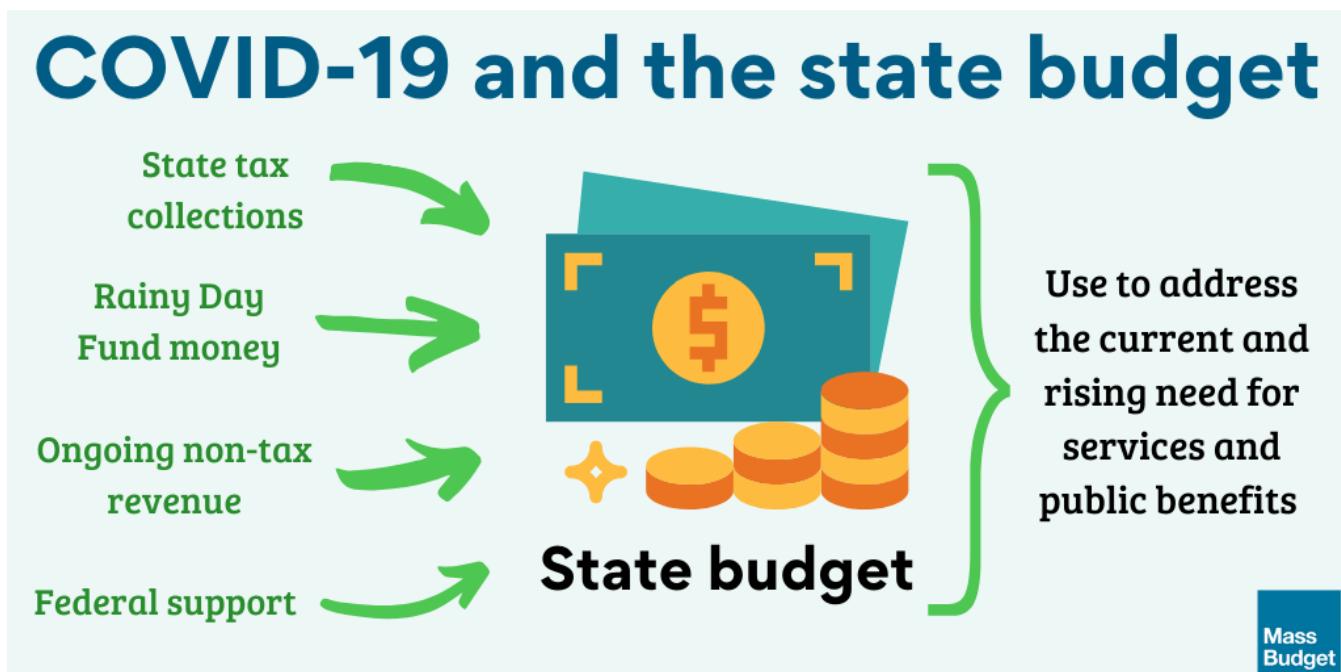


How is COVID-19 affecting the state budget?

Updated 04/30/2020. This document will be updated as the situation develops. Check back for updates.



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1. What is the timeline/process for creating the FY 2021 state budget?

In typical years the legislative portion of the state budget debate begins around mid-April, but the pandemic and its associated closures have upended the budget cycle. (For a description of the typical state budget cycle, see the [“How to follow the state budget process” section of this report](#).)

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It is unclear what process the state will use to build its budget for Fiscal Year (FY) 2021, because current social distancing recommendations make it difficult for legislators to go to the chamber for a roll call vote to approve the budget.

Legislators have been moving legislation while maintaining a safe distance largely through informal sessions, but this may not be possible for a typical budget. Legislative leaders are determining how they can finalize a budget in a way that complies with state law, legislative rules, and with current recommendations to keep lawmakers safe. If even one member objects to a voice vote during an informal session, then the vote is either postponed or a roll call vote is required.

House members are considering emergency changes to their rules that would give them more time to create their proposal for the FY 2021 budget.

The state Constitution does not place many requirements on the process of creating the state budget. Article 63 of the Massachusetts Constitution requires there be a budget and that the Governor can veto at the line item level.

While it is still unclear how the process will play out, we asked several experts (former and current State House insiders and experts on state policy) to offer insights on how the state budget process could occur. We have compiled their responses below.

- House and Senate leaders could engage with each other “pre-conference” (ahead of the Conference Committee, which typically resolves the differences between each chamber’s budget proposals) to reduce potential disagreements that could hold up the budget.
- The Legislature could pass a “one-twelfth” budget. In some years, the Legislature is not able to pass a budget in time for the start of the fiscal year on July 1. They can then pass what is known as a “one-twelfth” budget. This legislation authorizes the state to continue funding at current levels to cover expenses for one month at a time. The Legislature can continue to pass one-twelfth budgets as long as is needed. It is possible the Legislature will need to use this budget-delaying tactic until they are able to pass an FY 2021 budget.
 - The advantage of a one-twelfth budget is it allows lawmakers to keep the state running while their attention is focused on addressing the crisis.
 - A disadvantage of a one-twelfth budget is that the Legislature is more constrained in this option. The one-twelfth budget does not allow for new initiatives or allow the state to change its funding priorities. For example, if the state needs to spend more on public health or for local aid to governments, the one-twelfth budget is not a good option.

WHAT IS A “1/12TH” BUDGET?

If the Massachusetts Legislature is unable to finalize a budget by the start of the fiscal year, July 1st, they can pass a “1/12th budget.”

This allows the state to keep things running one month at a time so legislators have more time to work out the budget.

- The state could build a temporary budget to cover the first few months of FY 2021.
 - One advantage to this option is it allows state lawmakers to set themselves up for the new fiscal year without the constraints of a “one-twelfth” budget.
 - One disadvantage is this option may set the stage for certain funding priorities based on incomplete information on revenue and spending needs. Further, agencies and schools may have difficulty planning programs or staffing around a few months’ funding.

2. What are “9C cuts” and what are the rules around them?

WHAT ARE “9C” CUTS?

Since Massachusetts is required to have a balanced budget, the Governor can make cuts, or propose more revenues, when state funds for the year may come in lower than expected spending. These cuts are named after section 9C of state law, which grants the Governor this authority.

The state’s Constitution requires that the state budget be balanced, meaning that spending cannot exceed anticipated revenues. If, during the fiscal year, the Administration determines that revenues

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may come in lower than the state's projected spending the Governor must either reduce items in the state budget or propose additional revenues, so the budget remains balanced. This additional revenue may come from the state's Stabilization ("Rainy Day") Fund, if needed.

If the Governor reduces allocations in the budget, these are called "9C cuts," because this authority is laid out in [Chapter 29, Section 9C](#) of the Massachusetts General Laws.

The Governor can only make 9C cuts to parts of the government under her or his control — the executive branch agencies.

This means the Governor cannot use 9C authority to cut local aid (including "Chapter 70" school funding), the courts, the Legislature or other constitutional offices. The Governor can instead file legislation recommending cuts to those parts of the budget. The Legislature can then pass a law with those cuts, with other cuts, with new revenue, or with the use of reserves.

3. What will this mean for the education funding overhaul — the Student Opportunity Act

The upcoming fiscal year (FY 2021) will be the first year of the state's new K-12 education funding law, the Student Opportunity Act (SOA). This was designed as a seven-year overhaul of state funding for K-12 public schools, which is laid out by a formula known as "Chapter 70". The SOA focuses particularly on increasing support to students in low-income families.

With state revenue falling but potential federal relief coming, state lawmakers will have to figure out a way to stay on course to fulfill the SOA.

In January (before the crisis), the Governor's budget proposed increasing school funding by \$303.5 million for FY 2021. This was a greater increase than recent years, but it was short of the \$377.1 million necessary to [keep the SOA plan on track](#).

Despite the uncertain budget picture, the urgency for fully funding the SOA is even greater if we are to have a quick and stable economic recovery. Even before COVID-19, the state needed stable, growing, and progressive revenue to fully fund the SOA. If the state decides it must delay some investment towards the SOA, it will need to accelerate investments in the coming years to get back on track.

The critical role of schools in children's lives has been put in stark relief during this pandemic, as has inequity in access to learning across the Commonwealth. A well-resourced state budget will be necessary for ensuring that all children have equal access to all the supports they need to get back on track when they return to school-based learning.

4. What is the new revenue picture?

Before lawmakers begin creating the state budget, they first have to determine how much tax revenue the state expects to collect. This tax amount is known as the Consensus Revenue Estimate (CRE).

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Only a month or two ago, as lawmakers were developing FY 2021 budget proposals, the expectation was that the Commonwealth would collect \$31.151 billion in taxes in the coming fiscal year. However, in response to the spread of COVID-19, Governor Baker placed a halt on economic activity deemed “non-essential”. Not surprisingly, state revenues — both in the current fiscal year (FY 2020) and coming fiscal year (FY 2021) — now are anticipated to fall far short of earlier expectations. (The state’s tax filing deadline also has been extended this year from April 15 to July 15, further complicating the state’s revenue picture.)

The situation remains in flux — the economic and revenue impacts will be dictated largely by the progress of the pandemic, which is still unfolding. A panel of experts in mid-April delivered sobering news to state legislators: tax collections for FY 2020 are likely to fall \$500 million to \$5 billion below expectations and FY 2021 collections are likely to fall some \$4 billion to \$6 billion short of the FY 2021 CRE — which had been set at \$31.151 billion.

This abrupt and radical shift in tax collections will have a major impact on lawmakers’ decisions on the remainder of FY 2020 and all of FY 2021. The Commonwealth will depend heavily on support from the federal government. While the Federal Reserve has opened a \$500 billion loan program for states (the “Municipal Liquidity Facility”), this will help only with short-term cash flow issues. It will not address the core fiscal challenge faced by the Commonwealth: deep revenue losses in the years ahead.

Even with these federal supports, the Commonwealth will likely need to make substantial withdrawals from the state’s Rainy Day Fund to avoid or limit cuts to critical programs and services.

Even together, federal support and our Rainy Day Fund will not likely cover the gap between declining tax collections. To avoid damaging and unnecessary cuts, the Commonwealth will need to seek other ways to generate additional tax revenue. Lawmakers can ensure a robust and just recovery by examining our tax code, looking for ways to eliminate, reduce, and/or delay costly tax breaks for profitable corporations and very high-income households. By doing so, lawmakers will be better able to protect vulnerable populations and shore up state revenues for the near and the longer term.

5. How will federal aid affect our state revenue picture?

The federal government plays a vital role in helping the state get by and recover from the crisis. So far, Congress has passed [four significant pieces of legislation](#) addressing the impact of COVID-19 across the country. These laws have included significant funding for businesses, funding to bolster the health care sector’s response to the virus, direct assistance for unemployed workers, support for the education sector, and more.

Only a relatively small share of funding coming to Massachusetts from these bills will be available for the state budget.

For example, the second bill, the Families First Coronavirus Response Act, includes an increase in federal reimbursement for the state’s Medicaid (MassHealth) spending. This additional \$1.1 billion will go into the General Fund and be available for the state budget.

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The third bill, the Coronavirus Aid, Relief, and Economic Security (CARES) Act includes substantial funding directed to states and municipalities. The CARES Act includes \$2.7 billion for Massachusetts, with \$1.7 billion for the state and \$1.0 billion potentially directed to Boston or county governments. Although this money can't be used directly to make up for revenue shortfalls in the budget, it can be used to pay for increased expenses associated with the COVID-19 outbreak.¹ Exactly how these spending guidelines will be implemented at the state level is uncertain, so it is unclear whether any of these funds will be available for budget-writers to use for filling revenue gaps.

The CARES Act also includes an increase of \$45 million for the Child Care Development Block Grant to Massachusetts. As this funding usually goes to the General Fund to help pay for child care provided by the Department of Early Education and Care, it may be available to support child care expenses in the state budget.

In addition to direct relief from the federal government to states and municipalities through the CARES Act (and related legislation), the state can also make use of a newly established Federal Reserve loan program — the “Municipal Liquidity Facility” (MLF) — for states. (The program also will be available to cities with populations above 250,000 and counties with populations above 500,000.)

The MLF will buy up to \$500 billion in short-term bonds and various tax anticipation notes issued by eligible entities (the maturity dates on these bonds and notes must be less than three years). These bond and note purchases will provide states that are facing immediate cash flow and other revenue shortfall problems with much-needed dollars to maintain programs and services. The MLF rules also allow states to use these dollars to purchase short-term debt from “political subdivisions of the relevant state”, effectively extending the Federal Reserve’s support to cities and towns, through state governments.

While the MLF is a timely and crucial form of support that will help keep some states afloat over the coming three years, the program has significant design flaws. State constitutional prohibitions on debt will prevent some states from accessing these dollars altogether. Other states — including Massachusetts — may face constitutional constraints in carrying the resulting debt from one fiscal year to the next, thus limiting the value of the program even for relatively short-term fiscal relief.

Additionally, because states will continue to face daunting tax shortfalls in the coming years, federal support that requires repayment will only slow future recovery and prevent states from replenishing their reserves ahead of the next recession. Rolled out with understandable haste, the Federal Reserve has begun revisiting and revising its rules to address the various shortcomings of the MLF.

In short, though a useful short-term tool for some states, the MLF is no substitute for what states and the national economy will need: large infusions of federal dollars to support state budgets — dollars that do not require future repayment.

¹ Congressional Research Service, “The Coronavirus Relief Fund (CARES Act, Title V): Background and State and Local Allocations”, (Updated April 14, 2020) <https://crsreports.congress.gov/product/pdf/R/R46298>

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6. Should we dip into the “Rainy Day Fund”? If so, how much and for what?

WHAT IS THE STATE’S “RAINY DAY FUND”?

Also called the Stabilization Fund, this fund is a savings account that the state can draw from to fill revenue gaps during times of crisis.

To do this, it needs to build up the fund during good times so it has enough to draw from during bad times.

Given the scale of expected tax shortfalls in the months and years ahead, the state likely will lean heavily on its savings account – the “Rainy Day Fund” – to balance the budget. This likely will include either or both the current (FY 2020) and coming (FY 2021) fiscal year budgets, and possibly budgets in fiscal years beyond.

Currently, the state’s Rainy Day Fund holds \$3.5 billion. While this amount offers a substantial cushion, the scale of potential tax revenue shortfalls could dwarf the Fund’s holdings. The most recent tax loss estimates range from \$500 million to \$5 billion in FY 2020 and \$4 billion to \$6 billion in FY 2021. In recent recessions, state tax collections have taken six years to return to pre-recession levels.

When to access the Rainy Day Fund and how much to use for immediate needs depends greatly on how much federal fiscal relief the Commonwealth expects. The situation with regards to federal support remains fluid. The state could see several billions of dollars in direct relief from recent federal aid packages and there is pressure – and a great need – for much more relief to states.

The Federal Reserve also has established a \$500 billion loan program, the MLF, to help states with short-term cash flow issues. However, requirements to balance the state budget likely mean these borrowed dollars would need to be repaid within the same fiscal year in which they were borrowed. Massachusetts legislators currently are considering a temporary measure to allow the state to carry debt over multiple fiscal years. If the Legislature can’t find a solution, it would significantly reduce the MLF’s value in helping states address the deeper fiscal challenges they face.

Even with very significant federal support, it appears all but certain that the Commonwealth will need to draw on its Rainy Day Fund. Drawing on the fund during the remainder of the current fiscal year (FY 2020) would help the state avoid cuts that would hurt vulnerable communities. It would also allow

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the state to avoid delaying investments in the long-term well-being of Massachusetts workers and families.

Still, given that the state's fiscal challenges will continue – and quite likely worsen – during the coming fiscal year, lawmakers will want to preserve a larger share of the Rainy Day Fund for use in FY 2021. Factors that lawmakers will need to consider include whether the budget holes they seek to fill with Rainy Day dollars might be filled down the road instead with federal dollars. Maximizing the use of federal dollars will be a key strategy for preserving the Rainy Day Fund over the coming several years.

Finally, the Commonwealth likely will seek to retain some sizable minimum in the fund, because borrowing costs tend to rise when states deplete their savings. (Credit rating agencies tend to view states with lower fund balances as higher risk investments.) Despite large and repeated withdrawals from the fund during the Great Recession, the lowest balance in the Fund (at the end of FY 2010) was \$670 million.

7. What are some tools to generate revenue in the short term?

Given the scale of the tax revenue declines we expect, it will be advisable for the state to identify and access additional tax revenue streams as soon as possible. Not only will these dollars help see us through the current crisis and its immediate aftermath, but they will also help us make the investments in our people and infrastructure that will position us for a robust recovery down the road.

But how can the Commonwealth generate more revenue as we head into a deep recession? Despite the very real challenges that many households and businesses are facing, there will be some families and businesses that will continue to prosper during the COVID crisis – and some for whom COVID will prove unusually profitable. Eliminating tax breaks and closing tax loopholes that deliver benefits to these high-income households and profitable corporations is a first, reasonable step toward shoring up state tax revenues during the crisis and beyond.

So, what are some options for generating these new revenues?

- Lawmakers could delay, eliminate, or reduce the cost of a new state charitable deduction, which is set to kick in on January 1, 2021 and would cost the state \$300 million per year. Such a deduction [would largely benefit those with very high incomes](#).
- The state could make use of a [provision in the federal tax code \(the Global Intangible Low-Taxed Income, or “GILTI” provision\)](#), allowing states to recapture some of the revenues lost to extreme forms of tax dodging by profitable multinational corporations.
- Lawmakers could eliminate or reduce the state's film tax credit, the cost of which [far exceeds the revenue and economic benefits it generates for the state](#).
- Lawmakers could eliminate other costly tax breaks, like the [Single Sales Factor](#).

Read more about the state's options to generate revenue during the crisis and recovery here:

<https://medium.com/@MassBudget/amid-plummeting-state-tax-collections-the-commonwealth-has-options-4b9881548213>

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8. How will the crisis affect the current (FY 2020) budget?

In addition to the upcoming budget (FY 2021), state lawmakers have to also consider how this crisis is affecting the current (FY 2020) budget. If this recession follows a similar pattern as the last two recessions, in FY 2020, Massachusetts could collect \$4.2 billion to \$4.9 billion less in taxes than it did the previous year.²

The state is required to balance its budget and lawmakers have a couple of options to do this for its FY 2020 budget:

- State lawmakers draw from the state's Rainy Day Fund (its savings account; explained in question 6 of this report) to balance its FY 2020 budget.
- The Governor could issue 9C cuts (explained in question 2) for FY 2020, but, a lot of the current year's money has already been spent or contracted out.

At this point in FY 2020, using Rainy Day Fund money may be the state's best option for balancing the current year's budget. But the Senate President has expressed hope the state can make it through the final two months of FY 2020 without having to draw on the Rainy Day Fund.

9. How might demand on public services increase?

With widespread layoffs, people need public benefits more than ever to help them get by.

The full extent of the immediate needs — for health care, income supports, child care, and myriad other services — is not yet clear. State data show that weekly applications for food assistance, cash assistance, and other programs tripled between February and March.³ As people become unemployed, many also are losing health insurance. The state's Health Connector in early March saw 17,500 new enrollees and thousands reported changes to their income and switched to MassHealth, the state's Medicaid program.⁴

The Governor has committed to more funding for several programs and services, like health care and rental assistance, but more will likely be needed in the near term and as the state recovers from the economic crisis over the long term.

Municipal governments also will need significant state support during this crisis and in the recovery. To serve their residents, local governments must make unforeseen investments such as to meet increased overtime for public safety, create safe social distancing for housing shelters, and ramp up

² Marie-Frances Rivera, "Testimony: We must ensure collective well-being and economic security in the Commonwealth," MassBudget (April 15, 2020), <https://medium.com/massbudget/testimony-we-must-ensure-collective-well-being-and-economic-security-in-the-commonwealth-3f0937a98963>

³ Chris Lisinski, "Mass. Residents Turning to Public Assistance Programs," State House News Service (April 8, 2020), <https://www.statehousenews.com/email/a/2020723?key=f1ceac>

⁴ Gabrielle Emanuel, "Newly Unemployed Seek Health Insurance Amid Pandemic," WGBH (April 15, 2020), <https://www.wgbh.org/news/local-news/2020/04/15/newly-unemployed-seek-health-insurance-amidst-pandemic>



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their local health commissions. In the meantime, they have lost revenue they depend on from meals, hotels, jet fuel taxes, cannabis, lottery, and other sources.