues to free up cash reserves required by the current terms of the original bonds,

d) Accellerating tax payments by changing filing rules to require larger initial payments,

(e) Diverting unemployment insurance funds to re-employment and job placement programs,

(f) Diverting Lottery Fund receipts to state purposes,

(g) Using the proceeds from asset sales for current operating purposes.

9. Fiscal planning and management reforms recommended in the Report of the Governor's Task Force on Fiscal Management (chaired by William M. Crozier, Jr.)[7] should be implemented by the Legislature:

a) Reorganization of the Administration and Finance Secretariat into four major functions reporting directly to the Secretary and with the State Comptroller included in the core financial group as part of an intensive effort to strengthen financial operations, institute more effective priority-setting, and expedite cost forecasting and expense control;

b) Establishment of a joint executive-legislative revenue forecasting mechanism with an adequate professionally-trained, experienced staff;

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[7]Interim Report of the Governor's Task Force on Fiscal Management, December 18, 1989.

c) Rebuilding the state's depleted Stabilization Fund and adopting prudent criteria for drawing on Fund balances.

d) Reorganization of the state's badly-dispersed responsibilities for health care into a consolidated health care agency that can focus on health care strategies, their financing and implementation and that would manage state-owned health facilities and the state's rate-setting role.

APPENDIX

Massachusetts Economic Forecast

The Massachusetts Taxpayers Foundation' (MTF) econometric model produces three-year forecasts of the Massachusetts state economy and state tax revenues. This model uses the latest available economic and tax collection data and the most current forecast for the nation as a whole prepared by the WEFA Group to revise its forecast every quarter. Below are highlights of the model's April 19, 1990 update.

*Massachusetts personal income in current dollars will grow at an average rate of 5.1%, or only 0.2% more per year than inflation.

*1989 was the first year since 1981 that Massachusetts personal income grew more slowly than the nation's -- and we will continue to grow at rates below those for the nation through 1992.

*Job growth has slowed to a standstill. Total Massachusetts employment will actually decline by five-tenths of one percent (16,700 fewer jobs) in 1990.

*Manufacturing industries will continue to lose jobs -- a loss of 24,300 manufacturing jobs in 1990, 5,500 in 1991, and another 4,400 jobs in 1992.

*High tech's troubles continue, but the forecast looks for improvement in 1991 and beyond.

*The forcast indicates that there will be 32,500 fewer construction workers in 1992 than in 1988 despite several large-scale public construction projects.

*Housing starts will continue to fall through 1992, but the annual declines will be much smaller than in 1988 and 1989.

*Net outmigration from Massachusetts, which exceeded 14% in 1989, thereby reversing the trend that had brought the level to almost zero during the "miracle years" of the mid-1980s, has begun a new upward trend and about 20,000 more people will leave than enter the state in the next few years as a result of the high cost of living and lowered economic expectations.

*Despite all the gloom and doom, there are some bright spots -- the service industries, particularly health and "other services," should continue to grow over the next few years, and their growth should help offset some of the declines in manufacturing and construction.