

*Massachusetts Fiscal
Policy: The Legend v. the
Facts*

David G. Tuerck, PhD

Michael Head, MSEP

Frank Conte, MSPA

THE BEACON HILL INSTITUTE AT SUFFOLK UNIVERSITY

8 Ashburton Place

Boston, MA 02108

Tel 617-573-8750, Fax 617-994-4279

E-mail: bhi@beaconhill.org, Web: www.beaconhill.org



Table of Contents

Executive Summary	4
A Massachusetts Shadow Budget.....	5
Eliminating Structural Deficits.....	9
Introduction	12
The Massachusetts Fiscal “Crisis”	15
The Shadow Budget	19
High Spending.....	20
Low Spending	25
Calculating the Shadow Budget	28
Ending the Budget Crisis.....	31
The Current Budget Process	32
The Spending Formula.....	37
Conclusion.....	43
The Beacon Hill Institute Team	48

Table of Tables & Figures

Table ES-1: The Massachusetts Shadow Budget	7
Table ES-2: Expenditures under a BHI TEL (\$ billions).....	10
Table 1: The Massachusetts Shadow Budget	28
Table 2: Expenditures under a BHI TEL (\$ billions)	31
Figure 1: Massachusetts Tax Revenue Collections 1980 – 2009	34
Figure 2: Percent Change of Tax Revenue Collections and Total Return of the S&P 500	35
Table 2: All Budgeted Funds from Statutory Basis Financial Report	37
Table 3: A Comparison of Spending Growth: Actual v. the BHI TEL (\$, billions)	39
Figure 3: Expenditures: Actual v. BHI TEL	40

Executive Summary

There is a deep-seated legend that colors all thinking about state and local government finances in Massachusetts. According to this legend, the state spends too little on “safety-net” services and should therefore raise taxes in order to bring spending on those services up to a reasonable standard.¹ Even worse, the state suffers from intractable “structural deficits,” which, combined with occasional revenue losses, force the state periodically either to make cuts in its already underfunded safety-net services or to raise taxes.²

In this study, we argue that this legend stems from a false understanding of what Massachusetts spends on safety-net services, compared to other states, and of the underlying causes of its structural deficit. Specifically, we find the following:

- Massachusetts spends far more generously on safety-net services than the rest of the country. In three safety-net budget categories – Public Welfare, Unemployment Compensation and Veterans Affairs – the services provided Massachusetts residents exceed the national average by about 30 percent. Massachusetts could cut its spending on the same services by about \$1.6 billion and still exceed the national average by 13 percent.
- One major budget category in which Massachusetts spends far *less* generously than other states is highways. In order to bring its spending closer to the national average for this budget category, it should increase spending by about \$1 billion.

¹ See, for example, Massachusetts Budget and Policy Center, *Substantial Surpluses to Dangerous Deficits: A Look at State Fiscal Policies from 1998 to 2008* (January 2009)

http://www.massbudget.org/documentsearch/findDocument?doc_id=638 (accessed January 7, 2010)

² See, for example, Massachusetts Taxpayers Foundation, News Release, *MTF Calls for Substantial Spending Cuts Now to Avoid Deeper Cuts Later*, (July 10, 2008)

<http://www.masstaxpayers.org/files/Cuts%20now%20to%20avoid%20deeper%20cuts%20later.pdf> (accessed January 7, 2010).

- The state suffers from a structural deficit only because it has not limited the growth of spending to a rate that is commensurate with available revenues. We show how the state could have eliminated the structural deficit ten years ago by adopting a Tax-and-Expenditure Limitation (TEL). This TEL, which would set the growth of spending equal to inflation plus the growth of population, would have permitted the state to fund its Fiscal Year 2010 expenditures without \$1.32 billion in recent tax increases. It would also have permitted the state to maintain real, inflation-adjusted spending per capita straight through the recent downturn.

A Massachusetts Shadow Budget

The U.S. Census Bureau reports data on state and local government spending for various budget categories. These data are useful for comparing state expenditures within budget categories. The latest data are for Fiscal Year 2007.

We undertook the creation of a Massachusetts “shadow budget” that would identify major Census budget categories in which Massachusetts state and local government spending, adjusted for variations in population and in the cost-of-living, substantially exceeded, or fell short of, the national average. We decided to include a budget category in our shadow budget if Massachusetts spending was equal to the average for all states plus or minus 0.95 standard deviation or more.³

We found five categories in which spending exceeded the average by 0.95 standard deviation or more:

³ Standard deviation measures dispersion around the mean. If an observation falls 0.95 standard deviation above or below the mean for all observations (here, observations of states) and if the observations are normally distributed, then 82.89 percent of all observations are lower or higher. This means a state falling in the shadow budget for a particular category would outspend or under-spend about 41 states in that category. We chose 0.95, rather than one standard deviation as the cutoff, because it captures some important high or low-spending categories that would otherwise have slipped off our shadow budget.

- Public Welfare,
- Unemployment Compensation,
- Veterans Services,
- Public Transit and
- Interest on General Debt.

Of these, the first three represent safety-net categories.

We found three budget categories in which Massachusetts fell short of the average by 0.95 standard deviations or more:

- Highways,
- Parks and Recreation, and
- Other Governmental Administration.

We then set a standard by which Massachusetts could, if it so chose, decrease its spending in the “high-spending” categories and increase its spending in the “low-spending” categories to the end of coming closer to the national average. For the high spending categories, we determined how much the state would have spent in 2007 if it had reduced its spending per person to the national average plus 0.5 standard deviation. For the low spending categories, we determined how much the state would have spent if it had increased its spending per person to the national average minus 0.5 standard deviation.⁴ We omitted interest on general debt insofar as spending in that category is nondiscretionary, leaving us with four “high-spending” categories and three “low-spending” categories.

⁴ This means that Massachusetts would then, after making this adjustment, have outspent or under-spent about 35 other states in a given category.

Table ES-1 provides details. Column (7) provides the shadow budget – the amount that Massachusetts state and local government would have spent in each shadow-budget category had it brought its spending to within 0.5 standard deviation of the U.S. average.

Consider Public Welfare. In FY2007, Massachusetts state and local government actually spent \$11.63 billion, or \$1,798.11 per person, in this category. For the nation as a whole, spending per person, adjusted for variations in the cost of living, was \$1,444.49, for a

Table ES-1: The Massachusetts Shadow Budget

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Actual Total Mass.	Actual Mass. Per Person	National Per Person	National Per Person +/- .5 SD	Change in Mass. Per Person	New Total Mass.	Change in Mass. Spending
Category	(\$ billion)	(\$)	(\$)	(\$)	(\$)	(\$ billion)	(\$ billion)
High Spending							
Welfare	11.630	1,798.11	1,444.49	1,629.22	-168.89	10.538	-1.092
Veterans	0.038	5.90	0.98	3.09	-2.81	0.020	-0.018
Un. Comp.	1.309	202.38	102.30	127.67	-74.71	0.826	-0.483
Transit	2.005	310.04	99.85	155.79	-154.25	1.008	-0.998
Low Spending							
Highways	2.272	351.28	654.20	500.22	148.94	3.235	0.963
Parks and Recreation	0.407	62.90	138.73	108.73	45.83	0.703	0.296
Other Gov. Admin.	0.272	42.02	109.52	87.69	45.67	0.567	0.295
Difference					-160.22		-1.036

difference of \$353.62. Taking all three safety-net categories together, Massachusetts spent \$2,006.39 per person, 29.6 percent above the national average (\$1,547.77).

Had Massachusetts cut its 2007 spending on Public Welfare to a 0.5 standard deviation above average, it would have spent \$1,629.22 per person, for a total of \$10.538 billion (the shadow budget amount). It would then have saved \$168.89 (= \$1,798.11 - \$1,629.22) per person, for a total of \$1.092 billion. Had the Commonwealth cut its spending in all three safety-net categories to 0.5 standard deviation above average, it would have saved \$246.41 per person, for a total of \$1.594 billion.

Weighing against this prospective saving is the increased spending that would have been necessary to bring the low-spending categories to within 0.5 standard deviation of the national average. Massachusetts spent \$2.272 billion on highways or \$351.28 per person. Adjusted for cost-of-living differences, the national average was \$654.20. In order for Massachusetts to have raised its spending per person to within 0.5 standard deviation of the national average, it would have had to spend \$148.94 more per person than it did. In the aggregate it would have had to increase spending by \$0.963 billion.

Arguably, Massachusetts should shift about a billion dollars from safety-net to highway spending in order to bring the services provided in both categories closer to the national average. It could achieve a similar result by switching a billion dollars from transit to highway spending.

Were Massachusetts to have increased spending in all three low-spending categories to within 0.5 standard deviation of the national average, it would have had to increase spending by \$1.555 billion. This offsets the prospective saving of \$2.591 billion for all four high-spending categories. The state would have \$1.036 billion left over, to spend

on other budget categories or to apply to tax cuts, if it were to correct, as suggested, for the overspending in the four high-spending categories and for the under-spending in the three low-spending categories.⁵

Eliminating Structural Deficits

Another Massachusetts budget legend has to do with “structural deficits” – budget deficits that never go away because, even in the best of times, the state does not raise enough in current revenues to fund current expenses. These deficits are usually portrayed as an indicator that the state should raise taxes and, during economic downturns, cut services.

The structural deficits are real enough, but only because policy makers lack the will to eliminate them. The state could eliminate structural deficits by simply limiting the growth of spending to some rate commensurate with existing revenue sources and with the variability of economic activity. We propose a Tax-and-Expenditure Limitation (TEL) that would set the growth in spending equal to the growth of population plus inflation. Adoption of this TEL would put an end to the perennial exercise in which legislators strain to formulate a budget on the basis of an uncertain revenue outlook and misplaced concerns about the adequacy of safety-net spending. Our proposed TEL would allow the state to increase spending at a pace that would maintain real, inflation-adjusted government spending per capita at a constant level and without interruption from unpredictable but inevitable revenue shortfalls.

How would the Commonwealth have fared if a TEL had been in place over the last several years? We explore a counterfactual wherein state finances, beginning with

⁵ Difference owed to rounding.

FY1999 and running through FY2010, would have been guided by the restraints imposed by our proposed TEL. Table ES-2 shows actual revenues and hypothetical (under our TEL) expenditures and fund balances for this period.⁶ Hypothetical expenditures for FY1999 match actual expenditures for FY1999, the starting year. We apply the TEL to generate a comparison between actual spending and fund balances and hypothetical spending and fund balances through FY2010.

Table ES-2: Expenditures under a BHI TEL (\$ billions)

Fiscal Year	1999	2006	2007	2008	2009	2010^a
Actual						
Revenues	20.165	26.305	28.616	30.313	29.217	29.685
Expenditures	20.245	25.585	28.923	30.808	30.607	29.389
Fund Balance	2.192	2.487	3.208	2.901	2.406	2.622
BHI TEL						
Expenditures	20.245	25.333	26.179	27.127	28.018	29.057
Fund Balance	2.112	3.709	5.612	5.971	5.242	3.744
^a Estimated.						

Had the state proceeded along the “BHI TEL” path, it could have maintained real, per-capita spending at a constant level through the period 1999-2010 and avoided \$1.32 billion in sales, excise and corporate tax increases that were enacted in part to close the budget gap. Our TEL would have brought FY2010 expenditures to \$29.057 billion – only \$332 million short of our projected actual expenditures for that year.

The scenario explored here allows for the possibility that, contrary to legend, Massachusetts state and local government could spend less than it does and still meet important safety-net needs more generously than the rest of the country. Indeed, a case

⁶ Comptroller of the Commonwealth. “Statutory Budget Financial Report” under “Budgeted Funds –Operations.” (November 2009)
http://www.mass.gov/?pageID=oscterminal&L=3&L0=Home&L1=Publications+and+Reports&L2=Financial+Repts&sid=Aosc&b=terminalcontent&f=reports_audits_rpt_sbfr&csid=Aosc. (accessed January 7, 2010).

can be made for shifting funds from safety-net and transit services to highways and other underfunded services.

We have formulated a TEL that permits the state to meet its revenue needs, year in and year out, without having to engage in tax increases and emergency budget cuts. Structural deficits exist, not because there is no cure for them, but because their existence creates pressure to raise taxes – pressure that comes from policy makers and opinion leaders whose business it is to perpetuate the legend of underfunded safety-net services.

Introduction

In a report issued in December 2008, the National Governors Association warned that deteriorating economic conditions had forced more than half the states to face large budget gaps.⁷ On May 4, 2009, when the recession was in full bloom, *USA Today* reported that for the first time in history federal grants would displace the state sales tax as the principal source of state revenue. The reason was the dramatic decline in own-source state revenues brought about by the current recession.⁸

Most opinion leaders and policy makers would see this turn of events as just another distressing sign of the times. Few would see it for what it was – the result of myopic state government policies that had been formulated implicitly on the premise that state revenues would always rise and never fall.

During good times, the states ring up surpluses, which tempt governors and legislators to expand safety-net services and to embark on new capital projects and new initiatives such as education reform or universal health care. Irrespective of the required revenues needed to sustain them, these programs become the new baseline. Then when an economic downturn sets in and revenues fall, advocates for these programs bemoan the need for “painful” budget cuts and urge fiscal responsibility in the form of permanent tax increases. Spending cuts prove to be temporary while tax increases remain permanent.

⁷ National Governors Association & National Association of State Budget Officers, *Fiscal Survey of the States*, (December 2008): vii. <http://www.nga.org/Files/pdf/FSS0812.PDF> (accessed January 7, 2010).

⁸ Dennis Cauchon, “Federal Aid is Top Revenue for States,” *USAToday*, May 4, 2009, http://www.usatoday.com/news/nation/2009-05-04-fed-states-revenue_N.htm (accessed January 7, 2010).

In 2002, as the nation pulled out of a mild recession, the National Governors Association used language it would use again in 2008:

Nearly every state is in fiscal crisis. Amid a slowing national economy, state revenues have shrunk at the same time that spending pressures are mounting – particularly for Medicaid and other healthcare – creating massive budget shortfalls. As states fight to balance their budgets, the solutions available to them are increasingly dire, and some of the most difficult fiscal decisions have yet to be made.⁹

This analysis reveals the same myopia that would eventually give rise to the current gloom. After the recovery in late 2002, overall state spending grew 50 percent faster than inflation.¹⁰

As authors Michael Flynn and Adam Summers recently noted, “Since 2002 total revenue collections have been well above the levels needed to maintain services each year. This windfall has a cumulative impact. In just five years, taking inflation into account, the states collected \$2.2 trillion more than they would have needed to maintain revenues at 2002 levels.”¹¹ And now that another downturn has set in, the protests over “massive budget shortfalls” and an “increasingly dire” revenue situation are heard again.

According to the General Accounting Office, “tax receipts would need to rise considerably faster than historical experience to enable the operating balance to remain

⁹ See National Governors Association & National Association of State Budget Officers, *Fiscal Survey of the States*, (November 2002): <http://www.nga.org/cda/files/NOV2002FISCALSURVEY.pdf>, p. viii.

¹⁰ Michael Flynn and Adam B. Summers, “Failed States: After a Long Spending Binge, Governors Go Begging for a Handout. It Won’t be Their Last.” *Reason*, May 2009
<http://www.reason.com/news/show/132646.html> (accessed June 23, 2009).

¹¹ *Ibid.*

in the historical range.”¹² In other words, spending rather than tax cuts or revenue shortfalls drive the structural deficits facing the states today and in the foreseeable future.¹³

Given existing tax laws and spending rules, the size of the current government deficit (or surplus) depends on the performance of the economy. When the economy performs poorly, the government tends to run a deficit. When the economy performs well, it tends to run a surplus. Deficits and surpluses should not come as a surprise; they are a natural result of the inherent variability of economic activity. A problem arises only when government runs one or the other – a deficit or a surplus – straight through good and bad economic times. If the government runs a deficit in good as well as bad times, it suffers from a structural deficit.

The structural deficit equals the excess of current government expenditures over current revenues that would exist when the economy was operating at full employment, i.e., when all labor and capital resources were fully utilized. Responsible budget making requires policy makers to adopt budgetary practices that, insofar as possible, bring the structural deficit to zero.

Once a government entity adjusts its tax laws and budgetary practices to achieve that goal, it can weather periods of economic contraction without cutting services or raising taxes. It can expect to experience current deficits (spending flows that exceed revenue flows) during periods when the economy performs below its long-run full-employment

¹² U.S. General Accountability Office, "State and Local Governments: Growing Fiscal Challenges Will Emerge during the Next 10 Years," GAO-08-317 (January 2008) <http://www.gao.gov/new.items/d08317.pdf> (accessed January 7, 2010).

¹³ U.S. General Accountability Office, "Update of State and Local Government Fiscal Pressures," GAO-09-32R (January 26, 2009) 2, <http://www.nasbo.org/Publications/PDFs/2009/UpdateStateLocal2009.pdf> (accessed June 23, 2009).

potential and current surpluses (revenue flows that exceed spending flows) when the economy performs above its long-run full-employment potential. These differences become unimportant insofar as government can borrow, or draw on reserve funds, during economic downturns and then retire debt, or add to reserves, during economic upturns. Because state government is ordinarily restricted from borrowing to finance current expenditures, it must maintain large enough reserves in order to weather economic downturns without raising taxes or cutting expenditures below targeted levels.

Policy makers and opinion leaders who opine the persistence of structural deficits and of economic downturns that threaten vital services ignore the fact that the existence of a structural deficit is a policy choice, not a fiscal inevitability. If structural deficits are persistent, it is because policy makers have chosen to run deficits even during periods of full employment, given the revenue flows that can be expected under current tax law. Failure to resolve this problem reflects an unwillingness to decide what services to provide and at what level, given current tax law.

The Massachusetts Fiscal “Crisis”

The Massachusetts legislature recently approved a \$27 billion budget, which “makes steep government service cuts and raises taxes.”¹⁴ A budgeted \$900 million rise in the sales tax is the biggest tax hike in several years and comes on top of recent increases in the cigarette tax and in corporate taxes. All three yielded an estimated \$1.32 billion in

¹⁴ Matt Viser, “Budget calls for tax hikes, deep cuts: Local aid could drop by 15%,” *Boston Globe*, June 19, 2009, http://www.boston.com/news/local/massachusetts/articles/2009/06/19/budget_calls_for_deep_cuts_in_ma_ss_programs/?page=2 (accessed June 23, 2009).

increased revenue for the state. The state increased the sales and meals tax by 25 percent, from 5 percent to 6.25 percent, and removed the sales tax exemption for alcohol, upon which an excise tax is already levied. It also empowered cities and towns to increase hotel taxes and levy their own meals taxes. Several municipalities including the city of Boston have taken advantage of this option.

The appeal for higher taxes was based, as always, on concerns about safety-net services that are important to the state's neediest residents. According to popular legend, these services are always underfunded, and are the most likely to suffer cutbacks during hard economic times, unless taxes are raised.

In a report on the FY2010 budget, the Massachusetts Budget and Policy Center laments that "this total budget is \$196.7 million less than funding in the FY2009 General Appropriation Act (GAA) – adjusting for the costs of increased municipal participation in the Group Insurance Commission, and hundreds of millions of dollars short of what would be necessary to maintain the level of services provided in FY2009." They go on to predict that there will be "significant increases in out-of-pocket costs for the program's low-income enrollees," that there will be "broad cuts in public health programs" and that "hundreds of frail elders will lose the community-based services."¹⁵

This is a legendary refrain. During good times, such groups claim that safety-net programs are under-funded, even as spending increases. During bad economic times, any cuts are decried as cuts to the bone. According to legend, the state spends too little on safety-net services, with the consequence that it needs to raise taxes in order to bring spending on those services up to a reasonable standard.

¹⁵ Massachusetts Budget and Policy Center, *Substantial Surpluses to Dangerous Deficits*.

Like most states, Massachusetts has recently adopted the practice of engaging in temporary spending cuts and permanent tax increases. The goal is to ride out the storm, hoping (as history shows) that voters forget about tax increases that were enacted in response to a temporary crisis. This has allowed the governor and the legislature to shore up big spending plans (e.g., the Education Reform Act of 1993 and the Universal Health Care Law of 2006) that guaranteed the perpetuation of the structural deficit and the need for tax increases during economic downturns.

Like the household that uses a credit card to expand spending power beyond its ability to pay, the state has been spending and growing beyond its means, particularly in the areas of public welfare, health care and transit. Like households borrowing against future income, the Commonwealth gave little thought to the sustainability of new programs at the time they were proposed. Now, like many other states, it is facing the realities of the economic downturn.

Between FY2001 and FY2007– from one economic peak to the next – spending per capita increased greatly.¹⁶ In FY2001, the Commonwealth of Massachusetts spent \$32.435 billion or \$5,067 per capita.¹⁷ Adjusted for inflation (by applying the Consumer Price Index), this amount is equal to \$5,932 in expenditures per person in 2007 dollars. Actual FY2007 spending was \$6,829 per person, a real increase of 15 percent in just six years. The Massachusetts government could have provided the same level of services as in FY2007 by spending \$897 less per person, or \$5.785 billion less annually.

¹⁶ National Bureau of Economic Research, Business Cycle Dating Committee “Business-Cycle Peak of March 2001,” <http://www.nber.org/cycles/november2001/> (accessed June 17, 2009).

¹⁷ This number is larger than the budget numbers reviewed by the BHI TEL. It is based on an annual survey by the U.S. Census of State Finances, so is a more accurate number of total (on and off budget) spending by the state. U.S. Census Bureau, State Government Finances, <http://www.census.gov/govs/www/state.html> (accessed June 17, 2009).

In order to sort out the claims and counterclaims about the adequacy of safety-net expenditures and the need for increased taxes, it is useful to split the overall problem into two parts. The first part of the problem has to do with the budget items that Massachusetts may underfund or overfund by some national standard, irrespective of current economic conditions. If, compared to the rest of the country, Massachusetts safety-net services are in fact underfunded, even in the best of times, then the argument for higher taxes gains traction. If, by the same standard, they are well funded, then the argument is less compelling. We approach this part of the problem by constructing a Massachusetts “shadow budget” that shows how much state and local government would spend in selected budget categories if it conformed more closely to a national standard for those categories.

The second part of the problem has to do with the task of reducing the structural deficit to zero. It is always a matter of some guesswork to set the growth of expenditures at a level that guarantees adequate revenues to fund state expenditures in good times and bad. It is nevertheless the responsibility of government to provide some mechanism through which government can fund targeted expenditures during periods of economic contraction without having to raise taxes. Failure to do so amounts to creating a state of affairs in which government will inevitably have to raise taxes, not out of any wish to balance public and private priorities but out of necessity to avoid temporary budget cuts that may require politically unpopular budget cuts.

The Shadow Budget

A shadow budget is an alternative budget. If a governmental entity, by some standard, spends far more in a given budgetary category than would seem warranted, it is useful to suggest some amount by which it could reduce spending in that category and still spend more than warranted. Likewise, if it spends far less than would seem warranted, it is useful to suggest some amount by which it could increase spending in that category and still spend less than warranted. A shadow budget identifies these potential budget increases or decreases. Working through a shadow-budget is a useful exercise when assessing claims and counterclaims about whether a particular budget category is under or overfunded.

The analysis is necessarily subjective. We sought to construct a shadow budget for Massachusetts to determine whether there is truth to the frequent claim that Massachusetts spends too little in certain budget categories, particularly safety-net services, and to identify categories in which Massachusetts may in fact spend too little.

Our shadow budget is constructed for combined Massachusetts state and local expenditures and utilizes data for FY2007 published by the U.S. Bureau of the Census.¹⁸ We assess the extent to which Massachusetts spends in a particular budget category by determining how much it spends per person in the category and then comparing that amount with a national average, calculated by using a spatial price index to adjust expenditures per person in other states for differences in the cost of living.¹⁹

¹⁸ U.S. Census, “State & Local Government Finance,” <http://www.census.gov/govs/estimate/> (accessed January 7, 2010).

¹⁹ Bettina H. Aten, Bureau of Economic Analysis, “Estimates of State Price Levels for Consumption Goods and Services: a First Brush,” (November 2007) http://www.bea.gov/papers/pdf/estimates_of_state_price_levels_oct2007.pdf.

We proceed first by determining any categories for which Massachusetts spending per person in 2007 exceeded or fell short of the national average plus a 0.95 standard deviation. We found five – Public Welfare, Unemployment Compensation, Veterans Services, Transit and Interest on General Debt – in which spending exceeded the national average by this measure.²⁰ We found three categories – Highways, Parks and Recreation and Other Governmental Administration – in which spending fell short of the national average by the same measure.

We next calculated how much Massachusetts would have spent in each category if it had reduced or increased its expenditures per person to the national average plus or minus a 0.5 standard deviation, depending on whether it fell into a high or a low-spending category. This permitted us to identify potential budget cuts or increases for each category.

A summary of the budget categories follows.

High Spending

We identified four major budget categories in which Massachusetts spent substantially more than the national average: Public Welfare, Unemployment Compensation, Veterans Services and Transit.

Public Welfare

Public welfare is the second largest census category, behind Education. The Public Welfare budget encompasses items such as Temporary Assistance for Needy Families (TANF), Medicaid, the food stamp program and other welfare programs. One

²⁰ For public welfare, spending exceeded the average by a 0.95 standard deviation.

indication of overspending in this category is the low ratings for welfare reform that Massachusetts has received since President Clinton signed the Personal Responsibility and Work Opportunity Reconciliation Act (PWORA) of 1996.

TANF gave the states flexibility to administer benefits as long as federal TANF goals were reached. In a comprehensive study, the Heartland Institute recently gave Massachusetts an “F” for meeting these goals, based on a score of 34.9 percent and a ranking of 46th out of 50 states and the District of Columbia.²¹

Unemployment Compensation

Included in this category are benefits funded by the federal government, such as cash benefits to federal civilian and military employees, and benefits funded by the state, such as basic unemployment benefits financed by payroll taxes. It includes shared expenditures such as extended unemployment for states with high unemployment rates.

One indication that Massachusetts overspends in this category is that, in the second quarter of 2008, Massachusetts had the second highest weekly payment in the nation at \$391.91, compared to a national average of \$285.28.²²

²¹ Gary MacDougal, Kate Campaigne and Dane Wendell, “Welfare Reform after Ten Years: A State-by-State Analysis,” (June 2008) http://www.heartland.org/custom/semod_policybot/pdf/23500.pdf (accessed June 17, 2009).

²² U.S. Department of Labor, Division of Fiscal and Actuarial Services, Office of Workforce Security under “Unemployment Insurance Data” (2nd Quarter 2008) http://workforcesecurity.doleta.gov/unemploy/content/data_stats/datasum08/DataSum_2008_2.pdf (accessed June 17, 2009).

According to an Unemployment Insurance Trust Fund Report, the fund is at risk.²³ As of the end of November 2009, the fund had a positive balance of \$413.7 million, with employer contributions estimated to be \$1.407 billion. Expected payouts amount to \$2.731 billion, with Federal interest and the American Recovery and Reinvestment Act making up the difference — leaving an expected overall Trust Fund balance of \$78 million.

Unemployment rates exceeding 8 percent have certainly taken a toll on the Trust Fund. But Massachusetts' exceedingly generous unemployment benefits are largely at fault. This transfer payment also takes a toll on the state's competitiveness. According to BHI's Competitiveness Index, Massachusetts is the second most generous state in the country for providing unemployment benefits, as measured by the average first weekly unemployment payment.²⁴

Veterans Services

The Veterans Services line item is a spending category defined under Social Services and Income Maintenance, meant to capture federal and state veterans services not included in the other Social Services categories (i.e., Public Welfare, Hospitals or Education). This includes general outreach programs, administration of various veterans programs and claims representation. Not included in this area is spending on veterans' hospitals, veterans' retirement homes or tuition assistance targeted for veterans.

²³ Commonwealth of Massachusetts, "Unemployment Insurance Trust Fund Report," (October 2009) http://lmi2.detma.org/Lmi/trustfund/Trust_Fund_Report_1009.pdf.

²⁴ Beacon Hill Institute at Suffolk University, "Ninth Annual Competitiveness Report," (December 2009) <http://www.beaconhill.org/Compete09/Compete2009StateFinal.pdf>, (accessed December 16, 2009).

Transit

The Transit line item is included under Utility Expenditures in the U.S. Census data. By far the largest transit system in the state is the Massachusetts Bay Transportation Authority (MBTA); our discussion focuses on the MBTA.

According to a recent review requested by Governor Deval Patrick, the MBTA has been on a downward financial spiral for years, one that has been exacerbated since financial reforms in July 2000 that were intended to put the Authority on solid financial footing.²⁵ The reforms included “forward funding,” a mechanism that directs one percent of sales tax receipts to the Authority.²⁶

Since the implementation of forward funding, the MBTA has run deficits that have been covered by depleting cash reserves, restructuring debt and delaying planned debt payments.²⁷ In the current fiscal year, the system faces a \$160 million deficit. Since revenue has grown slowly over the past decade, the sales tax is not a reliable source of revenue for funding the public transit.

MBTA employee pension and healthcare costs also contribute to the high costs of the system. Employees contribute only four percent of their salaries to their pensions, compared to ten percent for most state employees. Moreover, MBTA employees are able to retire after only 23 years of employment – when they are often in their early 40s – and collect pension and health benefits for the length of their retirement, possibly

²⁵ David F. D’Alessandro, Paul D. Romary, Lisa J. Scannell, Bryan Woliner, “MBTA Review”, http://www.mbtareview.com/MBTA_Review_2009.pdf, (November 2009).

²⁶ The General Laws of Massachusetts. Chapter 10 Section 35T: Massachusetts Bay Transportation Authority State and Local Contribution Funds.

²⁷ MBTA Review,3.

another 40 years.²⁸ According to the Massachusetts Taxpayers Foundation, MBTA employee healthcare costs are 33 percent higher than they are for workers enrolled in the state health plan known as the Government Insurance Commission.²⁹

We note that using per-person spending for a transit system may not be the best measurement of expenditures. Expenditures per square miles of the urban area served by the transit system may be a better measurement. Using data from the Federal Transit Administration's National Transit Database, we calculated the cost per square mile of urbanized area for all 536 transit systems that reported data in 2007. We adjusted the reported costs to reflect costs differences between states using the SPI index mentioned above. The MBTA spends \$569,000 per square mile of urbanized area compared to an average (weighted using urbanized square miles) of \$120,444 for all 536 transit systems. The average plus one standard deviation is \$286,903 per square mile. Whether measured in terms of population or number of square miles, MBTA expenditures are well above spending for transportation systems in other states.³⁰

Interest on General Debt

The high level of interest payments reflects past spending levels. Interest on General Debt represents spending that was funded by issuing government bonds instead of

²⁸Joseph M. Giglio and Charles Chieppo, "Transportation Demands Better Management," *South Coast Today*, April 17, 2009

<http://www.southcoasttoday.com/apps/pbcs.dll/article?AID=/20090417/OPINION/904170307/-1/NEWS01>

²⁹, Massachusetts Taxpayers Foundation, "MTF Recommendations: Saving \$1 Billion in Unaffordable Health Care Costs at the MBTA," (April 2009)

http://www.masstaxpayers.org/publications/health_care/20090330/mtf_recommendations_saving_1_billion_unaffordable_health_care_cost, (accessed January 7, 2010).

³⁰ NTD Databases and Analytical Tools, National Transit Database, <http://ntdweb.com/data.htm>, (accessed January 2010).

using current revenues. Bonds are traditionally used to fund infrastructure projects like roads and bridges. However, in recent years they have been used for other purposes, such the “Massachusetts Life Sciences Initiative,” which helps seed state biotechnology industry.

The Big Dig was one of the largest and most expensive infrastructure projects in American history. The original budget for the decades-long project was under \$3 billion dollars, but recent estimates, which include an additional \$7 billion in interest payment on the projects debt, put the total closer \$22 billion. State highway officials began planning for the Big Dig under the assumption that the federal government would pick up most of the costs, but in the end Massachusetts paid 75 percent of the costs.³¹

Low Spending

We identified three major budget categories – Highways, Parks and Recreation and Other Government Administration (as defined by the U.S. Census) – in which Massachusetts spent substantially less than the national average.

Highways

The Highways category includes spending on maintenance, repair, operation and construction of both toll and non-toll highways. It also includes snow removal and salting. It does not include the policing of the highways or traffic control systems.

³¹ Jon Keller, “Report Big Dig Costs Explode to \$22 Billion,” *WBZ-TV*, (July 17, 2008) <http://wbztv.com/bigdig/big.dig.massachusetts.2.773232.html> (accessed January 7, 2010).

One reason for Massachusetts' low level of per-capita spending on highways is the state's small size and high population density. Massachusetts has only 36,000 miles of public roads not owned by the federal government compared to an average of 76,700 miles for all 50 states.³² By dividing spending on state and local roads by the number of miles of state and local roads, Massachusetts spends \$63,100 per mile of state and locally owned public roads compared to an average of \$47,187 per mile for all states. Thus the highway funding category is not nearly as problematic as the per-capita numbers indicate.

Although Massachusetts highway spending per mile is higher than the average for all states, much of the money has been diverted to finishing and financing the Central Artery/Tunnel project. The federal government allows states to use their own money to begin projects before the federal portion of the funding is available under the rubric of "advance construction." The federal government also allows states to bond against anticipated future Federal grants, using "grant anticipation notes" or GANS.

In the late 1990s Massachusetts issued \$1.5 billion of GANs to pay for the Central Artery. The current outstanding balance of these GANs is \$1.2 billion. Massachusetts has been using 25 percent of the state's obligation authority to repay the GANs. The GANs repayments will rise by about 8 percent per year from 2009 to 2014.³³ The Central Artery/Tunnel project will continue to absorb resources intended for the state's roadways.

³² Federal Highway Administration. "Highway Statistics 2008, Table HM-10" (October 2008) <http://www.fhwa.dot.gov/policyinformation/statistics/2007/hm59.cfm> (accessed January 7, 2010).

³³ Massachusetts Transportation Finance Commission, *Transportation Finance in Massachusetts: An Unsustainable System* (March 28, 2007): 12, http://www.eot.state.ma.us/downloads/tfc/TFC_Findings.pdf (accessed January 7, 2010).

Parks and Recreation

In the Parks and Recreation spending category, defined as the “provision and support of recreational and cultural-scientific facilities maintained for the benefit of residents and visitors,” Massachusetts spends \$62.90 per person, less than half the national average of \$138.73. An increase of \$46 per person would bring spending to a level equal to the average minus 0.5 standard deviation.

Other Governmental Administration

This is a catchall category. After spending in areas such as Financial Administration, Judicial and Legal or General Public Building is accounted for, the remainder of administration costs fall into the Other Governmental Administration category.

Calculating the Shadow Budget

Data for FY2007 from U.S. Census surveys permit us to determine where Massachusetts state and local government spends substantially more or substantially less than other states, when adjusting for differences in population and cost of living. Using the Census data, we are able to show how Massachusetts could have come closer to the national average by reducing or increasing spending, as appropriate.

Column (7) of Table 1 provides the shadow budget – the amount that Massachusetts state and local government would have spent in each shadow-budget category had it

Table 1: The Massachusetts Shadow Budget

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Actual Total Mass.	Actual Mass. Per Person	National Per Person	National Per Person +/- .5 SD	Change in Mass. Per Person	New Total Mass.	Change in Mass. Spending
Category	(\$ billion)	(\$)	(\$)	(\$)	(\$)	(\$ billion)	(\$ billion)
High Spending							
Welfare	11.630	1,798.11	1,444.49	1,629.22	-168.89	10.538	-1.092
Veterans	0.038	5.90	0.98	3.09	-2.81	0.020	-0.018
Un. Comp.	1.309	202.38	102.30	127.67	-74.71	0.826	-0.483
Transit	2.005	310.04	99.85	155.79	-154.25	1.008	-0.998
Low Spending							
Highways	2.272	351.28	654.20	500.22	148.94	3.235	0.963
Parks and Recreation	0.407	62.90	138.73	108.73	45.83	0.703	0.296
Other Gov. Admin.	0.272	42.02	109.52	87.69	45.67	0.567	0.295
Difference					-160.22		-1.036

brought its spending to within 0.5 standard deviation of the U.S. average.

Consider Public Welfare. In FY2007, Massachusetts state and local government actually spent \$11.63 billion, or \$1,798.11 per person, in this category. For the nation as a whole, spending per person, adjusted for differences in the cost of living, was \$1,444.49, amounting to a difference of \$353.62. Taking all three safety-net categories together, Massachusetts spent \$2,006.39 per person, 29.6 percent above the national average (\$1,547.77).

Had Massachusetts cut its FY2007 spending on Public Welfare to 0.5 standard deviation above the national average, it would have spent \$1,629.22 per person, for a total of \$10.538 billion (the shadow budget amount). It would then have saved \$168.89 (= \$1,798.11 - \$1,629.22) per person, for a total of \$1.092 billion. Had the Commonwealth cut spending in all three safety-net categories to 0.5 standard deviation above average, it would have saved \$246.41 per person for a total of \$1.594 billion.

Weighing against this prospective saving is the increased spending that would have been necessary to bring the low-spending categories to within 0.5 standard deviation of the national average. Massachusetts spent \$2.272 billion on highways or \$351.28 per person. Adjusted for cost-of-living differences, the national average was \$654.20. In order for Massachusetts to raise its spending per person to within 0.5 standard deviation of the national average, it would have to spend \$148.94 more per person than it did. In the aggregate it would have had to increase spending by \$0.963 billion.

Were Massachusetts to have increased spending in all three low-spending categories to within 0.5 standard deviation of the national average, it would have had to increase spending by \$1.555 billion. This offsets the prospective saving of \$2.591 billion for the

four high-spending categories. The state would have \$1.036 billion left over, to spend on other budget categories or to apply to tax cuts, if it were to correct, as suggested, for the overspending in the high-spending categories and for the under-spending in all low-spending categories.³⁴

³⁴ Difference owed to rounding.

Ending the Budget Crisis

By offering a Tax-and-Expenditure Limitation, the Beacon Hill Institute (BHI) provides an alternative scenario under which the current state budget is in line with a sustainable growth trend. Under this scenario, the state could have come close to meeting its targeted FY2010 spending without recent increases in sales and other taxes.

Using historical revenue and expenditure data, we determined that if a proposed Tax-and-Expenditure Limitation (TEL) had been in place beginning with FY1999, the Commonwealth would have avoided the large swings in spending and the revenue crises that characterized the ensuing period. Spending rose by 10.7 percent in FY2000 and then fell by 1.2 percent in FY2001, Between FY2006 and FY2008, spending increased by 20.4 percent or more than \$5 billion.

Table 2: Expenditures under a BHI TEL (\$ billions)

Fiscal Year	1999	2006	2007	2008	2009	2010^a
Actual						
Revenues	20.165	26.305	28.616	30.313	29.217	29.685
Expenditures	20.245	25.585	28.923	30.808	30.607	29.389
Fund Balance	2.192	2.487	3.208	2.901	2.406	2.622
BHI TEL						
Expenditures	20.245	25.333	26.179	27.127	28.018	29.057
Fund Balance	2.112	3.709	5.612	5.971	5.242	3.744
^a Estimated.						

The key to avoiding these ups and downs is to formulate a rule under which the state would build its fund balances when revenues are flush so that it could finance services at the desired level when revenues are lean – and without raising taxes. There is no one definition of “desired level,” which ultimately reduces to a political choice between the needs of state government and the needs of taxpayers. Our TEL takes “real” (inflation-

adjusted) state spending per person in FY1999, a year of very flush revenues and generous spending, as our benchmark.

To this point we have compared Massachusetts expenditures per person to those in the other 50 states, which allows us to evaluate spending categories across a standardized base. In the following section, we will focus on the Massachusetts state budget and spending levels over the past decade to review whether the current budget is, as claimed, “without question an austere budget, containing deep spending cuts that will have painful impacts and require shared sacrifice.”³⁵

The Current Budget Process

The Massachusetts budget process starts in the December before the budget goes into effect, when the Senate and House leaders meet with administration officials to determine a “consensus” tax revenue estimate. It involves meetings and public hearings that invite local economists and experts to provide testimony about the national and state economy and tax revenue estimates. The consensus revenue estimate serves as the basis on which the governor and legislature make their budget recommendations.

The state budget is passed by each legislative body and, after reconciliation, signed by the Governor usually before the beginning of the fiscal year, on July 1. The Executive Office of Administration and Finance is responsible for monitoring actual tax revenue

³⁵ Deval Patrick, Governor of the Commonwealth of Massachusetts, “FY2010 Signing Letter,” (June 29, 2009) http://www.mass.gov/?pageID=afterterminal&L=5&L0=Home&L1=Budget%2c+Taxes+%26+Procurement&L2=State+Budget&L3=FY2010+Budget+Information&L4=The+Governor%27s+FY2010+Veto&sid=Eoaf&b=terminalcontent&f=anf_fy2010_fy10veto_letter&csid=Eoaf (accessed January 7, 2010).

collections and adjusting the consensus estimate to reflect that reality. If collections are higher than the consensus revenue estimate, then the political leaders must decide what to do with the additional revenue. They face the choice of either engaging in supplemental spending or directing the extra revenue to the state stabilization fund or other funds.³⁶

Massachusetts, like most states, requires the legislature to approve a balanced state budget. When actual collections fall below the consensus estimates, the Governor is required to respond within 15 days and adjust spending levels to reflect the new reality.³⁷

Recent revenue shortfalls have been steep and prolonged. Figure 1 displays annual tax revenue collections from 1980 to 2009. In FY2009, tax revenues plunged \$2.6 billion, or 12.5 percent below FY2008 collections. Tax revenue collections in FY2002 dropped by \$2.4 billion or a staggering 14.6 percent. While tax revenues fell by only 3.4 percent in FY1990, the drop was mitigated by increases in the income tax to 5.95 percent and then temporarily to 6.25 percent and the expansion of the sales tax to some services. Despite the mild drop in tax revenues, the tax increases failed to lift tax revenue collections above 5.5 percent growth in the ensuing three fiscal years.

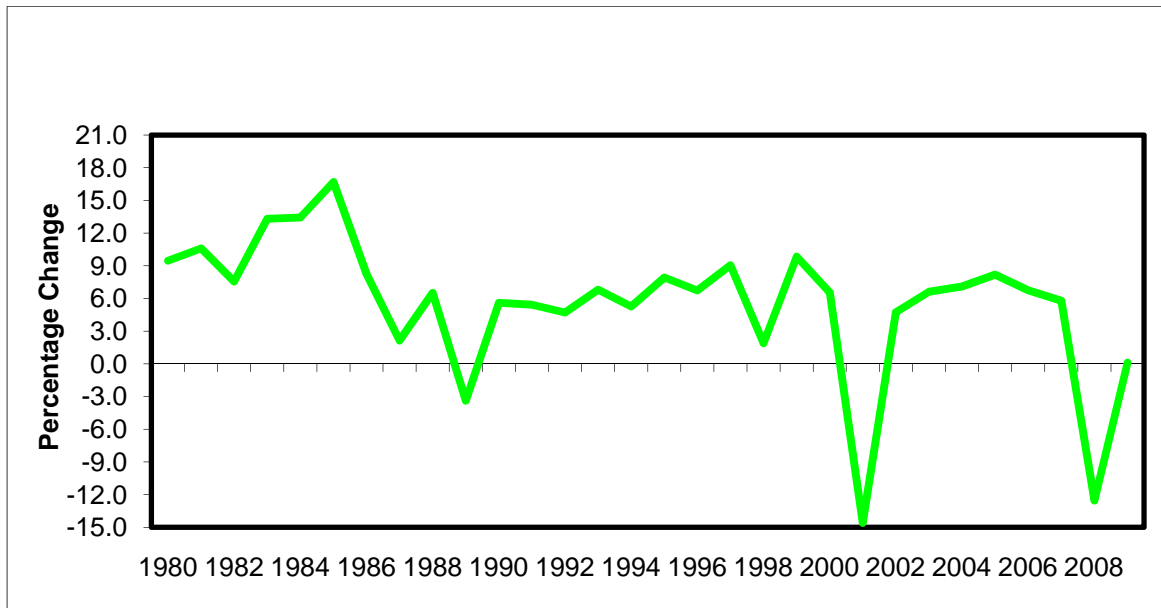
Even during times of relative prosperity, Massachusetts tax revenue collections can be extremely volatile. In FY1997 tax revenues grew by 9.1 percent, followed by a gain of only 1.9 percent in FY1998. Then revenues surged 9.8 percent in FY1999. This volatility reflects the sensitivity of revenue collections to economic conditions. As the state economy grows, incomes and private spending increase as do income tax and sales tax

³⁶ Budgeted funds include the General, Stabilization, Highway and Infrastructure funds. Other funds have moved from budgeted to non-budgeted status over the years.

³⁷ See Massachusetts General Law, Chapter 29, Section 9C.

revenues. This process goes into reverse when the economy is in recession and incomes and spending decrease.

Figure 1: Massachusetts Tax Revenue Collections 1980 – 2009

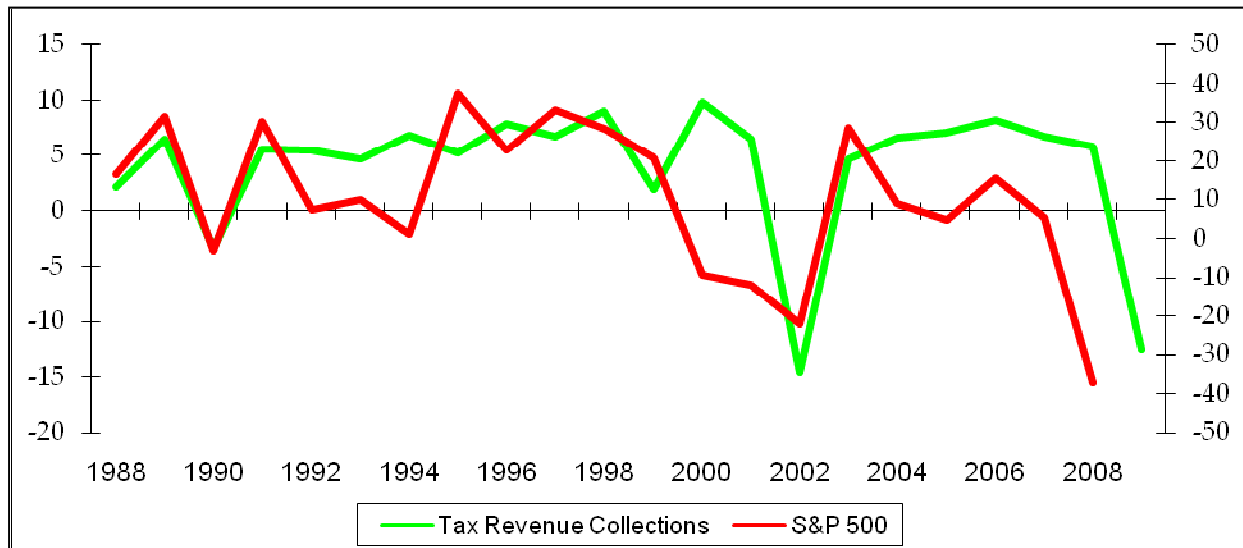


The fact that a large portion of personal income tax revenues consists of capital gains on stock market investments creates a major source of uncertainty.³⁸ Since 1997, income tax revenue from capital gains has accounted for an average of 6.3 percent of total tax collections, ranging from a low of 2 percent in FY2001 and a high of 10 percent in FY2007. Figure 2 charts the similarities between the total stock market return on the Standard & Poor 500 Index of large companies and Massachusetts tax revenue collections since 1988. We use the S&P 500 Index as a proxy for capital gains returns. It can also serve as a proxy for the performance of the national economy. Once again, the growth in tax revenues is closely correlated to the performance and volatility of the

³⁸ Cameron Huff, "Capital Gains: Avoiding Harm to the State Budget," *Fiscal Policy Brief 2*, MassInc., (December 2008) http://www.massinc.org/fileadmin/researchreports/capgains/cap_gains.pdf (accessed December 18, 2009).

stock market and the national economy. Over the past decade, we have learned just how bumpy this ride can be.

Figure 2: Percent Change of Tax Revenue Collections and Total Return of the S&P 500



The Massachusetts state budget process is tied by law to projections of annual state tax revenue collections. This process works reasonably well in times of steady economic growth and, thus, steady increases in revenue collections that fit well into the economic and forecast modeling. However, times of economic uncertainty – especially when an economic expansion turns into a recession – expose the weakness of the budget process. During these volatile times, the administration must revise the consensus revenue estimate and implement spending cuts in the middle of the fiscal year and often, as with FY2009, more than once. The administration makes these adjustments at just the time when revenues are most needed.

The Massachusetts Stabilization Fund has helped the state weather recent fiscal downturns. Without this fund, the spending cuts and tax increases implemented

during the last two recessions would have been more severe and more damaging to the state economy. Yet the Stabilization Fund has not been able to provide enough of a cushion to avoid any tax increases or spending cuts during these recessions.

These two factors – the problem of predicting revenue flows during periods of economic instability and the lack of stabilization funds to tide the state through economic downturns – are a prescription for permanent crisis in state budgeting. The crisis exists even during good economic times insofar as the state’s spending expectations leave it with a permanent structural deficit.

The only escape from this trap is a Tax-and-Expenditure Limitation that makes spending goals attainable even given the unpredictability of revenue flows and the inevitability of economic downturns. This TEL would permit the stabilization fund to grow large enough to absorb the hits that the two past recessions have dealt state finances. It would force state leaders to prioritize budget programs without the pressure of range-of-the moment revenue shortfalls.

According to the Commonwealth’s Statutory Budget Financial Report, state spending over the past decade has grown by a healthy compound annual growth rate of 4.2 percent through FY2009.³⁹ See Table 2. However, this average hides the volatility described above. The period includes seven years in which spending increased from the previous year by an average of 7.5 percent and three years in which spending dropped by an average of 1.2 percent from the prior year. In those years in which

³⁹ Comptroller of the Commonwealth, “Statutory Budget Financial Report,” (November 2009) http://www.mass.gov/?pageID=oscterminal&L=3&L0=Home&L1=Publications+and+Reports&L2=Financial+Reports&sid=Aosc&b=terminalcontent&f=reports_audits_rpt_sbfr&csid=Aosc. (accessed January 7, 2009).

spending growth was positive, real State Gross Domestic Product grew by only 2.6 percent and inflation grew at only 3.2 percent. Thus, state spending outpaced both real economic growth and the cost of goods and services over the same period. In the three

Table 2: All Budgeted Funds from Statutory Basis Financial Report

Fiscal Year	Total Expenditures (\$, billions)	Percentage Increase over Prior Year
2000	22.414	10.7
2001	22.141	-1.2
2002	22.800	3.0
2003	22.439	-1.6
2004	22.848	1.8
2005	23.779	4.1
2006	25.585	7.6
2007	28.923	13.0
2008	30.808	6.5
2009	30.607	-0.7
Compound Annual Growth Rate		4.2

years that spending dropped, prices of goods and services grew by 1.2 percent and the state economy grew by 1.4 percent.⁴⁰ In these years, spending did not keep pace with the growth of the economy or the price of goods and services.

The Spending Formula

The design of a spending formula depends on a political decision about the desired growth of government. If one wanted to assure that government spending grew at the same rate as the economy, spending could be linked to the growth of GDP. On the other hand, one could tie government spending to the cost of goods and services and

⁴⁰ Assuming a growth rate of 0% in 2009.

the size of the population that is served by state government. In this case, the TEL sets spending growth equal to the sum of the inflation rate plus the growth of population. This is the formula chosen under the Taxpayer Bill of Rights (TABOR) that has been in force in Colorado since the early 1990s.⁴¹ This is the TEL proposed here.

Our TEL works by diverting unused revenues to the Stabilization Fund during periods of economic expansion so that the same revenues are available to fund state expenditures during periods of economic contraction. It precludes the familiar practice of making supplementary appropriations toward the end of the fiscal year for the purpose of soaking up unexpected revenue windfalls made possible by a growing economy. This practice serves to ratchet up spending levels and to create a new baseline for spending in future years when the economy and revenues grow more slowly. It also sets the stage for future tax increases.

BHI proposes that the state legislators adopt a state spending formula that links state government expenditures for all budgeted funds to population growth plus a three-year moving average of inflation. This spending formula keeps the “real” (inflation-adjusted) per-capita size of government constant. Thus state government spending would grow at the rate needed to fund services currently provided the average resident. By itself, the spending formula does not dictate which programs should be funded, but instead sets a reasonable constraint on the growth rate of spending. The constraint forces lawmakers to prioritize claims on their resources and to live within their means.

We also recommend a fund balance ceiling equal to 25 percent of the state government’s own source of revenues. Any amount that exceeds this level would be used to alleviate

⁴¹ Recently, the state of Colorado formula has been modified to use the prior years’ TABOR revenue limit as its base, instead of actual revenues, for which to apply the formula.

Massachusetts's relatively large debt burden. We settled on 25 percent because it represents the equivalent of three-months of state and local tax revenues and conforms to the three to six months of expenses that financial advisors recommend to households maintain in an emergency fund.

The 25 percent formula is important for two reasons. First, it allows the fund balances to grow along with tax revenues and thus become large enough to mitigate the revenue drops that take place during a recession. Second, it keeps the ending fund balances from becoming so large as to become the target of lobbying by special interest groups to spend the money. This is especially true for prolonged economic expansions, through which tax revenues could grow faster than spending levels under the TEL.

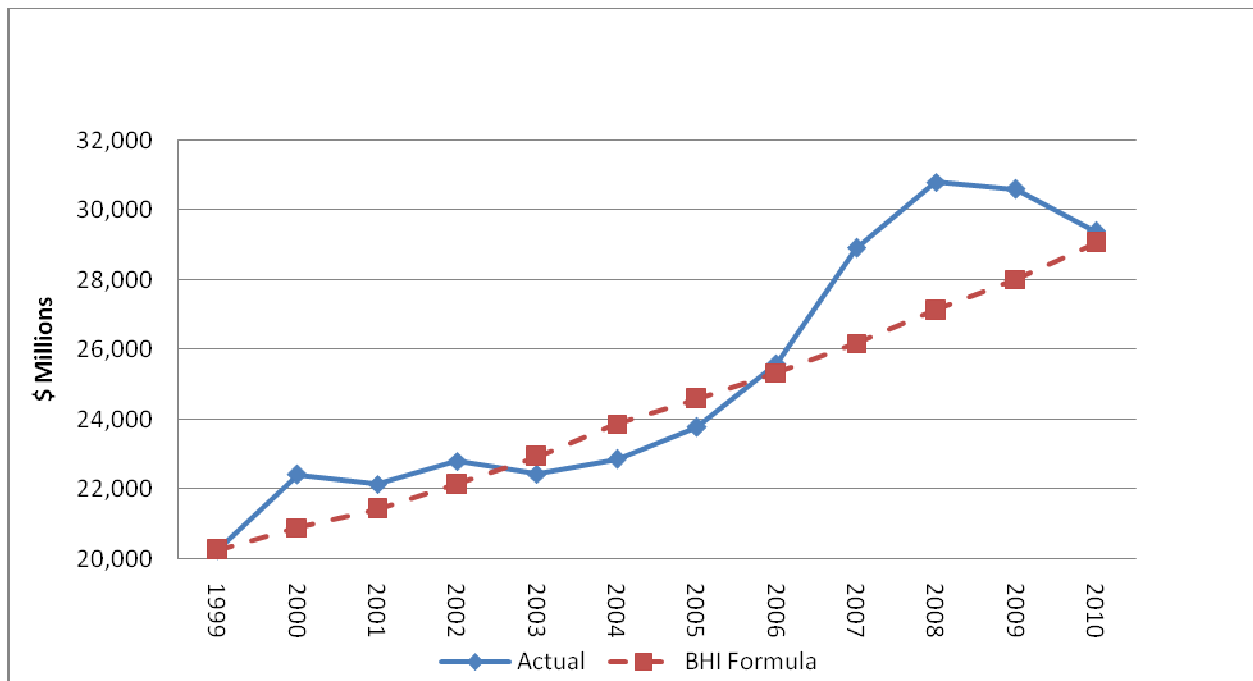
Table 3: A Comparison of Spending Growth: Actual v. the BHI TEL (\$, billions)

Fiscal Year	Actual				Spending Formula			
	Beginning Funds Balance	Total Revenues	Total Expenditures	Ending Balance	Expenditures	Avoided Tax Increases	Debt Payments	Ending Balance
1999	2.192	20.165	20.245	2.112	20.245		-	2.112
2000	2.112	22.587	22.414	2.285	20.887		-	3.812
2001	2.285	22.867	22.141	3.011	21.413		(0.543)	4.723
2002	3.011	21.175	22.800	1.386	22.131		-	3.767
2003	1.386	21.987	22.439	0.934	22.935		-	2.819
2004*	0.934	23.988	22.848	1.890	23.860		-	2.948
2005	1.890	24.373	23.779	2.485	24.586		-	2.736
2006	2.485	26.305	25.585	3.206	25.333		-	3.709
2007	3.206	28.616	28.923	2.899	26.179		(0.533)	5.612
2008	2.899	30.313	30.808	2.404	27.127		(2.827)	5.971
2009	2.404	29.217	30.607	1.014	28.018	(0.430)	(1.498)	5.242
2010**	1.014	28.880	29.389	506	29.057	(1.320)	-	3.744

*Includes reduction of \$183 million for "fund reclassification"
** BHI estimate.

How would the BHI spending formula have affected the trajectory of spending growth, had it been in place for the past decade? BHI compared the growth of actual spending and spending under the formula assuming that the formula had been in place since 2000, using 1999 as the base year. Table 3 and Figure 3 display the results.

Figure 3: Expenditures: Actual v. BHI TEL



In the first two years, spending under the formula would have been lower than actual spending, as one would expect. The largest difference would have been in FY2000, when actual spending grew by over \$2 billion but would have grown by only a little over \$600 million under our TEL. This difference provides a large positive fund balance that allows spending to grow future years. Actual spending levels remain below those under the BHI TEL, until FY2002, when spending under the TEL exceeds actual spending by about \$669 million. This was a period of slow state spending that followed

the steep fall in tax revenue collections in FY2002 and continued through FY2005. This is a period when actual spending was held to very low levels.

In FY2006, tax revenue collections surged by over \$2 billion over the prior year and actual spending increased by 7.6 percent. This marks three years of large tax revenue gains that are matched by higher actual spending growth.

Spending under the BHI formula remains well below actual spending over the period, although it does increase by almost \$1 billion dollars between FY2007 and FY2008, reflecting the surge in energy prices and the subsequent effect on the costs of goods and services. For the period, the average compound growth rate of spending under the formula is 3.3 percent through FY2009, which is only 0.9 percentage points below the 4.2 percent actual growth in spending.

During this period, the BHI formula would have held spending increases well below the actual increases. Fund balances would have hit our 25 percent maximum threshold. As a result, the state would have been compelled to reduce its debt by almost \$5 billion over the period. By reducing total debt, total annual interest payments would have been less for each year from FY2001 on. Approximately \$809 million in interest payments could have been avoided.⁴² Second, sales tax, corporate income tax and cigarette tax increases totaling \$1.32 billion could have been avoided. The final result is that the state of Massachusetts would have been in strong financial shape to weather the coming fiscal storm that is currently playing out.

⁴² Assuming an interest rate of 4.25% based on information from Treasurer and Receiver General, Commonwealth of Massachusetts. See http://www.mass.gov/?pageID=treterminal&L=3&L0=Home&L1=Finance+%26+Investments&L2=Bond+Resources+%26+Information&sid=Ctre&b=terminalcontent&f=debt_intro&csid=Ctre. (accessed December 7, 2009).

Spending under the TEL would be less than \$350 million below projected actual FY2010 spending. Figure 3 displays the results graphically. The steady spending increases under the TEL contrast with the rapid increases in actual spending at the beginning and end of the decade. Moreover, the TEL avoids the subsequent spending cuts that followed the periods of fast spending growth that took place over the period. The TEL would have held spending levels well below actual spending levels and thus, FY2010 spending levels would be only now reaching current spending levels. Thus the Commonwealth would have been able to maintain state expenditures near current levels, avoid spending cuts and tax increases and maintain fund balances that would support future increases in spending.⁴³

⁴³ It is important to note that our results are dependent on the year in which the TEL is implemented. Had the Formula been implemented in FY1997, the ending fund balances would have become almost as large as the total budget by FY2010 and allowed very large debt payments or contributions to reserves. Conversely, had the Formula been implemented in FY2001, the ending fund balances would have turned negative for several fiscal years during the middle of the decade.

Conclusion

It is unlikely that Massachusetts taxpayers understand how generous the state is with their tax dollars or how flimsy the case was for recent tax increases. It is unlikely as well that they understand how this case was contrived out of a conscious or unconscious decision to put the state on a path toward higher spending. Massachusetts taxpayers are the victim of a form of budgetary legerdemain in which they are lulled into accepting, as reality, a permanent crisis in state budgeting and in which the budget suffers from chronic structural deficits.

We have shown that Massachusetts outspends other states in four budget categories that represent discretionary spending of which three represent the provision of safety-net services. Additionally, there are three areas where Massachusetts spends much less than the national average. Bringing these seven categories closer to the national mean would result in just over \$1 billion in total savings. A reduction of the three safety-net categories to the national average plus 0.5 standard deviation could save \$1.6 billion. These reductions would in fact still preserve Massachusetts' longstanding preference for above-average safety-net spending.

The persistent worries over "structural deficits" can also come to an end. The Commonwealth could avoid emergency budget cuts and tax increases by adopting a TEL that fixes the rate of growth of state government spending at the rate of growth of population plus inflation. Thus, the budget process would be guided by realistic expectations of what state government can expect to raise and spend on programs.

The two measures combined — budget cuts in areas in which state and local government arguably overspend and a limitation on spending growth — would

dramatically change the manner in which the Commonwealth faces the inevitable vagaries of the business cycle. The only losers here would be the policy makers and opinion leaders who benefit from the perpetuation of that crisis.

References

- Aten, B. H. (2007, November). Bureau of Economic Analysis. *Estimates of State Price Levels for Consumption Goods and Services: a First Brush*.
http://www.bea.gov/papers/pdf/estimates_of_state_price_levels_oct2007.pdf
- Baker, C. (2004, March 31). U.S. Census Bureau Labor Statistics. *Cost Sharing in medical Insurance Plan*. Retrieved June 17, 2009,
<http://www.bls.gov/opub/cwc/cm20040326ar01p1.htm>
-
- _____. *Massachusetts Sales Tax Hike Would Destroy 12,000 Jobs and \$51 million in Investment*. (2009, May). Retrieved November 1, 2009:
<http://www.beaconhill.org/FaxSheets/2009/MA-SalesTaxHikeRev0625.pdf>
- Boston Municipal Research Bureau and Massachusetts Taxpayers Foundation. *Health Reform: Seizing the Moment*. (2007, August). Retrieved June 18, 2009:
<http://www.bmr.org/content/upload/BMRBMTF.pdf>
- Bristol, S. (2008, October 22). National Bureau of Economic Research. CFO of the Executive Office of Transportation. *Business Cycle Dating Committee "Business-Cycle Peak of March 2001"*. (n.d.). <http://www.nber.org/cycles/november2001/>
- Commonwealth of Massachusetts. Comptroller of the Commonwealth. *Statutory Basis Financial Report*.
http://www.mass.gov/?pageID=oscterminal&L=3&L0=Home&L1=Publications+and+Reports&L2=Financial+Reports&sid=Aosc&b=terminalcontent&f=reports_audits_rpt_sbfr&csid=Aosc
-
- _____. Executive Office of Transportation. *Mass. Highway Department, Accelerated Bridge Program*. (n.d.).
<http://www.eot.state.ma.us/acceratedbridges/> (see also)
<http://www.eot.state.ma.us/acceleratedbridges/downloads/byDate120808.pdf>
-
- _____. Executive Office of Transportation. *State Transportation Improvement Program, FFY2009*. (2009, March 13).
<http://www.eot.state.ma.us/downloads/stimulusprojects/09roadways.pdf>
- Division of Health Care Finance and Policy. *Comprehensive Review of mandated Benefits in Massachusetts*. (2008, July 7).
http://www.mass.gov/Eeohhs2/docs/dhcfp/r/pubs/mandates/comp_rev_mand_benefits.pdf

- Federal Reserve Bank of St. Louis. *Review* 86 no. 2. (2004, April).
<http://www.research.stlouisfed.org/publications/review/04/03/MarApr04Review.pdf#page=12>
- Flynn, M., & Summers, A. B. (2009, May). Reason. “*Failed States: After a long spending binge, governors go begging for a handout. It won’t be their last.*”
<http://www.reason.com/news/show/132646.html>
- Garret, T., & Wagner, G. A. *State Government Finances: World War II to the Current Crises.*
- Gilroy, L. (2008, November). *Lone Star Lessons: What Texas and Florida can teach big spending states.* Retrieved from Reason: <http://www.reason.com/news/show/130290.html>
- Governor’s Budget FY2010. *Group Insurance Commission.* (n.d.). Retrieved June 17, 2009:
<http://www.mass.gov/bb/h1/fy10h1/brec10/dpt/hlgic.htm>
- Henriques, C. (2008, August 13). Commonwealth of Massachusetts, Office of the Controller.
- Huff . C (2008),”Capital Gains: Avoiding Harm to the State Budget,” Fiscal Policy Brief 2
MassInc. (December)
http://www.massinc.org/fileadmin/researchreports/capgains/cap_gains.pdf (accessed December 18, 2009).
- Krol. R. (2007). “The Role of Fiscal and Political Institutions in Limiting the Size of State Government.” *Cato Journal* 27 (3): Fall. 431-445.
- MacDougal, G., Campaigne, K., & Wendell, D. (n.d.). Heartland. *Welfare Reform after Ten Years: A State-by-State Analysis.* Retrieved June 17, 2009:
http://www.heartland.org/custom/semod_policybot/pdf/23500.pdf
- Massachusetts Taxpayers Foundation. *MTF Recommendations: Saving \$1 billion in Unaffordable Health Care Costs at the MBTA.* (n.d.). Retrieved June 17, 2009:
<http://www.masstaxpayers.org/files/MBTA%20report%20-%20NT.pdf>
- National Governors Association. *Fiscal Survey of the States*, December 2008: vii.
<http://www.nga.org/Files/pdf/FSS0812.PDF>.
- Stansel, Dean and Mitchell, David .T. (2008) “State Fiscal Crises: Are Rapid Spending Increases to Blame?” *Cato Journal* 28 (3): 435-448.
- U.S. Census Bureau. *Government Finance and Employment.* Expenditure Federal, State, and Local Governments 2007 (2006). Retrieved June 17, 2009:
http://ftp2.census.gov/govs/class06/ch_5.pdf.
-
- _____. *Federal, State, and Local Governments, State and Local Government Finances.* <http://www.census.gov/govs/www/estimate06.html>.

_____. *State and Local Government Finances*. (n.d.). Retrieved June 18, 2009:
<http://www.census.gov/govs/www/estimate06.html>.

U.S. Department of Labor, Bureau of Statistics. *Local Area Unemployment Statistics*. (n.d.).
Retrieved June 17, 2009: <http://www.bls.gov/lau>.

_____. Division of Fiscal and Actuarial Services, Office of Workforce Security.
Unemployment Insurance Data 2nd quarter 2008. (n.d.). Retrieved June 17, 2009:
http://workforcesecurity.doleta.gov/unemploy/content/data_stats/datasum08/DataSum_2008_2.pdf.

Walker, David M. United States Government Accountability Office. *Growing Fiscal Challenges Will Emerge During the Next Ten years*. Retrieved June 23, 2009:
<http://www.gao.gov/new.items/d08317.pdf>.

The Beacon Hill Institute Team

[David G. Tuerck](#) is Executive Director of the Beacon Hill Institute for Public Policy Research at Suffolk University where he also serves as Chairman and Professor of Economics. He holds a Ph.D. in economics from the University of Virginia and has written extensively on issues of taxation and public economics.

[Michael Head, MSEP](#) is an Economist at the Beacon Hill Institute. He holds a Master of Science in Economic Policy from Suffolk University.

[Frank Conte](#) is Director of Communications and Information Systems for the Beacon Hill Institute. He holds an M.S.P.A. from the McCormack Institute of Policy Studies at the University of Massachusetts - Boston.

The Beacon Hill Institute at Suffolk University in Boston focuses on federal, state and local economic policies as they affect citizens and businesses. The institute conducts research and educational programs to provide timely, concise and readable analyses that help voters, policymakers and opinion leaders understand today's leading public policy issues.

©January 2010 by the Beacon Hill Institute at Suffolk University



**THE BEACON HILL INSTITUTE
FOR PUBLIC POLICY RESEARCH**

Suffolk University

8 Ashburton Place

Boston, MA 02108

Phone: 617-573-8750 Fax: 617-994-4279

bhi@beaconhill.org

<http://www.beaconhill.org>