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7 questions you have on the state budget and COVID-19, but were afraid to ask

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Updated 05/06/2020, check back for updates. This is an abbreviated version of a longer report. The full report is available here.

The coronavirus crisis and its induced recession are upending all areas of life. The Massachusetts state budget is no exception. How has the crisis affected the state budget and what does this mean?

MassBudget has compiled the answers to some commonly asked questions and provided a handy glossary of terms.

Share your questions, insights, and concerns with us at answers@massbudget.org.

1. What might be the process for creating the FY 2021 state budget?

Fiscal Year (FY) 2021 begins on July 1, 2020 yet the process for creating the FY 2021 budget remains unclear.

Ordinarily, the House would have its budget proposal in place by late April and the Senate by late May, but this has been derailed by the COVID-19 crisis. (*For a description of the typical state budget cycle, see the "How to follow the state budget process" section of this report*.)

To create the FY 2021 budget, lawmakers must first determine how much revenue we will have to build the state budget. The state Constitution requires that Massachusetts' state budget be **balanced**. Because so many people are out of work and aren't shopping or eating out, tax collections have taken a nose-dive and state lawmakers have to revise their initial tax revenue estimate before they build their budget for FY 2021.

While state house leaders grapple with this question, the July 1 start of FY 2021 looms. The next question before lawmakers is *how* they can keep the state running while also creating a budget that makes sense, given the tight timeline and incomplete information. These options include:

- A "pre-conference budget" — this option bypasses some of the typical back-and-forth between the House and Senate, as leaders of each chamber resolve differences ahead of time to come up with a joint budget proposal.

- A "one-twelfth budget" — this option authorizes the state to keep funding all its services at the same level one month at a time. This gives lawmakers more time to build a budget.

- A temporary budget — lawmakers could use this option to cover the state's expenses for the first few months into FY 2021.

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

If the Governor finds that revenues are coming in lower than expected, she or he must ensure the budget stays balanced. One way to do this is by cutting spending through authority granted to the Governor 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, meaning the executive branch agencies.

The Governor cannot issue 9C cuts to other parts of the government like local aid (funds to local governments, including for public schools), the courts, the Legislature, or constitutional offices. For those parts of government, the Governor can instead recommend cuts by filing a bill.

3. What will this mean for the school funding overhaul — the Student Opportunity Act (SOA)?

Last year the state passed a historic law to revamp the way it funds K-12 public schools. This new law, the Student Opportunity Act (SOA), was particularly focused on boosting support for students in low-income families.

FY 2021 was supposed to be the first year (out of seven) to fund that new law. But lawmakers are worried that plummeting revenues mean they will not be able to deliver on the SOA promise in its first year.

To keep the SOA on track, lawmakers will need to boost school funding by $377.1 million in FY 2021.

While the price tag seems high during an economic recession, this critical investment will be a down payment on a stronger recovery for the state's students, teachers, and its economy. Delaying this investment could come at a high cost, particularly for those hit hardest by the crisis.

4. What is the current situation around state revenue?

The state relies on taxes to help pay for essential services like schools, cash assistance, and roads. But, to prevent further spread of the coronavirus, Massachusetts has had to freeze a lot of economic activity that generates taxes. The state's income tax deadline also has been pushed to July 15, meaning the state does not yet know how much tax revenue it will get.

Latest estimates show the state's tax collections could come in much lower than anticipated:

- For FY 2020 (the current fiscal year), tax revenue could come in as much as $4.5 billion below what the state expected.

- For FY 2021, tax revenue could come in up to $7.2 billion short of expectations.

The state could receive help from the federal government (discussed in question 5), but some federal funding is restricted and cannot be used to make up for long-term revenue shortages.

The state also could dip into its $3.5 billion savings account, the "**Rainy Day Fund**", but it needs to be thoughtful about how it uses that money amid a crisis that's still unfolding. (Read more on this in question 6.)

Even with help from the federal government and money from the Rainy Day Fund, Massachusetts likely won't be able to make up for all the shortfalls from tax revenue.

To avoid harmful budget cuts to schools, elder services, public health, and other vital programs, the state will likely have to find ways to eliminate or scale back on the tax breaks it gives to large, profitable corporations and very high-income households. (Read more in question 7.)

5. How will federal relief affect state revenue and the state budget?

The federal government plays a key part in helping states get by and recover from the crisis. The first three federal relief bills will bring more than $4 billion in federal money to Massachusetts, but only a small portion of this will go into the state budget.

Some federal funding coming to Massachusetts will go directly to K-12 schools. And some of the funding that can go into the state budget is dedicated to particular uses, like child care. (For more details, see this MassBudget report.)

On top of federal relief, the Federal Reserve — the United States' central bank — also created a new loan program known as the "**Municipal Liquidity Facility**" (MLF). States and larger cities and counties can take out short-term loans from this $500 billion MLF.

While the MLF will help states with their short-term cash flow issues, it will not help states with their long-term revenue shortages. (Learn more about the MLF in this report.)

6. Should we dip into the state's "Rainy Day Fund"? If so, how much should we use?

Even though the state's savings account — the "Rainy Day Fund" — is at an all-time high of $3.5 billion, this amount still will not likely make up for the state's financial woes.

Some considerations around how much to withdraw from this fund depends on a few factors:

- How much federal relief can the state expect to receive and how restricted is that relief? The state could use the Rainy Day Fund to fill the holes left by federal funding.
- Will the state need to use Rainy Day Fund money to balance its current (FY 2020) budget before closing the year out?
- How much should the state keep in the Rainy Day Fund? It is unclear how long the crisis will last, so the state may need to stretch its savings. Further, if the state depletes its savings it could receive poorer scores from credit rating agencies, which makes it more expensive for the state to borrow money.

7. How can we generate more revenue in the short term?

The state is set to lose billions of dollars in taxes and — to avoid further harming our children and families — it must find ways to plug up those holes.

There are a variety of ways to generate taxes during a deep recession — the state already gives away a lot of its tax revenue to profitable corporations and very high-income households. Some of the tools to generate revenue in the short term include:

- Halting or eliminating a new **state charitable deduction**, scheduled to kick in January 2021. This new tax break could cost the state $300 million per year and would mostly benefit those with high incomes.
- Recapturing some extreme forms of tax-dodging by large corporations. (This is known as the "**GILTI**" provision — learn more here.)
- Eliminating or reducing expensive business tax breaks like the film tax credit or the **Single Sales Factor**.

For a full menu of options, read our blog post.

Glossary of terms

Balanced budget: The Massachusetts Constitution requires the state to balance its budget, meaning expected spending must not exceed expected revenues.

Global Intangible Low-Taxed Income (GILTI) provision: Many large, profitable multinational corporations go to great lengths to avoid paying taxes. In some cases, U.S. multinationals will shift their income (that they made in the U.S.) into accounts overseas — in places that collect few or no taxes, like the Cayman Islands or Cyprus. The GILTI provision allows states to recapture some of the money they lose to these corporate tax-dodging practices.

Municipal Liquidity Facility (MLF): The Federal Reserve — the country's central bank — in April created a $500 billion loan program, the MLF. The program will allow states, cities with populations above 250,000, and counties with populations above 500,000 to take out short-term loans. The states and local governments will have three years to pay back their loans.

Pre-conference: In typical years, the Governor kicks off the budgeting cycle with her or his budget proposal. Then, each chamber of the Legislature — the House then the Senate — goes through a process to make its proposals for the state budget. After this, a conference committee — made up of legislators from both the House and Senate — resolve the differences between the House and Senate budgets. The entire Legislature votes on this resolved version and that becomes the entire Legislature's budget proposal. A "pre-conference budget" bypasses some of this back-and-forth. Instead, leaders from each chamber will resolve differences ahead of time to come up with a joint proposal.

Rainy Day Fund: The "Rainy Day Fund" is a commonly used name for the state's savings account. It is also known as the state's Stabilization Fund. (The state's "checking account" is the General Fund.) The purpose of the Rainy Day Fund is to help carry the state through hard economic times until the crisis is past.

Single Sales Factor: States around the country typically tax the profits of multi-state companies based on how much of their business activity takes place in each state. States generally sort these activities in three categories: property, payroll, and sales. Under the Single Sales Factor, Massachusetts considers only whether the company makes any sales in the state. For example, if half a company's sales are made in Massachusetts the state would count half the company's total profits as taxable by Massachusetts. By contrast, if a manufacturing company had its factory and all its workers in Massachusetts but made all its sales to Texas customers, then Massachusetts would collect no income taxes from this company.