

Budget Development

Introduction

The state budget is the foundation for responsible government spending. It has a wide-ranging and far-reaching impact on the well-being of the residents of the Commonwealth. It is the vehicle through which we as a citizenry make investments together for the benefit of us all – investments for the “Commonwealth.” Serving as a blueprint for the activities and obligations of the year, the budget reflects our collective judgment about the state government’s role in our society, obligations to serve its people and strategic investments to secure its future prosperity. Each line item represents a critical service, program or responsibility that the state will provide throughout fiscal year 2011.

The Patrick-Murray Administration’s fiscal year 2011 budget is a balanced, responsible budget that reflects the continuing financial challenges confronting the Commonwealth during a time of international economic uncertainty. Nationally, state revenue collections have seen a severe decline in every tax category since fiscal year 2009. State and national economists predict revenue growth as the economy recovers but that the revenue growth will begin to reverse in the second half of this fiscal year, albeit slowly. The Commonwealth continues to experience significant challenges as a result. This Administration’s budget reflects the difficult choices made in response to this challenging reality.

The Administration submits its fiscal year 2011 budget proposal amidst continued economic challenges that have already required mid-year solutions to be implemented to close a \$600 million gap in fiscal year 2010. Even after accounting for \$590 million in projected growth in tax revenues, the Administration has to close a \$2.7 billion budget shortfall simply to maintain our current level of commitment to existing services and programs. In addition, we continue to grapple with a longstanding structural deficit caused by a reliance on one-time revenue sources to fund recurring expenses. One time resources such as State “Rainy Day” fund and Federal ARRA funds have allowed us to maintain vital programs and services during an unprecedented global recession; however, reduced amounts will be available to utilize in the budget for fiscal year 2011.

In times of recession, additional pressure is created as counter-cyclical needs emerge. The demand for government-supported services increases as revenues decrease and our resources are strained. This gap has required the Administration to make difficult decisions. While the Administration continues to seek out reforms, savings and efficiencies wherever possible, the magnitude of our economic challenges will require us to continue making difficult cuts to programs and services. This budget relies on Federal stimulus funds and uses a balanced approach of cuts, revenues, and one time resources to solve the budget gap. It makes key investments in education, health care, and cities and towns that are critical to strengthening our economy in the short-term and long-term.

The following sections describe the challenges faced by the Administration and the process that was used to develop the Governor’s budget recommendations for fiscal year 2011. Also included within this document is a user guide and glossary to assist in navigating this budget document.

Massachusetts' Government Structure

The government of the Commonwealth is divided into three branches: the Executive, the bicameral Legislature and the Judiciary.

Executive Branch

Chief Elected Positions

Governor

The Governor is the chief executive officer of the Commonwealth.

Lieutenant Governor

The Lieutenant Governor is elected along with the Governor. Together, the two work closely to address important issues facing the Commonwealth.

Executive Council

Also referred to as the "Governor's Council," this body consists of eight members who are elected to two-year terms in even-numbered years. The Executive Council is responsible for the confirmation of certain gubernatorial appointments, particularly judges, and must approve all warrants (other than for debt service) prepared by the Comptroller for payment by the State Treasurer.

Appointed Positions

Governor's Cabinet

The Governor's Cabinet is comprised of eight gubernatorial appointees. Each individual serves as the chief executive of the respective secretariat, all agencies fall within the jurisdiction of the seven executive offices. Collectively, the body assists the Governor in administration and policy-making.

The seven executive offices are:

- Executive Office for Administration and Finance;
- Executive Office of Health and Human Services;
- Executive Office of Public Safety and Security;
- Executive Office of Housing and Economic Development;
- Executive Office of Labor and Workforce Development;
- Executive Office of Education; and
- Executive Office of Energy and Environmental Affairs.

The Secretary of Transportation, appointed by the Governor to serve as the chief executive officer of the new Massachusetts Department of Transportation also serves on the Governor's cabinet.

Additionally, the Governor chairs an informal Development Cabinet to coordinate business development in the Commonwealth. It includes the Secretaries of Administration and Finance, Housing and Economic Development, Transportation, Energy and Environmental Affairs and Labor and Workforce Development.

Secretary of Administration and Finance

The Secretary of Administration and Finance is the Governor's chief fiscal officer. The activities of the Executive Office for Administration and Finance fall within six broad categories:

- Administrative and fiscal supervision, primarily the implementation of the Commonwealth's annual budget and monitoring of all agency expenditures during the fiscal year;
- State tax law enforcement and collection of tax revenues through the Department of Revenue for remittance to the State Treasurer;

- Human resource management, the administration of the state personnel system, civil service system and employee benefit programs and negotiation of collective bargaining agreements with certain of the Commonwealth's public employee unions;
- Capital facilities management, coordination and oversight of the construction, management and leasing of all state facilities;
- State 5 year capital plan development and implementation; and
- General service administration, including information technology services.

Of note, the Secretary of Administration and Finance serves as Chairperson of the Commonwealth Health Insurance Connector Authority, Co-Chairs the Massachusetts Life Sciences Center and serves as a member of numerous other state boards and commissions.

State Comptroller

The comptroller is responsible for administering and ensuring lawful and reasoned accounting policies and practices. Among the Comptroller's responsibilities are the publication of official financial reports and oversight of fiscal management functions within all state agencies and departments. The Comptroller also administers the Commonwealth's annual state single audit and manages the state accounting system. The Comptroller is appointed by the Governor for a term coterminous with the Governor's, and may be removed by the Governor only for just cause.

The annual financial reports of the Commonwealth, single audit reports and any rules and regulations promulgated by the Comptroller must be reviewed by an advisory board. This board is chaired by the Secretary of Administration and Finance and includes the State Treasurer, the Attorney General, the State Auditor, the Chief Administrative Justice of the Trial Court and two persons with relevant experience appointed by the Governor for three-year terms. The Commonwealth's audited annual reports include financial statements on both the statutory basis of accounting (the Statutory Basis Financial Report, or SBFR) and the GAAP basis (the Comprehensive Annual Financial Report, or CAFR).

Other Elected Offices

Treasurer and Receiver-General

More commonly referred to as the State Treasurer, this individual has four primary statutory responsibilities:

- Collection of all state revenues, with the exception of agency-held funds;
- Management of both short-term and long-term investments of Commonwealth funds (excluding state employee and teacher pension funds), including all cash receipts;
- Disbursement of Commonwealth monies and oversight of reconciliation of the state's accounts; and
- Issuance of almost all debt obligations of the Commonwealth, including notes, commercial paper and long-term bonds.

In addition to these responsibilities, the State Treasurer serves as Chairperson of the Massachusetts Lottery Commission, the State Board of Retirement, the Pension Reserves Investment Management Board, the Massachusetts Water Pollution Abatement Trust and the Massachusetts School Building Authority. The State Treasurer also serves as a member of numerous other state boards and commissions, including the Municipal Finance Oversight Board.

Secretary of the Commonwealth

The Secretary of the Commonwealth, commonly referred to as the Secretary of State, is responsible for collection and storage of public records and archives, securities regulation, state elections, administration of state lobbying laws and custody of the seal of the Commonwealth.

Attorney General

The Attorney General is the chief lawyer and law enforcement officer of the Commonwealth of Massachusetts. The Attorney General represents the Commonwealth in all legal proceedings in both the state and federal courts, including defending the Commonwealth in actions in which a state law or executive action is challenged. The office also brings actions to enforce environmental and consumer protection statutes, among others, and represents the Commonwealth in public utility and automobile rate-setting procedures. The Attorney General

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works in conjunction with the general counsels of the various state agencies and executive departments to coordinate and monitor all pending litigation.

State Auditor

The State Auditor provides independent and objective evaluations of the Commonwealth's financial and operational activities. The State Auditor is charged with improving the efficiency of state government by auditing the administration and expenditure of public funds and reporting the findings to the public. The State Auditor reviews the activities and operations of approximately 750 state entities and verifies contract compliance of private vendors doing business with the Commonwealth.

Each elected official is voted into four-year terms. The offices of the Governor and Lieutenant Governor have two-term limits. The terms of the current office holders began in January 2007.

Legislative Branch

The Legislature (formally called the General Court) is the bicameral legislative body of the Commonwealth, consisting of a 40 member Senate and a 160 member House of Representatives. Members of the Senate and the House are elected to two-year terms in even-numbered years. Each General Court meets for a two-year period. January of 2009 marked the start of the 186th General Court, which runs through January of 2011. The joint rules of the House and Senate require all formal business to be concluded by the end of July in even-numbered years and by the third Wednesday in November in odd-numbered years. The two legislative branches work concurrently on pending laws brought before them.

Lawmaking begins in the House or Senate Clerk's office where petitions, accompanied by bills, resolves, etc., are filed and recorded in a docket book. The clerks number the bills and assign them to appropriate joint committees. There are 24 of these committees, each responsible for studying the bills which pertain to a specific area (i.e., taxation, education, health care, insurance, etc.). Each committee is composed of six senators and eleven representatives, except the committees on Economic Development and Emerging Technologies, Health Care Financing and Transportation which consist of seven members of the Senate and thirteen on the part of the House.

The standing committees schedule public hearings for the individual bills, which afford residents, legislators and lobbyists the opportunity to express their views. Committee members meet at a later time in executive session to review the public testimony and discuss the merits of each bill before making their recommendations to the full membership of the House or Senate. The committee then issues its report, recommending that a bill "*ought to pass*", "*ought not to pass*" or "*as changed*" and the report is submitted to the Clerk's office.

All legislation proposing an increase in taxes or a new tax must originate within the House of Representatives. Once a tax bill is originated by the House and forwarded to the Senate for consideration, the Senate may amend it. All bills are presented to the Governor for approval or veto. The Legislature may override the Governor's veto of any bill by a two-thirds vote of each house. The Governor also has the power to return a bill to the chamber of the Legislature in which it was originated with a recommendation that certain amendments be made; such a bill is then brought before the Legislature and is subject to amendment or re-enactment, at which point the Governor has no further right to return the bill a second time with a recommendation to amend but may still veto the bill.

Judicial Branch

The judicial branch of state government is composed of the Supreme Judicial Court, the Appeals Court and the Trial Court. The Supreme Judicial Court has original jurisdiction over certain cases and hears appeals from both the Appeals Court, which is an intermediate appellate court, and in some cases, directly from the Trial Court. The Supreme Judicial Court is authorized to render advisory opinions on certain questions of law to the Governor, the Legislature and the Governor's Council. Judges of the Supreme Judicial Court, the Appeals Court and the Trial Court are appointed by the Governor, with the advice and consent of the Governor's Council, to serve until the mandatory retirement age of 70 years.

Independent Authorities and Agencies

The Legislature has established a number of independent authorities and quasi-public agencies within the Commonwealth, the budgets of which are not included in the Commonwealth's annual budget. These include the Commonwealth Connector Authority, Massachusetts Bay Transportation Authority (MBTA), Massachusetts

School Building Authority (MSBA), individual Regional Transit Authorities and other entities. Budgetary information can be requested directly from these agencies.

Local Government

All territory in the Commonwealth lies within one of the 351 incorporated cities and towns that exercise the functions of local government, which include public safety, fire protection and public construction. Cities and towns or established regional school districts provide elementary and secondary education. In addition to schools, various local and regional districts administer water and wastewater and certain other governmental functions. Cities are governed by one of many nuanced variations of the mayor-and-council or manager-and-council form. Most towns place executive power in a board of three or five selectmen elected to one- or three-year terms and retain legislative powers in the voters themselves, who assemble in periodic open or representative town meetings.

Municipal revenues consist of taxes on real and personal property, distributions from the Commonwealth under a variety of programs and formulas, local receipts (including motor vehicle excise taxes, local option taxes, fines, licenses and permits, charges for utility and other services and investment income) and appropriations from other available funds (including general and dedicated reserve funds). Because property tax levies are limited by Proposition 2½, an initiative petition approved by the voters in 1980, local governments have become increasingly reliant on distribution of revenues from the Commonwealth to support local programs and services (commonly known as “local aid”). The amount of local aid received varies significantly among municipalities.

The cities and towns of the Commonwealth are organized into 14 counties; county government has been abolished in seven of those counties. The county governments that remain are responsible principally for the operation of courthouses and registries of deeds. Where county government has been abolished, the functions, duties and responsibilities of the government have been transferred to the Commonwealth, including all employees, assets, valid liabilities and debts. On January 1, 2010, the remaining six county Sheriffs were moved within State jurisdiction.

Overview of the Operating Budget Process

The annual budget is a declaration of the Commonwealth’s priorities—a statement on how to allocate the limited collective resources that exist. In a recession, governments have fewer resources but the demand on public services is greater, which can make the budget development process challenging.

The operating budget enables the day-to-day functioning of state government. It pays for recurring expenditures for programs and services, employee salaries, utilities, supplies, insurance, and equipment repairs.

Developing the annual operating budget is a lengthy process that involves all three branches of government, hundreds of agencies, thousands of stakeholders and millions of residents. The Governor presents his budget recommendation to the Legislature. Then, the House of Representatives and the Senate will each separately review the Governor’s budget and develop their own recommendations. The House and Senate work together to reconcile their budgets and send the final bill to the Governor.

The Constitution and Budget Related Laws

Fiscal year is a commonly used term to describe annual budgeting period. State fiscal year 2011 extends from July 1, 2010 to June 30, 2011. The budget process begins in the fiscal year preceding the fiscal year for which the budget will take effect. For example, planning for the fiscal year 2011 budget began in fiscal year 2010.

The annual budget process varies from state to state. Here in Massachusetts, the State Constitution and Massachusetts General Laws outline and govern the budgeting process. The Massachusetts Constitution requires the Governor to present a budget to the Legislature within 3 weeks of the beginning of the new session in January. State finance law (Chapter 29 of the Massachusetts General Laws) requires the Legislature and the Governor to approve a balanced budget for each fiscal year. In other words, the Commonwealth cannot spend more than it receives in revenue. Further, during the fiscal year, the Governor may approve no supplementary appropriation bills that would result in an unbalanced budget.

Funds for the Commonwealth’s programs and services must be appropriated by the Legislature each fiscal year. The final budget is a law known as the General Appropriations Act (GAA). The GAA specifies how agencies and

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departments may spend their appropriations and allocates specific dollar amounts authorized for a specific period and purpose. Agencies are not allowed to spend more than what has been appropriated to them in the GAA and supplemental budgets.

Developing the Operating Budget: Planning for Next Year

Fiscal Year 2011 Planning

Department Planning & Secretariat Review

Department and agency staff review their policies and programs, develop future plans, and submit budget requests to their respective Cabinet secretary for review.

(July-September 2009)

The Cabinet Secretaries evaluate the requests and develop a Secretariat-wide budget. Secretariats have been assigned a spending cap by the Executive Office of Administration and Finance (A&F).

Formal Budget Request

Secretariats and agencies submit spending plans to A&F. Independents, Constitutional officers and the Judiciary also submit spending plans.

(October-December 2009)

The consensus revenue number is announced. The Executive and Legislative Branches jointly agree and commit to a single tax revenue projection for the next fiscal year. Both the Governor's budget and the Legislature's budget will be based off this number.

A&F, under the direction of the Governor's Office, prepares the Governor's budget recommendations. For this year's budget, each Secretariat held hearings across the state to solicit input on programs and services under their jurisdiction from the general public. This input was considered by agencies and A&F in the development of their spending plans.

Governor's Budget

The formal budget begins as a bill that the Governor submits to the Legislature. According to the Constitution of the Commonwealth of Massachusetts, the Governor must propose a budget for the next fiscal year within 3 weeks after the Legislature convenes, which this year translates into the 4th Wednesday of January.

(January 27, 2010)

In odd years, the Governor's budget is called House 1 (H.1) and in even years it is called House 2 (H.2).

Accordingly, the fiscal year 2011 budget will be filed on January 27, 2010. More detailed information regarding the specific budget development process for fiscal year 2010 can be found in the "Expenditure Development" section.

House Budget (February-April 2010)

The House Ways and Means Committee reviews the Governor's budget and then develops its own budget recommendation. Individual members of the House of Representatives submit budget amendments which are then debated on the House floor. Once debated, amended and voted on by the full House, it becomes the final House budget bill and moves to the Senate.

Senate Budget (February-May 2010)

The Senate Ways & Means Committee reviews both the Governor's and House budgets and develops its own recommendation. Individual senators submit budget amendments which are then debated on the floor. Once debated, amended and voted on, it becomes the final Senate's budget bill.

Conference Committee Budget (June 2010)	House and Senate leadership assign members to a "conference committee" to negotiate the differences between the House and Senate bills. The conference committee report can only be approved or rejected - no additional amendments can be made.
Veto (June 2010)	Once approved by both chambers of the Legislature, the Governor has ten days to review it. The Governor may approve or veto the entire budget, or may veto or reduce particular line items or sections, but may not add anything. If the Governor does not act within ten days, the conference committee bill becomes law.
Overrides (June 2010)	The House and Senate may vote to override the Governor's vetoes. Overrides require a two-thirds roll-call vote in each chamber.
Final Budget (June - July 2010)	Once the Governor signs the bill with his recommended vetoes, it becomes the budget for the fiscal year. The final budget is also known as the General Appropriations Act (GAA) or "Chapter (# to be determined) of the Acts of 2010." The new fiscal year 2011 begins on July 1, 2010.

Specific Budget Policies

The Governor's budget recommendations for the fiscal year beginning July 1, 2010 and ending June 30, 2011 are included in the following budget document and tools within. This submitted budget is balanced, outlines expenditures that are recommended, and provides sufficient revenues to fund those expenses. The Commonwealth uses a statutory basis of accounting to define the term 'balanced' where actual revenues received within the fiscal year must meet or exceed actual expenditures.

The state's finance laws are outlined in **Chapter 29** of the Massachusetts General Laws. They require that the Governor file a balanced budget, that the House and Senate each produce a balanced budget, and that the final general appropriation act (GAA) is in balance accordingly. Any supplemental budget bill that may accompany or follow a budget cannot impair the overall fiscal balance. One method of achieving balance may be through drawing from the Commonwealth's Stabilization Fund, also known as the Rainy Day Fund.

The budget may be amended through the filing of a supplemental budget request, which is submitted by the Governor to the House of Representatives. Supplemental budgets follow the same process as the overall budget, going first to the House Committee on Ways and Means, then to the House for approval, followed by the Senate Committee on Ways and Means and the full Senate. If there are differences between the House and Senate versions, a conference committee convenes to produce a final supplemental bill that is then enacted by both chambers and then sent to the Governor for approval. The Governor then has the same line-item veto authority as with the general budget, where he is able to veto specific amounts from particular line items, entire line items, or entire provisions of language.

Prior to the Governor's submission of the budget, the Secretary of Administration and Finance and the House and Senate Committees on Ways and Means are required to reach agreement on a "consensus tax revenue forecast" from which to build their spending projections. The consensus revenue process for fiscal year 2011 is discussed in more detail later in this section.

Generally, expenditures may not exceed the level of spending authorized for an appropriation account. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated.

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State finance law requires the Commonwealth to monitor revenues and expenditures during a fiscal year. As such, the Secretary of Administration and Finance is required to provide quarterly revenue estimates to the Governor and the Legislature, and the Comptroller publishes a quarterly report of planned and actual revenues. Department heads are required to notify the Secretary of Administration and Finance and the House and Senate Committees on Ways and Means of any anticipated decrease in estimated revenues for their departments from the federal government or other sources. Those same parties are also notified if a department projects that any appropriation will be insufficient to meet all expenditures required in the fiscal year by any law, rule, regulation or order not subject to administrative control.

If a revenue shortfall is identified, the Governor is required by section 9C of Chapter 29 to reduce agency appropriations or recommend a transfer from the Stabilization Fund. If additional revenues are available, the Governor may recommend a supplemental budget. At the end of the fiscal year, the Comptroller determines the statutory balance of the budgeted funds and transfers any excess funds to the Stabilization Fund.

General Fiscal Policies of the Commonwealth

The following principles and policies were used to guide the development of the fiscal year 2011 budget. Above all else, state finance law requires the Governor's budget and all later versions to be in balance; expenditures must not exceed available revenues. In addition, House 2 includes the following principles and goals:

Strategic Fiscal Policies

In developing the budget, special attention was paid to the following areas:

- Protect high-priority government functions
 - Preserve social safety net to cushion impacts of economic downturn and meet new caseload pressures. Includes preserving state-subsidized health insurance programs expanded under the Commonwealth's historic health care reform law.
 - Protect education funding as cornerstone of long-term economic growth and opportunity.
 - Maintain aid to cities and towns.
- Identify government reforms that promote efficiency and sustainability of services. Streamline government wherever possible.
- Identify additional recurring revenues to support worthwhile programs.
- Reduce reliance on volatile tax receipts like capital gains.
- Strike careful balance on the temporary use of one-time resources to balance the budget.

Financial Reporting

The Commonwealth possesses strong reporting capabilities, supported by accounting and payroll systems that are used consistently throughout state agencies and from which data is updated to an information warehouse.

- State agencies will continue to utilize the accounting and payroll systems.
- The presentation of the annual Comprehensive Annual Financial Report and official bond statements will continue to adhere to full disclosure.
- Websites will continue to be published to present the annual budget in an interactive format.

Revenue

- In preparation of the annual budget, a consensus revenue estimate for taxes has been agreed upon by the executive and legislative branches, and will serve as the basis for building the budget.
- All revenue received by departments will be deposited with the Treasurer and recorded in the Accounting system.

Cash Flow

- The Cash Management Division of the State Treasurer's office accounts on a daily basis for cash received into over 600 separate accounts of the Department of Revenue and other Commonwealth agencies and departments.
- The State Treasurer, in conjunction with Comptroller and the Executive Office for Administration and Finance, monitors cash to maximize the Commonwealth's return on investment and minimize the use of borrowing.
- Formal cash flow projections for the then current fiscal year are submitted to the House and Senate Committees on Ways and Means on or before each August 31, November 30, February 28 and May 31. The

projections include estimated sources and uses of cash, together with the assumptions from which such estimates were derived and identification of any cash flow gaps.

- The State Treasurer's office, in conjunction with the Comptroller and the Executive Office for Administration and Finance, develop quarterly and annual cash management plans to address any gap identified by the cash flow projections and variance reports.
- The State Treasurer's office oversees the issuance of short-term debt to meet cash flow needs, including the issuance of commercial paper

Expenditures

- The Comptroller is responsible for oversight of fiscal management functions, establishment of accounting policies and practices and publication of official financial reports.
- The Comptroller maintains the Massachusetts Management Accounting and Reporting System (MMARS), the centralized state accounting system that is used by all state agencies and departments but not independent state authorities. MMARS provides a ledger-based system of revenue and expenditure accounts enabling the Comptroller to control obligations and expenditures effectively and to ensure that appropriations are not exceeded during the course of the fiscal year.
- MMARS also tracks receivables, payables, fixed assets and other processes management.
- The Comptroller will annually review policies governing transactions in MMARS.

Expenditure Controls

- The amount of all obligations under purchase orders, contracts and other commitments for the expenditures of moneys are required to be recorded as encumbrances. Once encumbered, these amounts are not available to support additional spending commitments.
- As a result of these encumbrances, agencies can use MMARS to determine at any given time the amount of their appropriations available for future commitments.

Internal Controls

- The Comptroller establishes internal control policies and procedures in accordance with state finance law. These policies require all departments to develop and maintain an internal control plan. Agencies are required to adhere to such policies and procedures.
- All unaccounted-for variances, losses, shortages or thefts of funds or property must be reported to the State Auditor, who is authorized to investigate and recommend corrective action.

Reserves

- The Commonwealth will aggressively seek to replenish the Commonwealth Stabilization Fund when able to do so.
- Capital gains tax revenues that exceed \$1 billion will be deposited into the Fund to better calibrate spending with reliable revenue streams and to build a cushion against future economic and fiscal uncertainty.

Debt Affordability

- The Commonwealth conducts an annual debt affordability analysis to determine the affordable level for the administrative bond cap (determining annual borrowing levels).
- Required funding for debt service and other debt-like instruments will not exceed 8% of budgeted revenues.

Capital Budget

- Bond-funded capital spending will be limited by an annual administrative bond cap. Annual growth in that cap will not exceed \$125 million between fiscal year 2011 and fiscal year 2014.
- An annual capital budget will be developed and focus on affordability, targeted investments in projects that maintain our existing infrastructure and/or promote economic growth, and transparency.

Pensions

- The Commonwealth will continue to follow a pension funding schedule to address our unfunded liability and to pursue reforms that will reduce costs over the long term.

Other Post-Employment Benefits

- The Commonwealth will continue to pursue adoption of a funding schedule to fully fund public employee retiree health care benefits and to pursue reforms that will reduce costs over the long term.

Overview of Budget Funds

Government Fund Types account for the general governmental activities of the Commonwealth and are organized as follows:

Budgeted Funds are the primary operating funds of the Commonwealth. They account for all budgeted governmental transactions. The main budgeted funds include the General Fund, the Commonwealth Stabilization Fund, the Commonwealth Health and Prevention Fund, the Workforce Training Fund, the Massachusetts Tourism Fund, and the Commonwealth Transportation Fund, which are identified by the Comptroller as the operating funds of the Commonwealth.

Non-Budgeted Special Revenue Funds are established by law to account for specific revenue sources that have been segregated from the budgeted funds to support specific governmental activities such as federal grants, funds related to the tobacco settlement and the operations of the state lottery.

Capital Projects Funds account for financial resources used to acquire or construct major capital assets and to finance local capital projects. These resources are derived from proceeds of bonds and other obligations, which are generally received after related expenditures have been incurred, operating transfer authorized by the Legislature and federal reimbursements. Deficit balances in the Capital Projects Funds represent amounts to be financed.

Fiduciary Funds account for assets held by the Commonwealth in a trustee capacity (Trust Funds), or as an agent (Agency Funds) for individuals, private organizations, other governmental units, and/or other funds.

Expendable Trust Funds account for trusts whose principal and investment income may be expended for a designated purpose.

Nonexpendable Trust Funds account for trusts whose principal cannot be spent.

Post Employment Benefit Trust Fund account for the net assets available for plan benefits held in trust for State Employees' and Teachers' Retirement Systems and Other Post Employment Benefits (OPEB) for retirees.

Agency Funds account for assets the Commonwealth holds on behalf of others. Agency Funds are custodial in nature and do not involve measurement of operations.

Individual Budgeted Funds

Statutory balance is defined as *a measure of the fiscal condition which includes current year budgeted revenues and expenditures plus any designated revenues from prior years, stabilization deposit and funds carried forward*. It also includes any use of stabilization or any other non-budgeted reserves. A more general discussion of the funds is below:

The *General Fund* is the Commonwealth's primary governmental fund. All governmental activities not specifically directed to another fund are accounted for in the General Fund. As a result, most budgeted expenditures of the Executive secretariats, the Legislature, Constitutional offices, Judiciary, institutions of higher education and independent commissions are paid for from the General Fund. It similarly receives a significant portion of sales, individual income and corporate taxes, and the full amount of most other governmental taxes. It also receives federal reimbursement generated by the Commonwealth's Medicaid expenditures.

The *Commonwealth Transportation Fund* accounts for road and highway use revenues, including the gas tax, registry fees and 0.385% of the sales tax. The fund is used to pay debt service associated with highway maintenance and construction projects and provides funding for the operation of the independent Massachusetts Department of Transportation (MassDOT). Established as part of the historic transportation reforms implemented in fiscal year 2010, the fund is new for fiscal year 2011 and replaces the former *Highway Fund* as the principal source of transportation related revenues and expenditures for the Commonwealth.

The *Workforce Training Fund*, authorized by section 2RR of Chapter 29 of the General Laws and administered by the Executive Office of Labor and Workforce Development, provides employers with matching grants of up to \$250,000 over two years to help train new and incumbent workers. To maximize the number of grants, however, DWD has established a temporary maximum grant of \$100,000. The Workforce Training Fund was established in July 1998, and is financed entirely by Massachusetts employers. In fiscal year 2009, the Fund was financed by an employer surcharge of 0.06% on employees' wages, paid concurrently with payments into the Unemployment Insurance Trust Fund. Annual state revenues from employer contributions total approximately \$21 million, and the state appropriation for training grants is typically rolled forward into the next fiscal year to provide for the second year of each grant award.

The *Massachusetts Tourism Fund*, authorized in section 35J of Chapter 10 of the General Laws, is funded with 35 percent of the State's annual revenues received from the hotel occupancy tax authorized in section 3 of Chapter 64G. In fiscal year 2011, Tourism Fund revenues are estimated to total \$41 million. The Fund's use is prescribed in Chapter 10, which includes a formula that assigns various funding levels for tourism promotion programs and activities including the Massachusetts Office of Travel and Tourism, regional tourism promotion agencies, the Massachusetts Office of International Trade and Investment, the Cultural Facilities Fund, and the Massachusetts Convention Center Authority. While funding for the purposes prescribed in the section are being made in this budget, the specific requirements of the fund have been suspended through an outside section for the last several years.

The *Commonwealth Health and Prevention Fund* is comprised of the revenues generated from the 2010 elimination of the sales tax exemption on the purchase of alcoholic beverages consumed off-premises, as well as the proposed repeal of the exemption on soda and candy. This policy initiative aims to encourage healthy lifestyle choices. Monies appropriated from this fund will support programs and services that augment the health and well-being of the residents of the Commonwealth.

The *Marine Recreational Fisheries Development Fund* accounts for all recreational saltwater fishing permit fees collected by the director of the division of marine fisheries. Fees collected in this fund shall be used for the development and administration of the recreational saltwater fishing permit program, to support science and conservation programs designed to improve recreational saltwater fishing and other recreational saltwater fishing improvement programs.

The *Commonwealth Stabilization Fund* is a reserve to enhance the Commonwealth's fiscal stability. (A later section describes the Stabilization Fund in more detail.)

Administrative Control Funds account for the revenues generated by certain administrative functions of government, for which the Legislature has required that separate funds be established. These funds include:

- *Temporary Holding Fund* – The fund accounts for cumulative tax revenues during the fiscal year in excess of permissible tax revenues as defined in Section 6A of Chapter 62F of the General Laws. The fund balance is transferred annually to the Stabilization Fund only to the extent that stabilization funds are used to fund expenditures of the Commonwealth. Overall, any remaining balance is transferred to the General Fund.
- *Intragovernmental Service Fund* – Accounts for the charges of any state agency for services provided by another state agency, for example, charges levied by the Human Resources Division for workers' compensation costs.

The *Inland Fisheries and Game Fund* accounts for revenues from license and permit fees for inland fishing, hunting, trapping, and sporting licenses and revenue-producing stamps or the sales of land, rights and properties, gifts, interest, and federal grant reimbursements. These revenues are used for developing, maintaining and operating the Division of Fisheries and Wildlife within the Department of Fish and Game.

Budget Development

The Executive Office for Administration and Finance (A&F) is the state agency responsible for preparing the Governor's budget recommendations and monitoring of the annual budget enacted by the Legislature, known commonly as the General Appropriations Act or the GAA. Under state law, every state agency is required to

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annually prepare a budget for review and evaluation by the Secretary of A&F. The spending plan typically includes expenditure and revenue estimates for the current fiscal year (2010) as well as the agency's anticipated expenses and receipts for the next fiscal year (2011) based on the assumption that they will maintain the same level of services and programs from one year to the next.

In most cases, agencies recommendations as to the appropriate "maintenance" level of funding for an agency or program. A maintenance budget is defined as *the level of funding necessary to provide the same level of services in a fiscal year as those provided for in the prior fiscal year and to cover expenses for which the Commonwealth will be obligated to pay*. In developing maintenance budgets and ultimately budget recommendations, agencies incorporate projected changes in the programs they provide, such as caseload growth, or increases in fixed costs such as fuel and energy costs. Agencies also take into account changes in laws, regulations and policies that will impact programs and services for the next fiscal year.

During the summer and fall of 2009 agencies prepared "spending plans" corresponding to fiscal years 2010 and 2011 and filed them with the A&F for review in the fall.

Fiscal Year 2010 Update

The budget process has entailed a continuous review of all spending and revenue assumptions using the best possible economic data available. Since the fall of 2008 when the national recession began to drastically affect the tax revenue collections for Massachusetts. To put fiscal year 2010 into context, it is important to understand the significant measures that were taken in fiscal year 2009 to maintain a balanced state budget.

The Governor made four major downward revenue revisions totaling \$3.14 billion in fiscal year 2009 reflecting a 12.5% decline in tax revenue from fiscal year 2008. The decline represented a nearly \$4 billion loss in state revenues. On top of declining revenues, increases in caseloads in certain programs required supplemental funding and budgetary transfers. To accommodate both revenue shortfalls and programmatic caseload increases, budget solutions in fiscal year 2009 totaling \$3.9 billion were needed. The Governor used a balanced approach to closing the gap including budget reductions, savings, modest new revenues and some one-time funding in order to meet the constitutional requirement of maintaining a balanced budget. Budget cuts totaled approximately \$1.3 billion including \$1 billion from 9C reductions and voluntary contributions from non-Executive Branch agencies. When the American Recovery and Reinvestment Act was signed into law in February of 2009 by President Obama, the Commonwealth was able to utilize nearly \$1.3 billion to maintain a balanced fiscal year 2009 budget.

The swift and decisive action taken by the Patrick – Murray Administration during fiscal year 2009 proved successful when, at the end of the fiscal year, sufficient funding was available to make a \$10 million transfer to the Life Sciences Center and a \$65 million deposit into the State's Rainy Day fund. The additional deposit brought the ending balance in the Stabilization Fund to \$841 million at the close of fiscal year 2009.

As the Administration managed through fiscal year 2009, the Governor and legislative leaders took unprecedented action in preparing for fiscal year 2010. Amidst developing the fiscal year 2010 budget, the Administration and the Legislature further reduced the fiscal year 2010 revenue estimate by an additional \$1.5 billion in May of 2009. The new revenue estimate of \$18.879 billion prompted Governor Patrick to re-file his House 1 recommendation for fiscal year 2010. In June of 2009, the Governor re-filed his budget recommendation to address a projected budget gap of nearly \$5 billion. Despite these challenges, the budget for fiscal year 2010, which began on July 1, 2009, was balanced and signed on time. The fiscal year 2010 General Appropriation Act (GAA) totaled \$26.930 billion and was predicated on a tax forecast of \$18.879 billion.

Due to continued uncertainty caused by the national recession, the Administration anticipated that it may be necessary to budget for a revenue shortfall during fiscal year 2010. To prepare for this inevitability, agencies were asked early in the fiscal year to submit strategies to achieve mid-year savings if fiscal year 2010 revenue fell below benchmark.

For the first quarter of fiscal year 2010, revenue collections were approximately \$212 million below the consensus forecast. In an effort to understand the potential revenue declines that the Commonwealth might experience for the remainder of fiscal year 2010, the Governor met with his Council on Economic Advisors and a Joint Legislative hearing was called to gather information from economists and other experts regarding the revenue projection for the remainder of fiscal year 2010. Subsequently, on October 15th, the Secretary of Administration

and Finance notified the Governor that based on year-to-date revenue performance and information obtained through consultation with economists, forecasted revenues for fiscal year 2010 should be lowered by \$600 million. Based upon this guidance and pursuant to chapter 29, section 9C of the Massachusetts General Laws, the Governor revised the revenue forecast downward to \$18.279 billion and filed a fiscal action plan to close a \$600 million budget. Once again, the Governor proposed a balanced set of solutions including cuts, revenues, federal stimulus funds and reserves.

Since the October 2009 revenue revision, Massachusetts tax revenue has been performing above the monthly benchmark. The increase is attributed primarily to increased state income tax estimated withholdings as well as one-time tax collections that were not assumed in the revised forecast. In an effort to relieve some of the pressure felt by specific agencies due to budget reductions, the Governor has used a portion of the above benchmark revenue to revise the consensus number up to \$18.460 billion and restore some of the 9C reductions taken in October 2009. The Department of Revenue (DOR) and A&F continue to monitor closely the state revenue collections for the current fiscal year to assess any remaining exposure to shortfalls that would necessitate further reductions or other solutions. We remain cautious as we are only half way through fiscal year 2010 and there are large revenue collections due in January and April.

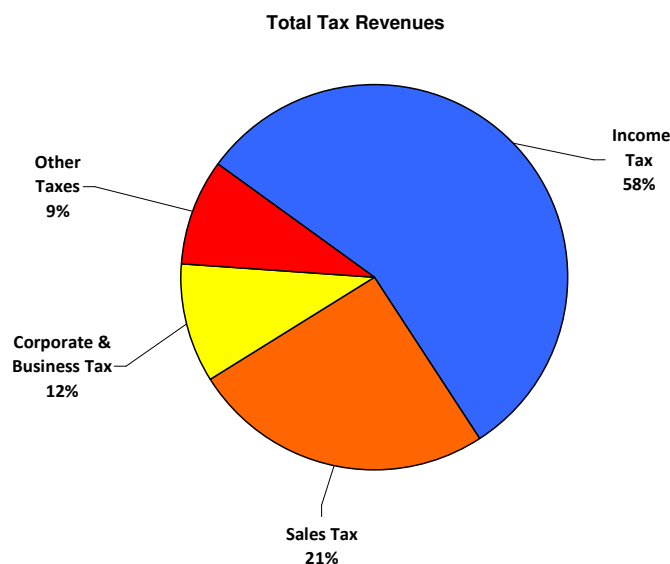
In the fall of 2009, A&F completed a detailed review of all fiscal year 2010 spending and revenue assumptions. Throughout the first half of the fiscal year there were several changes that have had an impact on the bottom line of the budget. A summary of the changes to the fiscal year 2010 budget are highlighted in the following table. They include:

- Recognition of \$92.3 million in fiscal year 2009 appropriations that were continued into fiscal year 2010;
- Line Item reductions totaling \$292.2 million through the 9C process;
- The restoration of \$43.9 million of the initial 9C reductions taken in October;
- Deficiencies primarily driven by increased caseload; some of these deficiencies are included in the January supplemental filed in conjunction with House 2, however others are continuing to be mitigated by the agencies; and
- Surpluses recognized through hiring and spending controls.

FY09 Spending	27,373.7
FY10 GAA	26,930.1
<i>PACs</i>	<i>92.3</i>
<i>Supplemental Budgets Signed</i>	<i>262.5</i>
<i>9C Reductions</i>	<i>(292.2)</i>
<i>9C Restorations</i>	<i>43.9</i>
<i>Deficiencies Recognized (not yet appropriated)</i>	<i>426.1</i>
<i>Surpluses Recognized</i>	<i>(75.0)</i>
FY10 Estimated Spending	27,387.7
FY10 GAA (% Change from FY09 Spending)	-1.62%
FY10 Estimated Spending (% Change from FY09 Spending)	0.05%

Fiscal Year 2011 Tax Revenues

Tax revenues comprise nearly 70% of all revenues used to support the Commonwealth's operating budget. Each year the Administration and the House and Senate consult with the Department of Revenue, economists, budget watchdog groups and others to gather information and analysis on the condition of the U.S. and Massachusetts economies. They use that information to project state tax revenue allowable for use in the state budget. The following is a general description of the consensus revenue process.



General Information Regarding Consensus Revenue

The consensus revenue process is required under M.G.L. c.29, s.5B and states that on or before January 15 the Secretary for Administration and Finance shall meet with the House and Senate Committees on Ways and Means and shall jointly develop a consensus tax revenue forecast for the budget for the next fiscal year, which shall be agreed to by the Secretary and the House and Senate. The law requires that the consensus revenue estimate be placed before the General Court in the form of a joint House and Senate Resolution for full consideration.

On December 16, 2009 the Secretary for Administration and Finance and the House and Senate Committees on Ways and Means held a public hearing in Boston and heard testimony from the Massachusetts Department of Revenue (DOR), the Federal Reserve Bank of Boston, the Massachusetts Taxpayers Foundation, the Beacon Hill Institute, and economists from Harvard University and Northeastern University. The three branches of government subsequently agreed upon a fiscal year 2011 tax revenue estimate of \$19.050 billion, consistent with testimony presented at the hearing.

As part of the statutorily required consensus revenue process, the Secretary of A&F, House and Senate also agree on the amount of tax revenues that will need to be transferred to support the State's Pension Fund, the School Building Authority and the MBTA (Massachusetts Bay Transportation Authority). For fiscal year 2011, these transfers are estimated to total \$2.853 billion and will be directed to the following funds:

• School Modernization & Reconstruction Trust Fund =	\$ 644.3 million
• MBTA State and Local Contribution Fund =	\$ 767.1 million
• Pension Reserves Investment Trust Fund =	<u>\$ 1.442 billion</u>
	\$ 2.853 billion total
	\$ 16.197 billion remaining

Basis for the Fiscal Year 2011 Consensus Revenue Forecast

Fiscal year 2010 tax revenues are estimated to be \$18.460 billion, representing an actual increase of 1.1% and a baseline decline of 3.5% from fiscal year 2009 collections (the baseline calculation adjusts for the impact of tax law and processing changes, so is a better indicator of underlying economic activity). Through December 2009, fiscal year 2010 year-to-date tax revenues were up 1.2% actual and down 4.2% baseline, and were \$230 million above the year-to-date benchmark based on the October 15, 2009 revised estimate of \$18.279 billion. It is expected that as the economy emerges from the recession, tax collections for the remainder of fiscal year 2010 will increase by \$548.4 million, or 6.0% actual, and \$162.3 million, or 1.8% baseline, from the same period in fiscal year 2009, with most of the increase over the remainder of fiscal year 2010 the result of the increase in the sales tax rate that took effect on August 1, 2009.

The fiscal year 2011 consensus tax revenue estimate is \$19.050 billion, representing revenue growth of 3.2% actual and 2.5% baseline from the fiscal year 2010 estimate of \$18.460 billion. The fiscal year 2011 estimate assumes that the national and state economies will continue a moderate recovery throughout the fiscal year. In developing the consensus estimate, the Commonwealth relies on economic forecasts from Moody's Economy.com, Global Insight, and the New England Economic Partnership (NEEP). The economic forecasts upon which the consensus revenue estimate is based are:

- The national economy is beginning to emerge from recession. Following declines in the first quarter and second quarter of calendar year 2009, real GDP growth turned positive in the third quarter and grew at an annualized rate of 2.8%, and is expected to remain positive in the fourth quarter and through calendar year 2010. Real GDP growth for the full fiscal year 2010 is projected to be 0.4% compared to growth of 2.2% in FY08 and -2.2% in FY09. In fiscal year 2011, real GDP growth is projected to range from 2.4% to 2.7%;
- Massachusetts employment is expected to decline by 1.2% to 3.0% over the remainder of fiscal year 2010, and by 1.8% to 3.2% for fiscal year 2010 as a whole. For fiscal year 2011, Massachusetts employment is expected to change by -0.6% to 0.5%;
- Massachusetts personal income (excluding capital gains) is expected to grow by -1.6% to 0.7% over the remainder of fiscal year 2010 and -1.9% to -0.1% for fiscal year 2010 as a whole. For fiscal year 2011, Massachusetts personal income is projected to grow by 2.6% to 3.5%;
- Massachusetts wages and salaries are projected to decline by 0.7% to 5.1% for the remainder of fiscal year 2010 and 1.7% to 5.1% for the year as a whole. For fiscal year 2011, the growth in Massachusetts wages and salaries is projected to range from 1.1% to 3.4%;
- Massachusetts retail sales growth is expected to range from -0.6% to 1.0% over the remainder of fiscal year 2010 and -0.4% to -1.9% for the fiscal year as a whole. For fiscal year 2011, Massachusetts retail sales are projected to grow by 3.5% to 4.4%;
- Corporate profits at the national level are expected to increase by 11.8% to 33.5% over the remainder of fiscal year 2010, and by 3.8% to 22.6% for the fiscal year as whole (there are no forecasts for state corporate profits). For fiscal year 2011, growth in corporate profits is projected to range from 2.9% to 6.4%.

In addition to the economic forecasts described above, the consensus revenue estimate takes into account forecasts for capital gains realizations and taxes. The consensus agreement capital gains forecast is based on the following considerations:

- Preliminary tax year 2008 data indicates that Massachusetts capital gains realizations decreased by approximately 60.4% in tax year 2008, to \$14.6 billion. Fiscal year 2009 taxes on those capital gains realizations totaled approximately \$541 million, a decrease of approximately \$1.632 billion, or 75.1%, from fiscal year 2008 (taxes on tax year 2008 capital gains realizations were paid mostly in fiscal year 2009).
- The stock market, as measured by the average of the S&P 500 over the entire year, declined by 22.5% in calendar year 2009 (which largely determines fiscal year 2010 capital gains taxes), and is expected to increase by 15.6%-24.7% in calendar year 2010 (which largely determines fiscal year 2011 capital gains taxes). Massachusetts capital gains realizations are projected to decline by 13.5% in calendar year 2009 and increase by 10.3% in calendar year 2010.

Because taxpayers were slow to adjust their 2008 estimated payments in the first half of calendar year 2008 (the second half of fiscal year 2008), capital gains tax payments were reduced in fiscal year 2009 substantially as taxpayers adjusted their payments when they filed their final tax returns. Similar end of year reductions are not expected to recur in fiscal year 2010 (since taxpayers have already reduced their estimate payments substantially), therefore, the fiscal year 2010 forecast assumes that capital gains taxes will actually increase by \$160 million in fiscal year 2010 compared to FY09, despite the decrease in tax year 2009 capital gains realizations.

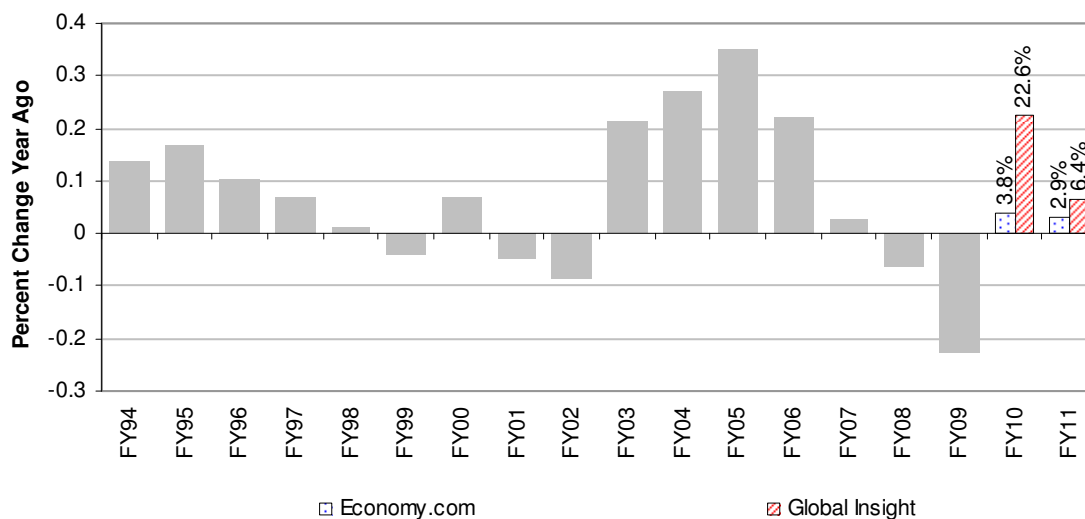
FY2011 Governor's Budget Recommendation

The charts below show the national and state economic forecasts presented at the December 16, 2009 consensus revenue hearing as well as the consensus estimate assumption for capital gains realizations and taxes, all of which were taken into consideration in developing the fiscal year 2011 consensus revenue estimates.

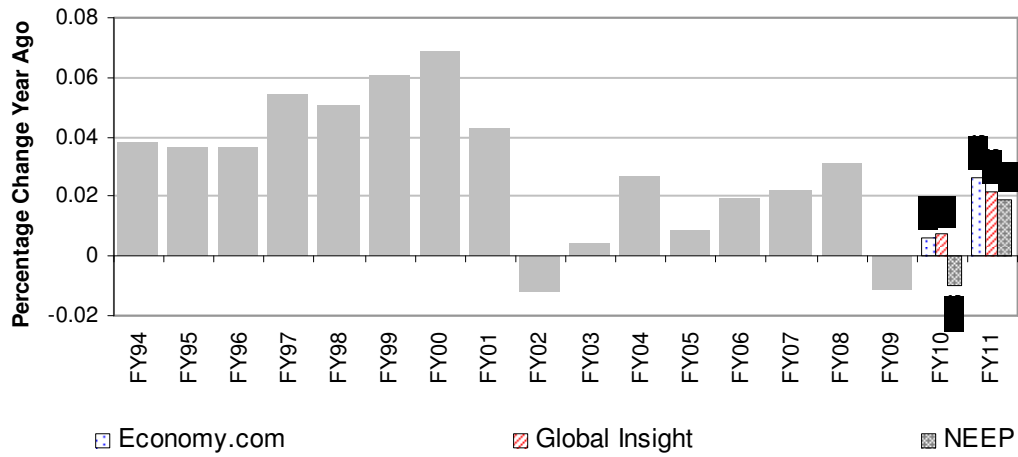
Real U.S. GDP Growth, FY1994-2011



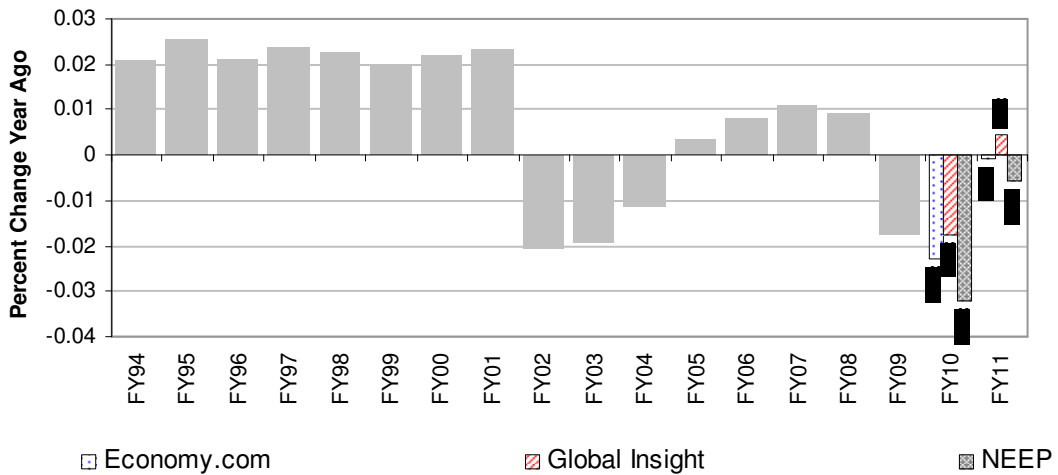
U.S. Corporate Profits Growth, FY1994-2011



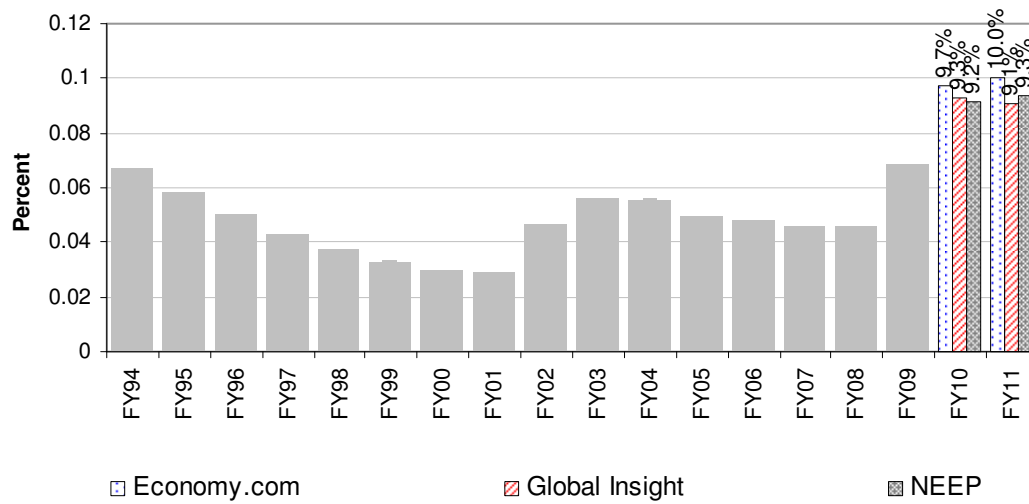
Massachusetts GDP Growth, FY1994-2011



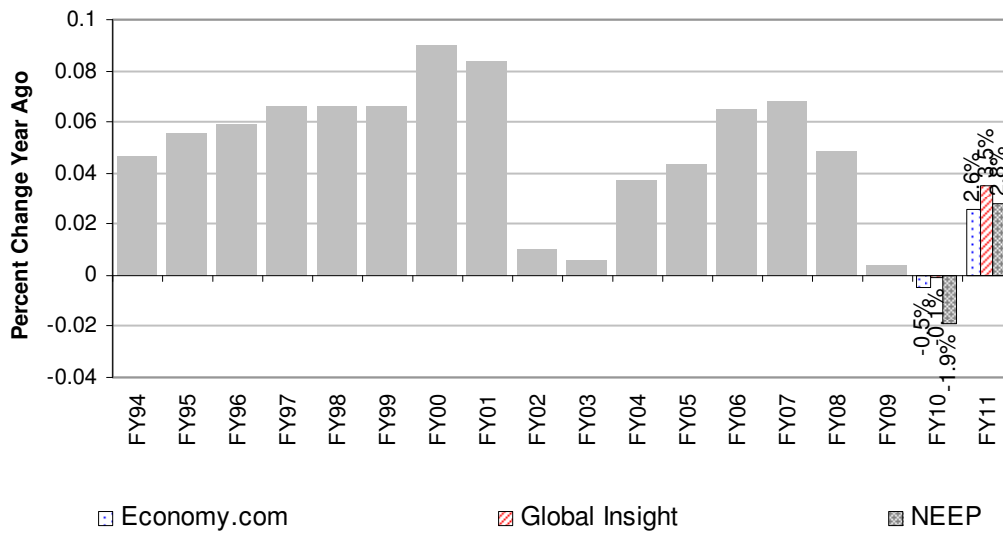
Massachusetts Employment Growth, FY1994-2011



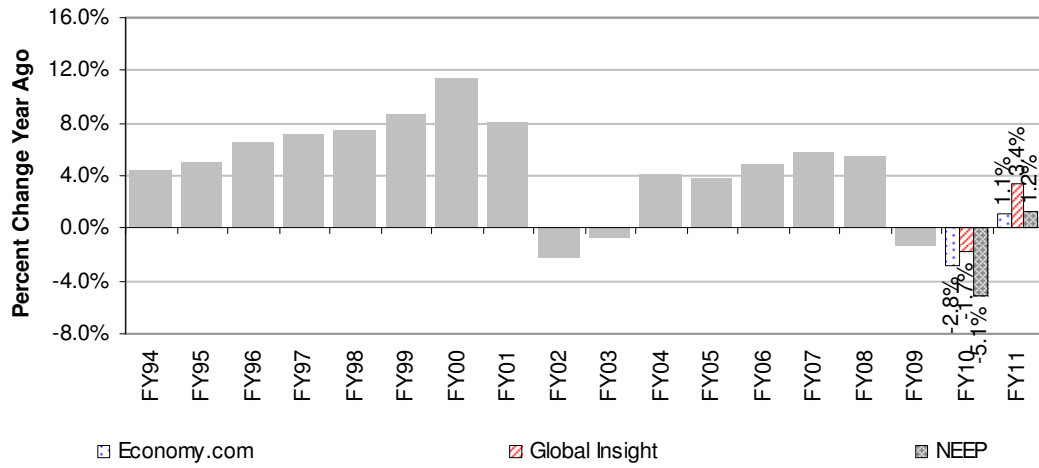
Massachusetts Unemployment Rate, FY1994-2011



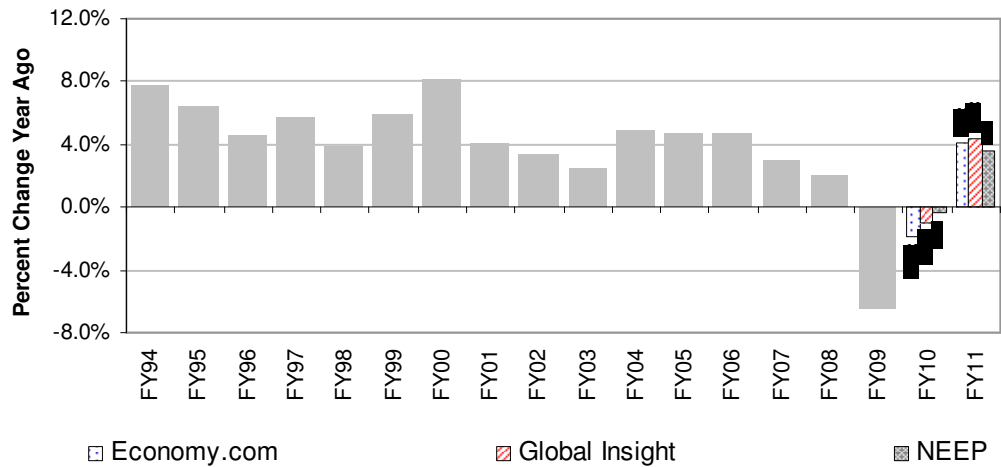
Massachusetts Personal Income Growth, FY1994-2011



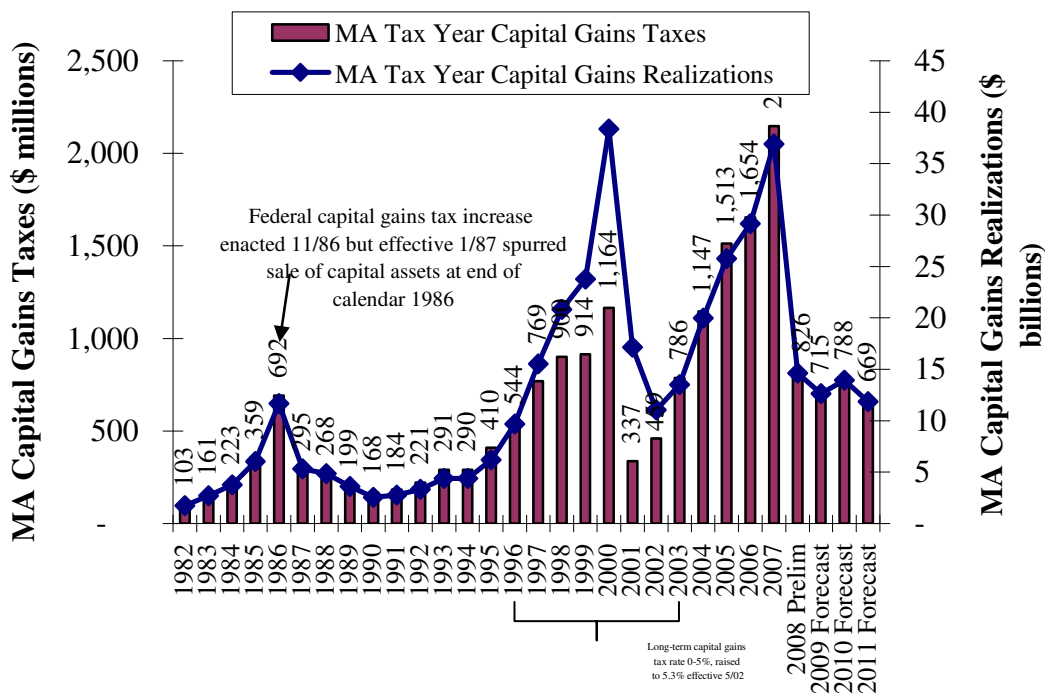
Massachusetts Wage and Salary Growth, FY1994-2011



Massachusetts Retail Sales Growth, FY1994-2011



Massachusetts Capital Gains Realizations and Taxes



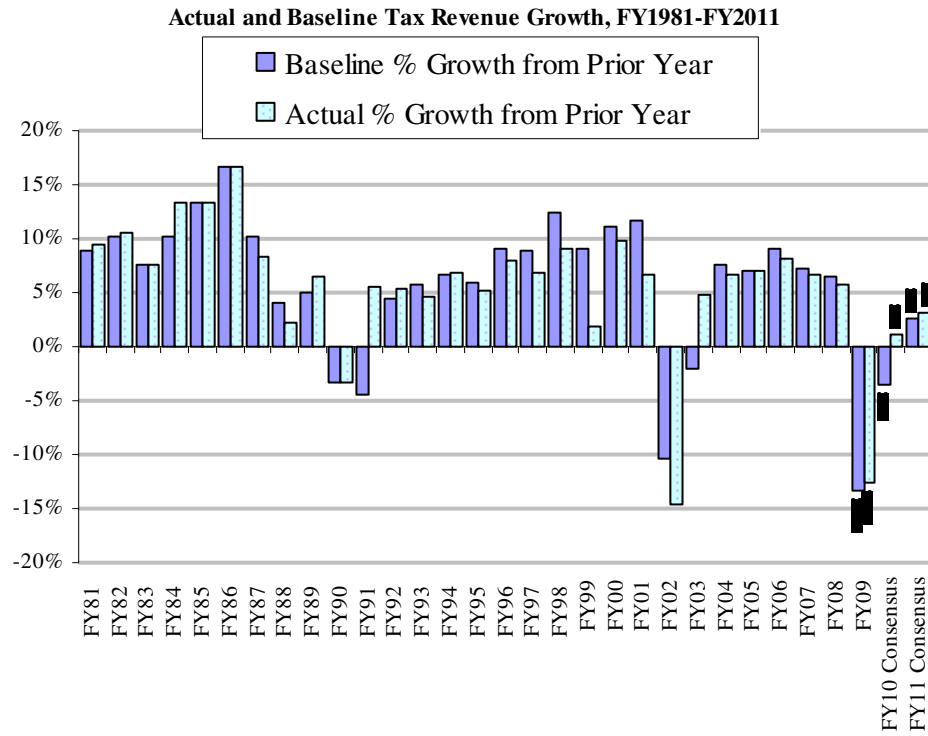
The consensus tax revenue estimate for fiscal year 2011 is \$19.050 billion, consistent with testimony presented at the hearing. The estimate for fiscal year 2010 has been revised to \$18.460 billion. Section 1A of this document details the consensus revenue estimate by tax category and budgeted fund.

Based on these economic projections and actual tax collections through December 2009, fiscal year 2011 tax collections are projected to grow by \$590 million, or 3.2% actual and 2.5% baseline from fiscal year 2010.

FY11 Consensus Tax Revenue Forecast

Tax Type	% Actual Revenue Growth from FY10	% Baseline Revenue Growth from FY10	FY11 Revenue Estimate (\$ Millions)	FY11 Growth from FY10 (\$ Millions)
Total Income	3.8%	4.0%	10,630	388
Withholding	3.3%	3.3%	8,957	289
Sales	7.0%	3.0%	4,817	317
Corporate/Business	-6.9%	-4.7%	1,891	-139
Other	1.4%	0.6%	1,712	24
Total	3.2%	2.5%	19,050	590
Memo: Capital Gains Taxes	13.9%	13.9%	798	97

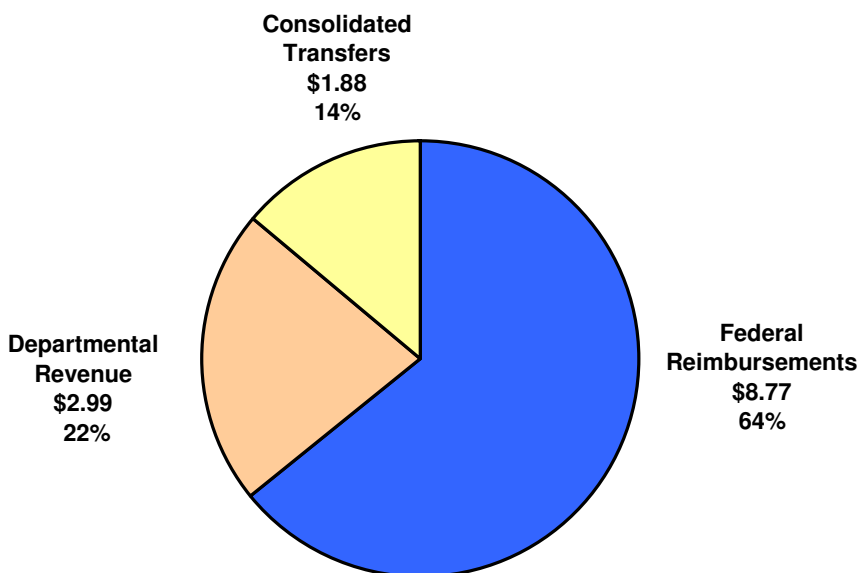
The chart below shows historical trends in actual and baseline tax revenue growth.



Fiscal Year 2011 Non-Tax Revenue Assumptions

The Commonwealth collects and receives revenues from several non-tax sources, including the federal government, various fees, fines, court revenues, assessments, reimbursements, interest earnings and transfers from non-budgeted funds. These revenues are deposited in the General Fund, the Commonwealth Transportation Fund and other operating budgeted funds. The Governor's fiscal year 2011 budget recommendation assumes approximately \$13.64 billion in non-tax revenues. Reimbursements from the federal government make up 64% of the State's non-tax revenue. The remaining non-tax revenues come from departmental revenues (22%) and operating transfers to fund programs and services off budget (14%). Sections 1B and 1C of this document details the different types of non-tax revenues.

House 2 Total Non-Tax Revenues: \$13.64 Billion (in \$ Billions)



Federal Revenues

Federal revenues are collected through reimbursements for the federal share of entitlement programs such as Medicaid and through block grants for programs such as Temporary Assistance for Needy Families (TANF) and Child Support Enforcement. The amount of federal reimbursements to be received is determined by state expenditures and federal regulations that govern federal programs. Staff from the Executive Office for Administration and Finance work with agencies to project budget year spending levels for these federally supported programs.

Until the passage of the American Recovery and Reinvestment Act (ARRA) the Commonwealth received reimbursement for approximately 50% of its spending for Medicaid programs. The state's Federal Medicaid Assistance Percentage (FMAP) was increased beyond 50% when ARRA was passed in February of 2009. The level of enhanced FMAP, under ARRA, for each state is dependent on the state's unemployment rates. Massachusetts qualifies for tier 3, which is the highest tier for FMAP percentages. The enhanced FMAP through the ARRA legislation extends through December 2010. The Administration has assumed that it will still be eligible under tier 3 for an enhanced FMAP percentage of 61.59% through the first half of fiscal year 2011 which will generate \$690 million. This is consistent with economic indicators and consensus revenue assumptions for unemployment. Also, the fiscal year 2011 budget assumes that federal legislation will be passed to extend enhanced FMAP for states through June 2011. Indications from the Obama Administration and Congress,

including the passage of 2 different bills already suggest that enactment of legislation extending enhanced FMAP is likely. Our decision to include this revenue in our budget is consistent with the budgeting approach we took last year when the ARRA legislation was pending in Congress but not yet enacted and is consistent with the budgeting approach taken by a number of other states. We have conservatively assumed that the Commonwealth will be in tier 2 for the second six months of fiscal year 2011 and that will result in an enhanced FMAP percentage of 60.2% which will generate \$608 million. In the unlikely event that Congress does not extend enhanced FMAP through the second half of fiscal year 2011, the Governor will re-file his House 2 budget recommendations for fiscal year 2011 to solve for the absence of this revenue.

Departmental Revenues

Departmental revenues are derived from licenses, tuition, fees for programs and services, reimbursements and assessments for services including, but not limited to, revenues from the Registry of Motor Vehicles, reimbursement of healthcare costs from municipalities participating in the state's Group Insurance Commission (GIC) health care programs, drug rebate money received by the Executive Office of Health and Human Services, interest earnings received on the state's budgeted fund balances and fees collected by the Secretary of State's Office. To the extent possible, the Administration has minimized fee increases. However, MGL Chapter 7:3B provides for an annual review of fees to confirm that they are sufficient to defray the cost of providing the service. As part of this exercise, A&F analyzes historical non-tax revenue receipts and works with agencies to develop budget-year projections for these revenues. During the budget process, agencies are asked to review the fees to ensure they are current and reflect the actual cost of doing business.

H.2 includes two sections that give a detailed overview of projected non-tax revenue for fiscal year 2011. Section 1B details projected fiscal year 2011 non-tax revenue receipts by the department, board, commission or institution that administers and collects the respective revenue source. The online version of H.2 allows the user to further examine each governmental area and view a title and description of each revenue source contributing to that area's total non-tax revenue. Additionally, the fund statements which are included in the "Financial Statements" section of the budget document offer another view of departmental revenues by operating fund.

Consolidated Transfer

Consolidated transfers reflect inflows to the General Fund from non-budgeted funds which include annual tobacco settlement proceeds received as part of the Master Settlement Agreement with tobacco companies, net revenues from the State Lottery Fund, fringe revenue to recoup the cost of various statewide benefits assessed on non-budgeted funds and revenues from the Commonwealth's Abandoned Property Division. A&F solicits agency feedback and uses historical data to project transfers to and from the budgeted funds for the proposed budget year.

Each year operating transfers are made to fund programs and services that are off budget. In prior fiscal years these transfers from budgeted funds to non-budgeted funds were hidden in the outside sections of the budget and the spending for the programs was captured as a loss of revenue. These programs include the Commonwealth Care Trust Fund and Medical Assistance Trust Fund which support the Commonwealth's Health Care Reform Law. For fiscal year 2011, H.2 aims to bring greater transparency to the Commonwealth's budget by breaking out these spending items from the outside sections of the budget and including them in a new Section 2E. Section 2E details these transfers.

Policy Recommendations

A&F worked other Cabinet Secretaries and the Governor's Office to identify policy priorities in fiscal year 2011, and several core policy recommendations that were incorporated into Governor Patrick's budget recommendation. These policy recommendations are discussed in greater detail throughout this budget (in the budget document itself) and in the various issue briefs that are filed along with the Governor's budget recommendations.

Fiscal Year 2011 Budget Challenge

Fiscal year 2011 will be the third straight year in which the Governor's budget reflects the impact of a national economic recession. As tax revenues plummeted nearly \$4 billion over a 14-month period, the demand for state programs and services have grown to an all time high. As it has been reported, Massachusetts is well positioned for economic recovery and we are beginning to see signs of recovery. Investments in education, local aid, life sciences, clean energy and infrastructure have helped create jobs and have laid the foundation for the long-term growth of our economy.

Still, it will take time for state tax revenues, which traditionally lag economic growth, to return to the levels we were at prior to the fiscal crisis. In the meantime, the fiscal year 2011 budget will, once again, require a series of creative solutions. The projected gap in the fiscal year 2011 budget is estimated at \$2.7 billion and is driven by three factors. The structural imbalance created from one-time revenues and federal stimulus funds used in fiscal year 2010, modest tax revenue growth resulting from an improving economy, but projected off of a much smaller base than we had just a year ago, and growth in costs in a few areas of the State budget due to caseload and inflationary increases. The development of the fiscal year 2011 budget is further complicated by the fact that the balance of the State's Stabilization Fund is lower than it was at the start of the fiscal crisis (understandably, given the need to use stabilization funds to cushion the fiscal impacts of an economic decline) and much of the federal stimulus funds that have been made available to the Commonwealth have been put to use in fiscal years 2009 and 2010.

Structural Imbalance:

In order to protect core programs and services during the fiscal crisis, the Patrick – Murray Administration has relied on the State's Rainy Day funds and federal stimulus funds. The fiscal year 2010 budget relies on nearly \$2.5 billion of one-time revenues to support critical programs and services, mostly to meet federal maintenance of effort requirements in education and Medicaid. It is important to understand that federal stimulus funds must be used to support the programs and services they were intended for and cannot contribute to the states reserves in any way – they must be spent or the state risks losing access to them.

Tax Revenue Growth:

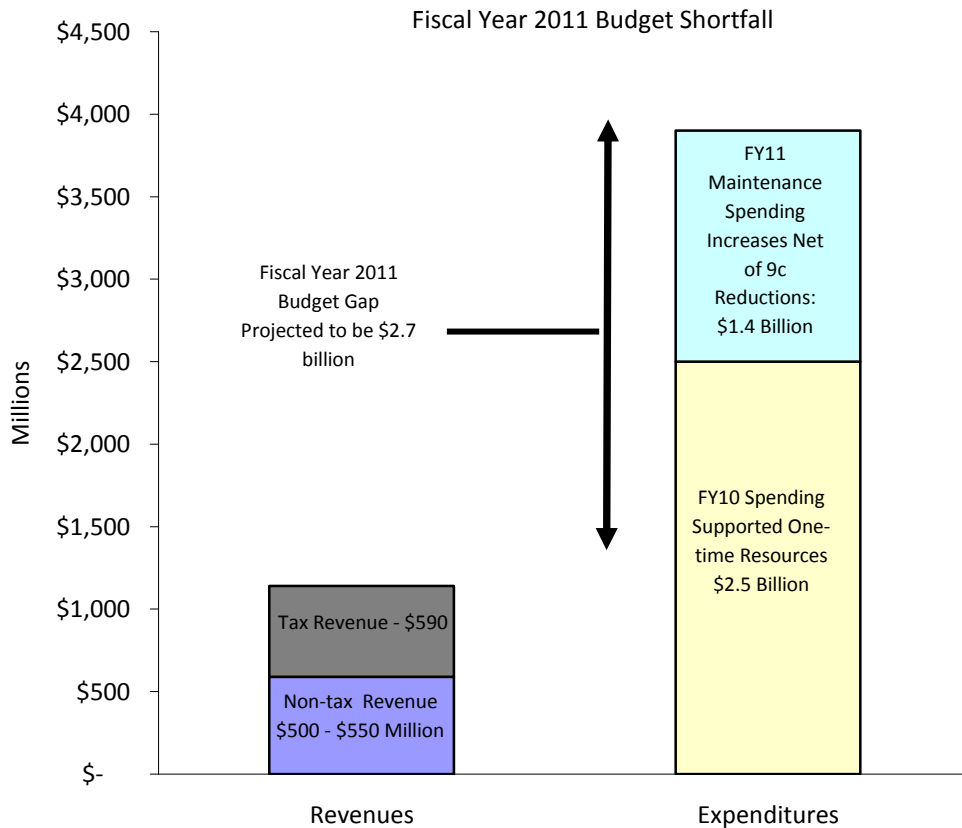
Based on the consensus revenue estimate for fiscal year 2011, revenues are projected to grow by \$590 million, about a 3.2% increase over the previous year estimates of \$18.460 billion. Despite projections that the economy is starting to recover and revenue growth is positive, the fiscal year 2011 consensus revenue estimate of \$19.050 billion is still far below the \$21.401 billion consensus revenue estimate for fiscal year 2009 before the fiscal crisis began.

Spending Growth:

In developing the fiscal year 2011 budget, year-on-year spending growth was assumed for a limited number of programs in the state budget. These included the state's contributions to local education costs or "school aid", health care costs for low-income persons enrolled in MassHealth (Medicaid) and Commonwealth Care, state contributions for its employees' health care costs, and a limited number of caseload-driven programs across state government. In general, without substantial regulatory or even statutory changes to these entitlement programs, costs for these areas increase every year, based on annual medical and other inflationary cost pressures, increased caseload and program utilization and other demographic factors (such as aging of the state's population). The H.2 recommendation provides for real but modest increases in spending for these programs in fiscal year 2011 from their fiscal year 2010 estimated spending levels.

A&F worked with each appropriate state agency to ensure that the assumed spending growth was as accurate as possible, and solicited recommendations from agencies and groups outside state government about short-term and long-term solutions for addressing spending growth. In addition, the Patrick-Murray administration continue to propose measures that offer savings to state and local spending on health care costs, which continue to be one of the greatest challenges to state and municipal finances.

In combination, the use of reserves and other non-recurring revenues in fiscal year 2010, the projected growth in costs to maintain core programs and services and slight growth in tax revenues result in a projected shortfall for fiscal year 2011 of approximately \$2.7 billion. The chart below illustrates the factors that when combined, led to the fiscal year 2011 budget gap



Fiscal Year 2011 Budget Solutions

The Governor's fiscal year 2011 budget is a balanced and fiscally responsible blueprint. Estimated fiscal year 2011 spending would grow by only 3% over estimated fiscal year 2010 spending, *less* than the projected 3.2% rate of growth in tax revenues.

In addition to delivering on many reforms, the Governor has once again proposed a balanced set of solutions that deliver on his commitment for a fiscally responsible budget that mitigates the impact on those most in need.

Of the \$2.75 billion budget shortfall, the Administration anticipates that \$1.394 billion will be funded with federal stimulus funds that will be required to spend – or lose – in fiscal year 2011. To close the remaining projected budget gap, the Administration has proposed budget cuts and savings and efficiencies totaling \$797 million gross (\$670 million net). The proposal includes \$29 million of budget cuts that will be offset by contributions from the State's independent and quasi-public agencies. It uses some select tax exemptions and dedicates the proceeds to fund wellness and other programs that will lead to cost savings in the long term. These solutions, along with a measured approach to the use of reserves and other one time revenues, have allowed the Governor to protect core services while responsibly balancing the fiscal year 2011 budget.

FY2011 Governor's Budget Recommendation

FISCAL YEAR 2011 SOLUTIONS		in millions
1 BUDGET REDUCTIONS, SAVINGS AND EFFICIENCIES	(\$797 million gross)	670
<i>Line Item Reductions</i>		310
<i>Mass Health Reductions (\$265 million gross)</i>		132
<i>Line Item Reductions Offset by Quasi-Public Contributions</i>		29
<i>Debt Restructuring: Smoothing</i>		199
2 FEDERAL STIMULUS FUNDS REQUIRED TO BE SPENT IN FY11		1,394
<i>Federal Stimulus - Education Stabilization Funds</i>		96
<i>Federal Stimulus - Enhanced FMAP (first 1/2 of FY11) - Tier 3</i>		690
<i>Extension of FMAP (second 1/2 of FY11) - Tier 2</i>		608
3 DISCRETIONARY RESERVES AND OTHER ONE TIME RESOURCES		489
<i>Rainy Day Funds</i>		175
<i>Medicare Repayment for Special Disability Workload</i>		160
<i>Sale of State Land</i>		19
<i>Trust Fund Reconciliation and Closure</i>		35
<i>Debt Savings</i>		100
4 REVENUES		199
<i>Administrative Provisions to Facilitate Tax Collections</i>		31
<i>Limiting Tax Expenditures</i>		136
<i>Departmental Revenue Increases</i>		33
TOTAL SOLUTIONS:		2,752

1. Budget Reductions, Savings and Efficiencies

Non-Executive Branch Agencies

Non Executive	FY10 GAA	FY10 Estimated Spending	FY11 H.2
Judiciary	584,222,928	593,067,928	432,109,302
Committee for Public Counsel Services	168,298,481	201,277,524	167,964,898
District Attorneys	92,646,673	92,646,673	92,646,673
Sheriffs	330,014,575	549,322,234	472,038,027
Other Constitutional	160,270,146	169,840,906	157,306,177
Lottery	82,403,845	82,403,845	82,403,845
Debt Service	2,098,749,596	2,075,076,451	2,071,593,691
Comptroller	17,820,389	19,020,389	13,977,337
Legislature	53,693,944	69,149,257	53,693,944
Total Non-Executive	3,588,120,577	3,851,805,207	3,543,733,894

Agencies outside of the Executive branch including Constitutional Officers, the Judiciary, District Attorneys and Sheriffs, among others comprise \$3.5 billion of the fiscal year 2011 budget recommendations. Some areas of note include –

- **Judiciary** –The Governor's House 2 recommends that the Office of the Commissioner of Probation move from the Judiciary to the Executive Office of Public Safety and Security. The funding amount being transferred is \$146 million. When adjusted for this re-organization, the overall budget for the Judiciary is 2.5% below the fiscal year 2010 estimated spending.
- **Committee for Public Counsel Services** – House 2 funding allows for the hiring of additional staff attorneys, shifting away from our reliance on Bar Advocates in an effort to reduce costs. The total funding recommended for fiscal year 2011 is essentially level to the fiscal year 2010 GAA.
- **Sheriffs** – A significant transition occurred in fiscal year 2010 that brought the remaining 7 County Sheriffs departments (Barnstable, Bristol, Dukes, Nantucket, Norfolk, Plymouth and Suffolk) into the state system consistent with the 7 State Sheriffs that transitioned in the 1990's. The fiscal year 2010 GAA included funding for these departments for one-half of fiscal year 2010 as the transition implementation date was January 1, 2010 (half way through the fiscal year). For fiscal year 2011, the House 2

recommendations adjust for a full year of spending. Overall, the 14 Sheriff Department budgets were reduced by 2% below fiscal year 2010 estimated spending.

Executive Branch Agencies

Executive	FY10 GAA	FY10 Estimated Spending	FY11 H.2
EO Administration & Finance	313,283,351	345,650,435	345,535,161
EO Energy & Environmental Affairs	209,917,322	204,252,286	197,905,899
EO Health & Human Services	4,749,176,462	4,696,005,290	4,667,934,484
MA Department of Transportation	78,821,155	88,497,769	-
EO Housing & Economic Development	315,125,004	350,285,917	324,456,038
EO Labor & Workforce Development	46,254,384	54,265,983	44,345,299
EO Education	1,890,706,891	1,807,518,661	1,923,903,941
EO Public Safety	932,767,320	928,545,292	1,072,853,430
Total Executive	8,536,051,889	8,475,021,633	8,576,934,252

Funding for Executive Branch Agencies for programs and services that fall within each of these Secretariats totals \$8.6 billion for fiscal year 2011. Several factors contribute to the varying levels of increases and decreases among them:

- **Executive Office of Education (EOE)** – The budget recommendation for the Secretariat for Education (excluding Chapter 70 discussed below) increases by 6.4% above the fiscal year 2010 estimated spending. In fiscal year 2011, funding for the University of Massachusetts and the State and Community Colleges increases to replace the use of Federal Stimulus dollars that supported these agencies in fiscal year 2010. For fiscal year 2011, \$96 million in stimulus funds will be used to hold the campuses harmless to the fiscal year 2009 and 2010 GAA levels as required by the Federal maintenance of effort rules.
- **Executive Office of Health and Human Services (EOHHS)** – Recognizing the importance of maintaining critical safety net programs and services, the Governor has limited budget reductions to EOHHS agencies to 0.6% (excluding MassHealth discussed below) below fiscal year 2010 estimated spending. Included in this funding are public health programs that are being supported through the creation of a Health and Prevention fund which has dedicated to it new revenues from the elimination of the candy and soda exemption and the alcohol tax that was initiated last fiscal year.
- **Executive Office of Public Safety (EOPS)** – As mentioned earlier, a significant re-organization is being recommended which would transfer the Office the Commissioner of Probation from the Judiciary to the Executive Office of Public Safety as a new department of Community Supervision. In addition, the Department of Correction is committed to seeking changes and efficiencies through the Governor's proposed Crime Package pending before the Legislature to achieve savings without closing any correctional facilities. Overall, most public safety agencies were level funded to fiscal year 2010 estimated spending.
- **Massachusetts Department of Transportation (MassDOT)** – Fiscal year 2010 marked a significant transformation of our transportation agencies. The successful implementation of the reform has completely changed the way we budget for transportation programs and services in the fiscal year 2011 budget. Funding is now supported through operating transfers reflected in Section 2E of the budget document. Total funding through these transfers is approximately \$375 million and is being transferred from the Commonwealth Transportation Fund to the Massachusetts Transportation Trust Fund, an off budget trust from which the new Massachusetts Department of Transportation is funded.
- **Executive Office of Energy and Environmental Affairs (EOEEA)** – Fiscal year 2011 funding for EOEEA is approximately 3.1% below fiscal year 2010 estimated spending. Core programs and services were preserved, however, changes within the Department of Environmental Protection and the Department of Conservation and Recreation may need to occur to accommodate reductions. Investments in recycling were made through the revenue from expanding the bottle bill. EOEEA will also be a key partner in implementing the consolidation of energy across the Commonwealth.
- **Executive Office of Housing and Economic Development (EOHED)** – Fiscal year 2011 funding is approximately 7.1% below fiscal year 2010 estimated spending. Fiscal year 2011 provides for the funding to maintain critical housing programs including funding for Local Housing Agencies, Emergency Shelters and the Mass Rental Voucher Program (MRVP is also receiving contributions from Mass Housing). Many of the budget cuts to economic development programs are being offset by contributions from quasi-public agencies with related missions

FY2011 Governor's Budget Recommendation

- **Executive Office of Labor and Workforce Development (EOLWD)** – Funding for programs across this small yet vital Secretariat is recommended at 4.1% below the fiscal year 2010 GAA levels. In an effort to continue the commitment to training people to enter the workforce, the Summer Jobs Program, One Stop Career Centers and Workforce Training Grants were virtually preserved at fiscal 2010 GAA levels.
- **Executive Office For Administration and Finance (ANF)** – Each year collective bargaining and other “reserve” accounts for various purposes are funded within the Secretariat. After accounting for those reserves the fiscal year 2011 budget for A&F agencies is 3.2% less than fiscal year 2010 estimated spending.

There are a few program in the budget that grow over the fiscal year 2010 levels for reasons that include the implementation of specific formulas, increased caseload assumptions and increased utilization.

Areas of Growth	FY10 GAA	FY10 Estimated Spending	FY11 H.2
Group Insurance Commission	1,049,621,804	1,063,874,301	1,241,596,385
MassHealth	8,922,854,888	9,237,363,684	9,838,263,308
Chapter 70	3,869,847,585	3,869,847,585	4,048,324,258
Local Aid	963,646,140	963,707,803	963,707,803

- Fiscal year 2011 will mark the first full year that all employees from the Department of Transportation and the seven Sheriffs Offices will be receiving health insurance coverage from the Group Insurance Commission, a proposal aimed at creating additional savings for these organizations in the long term. These costs along with the expected growth in the cost of health care for fiscal year 2011, contribute to the growth in the GIC's budget for fiscal year 2011.
- MassHealth is the state's Medicaid program that provides comprehensive health insurance to over 1.2 million Massachusetts residents. The fiscal year 2011 budget for MassHealth recommends funding to support 3% enrollment growth along with increases to support the Children's Behavioral Health Initiative, Adult Day Health, Personal Care Attendants, Day Habilitation and Home Health and many other programs offered by MassHealth.
- The state provides funding for school aid known as Chapter 70 that is allocated to the 328 school districts by formula. For fiscal year 2011, Chapter 70 education funding is at an all time high level of \$4.048 billion. At this funding level every district is fully funded at foundation; all districts are assured the same level of funding as they received in fiscal year 2010 levels (at a cost of over \$90 million), and all stimulus funds from the American Recovery and Reinvestment Act (ARRA) used in fiscal year 2010 to support education are backfilled with State General Fund dollars (at a cost of \$172 million). This represents a significant commitment by the Administration to preserve and increase state funding for the Commonwealth's school districts.

Medicaid Cost Controls and Savings (\$265 million gross / \$104 million net)

The Administration's fiscal 2011 budget includes \$9.838 billion for the MassHealth program. The proposed spending for MassHealth is 6.5% higher than fiscal year 2010 estimated spending of \$9.237 billion. The fiscal year 2011 budget continues to fund projected enrollment growth in the MassHealth program of 3%.

MassHealth Program Spending						
FY10 GAA	FY10 Spending Plan	FY11 Maintenance	Percent growth in Maintenance from FY10 Spending Plan	FY11 Final Spending	Spending reductions from FY11 Maintenance	Percent Growth in FY11 Final Spending from FY10 Estimated Spending
8,926	9,237	10,097	9.3%	\$ 9,838	\$ (259)	6.5%

In order to manage spending growth at MassHealth and to achieve the \$9,838 billion final spending number MassHealth is required to due some targeted spending reductions from the maintenance budget. The savings in the fiscal year 2011 H.2 budget total \$265 million (gross), or \$132 million (the \$132 million net number only includes reimbursement at 50%, if enhanced FMAP were to be included the total state share would be \$104 million) and can be categorized into the following; appropriate discipline on rates, program integrity, service restructuring and other initiatives (see below for a chart that highlights that amount in each savings category):

Categories	FY11 Gross Value	FY11 Net Value (50% Federal Medical Assistance Percentage)	FY11 Net Value (Enhanced Federal Medical Assistance Percentage)	FY11 Net Value (State Share)
Rates	(174)	(87)	(19)	(68)
Program Integrity	(23)	(11)	(2)	(9)
Service Restructuring	(58)	(29)	(6)	(23)
All Other	(11)	(5)	(1)	(4)
Total Savings	(265)	(132)	(29)	(104)

Notes: Savings total does not tie with amount in chart above due to IT transfers of \$4.5M and investments of \$10.5M.

Rates - All providers have experienced rate reduction or freezes in the past year and a half due to the extreme fiscal pressures that the state and the overall economy have encountered. The providers highlighted above for fiscal year 2011 savings have experienced minimal or no rate-related cuts.

Program Integrity - Program integrity measures are changes that tighten and strengthen operations at MassHealth. Program integrity measures can include billing changes, changes in the redetermination process, cost avoidance and third party liability recoveries and other items that contribute to efficiencies in the program.

Service Restructuring - Service restructuring includes changes in the way that MassHealth delivers some services. The most notable service restructuring is for the MassHealth adult dental program. The MassHealth Adult Dental program will only cover preventative and emergency services and it will no longer cover restorative dental services. This change will not impact children or intellectually disabled members with active cases through the or intellectually disabled members with active cases through the Department of Developmental Services.

All Other - This item is a "catch all" for the Administration's other reductions that did not fall into one of the above categories. The most significant savings in this category is related to member cost sharing. The only additional cost-sharing is a \$1 increase in co-payments for generic drugs (this will not be applied to antihyperglycemics, antihypertensives and antihyperlipidemics, which are used to manage and treat long-term chronic medical conditions).

The Administration's budget also proposes a couple of revenue solutions to help offset increases in spending. Revenue initiatives include restructuring payments for prescription drug coverage in managed care plans to achieve higher drug rebate revenues, and expanding the Health Safety Net payer surcharge to Managed Care Organizations serving MassHealth and Commonwealth Care members to generate additional funding for MassHealth and Commonwealth Care.

In order to achieve the savings and revenue proposals highlighted above there are some moderate investments in the MassHealth program. The investments amount is \$10.5 million gross or \$5.25 million net (the \$5.25M net number only includes reimbursement at 50%, if enhanced FMAP were to be included the total state share would be \$4.1 million) for enhancements to UMASS's pharmacy online processing systems (POPS) and additional resources for program integrity measures.

Reductions Offset by Quasi-Public Contributions

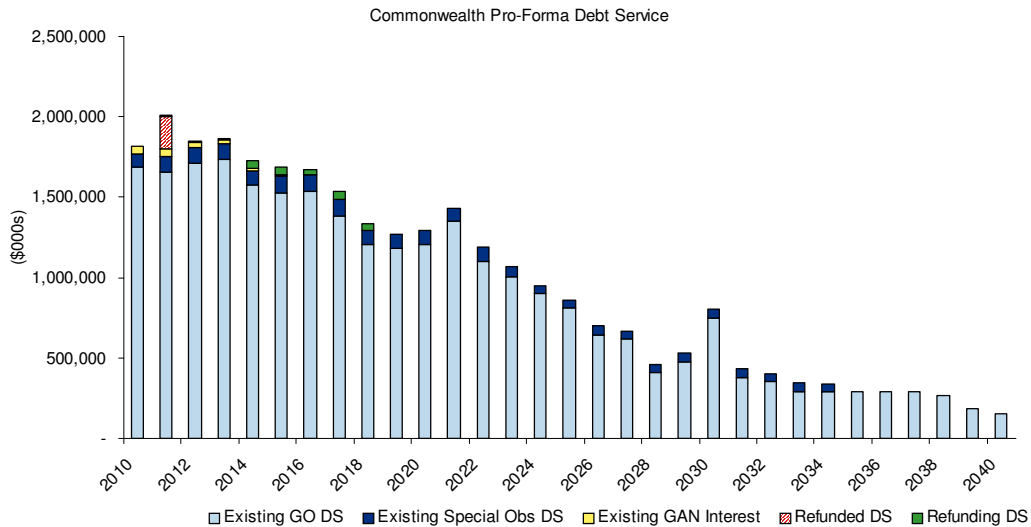
Since fiscal year 2009 the Patrick – Murray Administration has partnered with our Independent and Quasi-Public agencies to provide for nearly \$90 million in funding to help preserve vital programs and services that would have otherwise been suspended or cut during this fiscal crisis. For fiscal year 2011, many of these agencies have once again stepped up to help preserve important programs and services for the coming fiscal year.

Quasi	Program Preserved	Total Contribution
University of Massachusetts	Scholarship	3,500,000
University of Massachusetts	State Library	125,000
University of Massachusetts	Collins	541,000
Connector Authority	Enrollment Grants	2,500,000
MA Convention Center Authority	MOTT	5,000,000
MassHousing Authority	MRVP	8,000,000
Mass Housing Partnership	Soft Second	2,000,000
Mass Development Finance Authority	Mass Cultural Council	3,000,000
Mass Development Finance Authority	Office of Small Business	700,000
Mass Development Finance Authority	Permitting Office	335,000
Mass Tech Collaborative	STEM	500,000
Mass Tech Collaborative	HED Broadband	275,000
Mass Tech Collaborative	MOITI	300,000
Massport Authority	MOITI	300,000
Mass Tech Collaborative	Innovation Initiatives	500,000
Mass Education Finance Authority	McNair Scholarship	1,000,000
TOTAL		28,576,000

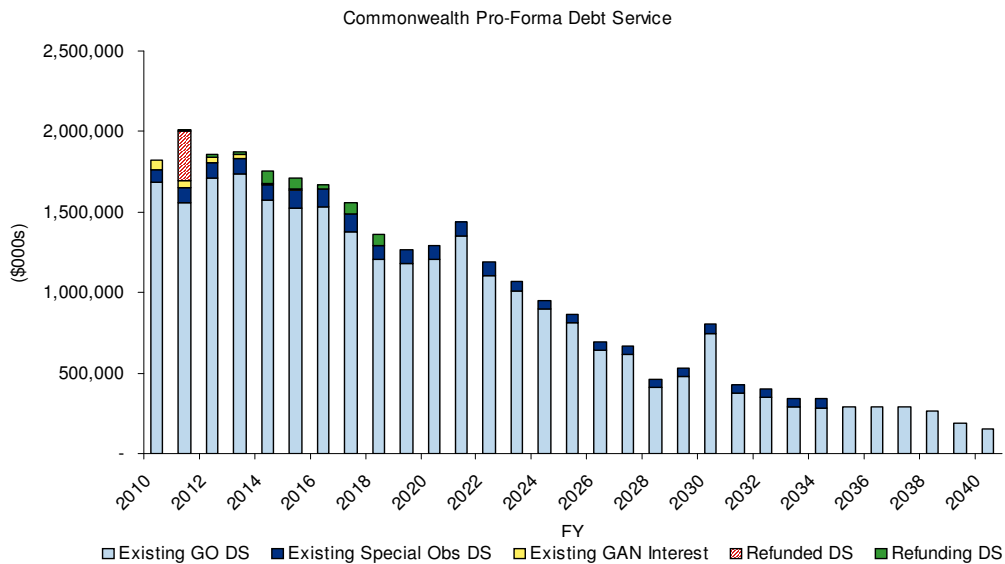
Debt Restructuring:

Debt service on outstanding long-term bonds is a significant portion of the Commonwealth's operating budget. As part of the comprehensive plan to address fiscal year 2011 budgetary shortfalls, the Administration proposes a two-part debt refinancing strategy. The first part is to refinance \$200 million of fiscal year 2011 amortizing principal to smooth the fiscal year 2011 debt service spike. The second part is to refinance an additional \$100 million of fiscal 2011 principal to achieve budgetary relief, if necessary.

- First transaction: Smoothing.** We propose refinancing \$200 million of \$1.02 billion in fiscal 2011 amortizing principal for the purpose of smoothing the 2011 spike in total debt service. Repayment of this refinancing would occur over the next seven years. Following this transaction, the resulting fiscal 2011 total debt service will be approximately equivalent to fiscal year 2010 debt service. The historically low interest rates available in the bond market make this a sound budget-balancing strategy in the current fiscal context. At a current interest rate of 2.1%, the estimated cost of the smoothing refinancing is only \$1.2 million, present value. In fact, the Administration plans to issue these refinancing bonds together with refinancing certain high interest rate bonds. In the aggregate, the refinancing will result in net present value savings of \$10.8 million. The following chart illustrates the effect of this refinancing on currently outstanding debt service. The smoothing effect, (shown as a checked bar) is redistributed to years in which the Commonwealth faces lower debt service.



- Second transaction: Budget Relief.** The debt refinancing strategy includes an option to execute a second transaction to refinance an additional \$100 million of principal due in fiscal year 2011 to achieve an additional \$100 million of budgetary relief. The graph below reflects the total effect of both transactions on the Commonwealth's debt profile. This second transaction could be executed mid-year, after the October revenue estimate review, if additional budgetary relief is desired at that time. At a current interest rate of 2.1%, we estimate the cost of both refinancings to be \$2.5 million, present value. Together with the other refinancing for savings described above, the combined refinancing transactions are expected to result in net present value of \$8.3 million.



As one limited component of a larger set of budget solutions, this debt refinancing proposal is a sound and reasonable proposal in the current fiscal context. This is particularly true based on the modest amount, the short amortization period, the historically low interest rate environment and the opportunity to pair this refinancing with another refinancing that will actually result in net present value savings. This refinancing will be taking into account and is consistent with our debt affordability policy.

2. Federal Stimulus Funds that Must be Spent in Fiscal Year 2011

Governor Patrick's effective advocacy in Washington helped secure a total of \$2.889 billion in enhanced federal Medicaid matching funds and \$994 million in Education Stabilization funds for the Commonwealth as part of the larger American Recovery and Reinvestment legislation that was signed by President Obama in February of 2009. In the absence of these federal funds, the state would have had to make deeper, harmful cuts to core public priorities or draw larger amounts from its own stabilization fund to balance the budget. This strategy has resulted in a sizeable balance (\$610 million) in the state's stabilization fund heading into fiscal year 2011 to help continue to cushion the impacts of a prolonged national economic downturn.

The federal aid amounts included in the fiscal year 2011 budget blueprint are based on current projections of temporarily enhanced federal Medicaid matching funds (FMAP) that will be available to Massachusetts based on the Governor's recommended appropriations for programs that generate matching federal funding under the State's FMAP formula as well as the remaining balance of the fiscal Stabilization funds used to support education.

The fiscal year 2011 budget includes a total of \$1.297 billion in enhanced FMAP, generated throughout fiscal year 2011. These resources reflect Governor Patrick's ongoing advocacy and anticipated success in helping to secure the expected enactment of a six-month extension of enhanced federal matching relief as part of pending federal legislation. This approach is consistent with our actions last year in filing our fiscal year 2010 budget proposal while the federal recovery act was pending. In the unlikely event that Congress ultimately decides not to extend enhanced Medicaid matching funds, the Administration would re-file House 2 based on revised federal revenue projections (just as we re-filed House 1 last year based on updated state tax revenue projections). The fiscal year 2011 budget also includes \$96 million in remaining federal recovery act Education Stabilization funds, which are used to fully protect higher education from budget cuts.

Federal Stimulus Funds Used to Support the Operating Budget

	FY09	Projected FY10	Proposed for FY11	
Federal Medical Assistance Percentage (FMAP) Based Original	(869)	(1,328)	(690)	
ARRA Legislation				
Extension of FMAP Benefits - (6 months)	-	-	(608)	
Fiscal Stabilization - Education Funds (81.8%)	(322)	(457)	(34)	
Fiscal Stabilization - General Government Services (18.2%)	(90)	(29)	(62)	
Transitional Assistance for Needy Families (TANF) Based on	(41)	(83)	(23)	
ARRA Legislation				
SUBTOTAL OF ARRA FUNDS	(1,322)	(1,897)	(1,417)	
Change in use of ARRA Funds Previous Year		575	(480)	-25%

The total amount of federal stimulus funding used to support the operating budget is reduced by approximately 25%, or \$480 million, from the amount that was used in fiscal year 2010. It is important to understand that any federal stimulus funds used to support the operating budget must be spent in accordance with the "use or lose" provisions of the federal legislation. In addition, there are federal maintenance of effort requirements that must be met as a condition of the stimulus funds and a state cannot use these funds to build up their reserves.

3. Use of Discretionary Reserves and Other One Time Resources

Stabilization Fund

The Administration strikes a careful balance in using one-time revenues in our fiscal year 2011 budget blueprints.

The Governor's use of the Commonwealth's Stabilization Funds throughout the fiscal crisis has been measured and adjusted based on the changing economic conditions. For example, when the Governor filed his budget recommendations for fiscal year 2010 he proposed using approximately \$500 million of Stabilization Funds. As

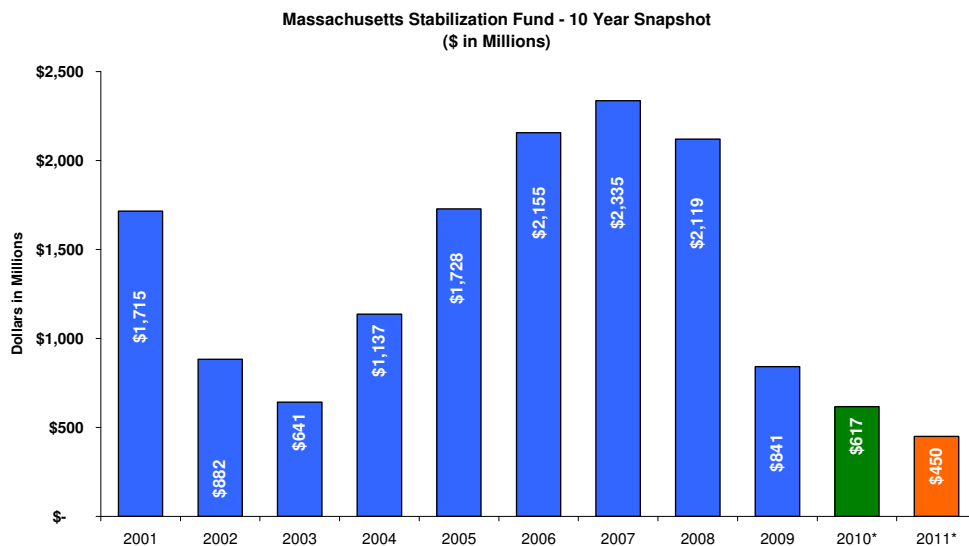
the revenue picture worsened and more federal stimulus funds became available to help stabilize programs such as MassHealth and Chapter 70 education aid, the Governor reduced the Stabilization draw to \$215 million. This amount was later increased by \$34 million bringing the total authorization for fiscal year 2010 to \$250 million. Ultimately, the total amount of Stabilization Funds that will be used in fiscal year 2010 will depend on revenue performance for the second half of the fiscal year. To the extent that revenues come in over benchmark, the Secretary of Administration and Finance may authorize a lesser amount to be drawn from the Stabilization Fund if revenues are sufficient to cover expenditures for the remainder of the year.

For fiscal year 2011, the Governor is proposing a modest draw from the Stabilization Fund of \$175 million. This represents a 30% reduction in the use of Stabilization funds from fiscal year 2010 and preserves an ending balance of approximately \$450 million. In addition, the Secretary of Administration and Finance intends to use his authority to reduce the amount of stabilization funds used in fiscal year 2011 to the extent supported by revenue collections. The following is a general description of the Stabilization Fund.

General Information regarding the Stabilization Fund

The Stabilization Fund is established in Chapter 29, section 2H of the General Laws as a reserve of surplus revenues to be used for the purposes of: (1) covering revenue shortfalls, (2) covering state or local losses of federal funds or (3) for any event which threatens the health, safety or welfare of the people or the fiscal stability of the Commonwealth or any of its political subdivisions. The fund is sometimes referred to as the state's "rainy day fund," serving as a source of financial support for the state budget in times of slow or declining revenue growth and as the primary source of protection against having to make drastic cuts in state services in periods of economic downturns.

The following table shows the amount on deposit in the Stabilization Fund at the end of each of the last 16 fiscal years and the projected balance for fiscal years 2010 and 2011.



* FISCAL YEAR 2010 and FISCAL YEAR 2011 Stabilization Fund totals are estimates based on current

As illustrated in the table above, the Stabilization Fund provided critical support in maintaining state services the last time the Commonwealth experienced declining tax revenues in the face of an economic downturn.

Use of Other One-Time Discretionary Revenues:

As state tax revenues grow due to projected improvement in the economy – and the Governor continues to exercise care and restraint in spending – we project being able to reduce the total amount of one-time resources used to balance the budget in fiscal year 2011 by 23% compared to fiscal year 2010 and 38% compared to fiscal year 2009. Through fiscal discipline, we are able to minimize the use of the State's Stabilization Fund – the state's most flexible reserve. The budget proposes only a \$175 million withdrawal from the State Stabilization Fund, an 87% decrease from fiscal year 2009 and 30% decrease from fiscal year 2010.

FY2011 Governor's Budget Recommendation

Total Use of One-Timers (Federal Stimulus and Other One-time Solutions)

	FY09 Actual	Projected FY10	Proposed for FY11	% Change
Federal Stimulus Funds				
Federal Medical Assistance Percentage (FMAP) Based Original ARRA Legislation	(869)	(1,328)	(690)	
Extension of FMAP Benefits - (6 months)	-	-	(608)	
Fiscal Stabilization - Education Funds (81.8%)	(322)	(457)	(34)	
Fiscal Stabilization - General Government Services (18.2%)	(90)	(29)	(62)	
Transitional Assistance for Needy Families (TANF) Based on ARRA Legislation	(41)	(83)	(23)	
Subtotal: Federal Stimulus Funds	(1,322)	(1,897)	(1,417)	
Change in use of Funds from Previous Year		575	(480)	-25%
Discretionary One-time Funds				
State "Rainy Day" Funds	(1,390)	(249)	(175)	
One-time Tax Settlement Revenue	(196)	(152)	-	
TANF Contingency Funds (non- ARRA Funding)	(80)	(18)	-	
Ma Convention Center Fund	(65)	-	-	
Bryne Grant	(13)	(4)	-	
Ma School Building Authority Repayment	-	(150)	-	
Independent and Quasi Contributions	(46)	(21)	(29)	
Trust Fund Balances	-	(28)	(35)	
Special Disability Workload Federal Reimbursement	-	-	(160)	
Sale/Proceeds from the Sale or Use of State Land	-	(9)	(19)	
Debt Savings Proposal	-	-	(100)	
Subtotal: Discretionary One-time Funds	(1,790)	(631)	(518)	
Total Use of One-timers	(3,112)	(2,529)	(1,935)	
Change in use of One-timers from Previous Year		(583)	(593)	-23%
Change in use of One-timers from FY09			(1,177)	-38%

4. Revenues

The budget does not include any broad-based tax increases. Based on a thorough, multi-agency examination of state tax exemptions, it proposes limiting select exemptions to provide sufficient resources to meet public priorities. This includes retaining existing film and life sciences tax credits, but temporarily capping the financial benefit they provide at levels calibrated to ensure Massachusetts remains a leader in both fields. The budget also repeals sales tax exemptions for candy and soda and ends the exemption of cigars and smokeless tobacco from the cigarette excise tax rate enacted by the Legislature in 2008. These measures promote public health and generate revenues that are dedicated to health care and wellness programs through the Commonwealth Care Trust Fund and the Commonwealth Health and Prevention Fund.

Limiting Certain Tax Expenditures (\$135.9 million net of transfers to the School Building Authority and the Commonwealth Care Trust Fund)

Massachusetts law defines "tax expenditures" as "state tax revenue foregone as a direct result of [a] law which allows exemptions, exclusions, deductions from, or credits against, the taxes imposed on income, corporations, and sales." Every year, as required by law, the Department of Revenue prepares a "Tax Expenditure Budget" that shows how much the Commonwealth spends for each of these tax expenditures. The current Tax Expenditure Budget is published as part of this document and can be viewed in its entirety under the section tab titled "Tax Expenditure Budget".

To carry out the Patrick-Murray Administration's policy of shared sacrifice during this fiscally challenging time, and based on an unprecedented, thorough review of the state tax code's many preferences, we recommend limiting specific tax expenditures worth \$161.6 million in fiscal year 2011.

- *Temporarily limit film tax credits (\$75 million).* Our budget temporarily limits total film credits to \$50 million for each of fiscal year 2011 and fiscal year 2012. We believe that this will not interfere with long-term plans to build film studios and will ultimately keep Massachusetts among the most competitive states for this significant industry.
- *Temporarily limit life sciences tax credits (\$5 million).* Although promoting the critical life sciences industry remains one of our top economic development priorities, we will administratively reduce fiscal year 2011 tax credit awards by \$5 million.

- *Repeal aircraft sales tax exemption (\$4.2 million).* This exemption can no longer be justified, especially since cars and boats are not exempt, and other states are likely to apply use taxes to aircraft if we do not. The H.2 recommendation does not seek to repeal the exemption for aircraft parts, because of the benefit that serves for our small airports.
- *Repeal sales tax exemption for candy and soda (\$51.7 million).* Repealing this exemption serves important public health purposes and will support critical wellness and prevention programs.
- *Remove exemption of cigars and smoking and smokeless tobacco from 2008 tobacco excise rate (\$15 million).* The new cigarette excise rate passed by the Legislature in 2008 did not apply to these other tobacco products. We cannot justify this distinction in view of important health and revenue benefits. The Governor's budget directs these revenues to the Commonwealth Care Trust Fund to support the state's health reform initiatives.

Commonwealth Health and Prevention Fund (\$51.7 million; \$157.1 million after dedicating the alcohol tax signed into law in the previous fiscal year)

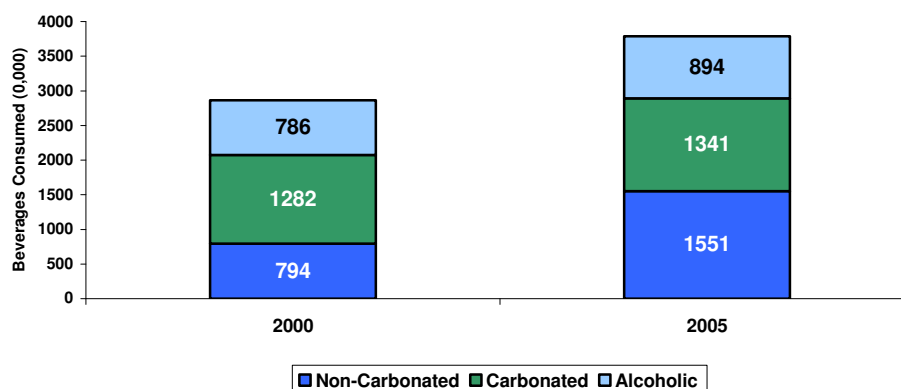
Massachusetts has long been an innovator in health care and public health. The public health programs that serve the people of the Commonwealth reflect the Administration's commitment to preventative care and wellness services as a vital component of health care reform. The Commonwealth Health and Prevention Fund will receive a total of \$151.7 million of revenue generated from eliminating exemptions on sweetened beverages and candy (\$51 million) and by dedicating the alcohol tax revenue (\$100 million) that was signed into law as part of the fiscal year 2010 budget. The fund will be used to support critical programs within the Massachusetts Department of Public Health, including addiction services, smoking prevention and cessation programs, violence prevention, and children's nutrition.

Health and Prevention Fund: Fiscal Year 2011			
\$151.7 Million			
Account Distribution	Acct #	% Funded from Health and Prevention Fund	Total Health and Prevention Fund Spend
Addiction Control Services	4510-0700	100%	\$ 81,184,876
Smoking Prevention and Cessation Programs	4590-0300	90%	\$ 4,725,969
Health Promotion, Violence Prevention and Workforce Expansion	4510-2500	83%	\$ 33,520,467
Children's Health and Nutrition	4512-0120	83%	\$ 32,268,688
Total Wellness Fund Spending			\$ 151,700,000

Bottle Bill (\$20 million)

Discarded cans and bottles are a major source of trash that impacts our communities while wasting precious natural resources and energy. The Massachusetts Bottle Bill, enacted in 1982, was designed to promote recycling by encouraging consumers to return their empty soda and beer containers by offering a \$0.05 deposit. In the fiscal year 2011 budget, Governor Patrick proposes to expand the \$0.05 deposit to include water, flavored waters, coffee based drinks, juices and sports drinks. When the bottle bill was enacted in 1982, the beverages covered by the law were limited to carbonated soft drinks, mineral water, beer and other malt beverages. Since that time, the beverage market has expanded and non-carbonated beverages have experienced near double-digit growth in the past decade.

Beverage Consumption in Massachusetts, 2000 and 2005



Of the estimated \$20 million in additional revenue generated through this change, \$5 million will be dedicated to the Executive Office of Energy and Environmental Affairs for recycling and solid waste management.

Fraud, Waste and Abuse

It is critically important that the Commonwealth be focused on detecting fraud and abuse in the delivery of all state programs and services. In this difficult fiscal environment, the Commonwealth is experiencing increased caseloads in many important programs. These programs, especially those that protect our most vulnerable residents, are in greater demand during these difficult economic times. We need to make sure every dollar is spent appropriately.

Because fraud, waste and abuse prevention is a cross Branch / cross- Secretariat initiative the Governor's budget recommendation for fiscal year 2011 proposes the creation of a task force comprised of all the state entities that play a critical role in the detection and prevention of fraud. The goal of the taskforce will be to create better coordination among these entities and to:

- Better coordinate across agencies and branches of state government.
- Examine best practices and apply them consistently across all state agencies.
- Identify areas where the Commonwealth may be susceptible to fraud and abuse and implement controls
- Collaborate with the Office of the Comptroller and other auditing professionals to review the state's compliance with internal controls aimed at detecting and preventing fraud.
- Hire consultants to develop recommendations for how Massachusetts can enhance our efforts in this area.

The Governor also proposes providing additional resources to these agencies by recommending a 10% increase in funding levels for those agencies that detect and prevent fraud and abuse.

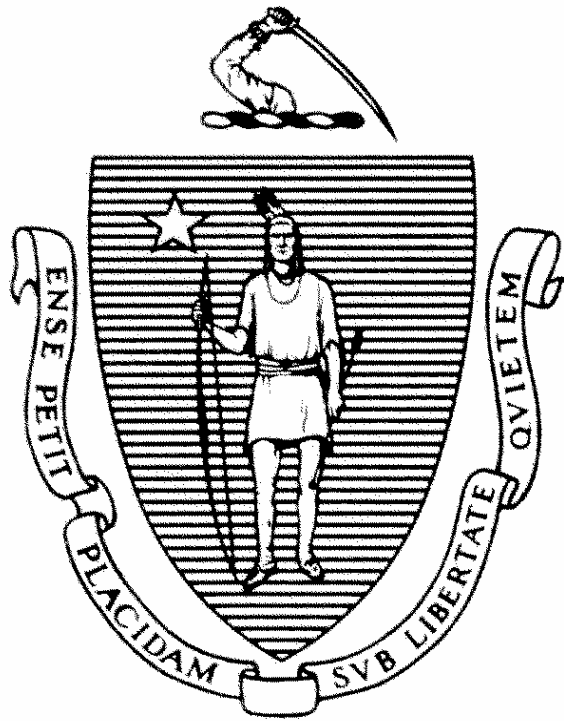
Additional Resources Dedicated to the Detection of Fraud and Abuse

Department	Account Name	FY10	H.2	Increase	% Change
		Estimated Spending			
State Auditor	Bureau Special Investigations	1,647,654	1,812,419	164,765	10.0%
State Auditor	Medicaid Audit Unit	790,702	897,829	107,127	13.5%
Attorney General	Medicaid Fraud Control Unit	3,467,021	3,814,923	347,902	10.0%
Operational Services Division	HHS Provider Recovery RR	499,240	549,925	50,685	10.2%

As a result of the work of the task force and the increased investment in fraud and abuse detection and recovery, the Administration conservatively estimates that it will save \$15 million through increased recoveries.



Fiscal Year 2011 Budget Recommendation



Health Care in the Commonwealth



Health Care in the Commonwealth

Health Care Reform

Introduction

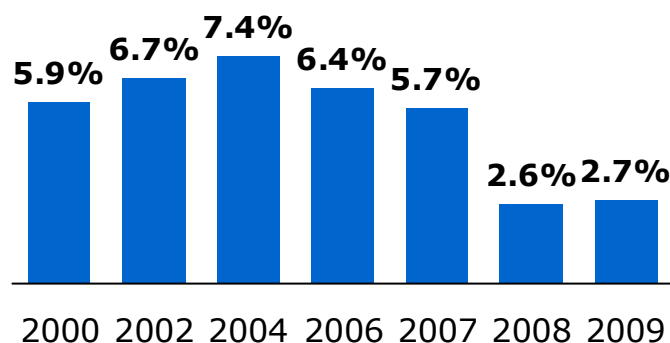
Governor Patrick's and Lieutenant Governor Murray's fiscal year 2011 budget proposal maintains our commitment to the Commonwealth's historic health care reform initiative. The Administration has implemented an innovative, thoughtful legislative vision which has transformed the way that the Commonwealth's residents access health care and has made Massachusetts a national model for how to expand coverage to virtually all of our residents. Today, over 97 percent of our residents have health insurance.

Health care reform in Massachusetts is an unprecedented initiative to expand health insurance coverage. *Nowhere in the nation* had policies like an individual mandate or minimum creditable coverage been tried or tested prior to health care reform in our state. A groundbreaking legislative framework delegated key implementation decisions to state and independent agencies led by the Administration – with success requiring expert policy judgment and the ability to maintain support among a diverse coalition of stakeholders.

Since Governor Patrick took office in 2007, he has committed himself and his Administration to making health care reform a *success*. Within weeks of taking office, he was on the phone with health plan executives demanding and delivering lower rates for our residents – and filing a budget making significant investments in health care reform. He secured an extension of our Medicaid waiver that expanded our ability to leverage federal support for health care reform. Last year, he led a successful charge to include additional Medicaid matching funds in federal stimulus legislation. Through his Administration's role on the Connector Board, the Governor has navigated some of health care reform's most challenging policy decisions – in particular, launching an "individual mandate" that produced gains in coverage without fracturing the health care reform coalition.

Thanks to these efforts – and the continuing commitment of the Legislature and a diverse coalition of stakeholders – health care reform in Massachusetts has been a tremendous success. Over 97 percent of our state's residents have health insurance, with gains in coverage that have given us the highest rates of insurance in the nation. Coverage levels have held steady even in the midst of a dramatic national economic downturn – a testament to the wisdom of the statutory framework for reform and the Administration's sure and steady approach to implementation.

Percentage of Massachusetts Residents Without Health Insurance



Source: Massachusetts Division of Health Care Finance and Policy. [Key Indicators Report](#). November, 2009.

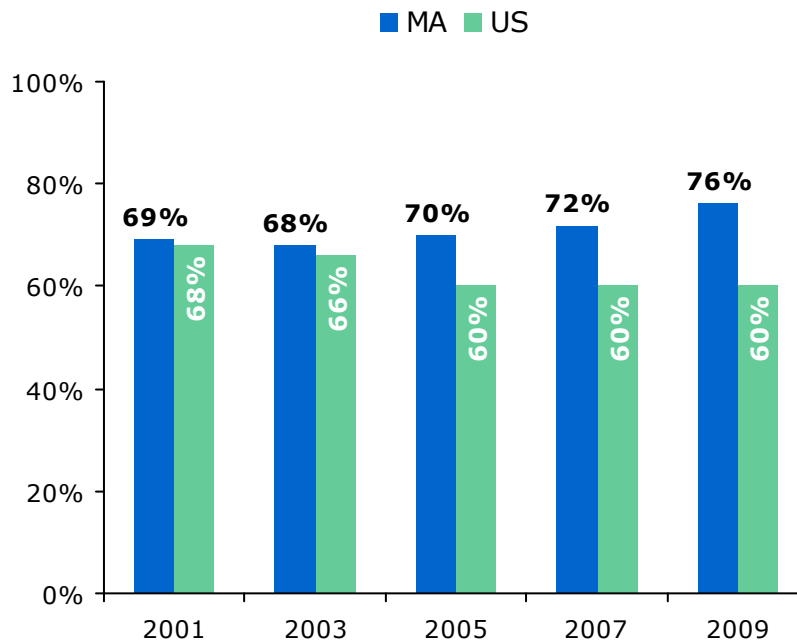
Across our state, we have seen how our residents have benefited from health care reform. Because of the steps we have taken to make health insurance more affordable and accessible, there are countless people throughout the Commonwealth who have access to *their own* doctor – or life-changing medications or procedures – for the

first time. We see gains in access to preventive care, less underinsurance, and a stronger financial safety net protecting our residents against an unconscionable situation of bankruptcy due to medical costs.

Health care reform benefits not just our residents but also our economy. Healthier people mean a more productive workforce for the Commonwealth. Likewise, investing in health care strengthens our world-renowned medical sector – a source of daily medical miracles; an engine for job creation; and a magnet for research dollars and human talent. The Administration's separate, ground-breaking investment in life sciences creates enormous potential synergies with our commitment to health care reform, together ensuring Massachusetts' status as *the world leader* in health care.

The Administration has carefully managed the finances of health care reform, delivering expansions in coverage without breaking the back of the state budget. Independent, non-partisan analysis underscores that the incremental state costs of health care reform have been moderate and in line with original expectations. The model is working *as intended* – with the costs of expanding state coverage partly offset by lower expenses for uncompensated care; a continuing strong financial partnership with the federal government; and an enduring commitment by the vast majority of our employers to offer coverage to their employees instead of relying on the state to do so.

Employers Offering Health Insurance: Massachusetts Compared To The Nation



Source: Massachusetts Division of Health Care Finance and Policy. [Results from the 2009 Employer Survey](#). January, 2010.

Even with the national economic downturn, the public and a broad coalition of stakeholders has continued to support health care reform, which the Administration has protected during a dramatic downturn in state tax revenues.

Governor Patrick's and Lieutenant Governor Murray's fiscal year 2011 budget maintains our commitment to health care reform and builds on this story of success. Health care reform *sets Massachusetts apart* – cementing our reputation as a world leader in health care, a policy innovator, and a caring Commonwealth. Whatever the economic and fiscal pressures, we have not backed away from health care reform. Our state cannot afford to do so without jeopardizing the health of its residents.

The Administration's fiscal year 2011 budget preserves eligibility for state health insurance programs – because over a million residents of this state *rely* on that coverage; our economy *needs* us to invest in the health of our residents; and our values *demand* it. Across state health programs, the Administration is devoting resources to

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allow more people who need access to coverage to enroll. We are also minimizing additional cost-sharing for our residents, recognizing that, in these challenging times, people need *relief* from health care costs, not additional burdens.

These policies embodied in our fiscal year 2011 budget proposal – filed amidst continuing economic and fiscal challenges – directly reflect the Governor's commitment to health care. These goals are accomplished through prudent purchasing, innovative approaches to get the best value for every dollar of state health care spending and the likely success of our coordinated efforts with other states to secure an extension of the enhanced Medicaid matching funds that the Governor first delivered a year ago.

The fiscal year 2011 budget is an important statement of the Administration's continuing commitment to health care reform. But the Administration's efforts to improve the quality and affordability of health care extend well beyond the state budget.

In particular, the Administration inherited a longstanding, national and state problem of rapidly growing health care costs for families, businesses (particularly small businesses) and government – escalating at rates that outstrip their capacity to keep up. This problem was not created by health care reform, but it does threaten the long-term sustainability of reform and, more fundamentally, force harmful choices between paying for health care and meeting other family needs, creating jobs or investing in other important public priorities.

Governor Patrick has rolled up his sleeves and begun the hard work of health care cost containment. His Administration has broken new ground on health care payment reform, securing unanimous endorsement of a nationally heralded blueprint to reward *value* instead of *volume* when it comes to paying for health care. Moreover, responding directly to concerns raised by small businesses, the Governor has launched a series of intensive hearings by his Division of Insurance on health insurance premium increases and the factors that drive them.

Just as has been the case with health care reform, the cost containment initiatives launched by Governor Patrick have Massachusetts once again leading the nation and charting the path to higher-quality, more affordable health care for all.

Section II. Health Care Coverage

The Administration's fiscal year 2011 budget continues to fully fund state health insurance coverage. Despite the significant fiscal pressures facing the Commonwealth, the budget maintains eligibility for state health insurance programs, a marked difference from the approach in prior fiscal crises.

MassHealth

The Massachusetts Medicaid program provides comprehensive health insurance to approximately 1.2 million low-income Massachusetts children, adults, seniors and people with disabilities. Health care reform expanded MassHealth eligibility to children with incomes up to 300 percent of the federal poverty level and broadened eligibility for the Insurance Partnership Program to individuals up to 300 percent of the federal poverty level. It also restored certain benefits that had previously been eliminated.

The Administration's fiscal year 2011 budget includes \$9.84 billion for the MassHealth program. This is 6.5 percent higher than fiscal year 2010 estimated spending of \$9.237 billion. The fiscal year 2011 budget fully maintains eligibility for Massachusetts residents and funds projected enrollment growth of 3 percent.

MassHealth Average Enrollment						
	FY07	FY08	FY09	FY10	FY11	Percent Increase
HMO	349,042	372,403	400,030	433,152.00	461,868	6.6%
PCC	293,645	302,819	313,047	357,943.00	362,218	1.2%
TPL	185,213	189,229	188,895	152,436.00	155,929	2.3%
Seniors	106,664	108,629	109,761	112,400.00	113,837	1.3%
FFS	161,091	166,204	166,188	164,212.00	162,896	-0.8%
Total	1,095,655	1,139,284	1,177,921	1,220,143.00	1,256,747.29	3.0%
% Change	5.1%	4.0%	3.4%	3.6%	3.0%	

Programs with significant increases include the Children's Behavioral Health Initiative (CBHI), Adult Day Health, Personal Care Attendants, Day Habilitation and Home Health. The budget also keeps MassHealth affordable for

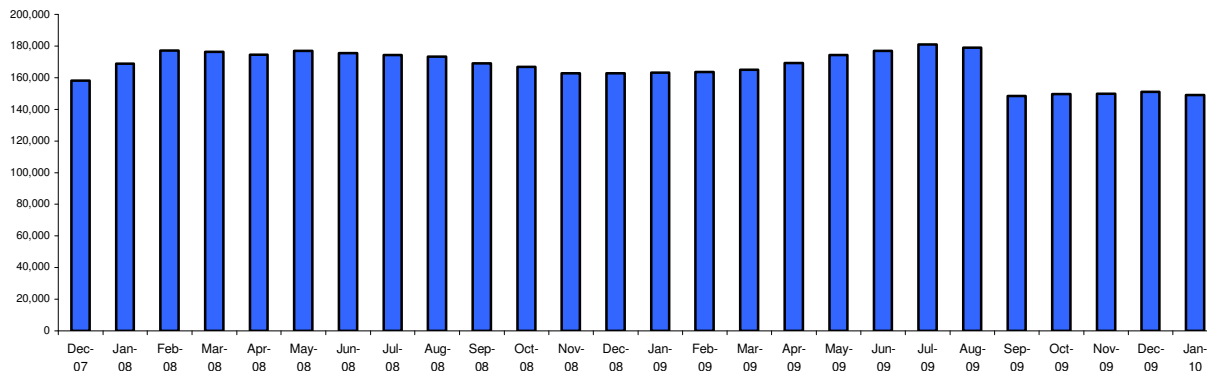
its members. Due to smart fiscal management and leveraging the most value for our spending, the only additional cost-sharing for members is a \$1 increase in co-payments for generic drugs, and this modest increase will not be applied to antihyperglycemics, antihypertensives and antihyperlipidemics (which are used to manage and treat long-term chronic medical conditions).

The budget keeps MassHealth costs affordable for the state and members by maintaining appropriate discipline on rates, introducing new program integrity measures and restructuring adult dental services. The MassHealth adult dental benefit is restructured to cover preventative and emergency services only, excluding restorative dental services. This change will not impact children or intellectually disabled members with active cases through the Department of Developmental Services, and all other members impacted by this restructuring will have access to restorative dental services at Community Health Centers through the Health Safety Net. Revenue initiatives at MassHealth include restructuring payments for prescription drug coverage in managed care plans to achieve higher drug rebate revenues, and expanding the Health Safety Net payer surcharge to Managed Care Organizations serving MassHealth and Commonwealth Care members to provide additional funding for MassHealth and Commonwealth Care.

Commonwealth Care

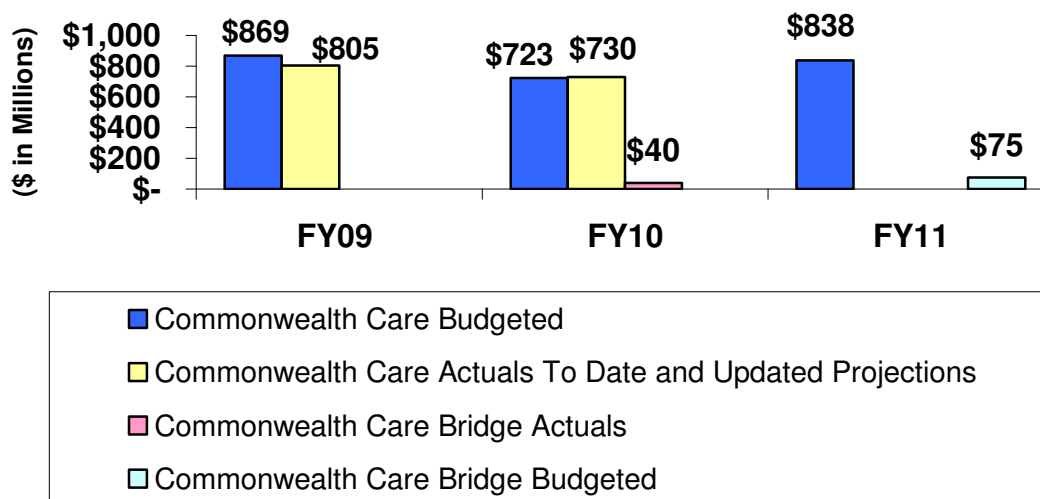
The Commonwealth Care program was created with the enactment of health care reform. The program provides health insurance coverage for individuals under 300 percent of the federal poverty level that do not have access to employer-sponsored insurance. Commonwealth Care fully subsidizes individuals under 100 percent of the federal poverty level and institutes a sliding scale of member premiums for those above that income threshold. It provides health care services through a fully capitated insurance model. As of January of 2010, there are approximately 150,110 members enrolled in Commonwealth Care, excluding the Aliens with Special Status population (see next section on Commonwealth Care Bridge).

Commonwealth Care Enrollment



The budget fully preserves current eligibility for Commonwealth Care and provides \$838 million to fund additional enrollment in the program in fiscal year 2011 (to fund over 20,000 additional members in the program from current enrollment levels). The budget does not include any increases in Commonwealth Care enrollee premiums. Plan Type 1 co-payments would increase by only \$1 for generic drugs, consistent with MassHealth changes, with no co-payment increases for Plans Type 2 and 3. Existing dental coverage for Plan Type 1 members would be restructured in the same manner as MassHealth dental benefits.

Commonwealth Care and Commonwealth Care Bridge Spending



Combined funding of \$913 million for Commonwealth Care (\$838 million) and the Commonwealth Care Bridge program for Aliens with Special Status (\$75 million) is 5 percent more than what was budgeted for Commonwealth Care in the General Appropriations Act for fiscal year 2009. Comparing fiscal year 2009 actual spending and the fiscal year 2011 budget proposal, Commonwealth Care spending (including coverage for Aliens with Special Status) has grown by 6.7 percent on average per year.

Commonwealth Care Bridge

Aliens with Special Status (*legal* immigrants who have resided in the U.S. for less than five years) lost eligibility for Commonwealth Care in fiscal year 2010, due to the extreme fiscal challenges created by a national economic downturn and the fact that the federal government does not reimburse states for health insurance coverage for this population. Instead, a separate investment of \$40 million was appropriated to provide health insurance for this population. This coverage is now available through the newly created Commonwealth Care Bridge program.

Commonwealth Care Bridge currently provides coverage to about 26,000 Aliens with Special Status, who were enrolled over a three-month period from October to December of 2010. Enrollees have been eligible to receive care through a network of providers that fully meets the Connector's Commonwealth Care network adequacy standards. While cost-sharing is in some instances higher than that for Commonwealth Care and some benefits are excluded, steps have been taken to reduce any hardships for members.

The Administration's fiscal year 2011 budget includes \$75 million for the Commonwealth Care Bridge program. This program will continue to be run by the Secretary of Administration and Finance, the Secretary of Health and Human Services and the Executive Director of the Connector.

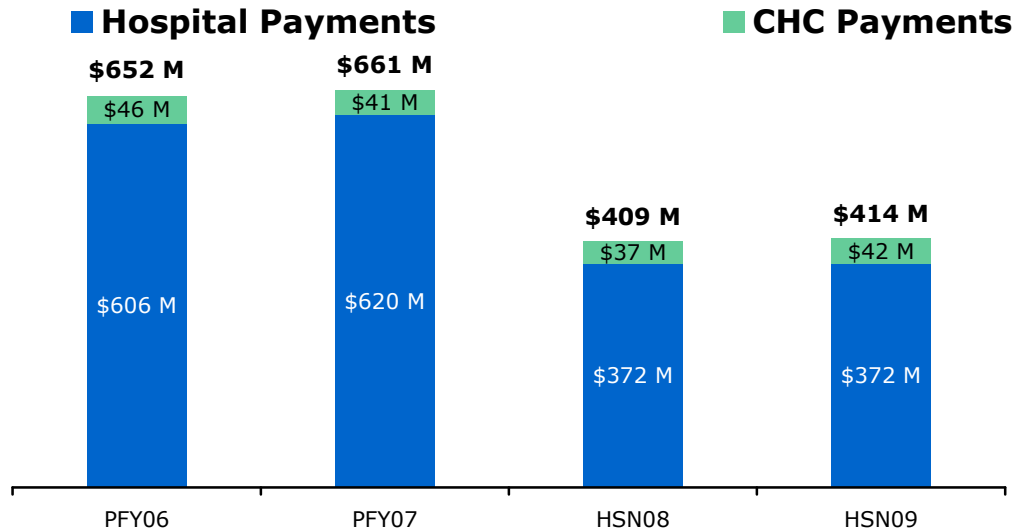
The growth in funding for coverage for Aliens with Special Status reflects the Administration's continuing commitment to providing health insurance to these legal residents of the Commonwealth. The Administration's ultimate goal remains fully integrating Aliens with Special Status into Commonwealth Care. While that is not possible in the current fiscal environment (particularly given current federal reimbursement policy), our proposed approach for fiscal year 2011 builds on last year's accomplishments and thus makes progress towards fully reintegrating this population into Commonwealth Care.

The \$75 million proposed for fiscal year 2011 is more than the annualization of the \$40 million that will provide coverage for Aliens with Special Status through Commonwealth Care Bridge for about eight months in fiscal year 2010. With that \$75 million investment – and with our intention to be aggressive in maximizing its value – our vision and goal is to expand the capacity of Commonwealth Care Bridge. The Administration intends to keep the same benefit and cost-sharing structure for Commonwealth Care Bridge, given fiscal constraints and our goal of maximizing capacity of the program, but will continue to take steps to mitigate hardships.

Health Safety Net

Overseen by the state's Division of Health Care Finance and Policy, the Health Safety Net (HSN) reimburses hospitals and community health centers for health care services provided to low-income uninsured or underinsured residents. It was formerly known as the Uncompensated Care Pool. The Health Safety Net is financed by dedicated revenues from a hospital assessment (\$160 million) and insurer surcharge (\$160 million), other offsetting payments (\$70 million) and any state contribution from the General Fund.

Success in expanding enrollment in health insurance through health care reform has resulted in decreased Health Safety Net utilization and payments. As compared to Uncompensated Care Pool fiscal year 2007, Health Safety Net payments sustained a record drop through Health Safety Net fiscal year 2009 (from \$661 million to \$414 million).



Source: Division of Health Care Finance and Policy, [Health Safety Net 2009 Annual Report](#), December 2009

Health Safety Net Fiscal Year 2010

To help reduce the burden on hospitals in Health Safety Net fiscal year 2010 (Oct. 2009-Sept. 2010) for providing care to the uninsured and underinsured, the Administration intends to dedicate accumulated Health Safety Net fiscal year 2008 and 2009 surpluses (approximately \$30 million) to offset 2010 costs. Absent affirmative steps to retain this surplus funding within the Health Safety Net, these funds would flow out of the Health Safety Net. Health Safety Net fiscal year 2010 is currently in progress (only one-third complete). Hospital demand is projected to increase due to the economic downturn (more service use is projected due to the possibility of additional growth in utilization based on past patterns during economic downturns and state policy decisions driven by the economy).

Health Safety Net Fiscal Year 2011

Despite continued fiscal challenges, the Administration is making a \$30 million General Fund contribution to the Health Safety Net in its fiscal year 2011 budget proposal – maintaining fiscal year 2010 revenues for the Health Safety Net. We will continue to closely monitor the Health Safety Net to refine projections for fiscal year 2010 and 2011 demand based on updated information.

Section III. Cost Containment

Cost of Health Care Reform

The Administration has carefully managed the finances of health care reform, delivering expansions in coverage in a fiscally responsible manner. Since its inception, the incremental net cost of health care reform to the state (net of federal reimbursement) is a little more than 1 percent of its entire annual budget. As noted by the independent, non-partisan Massachusetts Taxpayers Foundation, the state cost of health care reform “has been

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relatively modest and well within early projections of how much the state would have to spend to implement reform."

Health care reform is working as intended:

- We have retained a strong base of employer-sponsored coverage. 76 percent of employers in the Commonwealth now offer insurance to their employees, a figure that has risen since the enactment of health care reform. This rate outpaces the national average of 60 percent of employers offering coverage.
- New investments in state-subsidized health insurance have been significantly offset by decreased spending on care for the uninsured and underinsured. From fiscal year 2006 to fiscal year 2009, spending on uncompensated care for the uninsured and underinsured fell by approximately \$235 million.
- We are leveraging good value for state dollars. Notably, since the inception of Commonwealth Care in 2006 through fiscal year 2010, the average annual rate of increase in Commonwealth Care premiums per covered person has been held under 5 percent – about half the rate of growth in commercial health insurance.
- We have maintained a strong partnership with the federal government to share the costs of health care reform, including successfully renegotiating our Medicaid waiver to expand federal reimbursement.

Health Care Reform Financing						
	Pre-Health Care Reform	Health Care Reform				
	FY06 Actuals	FY07 Actuals	FY08 Actuals	FY09 Actuals	FY10 Estimated Spending	FY11 H.2
MassHealth Spending	\$ -	\$ 511	\$ 642	\$ 796	\$ 712	\$ 729
Commonwealth Care	\$ -	\$ 133	\$ 628	\$ 805	\$ 723	\$ 838
Aliens With Special Status	\$ -	\$ -	\$ -	\$ -	\$ 40	\$ 75
Uncompensated Care Pool/Health Safety Net Trust Fund	\$ 656	\$ 665	\$ 416	\$ 420	\$ 420	\$ 420
Total Spending	\$ 656	\$ 1,309	\$ 1,686	\$ 2,020	\$ 1,895	\$ 2,062
Health Safety Net Provider Assessment and Insurer Surcharge	\$ 320	\$ 320	\$ 320	\$ 320	\$ 320	\$ 320
Federal Financial Participation (FFP)	\$ 303	\$ 816	\$ 888	\$ 1,273	\$ 1,260	\$ 1,271
Total Revenue	\$ 623	\$ 1,136	\$ 1,208	\$ 1,593	\$ 1,580	\$ 1,591
Total State Share	\$ 33	\$ 173	\$ 478	\$ 428	\$ 315	\$ 471

Notes on MassHealth:

MassHealth spending includes eligibility and service changes, fee-for-service rate increases, MCO rates under Section 122, and Section 122 supplemental payments, on a date-of-service basis. No enrollment increases besides those that were directly attributable to eligibility changes have been included in this analysis. Does not include supplemental payments to managed care organizations, the non-federal share of which was funded through local revenues (versus state funds) and which accordingly did not result in state costs. Spending for fiscal year 2010 is projected.

Notes on Uncompensated Care Pool/Health Safety Net Trust Fund:

Spending includes offsets from the Medical Assistance Trust Fund. Uncompensated Care Pool/Health Safety Net spending based on UCP/HSN 10/1-9/30 fiscal year. Health Safety Net payments for fiscal year 2009 is based on latest projection. Health Safety Net payments for fiscal year 2010 and fiscal year 2011 are based on available sources.

Notes on Commonwealth Care:

Commonwealth Care spending is net of enrollee contributions.

Notes on Revenue:

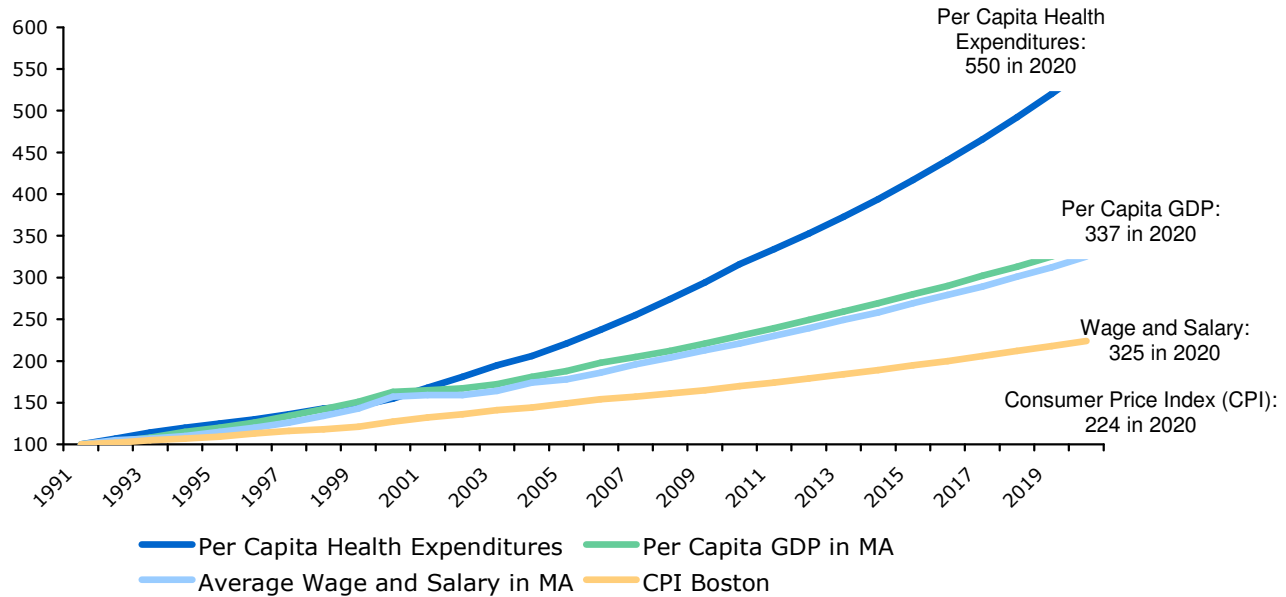
FFP includes FMAP on listed spending and Designated State Health Programs (DSHP), and increased FMAP under the federal stimulus bill. The enhanced FMAP for fiscal year 2011 assumes an unemployment tier 3 for the first six months and tier 2 for the second six months. Does not include new revenues dedicated to health care reform (e.g., Fair Share assessment, \$1 per pack increase in cigarette taxes).

Additionally, the state has adopted a series of carefully crafted, moderate new revenues that are dedicated to financing and sustaining health care reform, most notably a \$1 per pack increase in cigarette taxes that has generated revenue for the Commonwealth Care Trust Fund since fiscal year 2009.

Other Cost Containment Initiatives

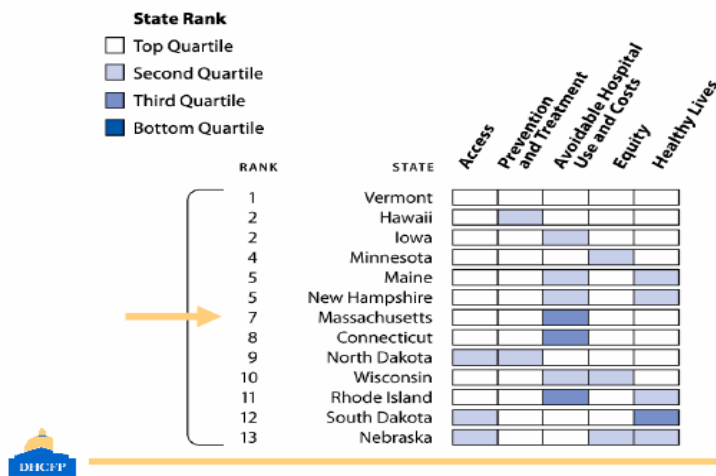
Massachusetts has a high-quality health care system that is a source of pride and prosperity for our state. But costs are a major area of concern. Health care costs are escalating at rates that far outpace every measure of our capacity to keep up.

Growth in Health Spending in MA Expected to Surpass Other Economic Indicators Index of Health Expenditures Per Capita and Other Indicators in MA, 1991-2020



Source: Massachusetts Division of Health Care Finance and Policy. Massachusetts Health Care Cost Trends - Historical (1991-2004) and Projected (2004-2020) November 2009

Our health care costs to some extent reflect the price of high-quality care. Yet they are also driven by care that is unnecessary, duplicative or even harmful to patients. Experts believe that approximately 30 percent of today's health care spending produces no benefit to patients. In Massachusetts, we spend a substantial amount of money per year on preventable and unnecessary emergency room visits, hospitalizations and readmissions, while the United States has the dubious distinction of leading the world in duplicative medical tests. At the same time, fewer than half of adults with diabetes in Massachusetts receive recommended screening and preventive care. A better coordinated system of care would address the challenges that the health care industry is currently facing (in Massachusetts and nationally).



Source: Commonwealth Fund State Scorecard on Health System Performance, 2009

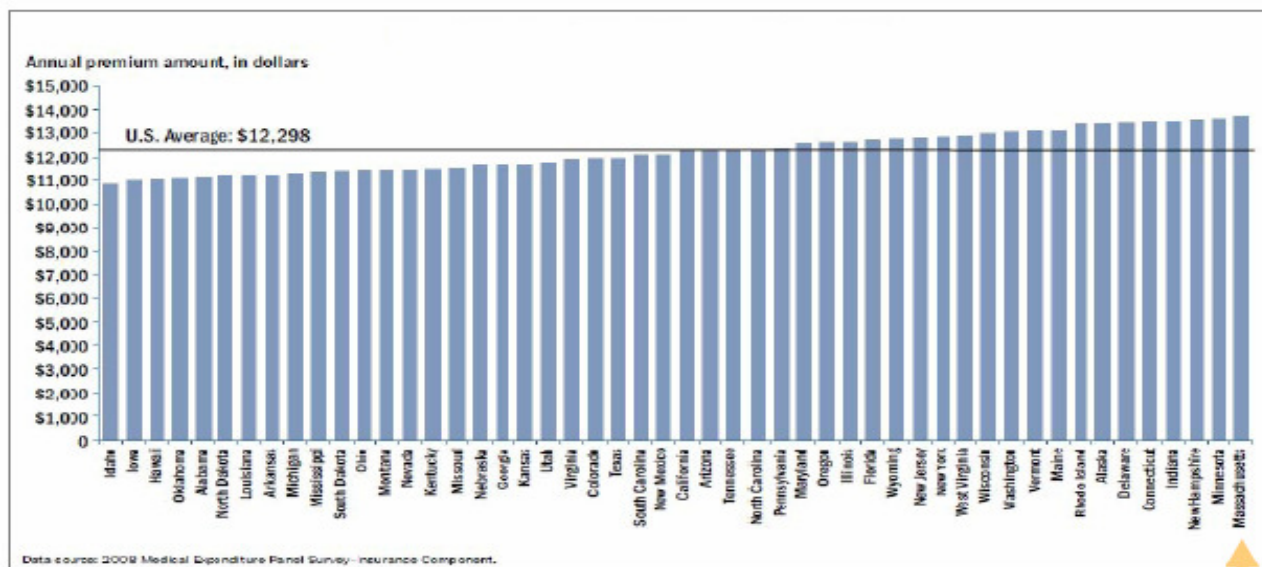
These challenges were neither created by health care reform nor first experienced under this Administration. Rather, they are longtime national and state challenges, rooted in the fundamentals of how we deliver and pay for care. Most significantly, the predominant form of paying for health care in Massachusetts has been a "fee-for-service" approach widely recognized as rewarding the delivery of *more* and *more expensive* care regardless of

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whether it is the *right* care for patients – and promoting fragmentation instead of coordination among doctors and hospitals. We have become heavily-reliant on hospital-based care, while we underpay and lack an adequate supply of primary care providers.

Consumers and businesses directly feel the impact in the form of escalating health insurance premiums. Without comprehensive health care cost and quality transparency – and without any formal oversight and scrutiny of these premiums – they have felt powerless to push back against an unyielding trend of double-digit cost increases.

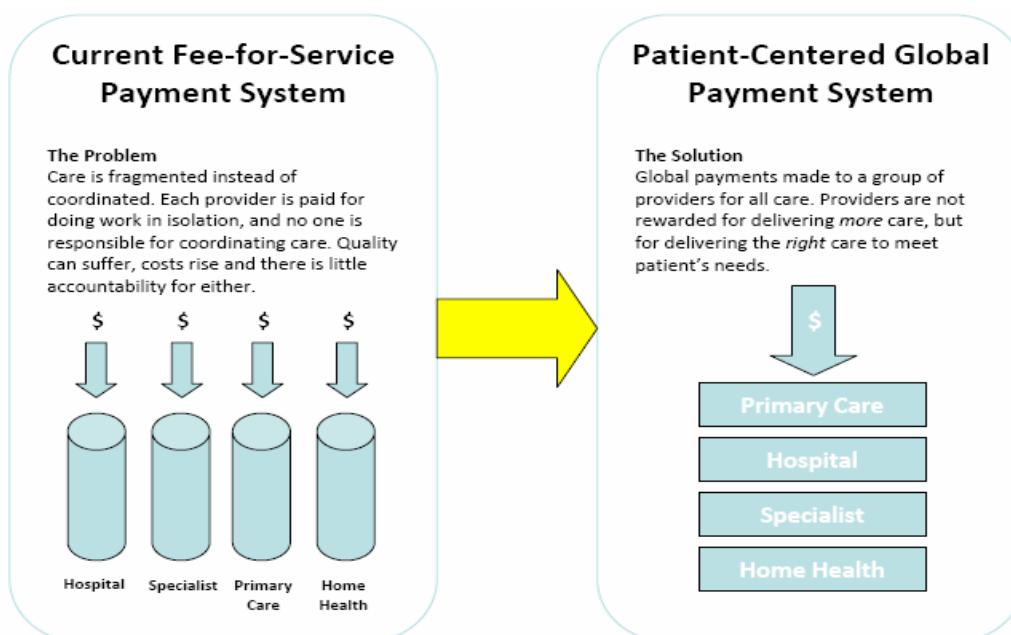
Total Median Monthly Premiums for Family Insurance Plans



Source: Commonwealth Fund Data Brief August 2009

Governor Patrick has not shrunk from the steep and complex health care cost and quality challenges that he has inherited. Rather, he has begun the difficult work of engaging providers, payers, employers and consumers in building a more efficient and accountable health care system that consistently offers our residents the highest-quality care, at a price they can afford. With these efforts well under way, Massachusetts is once again setting new frontiers in health care policy – blazing the trail to more affordable, higher-quality care for all.

- *Payment Reform:* The Administration has broken new ground on payment reform, leading a State Special Commission on the Health Care Payment System to unanimously endorse a groundbreaking blueprint to reward *value* instead of *volume* when it comes to paying for health care.



Source: Recommendations of the Special Commission on the Health Care Payment System, July 2009

As noted by Nobel Prize-winning economist and *New York Times* columnist Paul Krugman, “So where in America is there serious consideration of moving away from fee-for-service to a more comprehensive, integrated approach to health care? The answer is: Massachusetts.” (*NYT*, 7/23/09). The Administration is now working with stakeholders to develop approaches to implementation – following the consensus-building model that was essential to the enactment of health care reform three-and-a-half years ago – and developing key data and information technology infrastructure needed to launch payment reform. (*see below*)

- **All-Payer Claims Database:** The collection and distribution of health care claims data is essential to empowering consumers and laying the underpinnings of payment reform (enabling doctors and hospitals to understand their patients' care patterns and needs). Currently, multiple state and independent agencies collect claims data, but none receive a full set of claims data from all payers serving Massachusetts residents. The Administration's Division of Health Care Finance and Policy is moving forward on implementing an *all-payer* claims database to promote a broad array of cost containment and quality improvement initiatives involving providers, payers, employers and consumers.
- **Health Information Technology:** More widespread adoption and use of health information technology has the potential to improve quality of care and reduce costs. If implemented strategically, it can facilitate payment reform by fostering better coordination of care among providers and reducing unnecessary and duplicative testing. Led by the Administration, the Massachusetts Health Information Technology Council is actively coordinating federal recovery act (ARRA) and state funding to support the meaningful use of interoperable electronic health records and develop the capacity for widespread health information exchange.
- **Health Care Quality and Cost Council:** Under the leadership of the Administration, the Health Care Quality and Cost Council has launched a [website](#) (MyHealthCare Options) that provides consumers with cost and quality ratings for hospitals across the state, so they can make informed choices about their health care. The Council has also issued a comprehensive roadmap to cost containment that reinforces the drive towards payment reform and highlights additional, system-wide opportunities for improving quality and containing costs.
- **Determination of Need:** In 2008, the Public Health Council issued regulations that strengthened the Determination of Need Program by guaranteeing proper review of any proposed major outpatient capital project or costly equipment purchase – an effort to reduce health system costs by improving health system planning. It also required public reporting of medical mistakes and hospital infections and prohibited billing by any provider for care associated with a significant medical mistake. We know that hospitals and practitioners change their behavior when shown data about errors and unnecessary infections. Massachusetts is a national leader in barring hospitals and practitioners from charging patients for care made necessary by

medical errors. In this way, we are creating a health care market that is driven by *measurable quality outcomes*.

- **Premium and Cost Hearings:** For years, businesses (particularly small businesses) and individuals have faced double-digit increases in health insurance premiums without anyone “on their side” asking the tough questions about the causes and potential solutions. Under this Administration, that has changed. The Division of Insurance is currently conducting intensive public hearings on health insurance premium increases facing small businesses, focused specifically on work insurers are currently doing to reduce costs and future steps that may be necessary to eliminate the substantial increases impacting the small-group market. The Division of Health Care Finance and Policy will soon follow up with a series of reports and hearings that broadly examine health care provider and payer cost trends and recommend strategies to address cost drivers.

Section IV. Wellness

The Governor's fiscal year 2011 budget proposes eliminating the current sales tax exemption for soda and candy. In addition to generating over \$50 million for public health programs, the repeal of this sales tax exemption is a critical first step to discouraging the consumption of these unhealthy items. Net proceeds from removing these exemptions, along with the \$100 million in revenues to be collected in fiscal year 2011 from alcohol purchased in package stores, will be deposited into the Commonwealth Health and Prevention Fund to support critical public health programs. All other food products that are currently exempt from the sales tax will remain exempt, in line with the exemption's original intent to ensure the affordability of necessary goods.

The Commonwealth Health and Prevention Fund

Massachusetts has long been an innovator in health care and public health. The public health programs that serve the people of the Commonwealth reflect the Administration's commitment to preventative care and wellness services. \$151.7 million (\$51.7 million of which is new revenue generated from eliminating sales tax exemptions on soda and candy, while \$100 million is from last year's repeal of the sales tax exemption for alcohol) will be dedicated to the Commonwealth Health and Prevention Fund. The fund will be used to support critical programs within the Massachusetts Department of Public Health, including:

- **Addiction Control Services:** Substance abuse programs work with communities and youth that are at-risk for substance abuse to provide positive alternatives to drug use, critical treatment and step-down services for abusers and guidance and support to families and children of substance abusers. Additionally, prevention and treatment services for compulsive gamblers, funded in this line item, will continue to assist individuals wrestling with the financial and economic consequences of gambling addiction.
- **Smoking Prevention and Cessation Programs:** These programs have helped to produce a dramatic reduction in tobacco use, especially among youth, over the past decade. These programs will build on this success to further reduce tobacco use and abuse in the Commonwealth.
- **Health Promotion, Violence Prevention and Workforce Expansion:** The programs within this service category speak to the scope of the work that occurs at the Department of Public Health. Programs such as domestic violence prevention and treatment, suicide prevention, sexual assault nurse examiners (SANE), teenage pregnancy prevention, violence prevention grants and grants that support community centers for at-risk youth reduce violence and promote healthy alternatives to risky behaviors. In addition, these funds will support the ongoing effort to support and promote healthy lifestyles through family health programs, community health centers and disease prevention services.
- **Children's Health and Nutrition:** The health and well-being of the Commonwealth's children is of paramount importance to the Administration. The programs supported by the Commonwealth Health and Prevention Fund for children's health and nutrition include early intervention services for developmentally delayed children, nutrition services for pregnant women and infant children, newborn hearing screening services and palliative care for pediatric patients.

Wellness Fund: FY11			
\$151.7 Million			
Account Distribution	Acct #	% Funded from Health and Prevention Fund	Total Wellness Fund Spend
Addiction Control Services	4510-0700	100%	\$ 81,184,876
Smoking Prevention and Cessation Programs	4590-0300	90%	\$ 4,725,969
Health Promotion, Violence Prevention and Workforce Expansion	4510-2500	83%	\$ 33,520,467
Children's Health and Nutrition	4512-0120	83%	\$ 32,268,688
Total Wellness Fund Spending			\$ 151,700,000

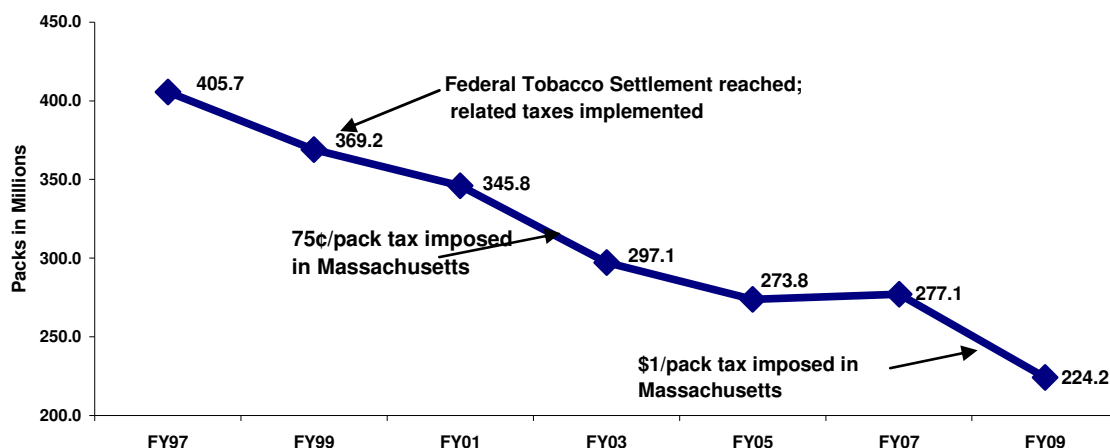
Closing the Tobacco Loophole

Tobacco use is the leading cause of preventable death in Massachusetts. Roughly 9,000 residents lose their lives each year to tobacco-related illness. It is widely acknowledged that even sporadic tobacco use results in costly and fatal diseases such as cancer, hypertension, heart disease and emphysema. Low-income populations smoke at twice the rate of the general adult population (roughly 36 percent compared to 16.4 percent). The costs of treating low-income individuals and the un- or under-insured ultimately fall on the state. Proactive policy measures to reduce tobacco use serve to reduce spending for treating tobacco-related diseases and allow Massachusetts residents to live longer, healthier lives.

In most cases, the decision to begin smoking is made prior to becoming an adult. 60 percent of smokers start by the age of 14, and 90 percent of smokers are firmly addicted before reaching age 19 (Foundation for a Smoke Free America, 2010). Each year in Massachusetts, about 7,000 young people become new daily smokers. If no more young people in Massachusetts started smoking, about 117,000 young people alive today would be saved from disability and death caused by tobacco use (Making Smoking History, 2010). Teenagers and young adults are a particularly price-sensitive demographic. Thus, policies that increase the cost of smoking and tobacco use can help reduce their tobacco use.

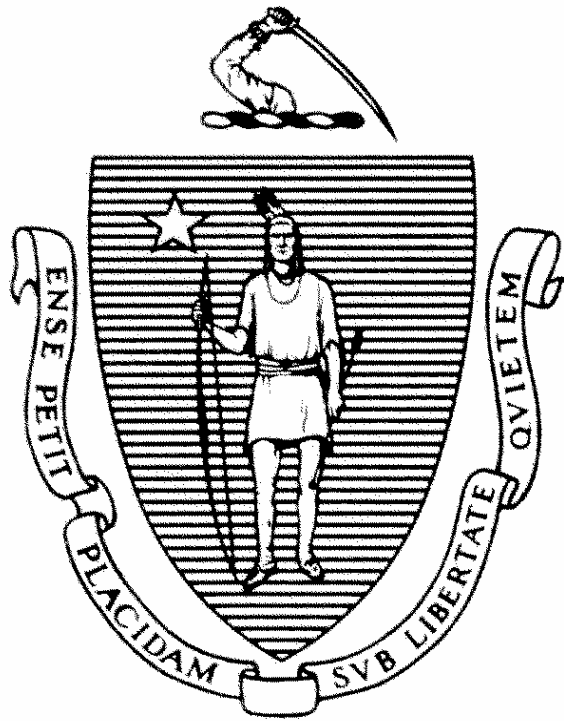
The landmark federal tobacco settlement of 1998 resulted in greater monitoring of tobacco sales to underage users and more explicit messaging around the dangers of tobacco use. This helped commence the steady decline of overall tobacco use in America. Massachusetts complemented the achievements of the federal tobacco settlement with the enactment of an additional per pack tax on cigarettes. Each increase in cigarette prices has successfully accelerated the reduction of smoking and smoking-related disease in the Commonwealth.

Cigarette Packs Sold Per Year In Massachusetts



In 2008, excise taxes on cigarettes were raised by \$1 per pack, with the proceeds dedicated to the Commonwealth Care Trust Fund to pay for health insurance coverage. However, purchases of cigars and smoking and smokeless tobacco were omitted from this change. The Administration proposes to close this tax loophole to improve public health and make significant gains in reducing underage tobacco use. The \$15 million that will be generated from closing this tobacco tax loophole will be likewise be dedicated to the Commonwealth Care Trust Fund to provide health insurance to low-income Massachusetts residents.

Fiscal Year 2011 Budget Recommendation



Transportation Reform



Transportation Reform

Transportation Reform

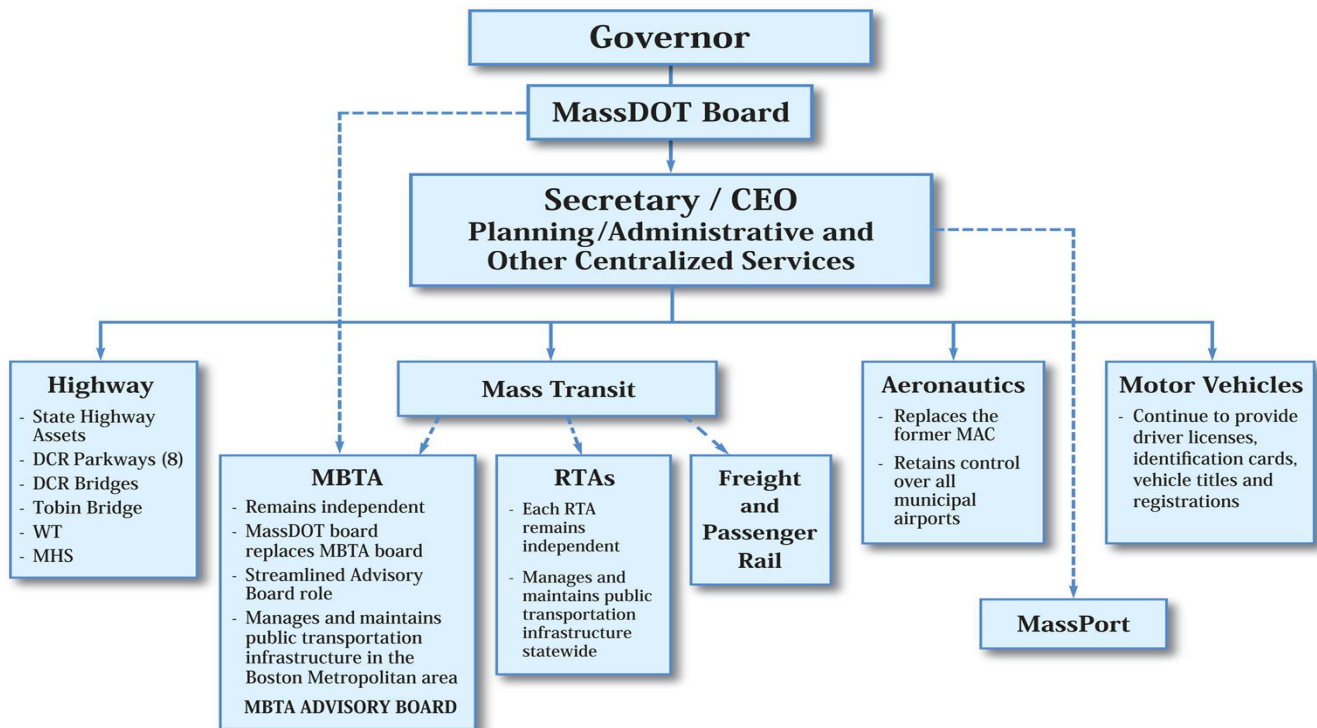
Overview of the Reform Act

The Patrick-Murray Administration is leading the radical change of the Commonwealth's transportation systems, which have suffered from decades of neglect and inaction. In June 2009, Governor Patrick signed Chapter 25 of the Acts of 2009, "An Act Modernizing the Transportation Systems of the Commonwealth of Massachusetts, (as amended by Chapter 26 of the Acts of 2009, collectively, the "Act") creating a streamlined Massachusetts Department of Transportation (MassDOT). A renewed focus on customers, safety, innovation and accountability drives the day-to-day operations of the new Massachusetts Department of Transportation.

A modern transportation network is essential to our economic future. Our roads, rails and bridges serve as the conduit for commerce and economic growth. A high functioning transportation system is a necessity for the Commonwealth to attract and retain the investment that assures opportunities for ourselves and our children. The improvements made possible through this Act matter to businesses which need to be able to move goods and services around, across and through the state to markets.

Transportation is an essential resource for the Commonwealth's residents and visitors. From Route 2 to Interstate 91, the MassPike to Route 24, a coordinated and functioning transportation system matters to residents who need to get to work every day and home again. A Regional Transit Authority or MBTA bus matters to students who need it to get back and forth to school. Our roads, buses and trains matters to the millions of tourists and other visitors who need convenient access to the Commonwealth's many cultural and recreational attractions

MassDOT represents a merger of the Executive Office of Transportation and Public Works (EOT) with the Massachusetts Turnpike Authority (MTA), the Massachusetts Highway Department (MHD), the Registry of Motor Vehicles (RMV), the Massachusetts Aeronautics Commission (MAC) and the Tobin Bridge. In addition, the Massachusetts Bay Transportation Authority (MBTA) and Regional Transit Authorities (RTA) are subject to oversight by the new organization. The new organization also assumed responsibility for many of the bridges and parkways formerly operated by the Department of Conservation and Recreation (DCR).



The department is governed by a five member board and administered by the Secretary of Transportation, appointed by the Governor to serve as Chief Executive Officer of the department. MassDOT is comprised of the following four divisions:

- *The Highway Division* includes the roadways, bridges, and tunnels of the former Massachusetts Highway Department, Turnpike Authority, Tobin Bridge and assets of DCR. The Highway Division is responsible for the design, construction and maintenance of the Commonwealth's state highways and bridges. The Division is also responsible for overseeing traffic safety, engineering activities and snow and ice removal to ensure safe road and travel conditions.
- *The Rail & Transit Division* is responsible for all transit initiatives and oversees the Massachusetts Bay Transportation Authority (MBTA) and all Regional Transit Authorities of the Commonwealth. The MassDOT Board of Directors serves as the governing body of the MBTA, which itself remains a separate organization within MassDOT.
- *The Aeronautics Division* has jurisdiction over the Commonwealth's public use airports, private use landing areas, and seaplane bases. It is responsible for airport development and improvements, aviation safety, aircraft accident investigation, navigational aids, and statewide aviation planning. The Division certifies airports and heliports, licenses airport managers, conducts annual airport inspections, and enforces safety and security regulations.
- *The Registry of Motor Vehicles Division* is responsible for vehicle operator licensing and vehicle and aircraft registration available both online and at branch offices across the Commonwealth. The Registry oversees commercial and non-commercial vehicle inspection stations.

While it has an appointed board and is generally independent of the Commonwealth as a separate body politic, MassDOT continues to be governed by state laws, rules and policies, including the use of the Commonwealth's central accounting system (MMARS), payroll system and adherence to state fiscal laws. In addition to the operating divisions, MassDOT has a central office, referred to in the Act as the Office of Planning and Programming that will house the administrative functions (finance, human resources, procurement, legal services, and administration) of the organization, including a planning office to be known as the Office of Transportation Planning.

Transportation Finance 101: How We Fund our Transportation System

Prior to the reform act, transportation policy, planning and financing were segregated into separate silos of quasi-independent authorities and state agencies. One primary goal of the reform act was to better coordinate our transportation efforts while finding economies of scale and best practices to reduce costs and manage a world class transportation network. The Commonwealth's transportation system consists of a vast network of streets and highways, public transit (bus and passenger rail), airports, freight rail facilities and other services such as bicycle paths and ferries that provide for the mobility of people, goods, and services throughout the state. Within the new streamlined MassDOT, jurisdiction over the operations and maintenance of the transportation system is shared among state, regional transit agencies and local governments.

The annual operating and capital budgets for transportation are developed through a collaborative process that encompasses many different organizations and individuals. These include:

- **Governor:** Establishes overall policies and spending priorities for MassDOT, including recommending the amount of funds that should be transferred to the authority within the annual operating budget. The Governor also determines the amount and timing of any authorized borrowing to fund capital investments. At the request of the Governor, the State Treasurer issues bonds to borrow funds for authorized and budgeted capital projects at MassDOT.
- **Legislature:** Appropriates funds through the annual budget consistent with state statutes (notably Chapter 35 of the Acts of 2009) for transportation programs and projects. The Legislature also authorizes the issuance of bonds, or statutory authorizations to borrow money, to fund the capital budget. The Legislature does not authorize bonds for the MBTA, which is a separate legal entity from the Commonwealth and from MassDOT. MBTA capital projects are financed using sales tax revenues legally dedicated to the agency, revenues collected by the agency, and federal transit funds.
- **Massachusetts Department of Transportation:** MassDOT owns, operates and maintains the state highway system, including the I-90 Turnpike and the Metropolitan Highway System and a large inventory of real and personal property. MassDOT plans and completes capital improvement projects on the state highway system and coordinates with the MBTA and RTAs on bus and rail operations. MassDOT is responsible for funding the Registry of Motor Vehicles, the Aeronautics Division and the removal of snow and ice on over 7,000 miles of roads and bridges. In consultation with the Governor and the Executive Office for Administration and Finance, the Secretary of Transportation develops an annual operating and capital budget for the department.
- **MassDOT Board of Directors:** The five member MassDOT board, appointed by the Governor, reviews and adopts the annual operating and capital budgets for the department and MBTA. The Board further recommends policy and funding priorities to the Governor and Legislature.
- **Metropolitan Planning Organizations (MPO) & Regional Transit Authorities (RTA):** MPOS and RTAs are responsible for planning, coordinating and, in the case of RTAs, operating regional transportation systems. In the Commonwealth, the thirteen MPOs develop transit plans which identify projects for funding from the State Transportation Improvement Program (STIP).

Transportation Funding Sources

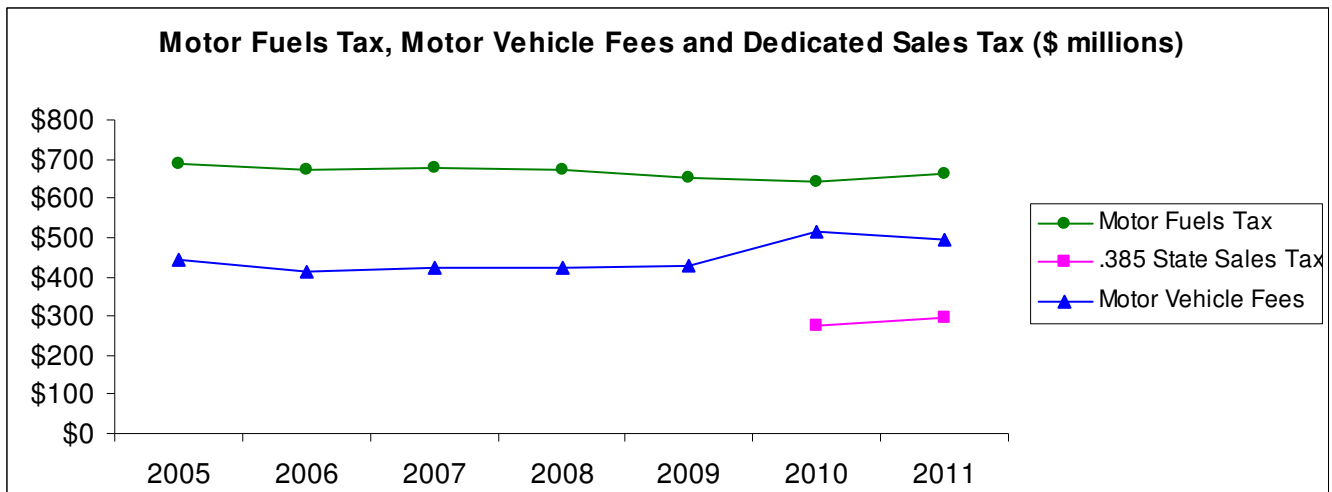
The Commonwealth's transportation system is funded from five sources and administered through two separate trust funds. Funding sources include state taxes, motor vehicle fees, federal funds, toll revenue and bond proceeds. These funding sources are maintained within the Commonwealth Transportation Fund (CTF) and Massachusetts Transportation Trust Fund (MTTF) to segregate and fully account for transportation-related revenue and expenditures. A description of these funding sources and the related trust funds is provided below.

The Commonwealth Transportation Fund retains revenue from the motor fuels tax, a dedicated 0.385% of the state sales tax and motor vehicle fees. The fund is used to pay debt service associated with highway maintenance and construction projects and provides funding for the operation of MassDOT. It also receives federal reimbursement generated by the Commonwealth's expenditures on transportation construction projects. The Fund was established as part of the historic transportation reform Act and replaces the former Highway Fund,

beginning in fiscal year 2011, as the principal source of transportation-related revenues and expenditures for the Commonwealth.

- **State Motor Fuels Tax:** The Commonwealth collects 21-cents per gallon excise tax on gasoline and diesel fuel, estimated at \$663.6 million in fiscal year 2011. Of the amount, 20.96 cents (99.85%) is credited to the Commonwealth Transportation Fund for transportation related purposes, including the special obligation (gas tax) bonds. One hundredth of one cent (.15%) is credited to the Inland Fish and Game Fund.
- **Sales Tax:** .385% of the state sales tax, estimated at \$296.7 million in fiscal year 2011, is dedicated to the CTF.
- **Motor Vehicle Fees:** The Commonwealth also collects vehicle license, registration and drivers license fees, estimated at \$495.3 million in fiscal year 2011.
- **Federal Funds:** The Internal Revenue Service (IRS) collects the federal fuels excise tax (18.4 cents per gallon and 24.4 cents per gallon diesel fuel) which are deposited in the Highway Trust Fund. These funds are allocated by the Federal Highway Administration (FHWA) as matching funds for projects on the State Highway System and by the Federal Transit Administration (FTA) to the MBTA and RTAs for local bus and rail programs.

FHWA funds are allocated directly to the Commonwealth and expended by MassDOT for road, bridge and other transportation improvements. FTA funds are allocated to the MBTA and RTAs for rail, bus and other transit projects.



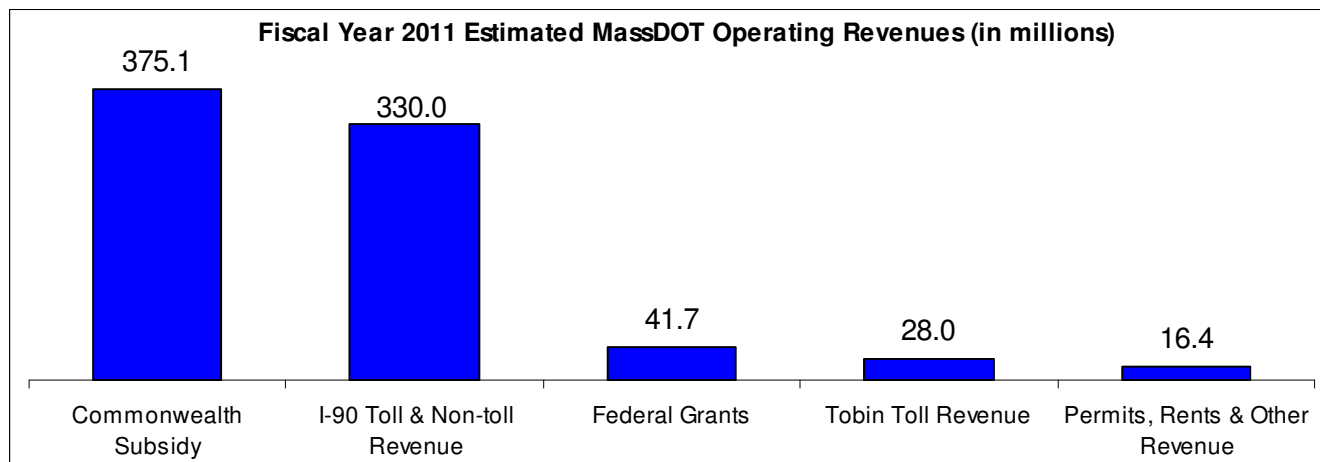
The Massachusetts Transportation Trust Fund is the primary governmental fund for the Massachusetts Department of Transportation. It receives an annual subsidy from the Commonwealth, tolls and other fee based revenue collected by MassDOT. All MassDOT activities, not specifically directed to another fund, are accounted for in this fund. As a result, most budgeted expenditures of the department are paid for from this trust fund.

- **Commonwealth Subsidy from State Revenue Sources:** The Commonwealth's annual operating budget will include a transfer of funds from the Commonwealth Transportation Fund to the Massachusetts Transportation Trust Fund for the operation of MassDOT and supplemental assistance to the MBTA and RTAs.
- **Toll Revenue:** The Act requires reform act requires that revenues collected, on the "Western Turnpike" (I-90 west of Route 128) and the Metropolitan Highway must be spent only on the tolled system from where the revenue was raised. These tolled revenues fund the operation and maintenance of the Metropolitan Highway System and the Western Turnpike as well as debt service associated with the former Massachusetts Turnpike Authority, including debt incurred in the construction of the Central Artery/Tunnel Project.
- **Federal Grants:** In addition to federal gas tax revenues, federal agencies such as the FHWA provide funding for other types of projects such as Intelligent Transportation Systems designed to provide additional information to travelers. These funds are often restricted to specific projects.

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- **Permits and Fees:** MassDOT collects revenues from permits and fees for the use of state highways, facilities and other sites owned by the department. These are unrestricted revenues available to support all divisions within the department.

The following chart illustrates the sources and projected amounts of revenue for MassDOT's operating budget in fiscal year 2011.



In addition, the Commonwealth is projected to expend through MassDOT an estimated \$1.2 billion in bond proceeds and federal funds for transportation improvement and construction projects in fiscal year 2011. Of this amount, \$525.5 million is projected for repairs to structurally deficient bridges financed through the Accelerated Bridge Program. The remaining amount, \$723.1 million, is for administrative expenses and road projects, including an anticipated \$150 million allocated to municipalities for local road and bridge projects through the Chapter 90 program administered by MassDOT.

For a number of years personnel and other goods (paper, utilities, etc.) at MassDOT have been charged to capital accounts – resulting in millions of additional dollars in interest payments while reducing the amount of money available for statewide construction projects. The practice of shifting operating costs to the capital budget was born years ago during tough economic times like those we are currently experiencing. Over the past two years, capital improvement initiatives at MassDOT for roads, bridges and other improvements required adding additional staff on the capital budget to complete projects. However, the Administration has monitored expenditures and additional employees assigned to the capital budget to ensure their appropriateness. Further, over the past two fiscal years the Administration has sought to reduce operating expenditures on the capital budget by closely monitoring capital expenditures, transferring costs to the operating budget and seeking additional appropriations to fund those obligations and proposing zero cost transfers to move capital type expenditures (equipment, furniture, construction materials) from the operating budget to the capital budget.

Massachusetts Bay Transportation Authority and Regional Transit Authorities

Under the Act, MBTA remains a separate legal entity, but is subject to greater levels of oversight by and coordination with MassDOT. The MassDOT and MBTA Boards of Directors have the same five members, allowing for improved communication, coordination and planning among the MBTA, MassDOT and the Commonwealth. As a separate entity, MBTA maintains its own financial systems, reporting and debt service obligations. The authority is required to budget and operate within its revenue sources while providing for both operating and capital expenses from available revenues. Funding for the MBTA includes:

- State sources including dedicated 1% of the 6.25% state sales tax and \$160 million,
- Assessments from the 175 cities and towns in the MBTA service district,
- Fares,
- Non-fare revenues (e.g. advertising, permits and other).

Prior to 2000, the MBTA received an unlimited “net cost of service” payment from the Commonwealth to offset costs incurred in the previous fiscal year for providing bus and rail service within the metropolitan Boston region. The “forward funding” reform of 2000 provides the authority with a current year dedicated 1% of the sales tax.

However, since 2000 the dedicated sales tax growth has been much slower than overall historic and projected trends. During this period, operating expenses have continued to grow based on the rising cost of health care, energy, transit services and collective bargaining agreements. For this reason, in fiscal year 2009 Governor Patrick and the Legislature agreed to provide the authority with an additional \$160 million in supplemental funding to ensure safe, cost effective services expected by riders of the "T."

Regional Transit Authorities have similar financing sources as the MBTA but they continue to receive net cost of service payments from the Commonwealth in arrears. The 15 individual authorities rely on fares, local assessments levied on cities and towns within their service district, operating subsidies provided the Commonwealth and federal funds. These authorities are also required to operate within their own revenue sources.

House 2 Recommendations for Transportation

In prior fiscal years, the annual budget included individual line items for transportation agencies and programs. The Act eliminated that structure. The fiscal year 2011 budget recommendations reflect changes brought about by the Act. MassDOT receives the amount appropriated from the Commonwealth Transportation Fund after obligations for debt service, contract assistance and other state transportation programs are funded. In addition, the transferred amount also includes the sales tax earmarked to the MBTA and RTAs by Chapter 35 of the Acts of 2009.

The new line item structure is consistent with the goals of reform and provides additional transparency and flexibility for the funding of MassDOT and its component divisions. Through the annual operating transfer, MassDOT will fund its operating divisions as well as targeted investments for the MBTA and RTAs. Based on available revenues and projected transportation debt service, the Governor's budget recommendation proposes to appropriate a transfer of \$375.1 million to the Massachusetts Transportation Trust Fund in fiscal year 2011. This amount includes \$160 million for the MBTA, \$15 million for Regional Transit Authorities and \$200 million for the operation of MassDOT. The amount of the transfer allocated to each MassDOT division and program will be reflected in a fiscal year 2011 budget to be released later in 2010 by MassDOT.

Reform Activities and Cost Savings

The road to transportation reform began long before June of 2009. After receiving the Transportation Finance Commission report in 2007 that detailed decades of inaction and neglect by previous administrations, Governor Patrick began a plan to secure the Commonwealth's economic future and maintain safety of the state's roads and bridges. Under Governor Patrick's leadership, the transportation agencies and authorities generated savings and efficiencies through the Massachusetts Mobility Compact, while working on a long-term reform plan. Those reforms included joining 49 other states in using civilian flaggers rather than police details on construction projects, streamlining project delivery time at MassHighway by 40%, saving \$47 million at the MBTA by reducing overtime costs and staff levels and increasing employee health care contributions, and saving \$31 million at the Turnpike by eliminating middle management and toll takers. With the legislature's support, the Governor launched the Accelerated Bridge Repair Program to address the backlog of maintenance projects left by previous administrations.

Over the past seven months employees from former state transportation agencies, quasi-independent authorities and other state agencies have been engaged in implementing the historic reform act. As a result of these activities, MassDOT is a functioning, independent department providing services to visitors and residents of the Commonwealth.

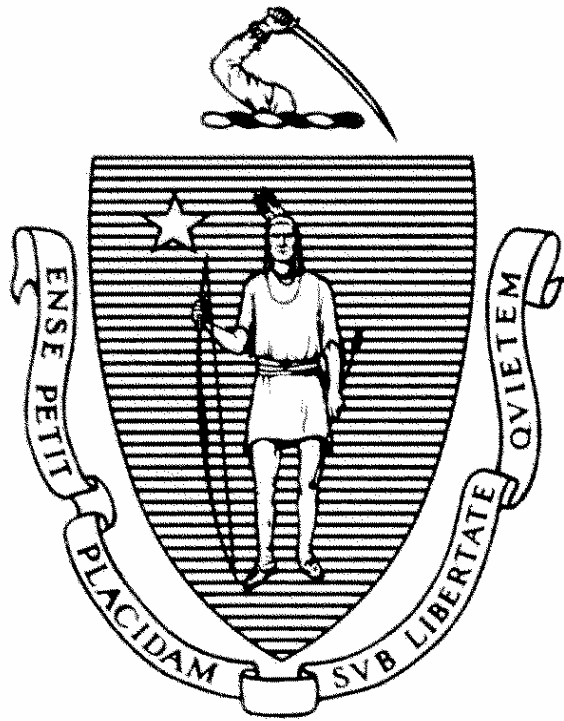
As a result of transportation reform, the department has realized the following savings and efficiencies:

- **Reduced Employee Benefits Costs:** The transfer of employees to the Group Insurance Commission will save MassDOT and the MBTA an estimated \$30 - \$40 million annually. The first transfer of employees will occur on February 1, 2010.
- **Lower Borrowing Costs:** The Commonwealth avoided \$261 million in termination payments associated with interest rate swap agreements as transportation reform legislation prompted an upgrade of the former MTA's bond rating. Additional savings will be generated as the higher rating provides access to lower cost funding sources, increased opportunity to re-finance existing debt at lower rates, and the capacity to raise additional funds for capital improvements.

- **Consolidation of Administrative Functions:** The savings impact of consolidation initiatives completed in the first 3 months is estimated to be \$2 million annually. These initiatives include the integration of the former MTA's accounting system onto the Commonwealth's Massachusetts Management, Accounting, and Reporting system (MMARs) and the consolidation of worker's compensation administration with the state's existing worker's compensation department. Savings are also being realized as the former MTA benefits from the Commonwealth's tort reform legislation and insurance programs. Efforts to further consolidate MassDOT's finance, HR, and IT functions are also underway.
- **Operational Efficiencies:** Savings of over \$5 million have been generated by replacing the existing 511 information news service, forming a partnership with municipalities and state agencies to use rent free locations for the Registry Division and the development of a public-private partnership at the Registry Division to reinstate electronic courtesy notes for driver's licenses and ID renewals at no cost to taxpayers. Areas targeted for additional savings include procurement and fleet.

MassDOT continues to integrate the Turnpike Authority and Highway Department into the new Highway Division. The administration will improve Registry operations for the 21st century with the goal of shorter wait times, enhanced customer service and focus on safety programs. Statewide airport planning, financing and operations efficiencies will be realized through the new Aeronautics Division. Finally, the newly formed MassDOT is building upon the fiscal, human resources and legal "Shared Services" programs implemented by the former Executive Office of Transportation and Public Works in 2004. Shared Services allows division heads to make policy and funding decisions while implementation of those decisions is managed by secretariat staff. This creates additional freedom and resources for line level and division managers to focus on core mission activities. The new MassDOT website, www.mass.gov/massdot, is routinely updated with progress reports demonstrating the department's commitment to safety, transparency and the goal of creating one transportation system for the Commonwealth.

Fiscal Year 2011 Budget Recommendation



Other Financial Assumptions



Other Financial Assumptions

Other Financial Assumptions Used In House 2

Challenges of Capital Gains Revenues

State governments and budgets are always subject to the ups and downs of the economic cycle. Massachusetts is no exception. The current economic crisis demonstrates that the volatility of the Commonwealth's budget is exacerbated by its reliance on capital gains tax revenue to support spending. The fiscal year 2011 budget includes a proposal to reform the way the Commonwealth budgets for capital gains tax revenues to promote fiscally sound budgeting practices and curb the problem of recurring structural deficits.

Tax receipts from capital gain income are the state's most volatile source of revenue. These tax revenues nearly doubled from fiscal year ("FY") 2004 to 2008, from \$869 million to \$2.2 billion. But in fiscal year 2009 fell by over \$1.6 billion to \$554 million. While some of the revenue during the 2004-2008 period was used to replenish the state's Stabilization Fund, there was no formal policy guiding the use of these revenues. Without such a policy, fluctuations in tax revenue can contribute to structural budget deficits when the state makes spending commitments during strong years that cannot be fully sustained when the economy declines.

To address this problem, the fiscal year 2011 budget establishes a new mechanism for budgeting for capital gains revenues. As one element of the yearly consensus revenue process, the Governor and Legislature would agree on a maximum amount of capital gains tax revenues that would be included in the overall consensus revenue estimate. This amount would be based on projections for the fiscal year, as well as principles of prudent budgeting necessary to modulate the impact of this fluctuating revenue source, and subject to a \$1 billion annual maximum.

Any capital gains tax revenues in excess of \$1 billion would be transferred to the Stabilization Fund, except for 5% of such excess which will be transferred to the State Retiree Benefits Trust fund to pay for unfunded retiree health insurance liability.

How was the \$1B threshold established?

Long-term historical averages were mostly in the \$.9-\$1.2 billion range depending on the time period and inflation assumptions. We selected a figure at the low end of the range to ensure discipline and in light of the recent steep decline in the stock market. This decline has resulted in a significant amount of unrealized losses and capital loss carryovers that will likely dampen growth in revenue from capital gains income over the next several years.

Average Annual Revenue from Capital Gains

Normalized for Changes in Tax Law

Historical Adjusted by:

	Inflation (CPI)	GDP
1981-2010	0.9	1.1
2001-2010*	1.2	1.2

All figures in 2009 dollars

*Includes estimated for 2008 and projected for 2009-10

The deposit of excess capital gains tax revenues to the state's Stabilization Fund during periods of economic prosperity would serve as a "cushion" in years when markets decline and capital gains revenues fall. This will help ensure that the state does not build recurring spending on a foundation of unsustainable levels of revenue and help mitigate the fiscal impact of economic downturns.

Debt Service

Debt service is a significant component of the operating budget and arises from the issuance of debt to finance the Commonwealth's capital investment plan. The Patrick-Murray Administration recognizes the need for

increased capital investment as a means to create jobs in the near term and create the environment needed to support job creation and economic growth over the long term. The Administration also recognizes that the level of annual borrowing to support these capital investments must be set at affordable levels.

Debt Service Generally

Although a portion of the Commonwealth's capital investments is funded from federal grants and other sources, including the American Recovery and Reinvestment Act of 2009, the Commonwealth borrows funds through the issuance of bonds to fund the majority of its capital investments. The issuance of bonds generates financial resources to fund capital programs, and also obligates future annual operating revenue for repayment of the bonds. Debt service is the annual payment of principal and interest on these borrowed funds.

The issuance of bonds to fund capital projects must be approved by a two-thirds vote of each house of the Legislature. The State Treasurer is responsible for the issuance of the Commonwealth's debt obligations upon the request of the Governor. The Governor, through the Executive Office for Administration and Finance (A&F), allocates the proceeds of the bonds to support authorized projects and monitors spending.

Fiscal Year 2011 Debt Service Budget

The Commonwealth's budget includes several line items for the payment of debt service or other debt-like obligations, as described below.

Line Item	Description	FY11 Budget
0699-0015 Consolidated Long-Term Debt Service	For the payment of principal and interest on general obligation bonds (secured by a pledge of the full faith and credit of the Commonwealth) and special obligation bonds (secured by a pledge of receipts credited to the Commonwealth Transportation Fund (formerly the Highway Fund)).	\$1.63 billion, <i>net of \$299 million refinancing described below.</i>
0699-9100 Short Term Debt Service	For the payment of interest on bond and revenue anticipation notes and for the payment of the fees associated with the costs of liquidity or credit support on outstanding variable rate notes and commercial paper. Also for the payment of costs of issuance on bonds and bond and revenue anticipation notes.	\$67.0 million
0699-0016 Accelerated Bridge Program	For the payment of principal and interest on bonds and grant anticipation notes issued to finance the Accelerated Bridge Program.	\$40.0 million
0699-2004 Central Artery/Tunnel Debt Service	For the payment of principal and interest on bonds issued to finance the Central Artery/Tunnel project.	\$90.1 million
0699-9101 Grant Anticipation Notes Debt Service	For the payment to a trust account of interest due on federal grant anticipation notes. The principal of such notes is paid by future federal highway construction grants.	\$35.9 million
1599-0093 Water Pollution Abatement Trust Contract Assistance	Funds the Commonwealth's general obligation commitment to provide debt service assistance to bonds issued by the Water Pollution Abatement Trust that fund water infrastructure projects throughout the Commonwealth through the State Revolving Fund programs capitalized by federal grants and state matching funds.	\$67.9 million
0599-1970 Massachusetts	Funds the Commonwealth's commitment to make contract assistance payments to Turnpike Authority or the Massachusetts Department of	\$125.0 million

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Turnpike Authority Contract Assistance	Transportation, as appropriate, for the purposes of defraying costs, including relating to operation and maintenance of certain roadways in the Metropolitan Highway System that were formerly maintained by the Commonwealth and debt service.	
1599-0050 Route 3 North Contract Assistance	Funds the Commonwealth's payment obligations associated with bonds issued to finance Route 3 North improvements.	\$9.6 million

Refinancing Commonwealth Debt

As part of a comprehensive approach to managing the budget through the current economic challenge, the Governor is filing legislation that will allow the refinancing of \$300 million of debt due in fiscal year 2011. This will provide two benefits:

1. *Smoothing* an abnormal peak in debt service costs in FY11. As a result of an unusual peak in outstanding principal due, and a steep increase in the cost of bank liquidity, the maintenance estimate for FY11 Commonwealth debt service jumps \$201.7 million from our current expectation for FY10. The Administration proposes refinancing \$200 million of general obligation debt due in FY11 in order to "smooth" the total debt service profile over the next seven years. Short term interest rates are currently very low. Based on the current market, the cost of this strategy is estimated to be \$1.2 million, present value, at an average interest rate of 2.1%.
2. *Budgetary Relief*. Because short-term interest rates remain low, refinancing an additional \$100 million of principal due in FY11 is an inexpensive strategy to achieve additional budgetary relief, when compared to other financial strategies such as using additional Stabilization Funds or adjusting the pension schedule. The Administration would undertake this transaction only if needed, following the October 2010 revenue estimate revision. The combined cost of both the "smoothing" transaction and the "budgetary relief" transaction would be \$2.5 million at a 2.1% interest rate.

See the "Debt Refinancing" section in the Budget Development section for more information regarding this proposal.

Limitation on Commonwealth Debt

Statutory Debt Limits – Legislation enacted in December 1989 restricts the amount of the Commonwealth's outstanding direct debt (M.G.L. Chapter 29, Section 60A). This legislation imposed a "statutory debt limit" of \$6.8 billion in fiscal year 1991 and set the limit for each subsequent year at 105% of the previous fiscal year's limit. The statutory debt limit is calculated according to certain rules and excludes several direct and contingent obligations of the Commonwealth. The statutory debt limit on "direct" debt during fiscal year 2009 was approximately \$16.4 billion, and the Commonwealth's outstanding direct debt subject to the limit at June 30, 2009 was \$14.7 billion.

Legislation enacted in January 1990 imposes a limit on debt service appropriations in Commonwealth operating budgets (M.G.L. Chapter 29, Section 60B). No more than 10% of total budgeted appropriations may be spent on debt service (both interest and principal) on Commonwealth general obligation debt in any fiscal year. Payments on debt not subject to the statutory debt limit described above are also excluded from the debt service limit. In fiscal year 2009, budgeted debt service on debt subject to this limit was approximately \$1.6 billion, representing 5.2% of total budgeted expenditures, which were approximately \$30.7 billion.

Administrative Bond Cap – The statutory debt limit and debt service limits represent only an upper limit on the amount of direct debt the Commonwealth may incur, and they do not count many types of Commonwealth debt and debt-like obligations (e.g., contract assistance liabilities). Since fiscal year 1991, A&F has established an "administrative bond cap" to limit annual bond issuance to affordable levels. Prior to the Patrick-Murray Administration, the stated bond cap was not based on transparent, analytical measures of affordability.

Debt Affordability

The Patrick-Murray Administration is the first to engage in an affordability analysis which has resulted in a transparent, rational policy for determining the annual bond cap. The Administration believes that this analysis and policy is necessary to ensure that the state's capital budget is based on a level of debt that will keep annual debt service payments in the operating budget at affordable levels.

Based on the debt affordability analysis, the Administration established a policy for setting the bond cap subject to the following constraints: (a) payment of debt service and debt-like obligations for existing and new debt must stay within 8% of total annual budgeted revenues and (b) future growth of the bond cap to fund the regular capital program is limited to not more than \$125 million per year. This policy ensures that the annual borrowing limit is informed by changing fiscal conditions – such as the challenging current economic conditions we have face for the last two fiscal years.

A \$3 billion capital investment program, known as the Accelerated Structurally Deficient Bridge Program, was authorized in 2008 to rehabilitate and repair bridges in the Commonwealth that are structurally deficient or that would otherwise become structurally deficient within the next few years. In an effort to achieve the public safety and cost savings benefits through the acceleration of investment in these bridges, the amounts to be borrowed for the Program will be in addition to the annual bond cap. The debt service impact of financing the Program has, however, been taken into account for purposes of determining the affordable level of debt to fund the regular capital program.

The Administration will revisit the debt affordability analysis at least each year to reflect fluctuations in interest rates, revenues, and other changes impacting the Commonwealth's debt capacity. See "Debt Affordability Analysis" at mass.gov/capital for more information.

Transfer of State Personnel from the Capital Budget to Operating Budget

In 2008, the Legislature authorized the borrowing of \$50 million per year to fund the acquisition of equipment on the capital budget instead of the operating budget. This effort was the first component of Governor Patrick's no-cost mechanism for taking employees and other budgetary expenses off the capital budget with the goal of significantly scaling back the fiscally imprudent practice of funding these expenses with debt.

Each year, the operating budget includes purchases for the following types of equipment:

- Computers, computer cables and two-way radios;
- Cars, trucks and all terrain vehicles;
- Lawnmowers, snow blowers, power tools and other equipment;

Construction supplies such as lumber and hardware;

Using the \$50M bond authorization, the Executive Office for Administration and Finance (A&F) will direct agencies to purchase durable goods with a life span of five years or more through the annual capital budget. The money budgeted for these durable goods in the annual operating budget will then be used to transfer existing employees paid from bond funds to the operating budget. If a line-item funded the acquisition of durable equipment, Outside Section 26 of the Governor's budget would allow A&F to transfer that amount to another line-item to fund the cost of personnel that would have otherwise been funded from the capital budget. With line item transferability, the Governor can ensure that the initiative is cost neutral to the operating budget while reducing the costly practice of funding employees through bond proceeds.

For a number of years personnel and other goods (paper, utilities, etc.) have been charged to capital accounts – resulting in millions of additional dollars in interest payments while reducing the amount of money available for statewide construction projects. The practice of shifting operating costs to the capital budget was born years ago during tough economic times like those we are currently experiencing. This proposal is a no cost and responsible way to start to bring some capital project personnel back onto the operating budget.

Section 26 of the Governor's Fiscal Year 2011 budget completes the reforms started in 2008. The Administration is committed to monitoring transfers to ensure their appropriateness, while also looking for fiscally responsible ways to bring proper costs back onto the operating budget. The total amount of such transfers cannot exceed \$50 million, and ANF will be required to give the Senate and House Committee on Ways and Means a schedule of all such transfers.

Full Time Equivalent (FTE) Assumptions

Chapter 29, Section 6 states that "The operating budget shall indicate the number of positions proposed to be authorized for each state agency or such other public instrumentality for the ensuing fiscal year, the number of

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positions for each state agency in the current and ensuing fiscal years and such other information as may be held to explain the anticipated results of the proposed expenditures”.

To address this requirement, the House 2 recommendations include employee counts summarized at the Government area level. Additional detail is included throughout the Budget Recommendations to indicate the employee level within specific departments.

Workforce Planning Goals

Beginning in fiscal year 2009, the Executive Office for Administration and Finance (A&F) and the Human Resources Division have worked together to implement clear policies surrounding employees. Each fall, A&F engages each agency in a spending plan process in which each account is evaluated to determine how funds will be spent for the current fiscal year. This requires a detailed description of employees for the current year - including those currently on staff, positions that are open and intended to be filled and new positions for which funding is available. The goals of the employee caps that have been in place since fiscal year 2009, at the start of the fiscal crisis, and the subsequent review of all employee spending are to:

- **Restrain Growth in State Employee Levels** - Since payroll is a large portion of many agency expenditures, and reductions in force can take so long that savings cannot be realized in a fiscal year, caps are needed to constrict hiring. Although some hiring may have small costs for the current year, the full year value of new staff have budget impacts that must be considered.
- **Mitigate Shifts to Other Funding Sources** – Employees come onto the state payroll several ways including the operating budget (FTEs and contractors), the capital budget, federal grants and trusts. All sources are carefully reviewed to ensure we are maintaining compliance with employment laws and also to ensure that we are not using one time sources to pay for ongoing costs.
- **Manage Overtime Costs** – Although hiring restrictions are important, overtime costs must be considered to ensure that proper staffing levels are maintained for public health and safety where responsibilities are 24 hours / 7 days per week. Oftentimes, the savings of FTE restrictions are simply shifted to higher overtime. Therefore, prudent management of both overtime and staffing levels must be evaluated.

While A&F continues to work with Executive Branch agencies to develop comprehensive and affordable staffing plans, it is also a goal to maintain accountability and transparency in public reporting of staffing levels.

Affect of the Budget on Personnel to Date

FTE Caps

Since the fall of 2008 The Administration has provided strict FTE caps to the Executive Branch Departments. The caps are implemented at the department level and reviewed regularly by A&F to ensure agencies are taking the necessary steps to live within capped levels.

FTE caps are meant to be consistent with amounts allocated for FTE spending. If an agency does not project that enough funding is available to maintain an FTE level, a “reduction in force” plan must be submitted to the Human Resources Division within A&F. These plans are reviewed for their impact on public health and safety.

Reduction in Workforce

As a result of the fiscal crisis, all Agencies are being asked to do more with less. Since the fall of 2008 the state workforce for jobs in the Executive Branch funded with operating dollars has declined by 2,111 jobs. The reduction can be attributed to layoffs, attrition and retirement across all agencies in the Executive Branch.

EXECUTIVE BUDGETARY JOBS		
BENCHMARK*	01/20/07	Jobs: 37,473
BENCHMARK*	10/11/08	Jobs: 38,285
PREVIOUS PAY PERIOD	01/02/10	Jobs: 36,234
CURRENT PAY PERIOD	01/16/10	Jobs: 36,174
VARIANCES VS. CURRENT		
YTD VARIANCE FROM*	01/20/07	Jobs: (1,299)
YTD VARIANCE FROM*	10/11/08	Jobs: (2,111)
PREVIOUS VS. CURRENT		Jobs: (60)
BENCHMARK VS. CURRENT*	10/11/08	38,285
*1269 jobs adjusted for MassDOT reform as of 11/01/2009	01/16/10	36,174
	Job Variance	(2,111)

Furloughs

The Governor is also requiring approximately 4,000 managers within the executive branch to take up to nine furlough days in fiscal year 2010. This is in addition to furloughs required of managers in fiscal year 2009. Additionally, since 2008, the Governor and the Legislature have increased employee health care contributions, premium contributions and co-pays for health services, as a means of achieving budgetary savings.

Union Contributions

The Governor called for renewed union negotiations and contributions in October, as the Administration identified a \$600 million revenue shortfall in the current fiscal year. To date, the Governor has reached agreement with the leaders of four state employee unions representing 30,000 state employees. The Patrick-Murray Administration has reached agreement with union workers on a new contract that will save the Commonwealth millions of dollars and help mitigate employee layoffs.

Members of SEIU Local 509 and members of Unit 2 represented by AFSCME Council 93 have ratified contract revisions that will save taxpayers over \$50 million over the next three years, including roughly \$14 million this fiscal year. It is the first time since collective bargaining was established in the Commonwealth that a Governor has successfully negotiated such compromises.

If approved by the Legislature, the new contracts will save tens of millions of dollars through a combination of delayed wage increases and eliminating some payments to the Health and Welfare fund.

The savings from these revisions will allow the Administration to protect key programs and services and prevent some employee layoffs.

H.2 Employment Levels

In reviewing the reductions needed to live within fiscal year 2011 available funding, each agency will be required to critically evaluate their employee level and determine if a reduction in this area is needed to maintain a balanced budget. The fiscal year 2011 H.2 recommendation estimates 66,575 FTEs. This amount includes FTEs from both Executive and Non-Executive departments as well as positions funded from the operating accounts listed within the budget.

FY2011 Governor's Budget Recommendation

Government Area	Approved FY 2010	Approved FY 2011
	Budgetary	Budgetary
Executive		
Administration & Finance	2,653	2,610
Education	545	546
Energy & Environmental Affairs	2,113	2,033
Health & Human Services	19,895	19,361
Housing & Economic Development	728	713
Independents	297	285
Labor & Workforce Development	305	307
Public Safety	8,546	10,609
Transportation	-	-
<i>Executive Total</i>	35,083	36,465
<i>Executive Adjusted Total*</i>	<i>35,083</i>	<i>34,419</i>
Non-Executive		
Higher Education Campuses	14,296	14,296
Independents	9,755	9,027
Judiciary	7,608	5,831
Legislature	956	956
<i>Non-Executive Total</i>	32,615	30,110
<i>Non-Executive Adjusted Total*</i>	<i>32,615</i>	<i>32,156</i>
Grand Total	67,698	66,575

*H.2 recommends re-organizing the Department of Community Supervision (formerly Commissioner or Probation and Community Corrections) from the Judiciary to the Executive Office of Public Safety.

For fiscal year 2011, FTE caps will continue to be in place in order to continue to manage the state workforce. For the Executive Branch, head count will be managed for all funding sources but specifically for the operating budget funds recommended in the H.2 recommendation.

Key initiatives Impacting the State Workforce

MassDOT Reform

In June 2009, Governor Patrick signed Chapter 25 of the Acts of 2009 creating the new, streamlined Massachusetts Department of Transportation (MassDOT). MassDOT represents a merger of the former Executive Office of Transportation and Public Works (EOT) with the Massachusetts Turnpike Authority (MTA), the Massachusetts Highway Department (MHD), the Registry of Motor Vehicles (RMV), the Massachusetts Aeronautics Commission (MAC) and the Tobin Bridge. The new organization also assumed responsibility for many of the bridges and parkways formerly operated by the Department of Conservation and Recreation (DCR). Implementing the reform act has lead to changes in the classification of transportation FTEs, namely the transition of the 1,200 former EOT and DCR budgetary FTEs to an off budget trust fund.

Sheriffs

A year ago, Governor Patrick proposed the alignment of all 14 Massachusetts State and County Sheriffs under the state budgeting and finance laws. The Legislature approved the Governor's proposal through passage of the sheriff transfer legislation, Chapter 102 of the Acts of 2009, which was approved by the Governor on August 6, 2009. This act transferred the remaining 7 county sheriff departments to the Commonwealth effective January 1, 2010. Since then, sheriff departments have successfully transitioned onto the state budgeting and accounting system and all sheriff employees have been placed on state payroll, increasing the state FTE count by approximately 2,750 employees. However, this does not represent a parallel increase in state spending as sheriff operations prior to the transfer were predominantly funded by the Commonwealth. Additionally, deeds excise revenue previously funding sheriff operations will now be remitted to the Commonwealth.

Information Technology Realignments

Because of an initiative to transfer all information technology employees to secretariats, those employees that have routinely been funded from off-budget sources are being transferred into Intragovernmental Service Fund accounts where they will report to staff at the secretariat-level, but continue to be paid from the off-budget sources. This represents an “increase” of nearly 300 FTEs on the overall totals.

Contractor / Capital Conversions

Given the cost associated with paying for employees from capital funds and the renewed focus on wage enforcement efforts, every effort continues to be made to convert contract employees to full-time equivalents, and to transfer employees onto the operating budget. Along with conversions that have already been made, H.2 includes an outside section that allows for certain capital and operating costs to be exchanged so that appropriate operating dollars spent on capital needs can be shifted to the capital budget and vice versa. This section will have an impact on our budgeted employee level but it should be noted that these are not new state employees, they are just new to the operating budget.

Other Considerations

Like all departments, the non-executive branch agencies will be working to evaluate impacts on employees. Additionally, because funding at the Higher Education campuses comes from various sources, some employee impacts may be mitigated. Additionally, certain FTE increases due to compliance with legal settlements and to address needs around public health and safety must be considered.

Equal Opportunity Employment / Employee Diversity

Diversity and Equal Opportunity under the Patrick-Murray Administration continues to flourish. Since the beginning of this administration there has been a conscious effort to increase the diversity of our employee base with respect to the women and minority groups.

Focus was first placed on recruitment and outreach, in an effort to increase the overall representation of women and minorities in our workforce. As of the end of fiscal year 2009, women comprised 52.4% of the overall workforce. Minorities represented 22.3% of our workforce which represents a 3.8% increase overall.

In particular there has been a focus on increasing the representation of females and minorities in the senior level management ranks. As of the end of fiscal year 09, females represented 47.0% of our senior managers and minorities represented 12.5% of our senior managers.

Women represent 48.2% of the Commonwealth’s non-management workforce, while minorities represent 22.1%.

Seven-Year Trend of Executive Branch Employment by Race and Sex

	FY03	FY04	FY05	FY06	FY07	FY08	FY09
Black	13.71%	13.70%	14.28%	14.41%	14.43%	14.70%	14.90%
Hispanic	4.27%	4.34%	4.54%	4.65%	4.76%	4.90%	5.00%
Asian	2.65%	2.73%	2.85%	2.92%	2.95%	3.10%	3.20%
Native Am.	0.23%	0.22%	0.22%	0.22%	0.23%	0.20%	0.20%
White	80.23%	77.46%	77.90%	77.53%	77.15%	76.50%	76.10%
Male	49.96%	48.35%	47.79%	47.70%	47.59%	47.60%	47.50%
Female	53.20%	51.65%	52.21%	52.30%	52.41%	52.40%	52.50%