Budget Development - Table of Contents

Introduction

Serving as a blueprint for the activities and obligations of the year, the state budget reflects the Commonwealth's collective judgment about 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 perform or provide to families and individuals throughout FY 2013.

The Patrick-Murray Administration's FY 2013 budget is a balanced, responsible budget that reflects the continuing financial challenges confronting the Commonwealth since the start of the economic recession in 2008. Having already tackled several challenging budget years since the beginning of the fiscal crisis, the Administration is once again submitting a thoughtfully balanced and responsible FY 2013 budget proposal.

Despite continued improvement in revenue growth in FY 2013, the state's revenue is not keeping pace with the rate of growth for costs in core services such as health care, safety net programs, education, public safety and transportation without difficult cuts. The Administration's budget once again reflects difficult choices and fundamentally changes the way we do business across an array of government programs, services and operations. This budget relies on a responsible amount of one-time resources and a modest amount of new revenue, which will assist in preserving crucial state services while maintaining our nationally-recognized fiscal standing.

In addition, the FY 2013 budget invests in core areas of state government: funding for public education to help close the achievement gap, controlling growth in health care costs in order to preserve our nation-leading access to affordable health insurance, job creation and addressing youth and urban violence. The Patrick-Murray Administration is committed to protecting these investments and making difficult choices today that will allow us to uphold our responsibilities to future generations and position us for growth in the future.

The following sections describe the particular challenges facing the state in developing the FY 2013 budget and highlights the measures proposed to bring fundamental change and innovation to the way the state does business. Graphs and tables have been provided to help illustrate many of the trends and factors affecting the state budget. 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 branch, the bicameral Legislature consisting of the House of Representatives and the Senate and the Judiciary.

<u>Executive Branch</u>

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. The two work closely together to address important day to day administrative functions of 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 who assist the Governor in administration and policy making. Each cabinet secretary serves as the chief executive of their respective executive office.

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.

In addition, the Governor appoints the Secretary of Transportation, who chairs the Department of Transportation Board, an independent authority created in the FY 2010 transportation reform.

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 members 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.

Secretary of Education

The Secretary of Education directs the Executive Office of Education and works closely with the Commonwealth's education agencies – Department of Early Education and Care, Department of Elementary and Secondary Education, Department of Higher Education and the University of Massachusetts system - while serving as a voting member of the governing board of all four education agencies. The Secretary is the Governor's top advisor on education and helps shape the Commonwealth's education reform agenda, including closing the achievement gap.

Secretary of Energy and Environmental Affairs

The Secretary of Energy and Environmental Affairs manages the only state Cabinet-level office in the country that oversees both environmental and energy agencies. The Secretary develops and implements policies that safeguard public health from environmental threats, preserves the natural resources of the Commonwealth and ensures affordable and clean energy across Massachusetts.

Secretary of Health and Human Services

The Secretary of Health and Human Services administers the largest secretariat of the Commonwealth and works to achieve the highest levels of health and well-being for all residents of Massachusetts. As the Governor's top health care advisor, the Secretary plays an intricate role in developing health care cost containment strategies.

Secretary of Housing and Economic Development

The Secretary is the Governor's chief economic development and housing advisor and cabinet member, and is responsible for helping achieve the Governor's top priorities, including strengthening and accelerating our economic recovery by supporting job creation in every region of the state. The Secretary oversees the Commonwealth's business development, housing & community development and consumer affairs agencies.

Secretary of Labor and Workforce Development

The Secretary of Labor and Workforce Development enhances the quality, diversity and stability of the Commonwealth's workforce. This is done through workforce training, providing temporary assistance when employment is interrupted and promoting labor-management partnerships. The Secretary also manages the Joint Task Force on the Underground Economy and Employee Misclassification, working with state officials across state government to combat workplace fraud and protect exploited workers.

Secretary of Public Safety and Security

The Secretary is responsible for the policy development and budgetary oversight of secretariat agencies, independent programs and several boards which aid in crime prevention, homeland security preparedness, youth violence prevention and ensuring the safety of residents and visitors in the Commonwealth.

Secretary of Transportation

The Secretary of Transportation leads an organization that operates with a single mission: to provide a safe, reliable and efficient transportation network for residents of the Commonwealth. The Secretary chairs a five-member Board of Directors appointed by the Governor with expertise in transportation, finance and engineering, and oversees four divisions: Highway, Mass Transit, Aeronautics and the Registry of Motor Vehicles (RMV).

State Comptroller

The State 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, the management of the state accounting system and the oversight of fiscal management functions within all state agencies and departments. 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 published 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 General Accepted Accounting Principles (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 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.

Legislative Branch

The Legislature (officially 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 2011 marked the start of the 187th General Court, which runs through January of 2013. 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 over 20 of these committees, each responsible for studying the bills which pertain to a specific area (i.e., taxation, education, health care, insurance, etc.), and each committee is composed of senators and representatives.

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, 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.

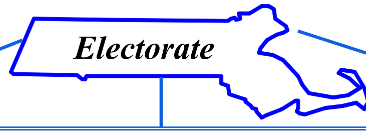
The cities and towns of the Commonwealth are organized into 14 counties; county government has been abolished in seven of those counties. The county governments that remain are responsible principally for the operation of courthouses and registries of deeds. Where county government has been abolished, the functions, duties and responsibilities of the government have been transferred to the Commonwealth, including all employees, assets, valid liabilities and debts.

Organizational Chart

The following organization chart identifies the present structure of state government and its constituent agencies. The Governor's House 2 budget, and legislation that will be filed concurrent to the House 2 recommendation, proposes consolidations and reorganizations of a number of agencies, including the following:

- Transfer of the Department of Probation from the Judicial Branch to a newly created Department of Re-Entry and Community Supervision at the Executive Office for Public Safety and Security. This will create a seamless continuum of services, decrease criminal activity and victimization, and reverse the extraordinary escalation of costs associated with duplication and inefficient administration of existing services within Probation;
- Restructuring of the Bureau of State Office Buildings as the Bureau of the State House; and
- Transforming drug lab capabilities from the Department of Public Health (DPH) to the State Police Crime Lab. In an effort to improve efficiency and meet testing demands, the Executive Office of Health and Human Services and the Executive Office of Public Safety are developing a long-tear comprehensive plan to transition all drug testing currently funded and performed by the Department of Public Health to the State Police Crime Laboratory. This move is cost-neutral. The state employees currently performing the drug testing at the Department of Public Health will be moved to the State Police Crime Lab.

Organizational Chart



Legislative Branch

House of Representatives
Senate

Executive Branch

Governor
Lieutenant Governor
Governor's Council
Attorney General
Inspector General
Office of the Comptroller
Sheriffs
Disabled Person Protection Commission
Independent Offices and Commissions
State Auditor
Secretary of the Commonwealth
Treasurer and Receiver-General
Office of Campaign and Political Finance
District Attorneys
Ethics Commission

Judicial Branch

Supreme Judicial Court
Appeals Court
Trial Court
Committee for Public Counsel
Board of Bar Examiners
Commission on Judicial Conduct
Mental Health Legal Advisors

State Agencies

Administration and Finance

Executive Office for Administration and Finance
Appellate Tax Board
Bureau of State Office Buildings
Civil Service Commission
Department of Revenue
Developmental Disabilities Council
Division of Administrative Law Appeals
Division of Capital Asset Management and Maintenance
George Fingold Library
Group Insurance Commission
Human Resource Division
Information Technology Division
Massachusetts Office on Disability
Massachusetts Teachers' Retirement System
Operational Services Division
Public Employee Retirement Administration Commission

Public Safety

Executive Office of Public Safety and Security
Chief Medical Examiner
Department of Criminal Justice Information Services
Department of Correction
Department of Fire Services
Department of Public Safety
Department of State Police
Massachusetts Emergency Management Agency
Merit Rating Board
Military Division and Massachusetts National Guard
Municipal Police Training Committee
Parole Board
Sex Offender Registry

Housing and Economic Development

Executive Office of Housing and Economic Development
Department of Business Development
Office of Consumer Affairs & Business Regulations
Massachusetts Marketing Partnership
Department of Housing and Community Development
Department of Telecommunications and Cable
Division of Banks
Division of Insurance
Division of Professional Licensure
Division of Standards

Energy and Environmental Affairs

Executive Office of Energy and Environmental Affairs
Department of Agricultural Resources
Department of Conservation and Recreation
Department of Environmental Protection
Department of Fish and Game
Department of Public Utilities
Division of Energy Resources
State Reclamation Board

Executive Office of Labor and Workforce Development

Executive Office of Labor and Workforce Development
Department of Labor
Department of Workforce Development
Division of Industrial Accidents
Division of Labor Relations

Health and Human Services

Executive Office of Health and Human Services
Executive Office of Elder Affairs
Department of Children and Families
Department of Developmental Services
Department of Mental Health
Department of Public Health
Department of Transitional Assistance
Department of Veterans' Services
Department of Youth Services
Division of Health Care Finance & Policy
Massachusetts Commission for the Blind
Massachusetts Commission for the Deaf and Hard of Hearing
Massachusetts Rehabilitation Commission
Office for Refugees and Immigrants
Soldiers' Home, Holyoke
Soldiers' Home, Massachusetts

Education

Executive Office of Education
Department of Early Education and Care
Department of Elementary and Secondary Education
Department of Higher Education
State Universities
Community Colleges
University of Massachusetts System

Health Care Security Trust

Board of Library Commissioners

Commission Against Discrimination

**The chart above identifies the state government structure as it exists in FY 2012. For FY 2013 the Governor proposes several reorganizations in the budget recommendation for next year.*

Overview of the Operating Budget Process

The annual budget is a declaration of the Commonwealth's priorities and a statement on how to allocate the limited collective resources available to the state. In the wake of the deepest economic downturn since the Great Depression, resources are more scarce than typical, because the demand on public services is greater, particularly for those services to residents most affected by the economy. While the state's economy will continue to recover during FY 2013, the allocation of resources to adequately meet these demands.

The operating budget supports the day-to-day functions of state government. The budget is a financial plan, reflecting the state's projected available resources and how it intends to use this funding to operate programs and services and meet its long-term liabilities.

Developing the annual operating budget is a lengthy process that involves all three branches of government, hundreds of agencies and thousands of stakeholders and residents.

- The Governor presents his budget recommendation to the Legislature.
- The House of Representatives and the Senate will each separately review the Governor's budget and develop their own recommendations.
- House and Senate work together to reconcile their budgets and send the final bill to the Governor, who then signs the budget in full, or in part, into law.

The Constitution and Budget Related Laws

The *fiscal year* is a commonly used term to describe annual budgeting period. State fiscal years start in one calendar year and end in the next. For example, fiscal year 2013 extends from July 1, 2012 to June 30, 2013. In a typical year, state agencies have the authority to spend funding provided for a fiscal year over a 14-month period, after accounting for the two month "accounts payable" period through August during which final payments for costs incurred before June 30 are reconciled and made.

The budget planning process for any fiscal year begins before the end of the previous fiscal year. For example, planning for the FY 2013 budget began no later than July 2011. State agencies develop their budget plans for the following fiscal year with the consideration on "out-years" as well, projecting the costs of current state employees, programs and services over the next two years.

The Massachusetts State Constitution and 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 during any single year. 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 departments may spend their appropriations and allocates exact dollar amounts authorized for a specific period and purpose. The budget also lists major revenue assumptions and reflects the most up-to-date projections for the total amount of resources that can be budgeted against from tax collections, reimbursements to the state from the federal government, and other revenues (fees, penalties) that are collected by state agencies.

Developing Next Year's Operating Budget: FY 2013 General Appropriations Act

	FY 2013 Planning
Department Planning & Secretariat Review (July-September 2011)	Department and agency staff review their policies and programs, develop spending plans for FY 2012 and 2013 and submit budget requests to their respective Cabinet secretary for review. The Cabinet Secretaries evaluate the requests and develop a secretariat-wide budget. Secretariats were assigned a spending cap by the Executive Office for Administration and Finance (A&F) based on projections at the time of available FY 2013 revenues.
Formal Budget Request (October-December 2011)	Secretariats and agencies submit spending plans to A&F. Independents, constitutional officers and the judiciary also submit spending plans. 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 (January 25, 2012)	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. 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 FY 2013 budget will be filed on January 25, 2012. More detailed information regarding the specific budget development process for FY 2012 can be found in the "FY12 Current Year Update" section.
House Budget (February-April 2012)	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 2012)	The Senate Ways and 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 Senate floor. Once debated, amended and voted on, it becomes the final Senate's budget.
Conference	House and Senate leadership assign members to a "conference committee"

Committee Budget (June 2012)	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.
Vetoes (June 2012)	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 2012)	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 2012)	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 2012." The new fiscal year 2013 begins on July 1, 2012.

Developing Supplemental Budgets

While the GAA is the primary budget law, supplemental budgets are also passed throughout the fiscal year. A supplemental budget authorizes additional spending above GAA levels. A supplemental budget is similar to the GAA but is generally smaller in size and often contains technical or “corrective” language in additional to increasing funding. It addresses unforeseen growth and/or decline in state revenues and or additional expenses and/or savings. The supplemental budget process is the same as the GAA budget process; supplemental budgets are bills filed by the Governor with the Clerk of the House of Representatives, debated and passed by both the House and Senate, negotiated in a Conference Committee and signed by the Governor in order to become law.

The timeline for supplemental budget legislation is usually shorter since supplemental budgets often provide funding for unforeseen situations that need timely resolution. For example, supplemental budget funding may be necessary from year to year to ensure that the Commonwealth can pay for unanticipated additional costs for snow and ice removal. In this case, at the time the GAA became law specific assumptions for the winter’s costs for snow and ice removal were in place. As the winter progresses and the state’s Department of Transportation begins to manage snow and ice removal, total projected costs may change and additional funding may be necessary.

Spending Plan and Budget Proposal Development

The Executive Office for Administration and Finance (A&F) is the state agency responsible for preparing the Governor’s budget recommendations and for oversight 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 annually prepare a budget for review and evaluation by the Secretary for A&F. The spending plan typically includes staff, expenditure and revenue estimates for the current fiscal year (2012) as well as the agency’s anticipated staffing additions or deletions, expenses and receipts for the next fiscal year (2013) based on the assumption that they will maintain the same level of services and programs from one year to the next.

In July of each year, after the GAA is signed into law by the Governor, agencies present spending plans to A&F to identify in extensive detail how funds appropriated for the current fiscal year will be spent.

These spending plans reflect each agency's plans to operate their programs and services for the current fiscal year. Agencies are also requested to reflect any changes that may be necessary to their operating budgets, whether savings or increased costs, that will result from projects and investments made through the five-year capital plan.

For FY 2012 virtually all agency operations budgets were level-funded to FY 2011, meaning that they needed to account for increased costs within their budget for such items as collectively-bargained wage increases, mileage increase and inflation in fuel and leasing costs. Agencies submitted their FY 2012 plans to A&F for review in August 2011. Spending plans were approved in September 2011 after A&F budget analysts carefully reviewed all spending and revenue projections. These approved plans then served as the base for then developing the FY 2013 budget.

FY 2013 Budget Development

In developing budget recommendations for FY 2013, agencies incorporated projected costs for the programs and services they operate, such as anticipated changes in staffing, 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 year. Based on revenue projections and other changes that A&F projected for available budgetary resources, agencies were asked to focus on developing spending plans for FY 2013 with an emphasis on controlling or preventing growth in spending over the projected FY 2012 spending levels.

After reviewing reported agency cost in FY 2013 and consulting A&F's long-term financial modeling of sustainable growth levels, A&F established spending parameters that would be necessary in FY 2013 to balance the state's budget. Agencies were required to submit proposals that would ensure that total spending fell below FY 2013 reported costs. These plans were submitted to A&F and serve as the base for the Governor's FY 2013 budget recommendations.

Throughout the fall, A&F continued to work with agencies to develop their spending proposals. Agencies were given the opportunity to review and revise the line items, make reform and re-organization proposals and other changes necessary to live within budgetary parameters and meet core requirements of state government. Following the submission of spending targets, A&F worked with each secretariat to assess the impact of reductions and identify which cuts will be most challenging for agencies to implement. A&F has sought to mitigate these reductions to the greatest extent possible.

On December 12, 2011the annual Consensus Revenue hearing was held by the administration, the Senate and the House. The three branches received testimony from the Department of Revenue and other economists regarding the amount of tax revenue that could be expected for FY 2012 and 2013. While the testimony suggested that revenues would continue to increase and that the state's economy was recovering, the economists also warned of slowing growth in the national economy.

For the second straight year, A&F established an Inter-Secretariat Budget Team (ISBT) to identify and develop additional cost-saving proposals. The ISBT team members were selected from across the secretariats and were charged with developing innovative ideas that would help to mitigate budgetary reductions and improve how government works. This team worked with A&F throughout the FY 2013 budget process and will continue their work after the submission of the FY 2013 budget to ensure timely implementation of the approved solutions.

Fiscal Year 2013 Post-Budget Release Process

In preparation for the start of FY 2013 (July of 2012), A&F will continue to work with agencies to develop implementation plans well ahead of the beginning of the fiscal year. As part of the budget development process most agencies have successfully identified areas already where reductions to programs and services will be necessary or where they may capitalize on efficiencies. However, due to the complexity of some recommended programmatic changes, in some cases agencies have not yet been able to determine exactly how they will restructure programs to live within recommended funding levels. The implementation planning process led by A&F helps to best ensure that all necessary steps are completed by the beginning of FY 2013 to ensure that agencies will be able to operate at expected funding levels.

Specific and General Financial Policies

Overview of State Finance

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. Typically, surplus resources at the end of any given fiscal year will be deposited into the Commonwealth's Stabilization Fund, also known as the Rainy Day Fund. Any further use of the Fund's resources must be explicitly authorized in legislation.

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 FY 2013 is discussed in more detail later in this section. In addition to tax revenues, non-tax revenues are forecast within the Governor's budget and factor into the total amount of resources that are available to the state to support its costs in FY 2013.

Budget Administration

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 other funds. 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 FY 2013 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 utilize the accounting and payroll systems to ensure adequate audit controls are in place for the purpose of reporting on the receipt and expenditure of tax dollars and other revenues.
- The presentation of the annual Statutory Basis Financial Report, 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.
- Since November 2011, the public has been able to visit the state's transparency website, "Open Checkbook", which is regularly updated with state payroll and expenditure data

Revenue

- In preparation of the annual budget, a consensus revenue estimate for taxes must be agreed to 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, ensuring the timely and transparent receipt of all state funding sources.

Cash Flow

- The Cash Management Division of the State Treasurer's Office utilizes 958 operating accounts to track cash collections and disbursements for the Commonwealth. The Division relies primarily upon electronic receipt and disbursement systems. 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.
- The State Treasurer, in conjunction with the Executive Office for Administration and Finance, is required to submit quarterly cash flow projections for the current fiscal year to the House and Senate Committees on Ways and Means on or before the last day of August, November, February and May. The projections must 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 Executive Office for Administration and Finance, is also required to 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 process 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.
- The bulk of state appropriations must be "subsidiarized" in the central accounting system with total funding budgeted and allocated for spending categories such as payroll, travel, operational expenses, leases and information technology services.
- Executive branch agencies are restricted from transferring funds between spending categories without first gaining the approval of the Executive Office for Administration and Finance.
- Total cash allotments, or the amount of total appropriations available for actual expenditure at any given time, are subject to a published schedule by the Secretary of Administration and Finance. A&F staff will consult state cash flow projections and agency expenditure activity before approving any increased allotments beyond the published schedule.

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 B 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. In fiscal year 2013, an estimated $100 M will be deposited in the Fund under this policy.
- Any one-time tax or other revenues collected as a result of a judgment or settlement of outstanding tax litigation that exceeds $10 M will be segregated and deposited into the Stabilization Fund, ensuring that this non-recurring revenue source is not relied on for general budget needs. Thus far in FY 2012 (through December 2011), the Attorney General and Commissioner of Revenue have certified $163.2 M for transfer to the Stabilization Fund on account of settlements and judgments.

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. The cap will be established based on debt affordability, and annual growth in that cap will not exceed $125 million between FY 2012 and FY 2015.
- A five-year capital investment plan will be developed and update annually, and will 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

- To address the Commonwealth's retiree health care funding liability, reforms have been adopted that will annually allocate a portion of the state's tobacco master settlement revenue to the State Retiree Benefits Trust Fund (SRBTF), the trust from which we pay for retirees' health costs. This portion of the tobacco settlement will increase incrementally each year until 2022, when it will be fully dedicated to SRBTF. In addition, included in Pension Reform legislation adopted in FY 2012, a new Commission was established to study and propose recommendations to further address the state's unfunded liability.

Strategic Fiscal and Budgetary Policies

In developing the FY 2013 budget, special attention was paid in the following areas:

- Cost-containment in the state's various health care programs, including the costs for current and retired state employees and health coverage for low-income and unemployed residents in the Commonwealth.
- Preservation of programs to ensure residents can lead safe and healthy lives and find long-term employment in a competitive global economy:
  - Addressing youth and urban violence through investments in our youth and communities
  - Closing the achievement gap and protecting education funding as a cornerstone of long-term economic growth and opportunity.
  - Increasing job creation through investments that enhance Massachusetts' ability to compete for the jobs and businesses of tomorrow, such as green technology and the life sciences, while ensuring a more competitive environment for the state's private employers in more traditional sectors.
  - Ensuring the state's most vulnerable populations, particularly the disabled and those who have served our country, can continue to receive assistance and life-changing services from the state where needed.
- Adopt government reforms that promote efficiency and sustainability of services and ensure state dollars are stretched further in challenging fiscal times.
  - Implementing technology improvements to support innovative service delivery to improve services for the public at lower costs to taxpayers.
  - Pursuing shared service models across state government more aggressively for the most-effective administration and operation of state agencies and programs.
  - Improving state purchasing and procurement processes to leverage state buying power and drive further cost savings.
- Identify additional recurring revenues to support worthwhile programs while recognizing the state cannot afford to maintain all programs and services that have been operated in the past.
- Reduce the use of temporary or one-time resources to balance the budget.
- Utilize long-term financial model to set annual and multi-year budget targets with respect to expected revenues, sustainable spending levels and appropriate annual use of non-recurring resources in developing a balanced budget.

Performance Management, Accountability and Transparency

- The FY 2012 budget established the Office of Commonwealth Performance, Accountability and Transparency (CPAT) to execute nation-leading strategies for improving performance and transparency, maximizing federal grants, reducing fraud, waste and abuse and informing our financial planning by using the latest economic and caseload forecasting tools.
- Since it was inaugurated in June, CPAT has had some notable successes in driving reform and innovation across state government:

- Performance Management - establishing a collaborative relationship with the Collins Center at UMASS Boston to develop strategies and dashboards for the Governor's four strategic priorities; initiating discussions with Secretariats to develop strategic plans and put them in place by June 2012; and rolling out a comprehensive training program on performance management for staff across state government.
- Enhanced Coordination and Federal Grants - leveraging experience in coordinating ARRA funds to secure and maximize federal dollars and ensure compliance with federal requirements; engaging Cabinet Secretaries to develop better cross-government coordination of grant applications and rewards; utilizing the outcome measurement regime required to comply with the federal Recovery Act for all grants secured in state government; and commencing procurement of unified grants management technology that will enable coordination to be achieved.
- Transparency Website - launching the State's Open Checkbook website in December, which details state spending, including payrolls and pensions.
- Program Integrity - making permanent the Lt. Governor's task force on fraud, waste and abuse, and coordinating efforts throughout government, including with other executive officers such as the Auditor and Attorney General.
- Economic Forecasting & Analysis - appointing its Advisory Board and conducting its first meeting; developing its forecasting approach and methodology; began working with high impact service areas, such as MassHealth (Medicaid), to better model caseloads; and linking historical data into a 5-year economic model.

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. Typically, the level of expenditures made annually from these fund sources is "subject to appropriation", meaning that no payments can be made from these funds until they are explicitly authorized in the state budget. The main budgeted funds include the General Fund the Commonwealth Stabilization 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. Typically, these funds are available annually to one or more agencies for dedicated purposes, but do not require annual legislative approval for the use of the funding. Most funds are subject to annual reporting rules and all funds are subject to state accounting and audit practices.

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 short-term purpose. They typically are created administratively for a brief period to allow a state agency to collect one-time revenue and spend this funding for a dedicated purpose. For example, the Department of Public Health receives funding from private organizations from time to time to conduct research and studies on specific issues and must collect and segregate funding dedicated for this purpose from all other funding sources.

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 FY 2010, this fund replaced the former *Highway Fund* as the principal source of transportation related revenues and expenditures for the Commonwealth.

The *Massachusetts Tourism Fund,* authorized in section 35J of Chapter 10 of the General Laws, is funded with 35 % of the State's annual revenues received from the hotel occupancy tax authorized in section 3 of Chapter 64G. In FY 2012, Tourism Fund revenues are estimated to total $40.3 M. 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 in the Governor's FY 2013 proposal.

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. Annual spending from this fund is subject to annual appropriation by the Legislature, and any unexpended funds remain in the Fund for future use for related purposes.

The *Commonwealth Health and Prevention Fund*, established in House 2, will collect revenues generated from the elimination of the existing sales tax exemptions on the purchase of soda and candy. Monies appropriated from this fund will support programs and services that augment the health and well-being of the citizens of the Commonwealth. This policy initiative aims to encourage healthy lifestyle choices.

Long-Term Forecasting

The Patrick-Murray Administration is the first Administration in Massachusetts to establish a long-term planning policy to ensure that the state budget is consistent with the principle of fiscal sustainability. The FY 2013 budget achieves fiscal sustainability based on an evaluation of structural balance as defined by the long-term planning policy. Structural balance is achieved when budgetary spending is based on sustainable levels of revenue and does not include excess spending that would result in a structural deficit. The policy benchmark to evaluate structural balance compares the cyclical shortfall in tax revenue that is a result of the economy operating under capacity to the use of one time resources included in the budget to offset this shortfall. The FY 2013 budget is in structural balance based on this benchmark because the proposed use of $541 M in one time resources is significantly lower than the estimated $1.025 B cyclical shortfall.

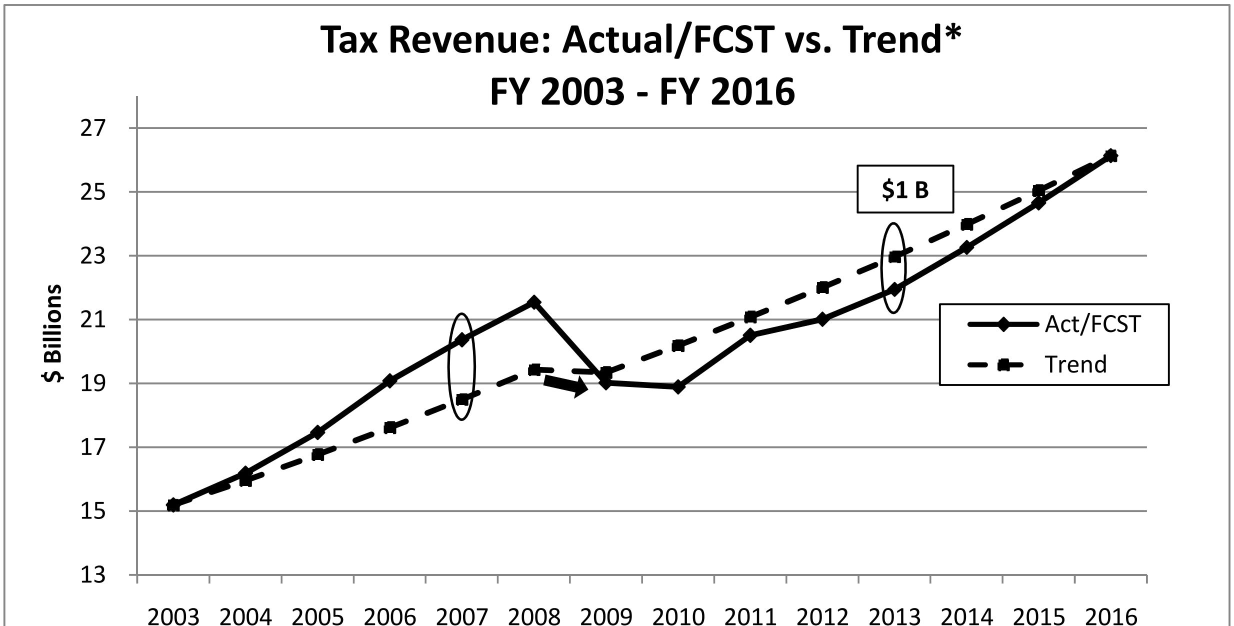
This policy benchmark is based on a framework for long-term tax revenue forecasting, developed by the Executive Office of Administration and Finance (A&F) in collaboration with the state's Office of Tax Policy Analysis, using revenue projections provided by outside economists. The forecast is also used to evaluate other policy benchmarks based on best practices recommended by the Government Finance Officers Association (GFOA) and accounting standards being proposed by the Government Accounting Standards Board (GASB). These policies are described in more detail in the FY 2013 budget brief on financial reforms and the Commonwealth's long-term planning policy document which is posted on www.mass.gov/anf.

Measuring Structural Balance

The FY 2013 budget achieves structural balance based on an estimated $1.025 B cyclical shortfall and the use of $541 M in one time resources. The cyclical shortfall reflects the difference between the FY 2013 consensus revenue forecast and the amount of revenue that the Commonwealth would generate if the economy were at (but not over) full capacity, as represented by the revenue trend line in Figure 1. The use of one time resources to address a cyclical shortfall is fiscally prudent based on the policy benchmark summarized below. It is critical, however, that when the economy has recovered to the point that tax revenues exceed the revenue trend line, such excess revenues are deposited in the Stabilization Fund and not relied on to support recurring budgetary costs. These benchmarks are designed to account for the inherent uncertainty in long-term forecasting and ensure that there are sufficient stabilization fund balances available in the future.

The $541 M limitation on the use of one time resources provides a significant margin of safety in comparison to the cyclical shortfall. Further, a $300 M limitation on the use of rainy day funds (net of deposits related to capital gains) will maintain over $1 B in stabilization fund balances at the end of FY 2013. The Commonwealth currently has one of the 3 highest stabilization fund balances in the country and the projection for year-end FY 2013 will ensure that there are sufficient resources to support the balance of the economic recovery and to provide protection in the event of another economic slowdown. These benchmarks, as well as the current limitation on the use of capital gains revenue for budgeting purposes, and other policies to prevent over-spending when the economy is above capacity, are described in further detail in the Long Term Planning Policy document.

Figure 1.



*Actuals reflect adjustments for significant changes in tax law prior to FY 2012.

Long-Term Revenue Forecast Methodology

The long-term tax revenue forecast used to estimate the cyclical shortfall is developed in three steps. The foundation for the analysis is the 10 year tax revenue forecast developed by outside economists for the FY 2012 - FY 2021 time period. Second, these forecasts include an estimate of the long-run "steady-state" tax revenue growth rate, which reflects the level of tax revenue growth that may be expected in the future when the economy is at full capacity. The third step is to develop an imputed revenue-trend line which is based on the FY 2021 tax revenue estimate for each forecast, discounted for the steady-state rate of revenue growth.

A summary of the external forecasts, the Administration's estimates for long-term tax revenue growth, key assumptions and calculations are reflected in Table 1 below. These results show strong revenue growth of 6% annually during a projected economic recovery between FY 2014 – FY 2016, a steady state growth estimate of 4.4% applied to the period between FY 2017 – FY 2021, and a resulting growth rate of 4.9% during the full forecast period. The cyclical shortfall reflects the difference between the FY 2013 consensus tax revenue estimate of $21.950 B and $22.975 B, which is the FY 2013 estimate associated with the revenue trend-line calculated using the formula described above and noted in Table 1. This long-term tax revenue forecast is a central component of the long-term planning policy and incorporates significant improvements in methodology relative to the projections used in the FY 2012 budget development.

Commonwealth of Massachusetts
Long-Term Tax Revenue Forecast Summary
FY 2012 - FY 2021
$ Ms

		External Forecasts			
		Low	Median	High	**A&F Estimate**
Key Data Points	(1)				
FY16 Tax Revenue Forecast		$25,681	$26,281	$27,297	$26,143
FY21 Tax Revenue Forecast		$31,126	$32,405	$33,137	$32,423
Compounded Annual Growth Rates (CAGR)	(1)				
FY12-FY21		4.5%	4.9%	5.2%	4.9%
FY14-FY16 (Recovery)		5.4%	6.2%	7.5%	6.0%
Long-Run Steady-State		4.0%	4.4%	4.5%	4.4%
Calculation of Estimated Cyclical Shortfall					
A) FY13 Trend	(2)	$22,763	$22,900	$23,282	$22,975
B) FY13 Consensus Revenue		$21,950	$21,950	$21,950	$21,950
C) FY13 Estimated Cyclical Shortfall (A-B)		-$813	-$950	-$1,332	-$1,025
MEMO: FY 2012 Cyclical Shortfall					$996

(1) Growth calculations use FY 2012 and FY 2013 consensus tax revenue (see below). Any variance between consensus
figures and individual forecaster estimates are assumed to be timing differences that are resolved in FY 2014 -FY 2015

FY12 Consensus Revenue: 21,010

FY13 Consensus Revenue: 21,950

(2) FY13 Trend Tax Revenue = $(\text{FY21 Tax Revenue Forecast})/(1+4.4\%)^8$

(3) Assumed inflation for FY14-21: 2.30%

Role in the Long-Term Planning Framework

The long-term tax revenue forecast also plays a central role in developing other policy benchmarks that are included in the Commonwealth's Long-Term Planning Policy. The projections for long-term growth in tax revenue and the Massachusetts economy are used to formulate policy benchmarks for the sustainable rate of growth in total spending and health care spending in the budget. The projected rate of growth for Massachusetts gross state product, which is inherent in the tax revenue forecast, is used to evaluate projected changes in the level of long-term liabilities as a percentage of the state economy over time. The alignment of these policy benchmarks and the best practices for long-term planning prescribed by GFOA and GASB are described in more detail in the complete Long-Term Planning Policy document, which will be posted on www.mass.gov/anf.

Long-Term Planning and Annual Budget Development

For the first time beginning in FY 2012, A&F budget staff consulted the long-term planning model to establish parameters for agency and program cost growth based on projected annual revenues over medium and long term periods. These parameters were used to inform decision-making related to allowable hiring and related program expenditures, as well as served to help A&F develop funding targets for FY 2013 to ensure that state spending ultimately could be sustained by available resources.

FY 2012 Update

In July 2011, the Governor signed into law the FY 2012 General Appropriations Act (GAA) – Chapter 68 of the Acts of 2011. The FY 2012 budget authorized spending $30.597 B, which was estimated by the Executive Office for Administration and Finance (A&F) to be $750 M less than FY 2011 projected spending after accounting for expenditures in FY 2011 from federal stimulus sources on items (primarily K-12 school aid and higher education) that would typically be supported by the operating budget. This reduction based on the FY 2012 GAA provided for the largest percentage decrease in spending in over 20 years.

FY 2011 Year-End Supplemental Funding for FY 2012

Similar to most fiscal years, total FY 2012 spending was increased in October 2011 upon the adoption of the “year-end” FY 2011 supplemental budget, which authorized $380 M ($376 M for budgetary spending) in FY 2011 appropriations (known as Prior Appropriations Continued or “PACs”) to continue to be expended into FY 2012. The year-end FY 2011 supplemental bill (Chapter 142 of the Acts of 2011) also provided additional supplemental appropriations for FY 2012 in the amount of $36.8 M.

FY 2012 October Revenue Revision

On October 17, 2011 the Secretary of Administration and Finance announced the increase of projected tax revenues above the FY 2012 consensus revenue estimate of $20.516 B by $395 M, to $21.010 B. This increase in tax estimates accounted for the January 1, 2012 income tax reduction of 0.05% (triggered by actual tax collections exceeding statutory tax benchmarks established under 2000 legislation). The Secretary also noted that roughly $71 M of such tax revenue was not available for budgetary purposes because it was one-time tax settlements in excess of $10 M that had been received by the state through September 30, 2011 and which, under FY 2012 budget reforms, were required to be deposited directly into the state’s rainy day fund. Finally, the Secretary announced that he was lowering the estimates for FY 2012 non-tax revenue by a net $26 M. The result of these changes was to increase net budgetary resources in FY 2012 by $298 M.

FY 2012 Tax Projections, Original vs. October 17 Revised $s in millions	
Original Consensus:	20,615
Revised Forecast:	21,010
Increase in Forecasted Revenues:	395
Tax Settlements (above $10 M):	(71)
Reduced Non-Tax Revenue Estimates:	(26)
Net Increased Budgetary Resources:	298

On October 17, 2011 the Governor filed FY 2012 supplemental legislation totaling $161.2 M, with a cost to the state of $131.6 M after accounting for additional federal reimbursements. The supplemental funding was needed to support urgent funding needs primarily for state health care and safety net spending and other obligations, such as the costs for emergency response to storms. On November 11, 2011 the Governor signed into law Chapter 171 of the Acts of 2011, in which the Legislature partially adopted the Governor’s supplemental funding proposed, in an amount of $51.9 M. On November 22, 2011 the Governor signed into law a bill authorizing expanded gaming in the Commonwealth (Chapter 194 of 2011) which provided $5.5 M in supplemental funding for expanded oversight.

Finally, A&F currently projects roughly $303 M in net additional expenditures, including $187 M for new Delivery System Transformation Initiative payments approved in the recent Medicaid waiver by the federal government and other cost exposures, like caseload increases and other costs that cannot be avoided (e.g., snow and ice removal, additional one-time tax settlements to the stabilization fund and other potential costs). The state would receive close to $100 M in new revenues to support these projected costs, primarily from the federal government. The $303 M of net additional expenditures also takes into account expected reductions in spending in certain areas that A&F anticipates. Based on the FY 2011 PACs, supplemental funding adopted to-date and other funding contingencies we are planning to address, total estimated spending in FY 2012 is projected to be $31.375 B, or 2.4% above FY 2011.

FY 2012 Estimated Spending	
FY 2011 Spending	**30,636**
FY 2012 GAA	**30,597**
FY 2011 Prior Appropriations Continued (PACs) into FY 2012	*380*
Supplemental Budget - Chapter 142 of 2011	*37*
Supplemental Budget - Chapter 171 of 2011	*52*
Expanded Gaming - Chapter 194 of 2011	*6*
Net ANF Contingency Expenditures	*303*
FY 2012 Estimated Spending	**31,375**
FY 2012 GAA - % Change from FY 2011 Spending	**-0.1%**
FY 2012 Estimated Spending - % Change from FY 2011	**2.4%**

FY 2012 One-Time Resources

Based on current revenue and spending assumptions, ANF estimates that total FY 2012 one-time resources used to support the budget total $620 M. Of this amount, the largest is $202 M in FY 2011 resources used (via PACs) to support ongoing expenditures in FY 2012. These PACs are treated as one-time resources since the funding with which they are supported (FY 2011 year-end surplus) is not recurring, while the FY 2012 costs associated with these expenditures continue for the state into FY 2013. Not all of the $380 M in PAC funds were treated as one-time, since many of these items were intended to be one-time expenditures only and not treated as ongoing. PACs for non-recurring spending or one-time purposes are estimated to total $173 M.

FY12 One-Time Resources $s in millions	
Budgetary Resources:	
FY11 Resources Used to Support Ongoing FY12 Costs:	202
Stabilization Resources:	185
Abandoned Property:	85
Delay FAS 109 Deduction:	46
Trust Fund Resources:	43
Sale of Assets:	12
Non-Budgetary Resources:	
Quasi Public Contributions:	26
Commonwealth Care Reserves:	21
TOTAL FY 2012 ONE TIME RESOURCES	**620**

The next largest one-time resource in the FY 2012 budget is $185 M in Stabilization Fund reserves. A total of $200 M was authorized in the original FY 2012 GAA; however, A&F only projects at this time that $185 M is needed to ensure that the budget remains balanced. Other one-time resources include $85 M in one-time unclaimed property proceeds; $46 M from the delay of FAS 109 corporate tax deductions (that would otherwise be effective in tax year 2012); $43 M in non-recurring surplus funds from non-budgetary trusts; $26 M of resources from quasi publics to help support costs for ongoing programs and services that would otherwise be supported in the operating budget; $21 M in surplus resources from the Commonwealth Care Trust Fund; and $12 M in projected revenues from the sale of state assets authorized in the FY 2012 GAA.

Fiscal Year 2013 Budget Development

Critical Factors for the FY 2013 Budget Development
There are typically three major factors that impact the state's budget from year to year; change in available budgetary revenues, including tax collections and other non-tax sources; the impact from the loss of any one-time resources utilized in the preceding year's budget; and the extent to which costs grow to operate state programs and services from the previous year. Since the state budget must be balanced each year, the year-to-year impact of these factors –and how they affect available budgetary resources- will play a critical role in how challenging it will be for developing a balance budget for any given year.

One-Time Resources
Unlike FY 2012, the state budget next year will not need to account for the loss of an unsustainable level of one-time resources. Incrementally, since FY 2009 the Governor and the Legislature have successfully been able to reduce the amount of one-time resources required to maintain a balanced budget, from over $3 B in FY 2009 to $620 M in FY 2012. The level of one-time resources being used in FY 2012 is sustainable since they are less than the cyclical shortfall in tax revenues as the state continues to recover from the recession. They also represent only a small percentage of the total state operating budget (2% of FY 2012 estimated expenditures vs. 11% of FY 2009 expenditures). Even so, the starting point for developing the FY 2013 budget assumes a reduction of $620 M as a result of one-time resources in FY 2012 that will not be available in FY 2013.

One-Time Budgetary Resources, FY 2009 vs. FY 2012 ($s in millions)			
FY 2009	**FY 2010**	**FY 2011**	**FY 2012**
3,112	**2,479**	**1,857**	**620**

Cost Growth and Major Budget Increases

While state tax revenues experienced an historic drop in FY 2009 and are continuing to recover, increased enrollment in state health care and other safety net programs have significantly increased costs in these programs, putting further demand on diminished state resources. Beyond health care and safety net costs, there are also a limited number of items in the state's budget for which the state is legally obligated to incur costs each year, such as debt service, collective bargaining, pension contributions for existing and retired employees and the costs of funding K-12 school aid under the state's chapter 70 education reforms. Controlling annual costs in these areas is a challenge, and such costs represent a significant share of the state's annual funding.

As the following table shows, the costs of health care, chapter 70 and debt service alone represent 61% of annual estimated spending in FY 2012. In addition, A&F estimates that non-health care safety net expenditures across all other state spending total $3.985 B (primarily in Health and Human Services, Housing and Economic Development and Education) in FY 2012 and, together with health care, chapter 70 and debt service, makes up roughly 73% of all budgetary spending. Areas where annual cost pressures are the greatest make up roughly three-quarters of the state budget.

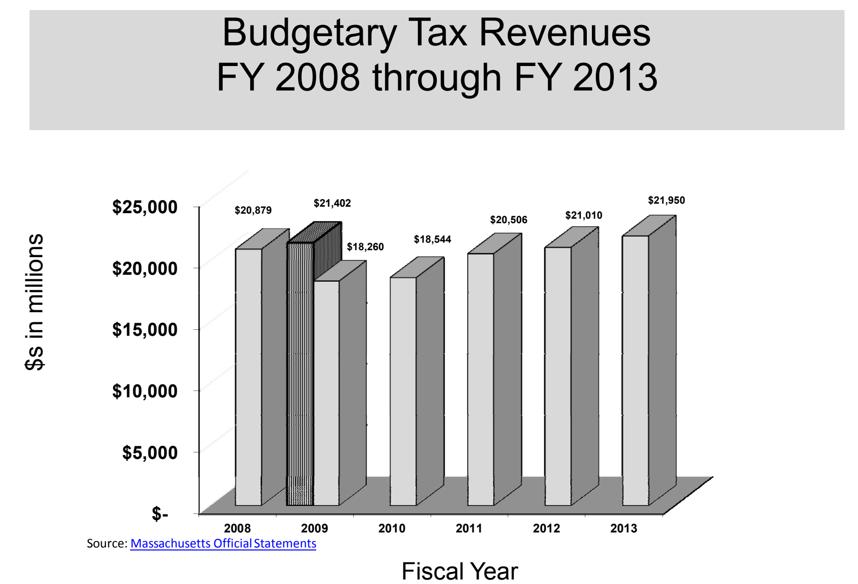
State Budgetary Spending by Governmental Area, FY 2012

Government Area	Estimated Spending	Percent of Total Estimated Spending
Health Care:		
MassHealth	10,619,492,582	33.85%
Group Insurance	1,656,042,754	5.28%
Commonwealth Care	687,000,000	2.19%
Chapter 70 (K-12 School Aid):	3,990,812,680	12.72%
Debt Service:	2,257,042,623	7.19%
Other Spending:		
Unrestricted Local Government Aid:	898,980,293	2.87%
Labor and Workforce Development	59,418,415	0.19%
Housing and Economic Development	392,096,351	1.25%
Administration and Finance	460,558,926	1.47%
Sheriffs	501,641,668	1.60%
District Attorneys	98,704,598	0.31%
Constitutional Officers and Other Independent Agencies	312,442,300	1.00%
Judiciary	760,717,483	2.42%
Education	1,023,450,889	3.26%
Transportation	363,934,869	1.16%
Higher Education	924,462,336	2.95%
Public Safety	954,113,334	3.04%
Energy and Environmental Affairs	194,062,786	0.62%
Health and Human Services	4,824,649,768	15.38%
Transfers to Non-Budgetary Sources	394,917,074	1.26%
TOTAL SPENDING	**31,374,541,729**	**100.00%**

Other areas in the state budget typically experience modest cost increases from year to year, mostly related to negotiated wage increases, leasing, the cost of fuel or related factors that are sensitive to annual cost inflation. As funding for the major budget cost drivers outlined above has increased, funding for other parts of state government has been reduced and agencies have needed to find new ways to control and reduce costs, often eliminating staffing, cutting or limiting contracts or curtailing other investments.

FY 2013 Tax Revenues

As discussed in greater detail below, FY 2013 tax revenues are projected to increase next year, as the state economy continues to recover from the recession. Tax revenues in FY 2013, however, will still be substantially below what they would have been in FY 2013 without the economic recession. The FY 2013 consensus tax projection totals $21.950 B. When one considers what revenue would have been since FY 2008 if taxes had grown at the rate of inflation over the 5-year period, then FY 2013 tax collections would have been an estimated $22.9 B next year, or $1 B more than what is currently assumed will be available for the budget. This gap is even more pronounced after accounting for the fact that the sales tax was increased in FY 2010 by 20%, generating roughly $1 B in additional revenues each year for the state.

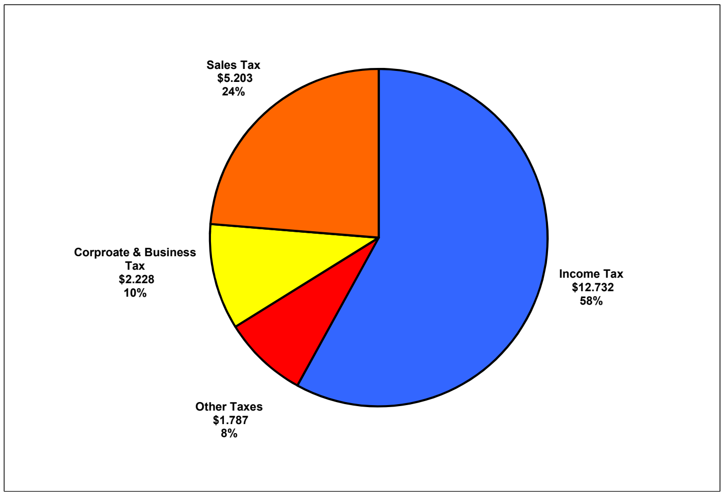


*Striped bar shows original revenue projection for FY09.

FY 2013 Tax Revenue Consensus Forecast

Tax revenues comprise nearly 63% of all revenues (including new revenues proposed in the H.2 recommendations) used to support the Commonwealth's operating budget. Each year the Administration and the House and Senate consult with economists and other groups to gather information and analysis on the condition of the U.S. and Massachusetts economies. They use that information to project state tax revenue for use in the state budget. The following is a general description of the consensus revenue process followed to establish the budgetary tax revenue estimate.

FY 2013 Consensus Tax Revenue Estimate of $21.950
(in $ Billions)


Sales Tax
$5.203
24%
Corproate & Business Tax
$2.228
10%
Income Tax
$12.732
58%
Other Taxes
$1.787
8%

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 12, 2011, 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 Massachusetts Taxpayers Foundation and the Beacon Hill Institute and economists from the University of Massachusetts and Northeastern University. The three branches subsequently agreed upon a FY 2013 tax revenue estimate of $21.950 B, consistent with testimony presented at the hearing.

As part of the statutorily required consensus revenue process, the Secretary, House and Senate also agree on the amount of tax revenues that will need to be transferred to support the State's Retiree Pension Fund, the School Building Authority, the MBTA (Massachusetts Bay Transportation Authority) and the Workforce Training Trust Fund pursuant to statutory requirements.

For FY 2013, these transfers are estimated to total $3.05 B and will be directed to the following funds in the following amounts:

- School Modernization and Reconstruction Trust Fund = $ 689.4 M;
- MBTA State and Local Contribution Fund = $ 786.8 M;
- Pension Reserves Investment Trust Fund = $ 1.552 B; and
- Workforce Training Trust Fund = $20.2 M.

Basis for the FY 2013 Consensus Revenue Forecast

FY 2012 tax revenues are estimated to be $21.010 B, representing an actual increase of 2.4% and a baseline increase of 3.1% from FY 2011 collections (the baseline calculation adjusts for the impact of tax law and processing changes, which is a better indicator of underlying economic activity). Through December 2011, FY 2012 year-to-date tax revenues were up 2.6% actual and 2.9% baseline, and were $49 M below the year-to-date benchmark based on the revised FY 2012 estimate of $21.010 B (including the impacts of the revenue initiatives in the FY 2012 budget, the Sales Tax Holiday in August 2011, and the statutorily-required reduction in the personal income tax rate as described above). It is expected that as the economy continues to recover and grow slowly, tax collections for the remainder of FY 2012 will increase by $241.4 M, or 2.2% actual, and $360.4 M, or 3.3% baseline, from the same period in FY 2011.

The FY 2013 consensus tax revenue estimate is $21.950 B, representing revenue growth of 4.5% actual and 5.4% baseline from the FY 2012 estimate of $21.010 B. The FY 2013 estimate assumes that the national and state economies will grow slowly throughout the fiscal year. In developing the consensus estimate, the Commonwealth relied 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 as follows:

- While the national and state economies continued to grow, the growth has slowed down in 2011, and is expected to remain slow during 2012 and 2013;

- Massachusetts employment is expected to increase by 0.5% to 1.3% over the remainder of FY 2012, and by 0.6% to 1.4% for FY 2012 as a whole. For FY 2013, Massachusetts employment is expected to change by 0.2% to 0.9%;

- Massachusetts personal income (excluding capital gains) is expected to grow by 3.5% to 4.3% over the remainder of FY 2012 and 3.7% to 4.2% for FY 2012 as a whole. For FY 2013, Massachusetts personal income is projected to grow by 3.2% to 6.3%;

- Massachusetts wages and salaries are projected to increase by 3.7% to 5.1% for the remainder of FY 2012 and 3.6% to 4.7% for the year as a whole. For FY 2013, the growth in Massachusetts wages and salaries is projected to range from 3.4% to 6.4%;

- Massachusetts retail sales growth is expected to range from 2.8% to 4.4% over the remainder of FY 2012 and 3.7% to 5.1% for the fiscal year as a whole. For FY 2013, Massachusetts retail sales are projected to grow by 3.0% to 4.1%;

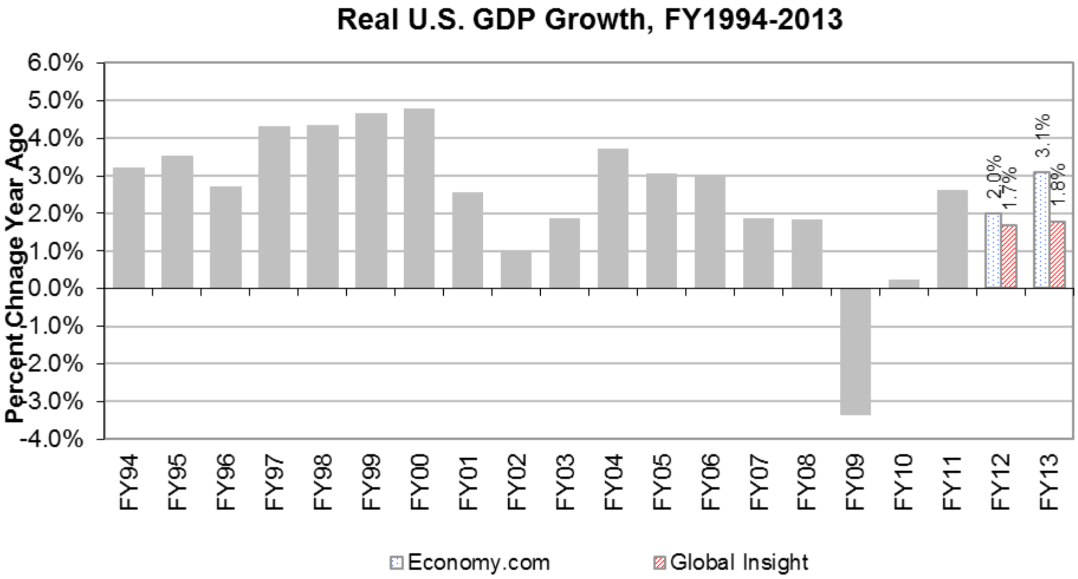
- Corporate profits at the national level are expected to increase by 6.4% to 9.5% over the remainder of FY 2012, and by 6.2% to 9.1% for the fiscal year as whole (there are no forecasts for state corporate profits). For FY 2013, growth in corporate profits is projected to range from 1.0% to 7.4%;

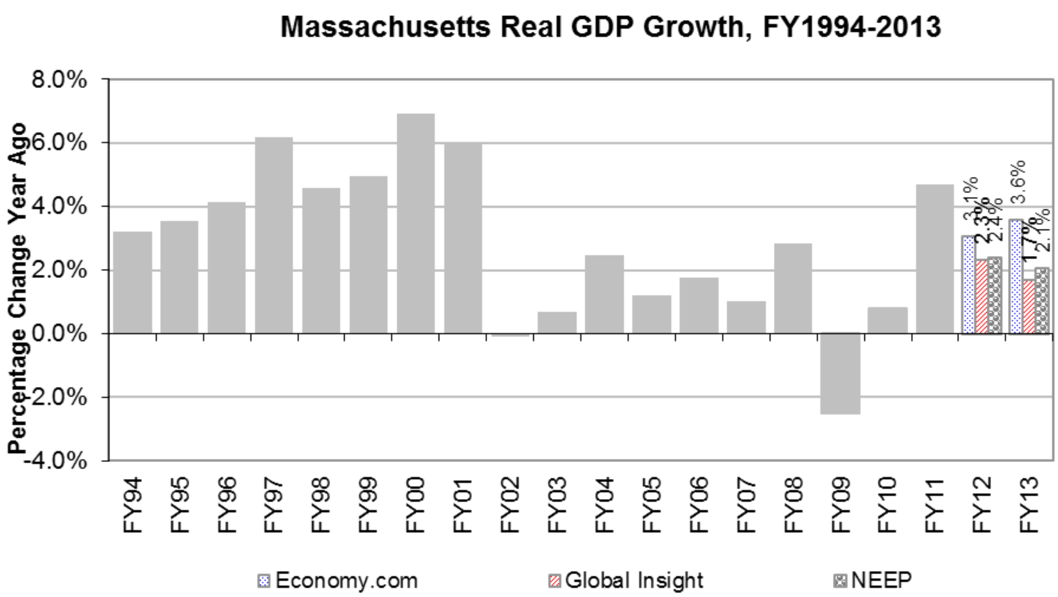
In addition to the economic forecasts described above, the consensus revenue estimate takes into account forecasts for capital gains realizations and taxes. The consensus agreement capital gains forecast is based on the following considerations:

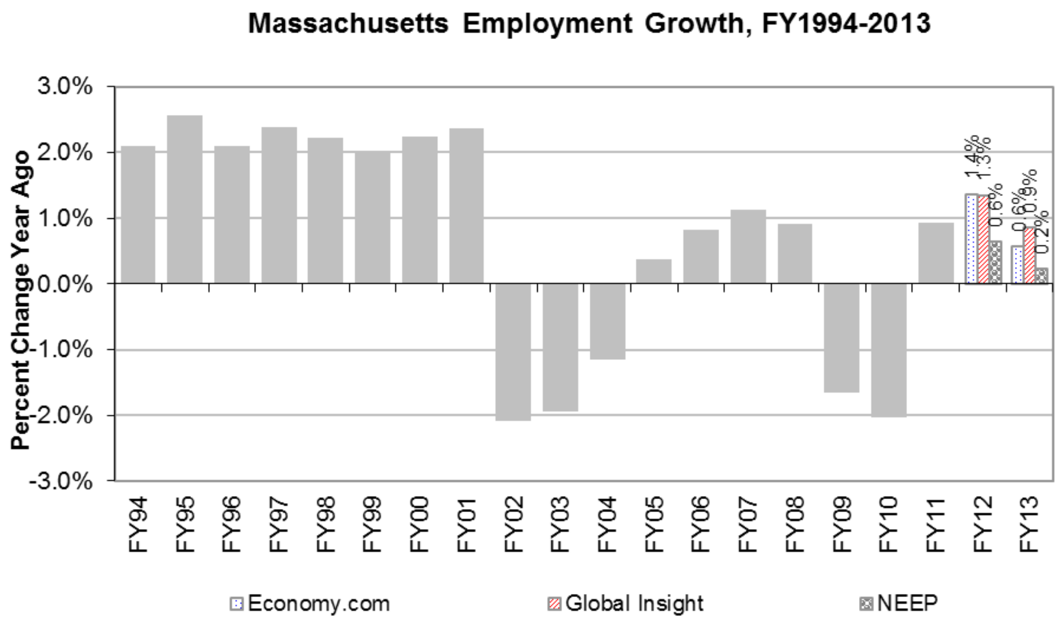
- Preliminary tax year 2010 data indicates that Massachusetts capital gains realizations increased by approximately 107.3% in tax year 2010, to $16.5 B. FY 2011 taxes on those capital gains realizations totaled approximately $991 M, an increase of approximately $418 M, or 73%, from FY 2010 (taxes on tax year 2010 capital gains realizations were paid mostly in FY 2011).

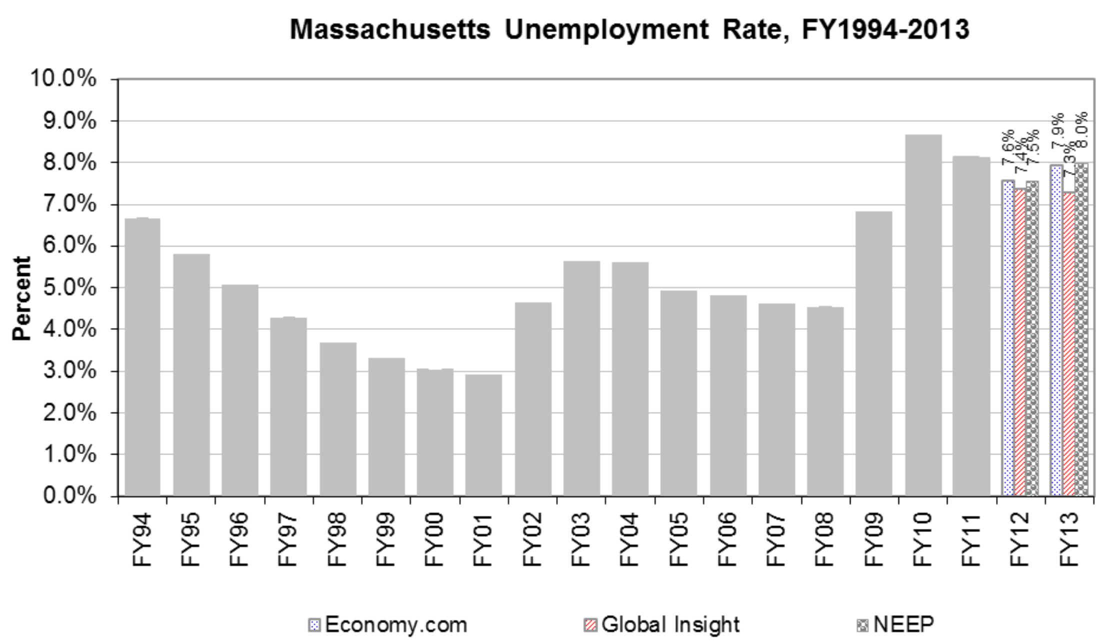
- The stock market, as measured by the average of the S&P 500 over the entire year, rose by 11.4% in calendar year 2011 (which largely determines FY 2012 capital gains taxes), and is expected to increase by -2.1% to 5.8% in calendar year 2012 (which largely determines FY 2013 capital gains taxes). Massachusetts capital gains realizations are projected to be about the same in calendar year 2011 compared to calendar year 2010, and increase by 6.8% in calendar year 2012.

The charts below show the national and state economic forecasts presented at the December 12, 2011 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 FY 2012 and FY 2013 consensus revenue estimates.


Real U.S. GDP Growth, FY1994-2013
Percent Chnage Year Ago
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
-1.0%
-2.0%
-3.0%
-4.0%
FY94
FY95
FY96
FY97
FY98
FY99
FY00
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09
FY10
FY11
FY12
FY13
2.0%
1.7%
3.1%
1.8%
Economy.com
Global Insight


Massachusetts Real GDP Growth, FY1994-2013
Percentage Change Year Ago
8.0%
6.0%
4.0%
2.0%
0.0%
-2.0%
-4.0%
FY94
FY95
FY96
FY97
FY98
FY99
FY00
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09
FY10
FY11
FY12
FY13
3.1%
2.4%
3.6%
2.1%
Economy.com
Global Insight
NEEP


Massachusetts Employment Growth, FY1994-2013
Percent Change Year Ago
3.0%
2.0%
1.0%
0.0%
-1.0%
-2.0%
-3.0%
1.4%
1.3%
0.6%
0.6%
0.9%
0.2%
FY94
FY95
FY96
FY97
FY98
FY99
FY00
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09
FY10
FY11
FY12
FY13
Economy.com
Global Insight
NEEP


Massachusetts Unemployment Rate, FY1994-2013
Percent
10.0%
9.0%
8.0%
7.0%
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
7.6%
7.4%
7.5%
7.9%
7.3%
8.0%
FY94
FY95
FY96
FY97
FY98
FY99
FY00
FY01
FY02
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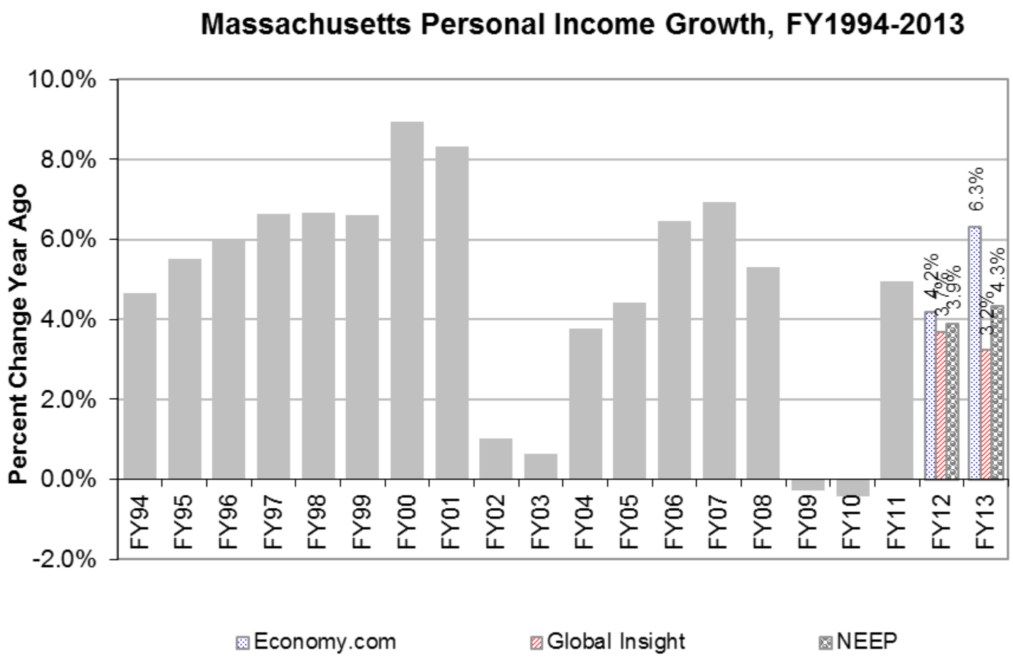
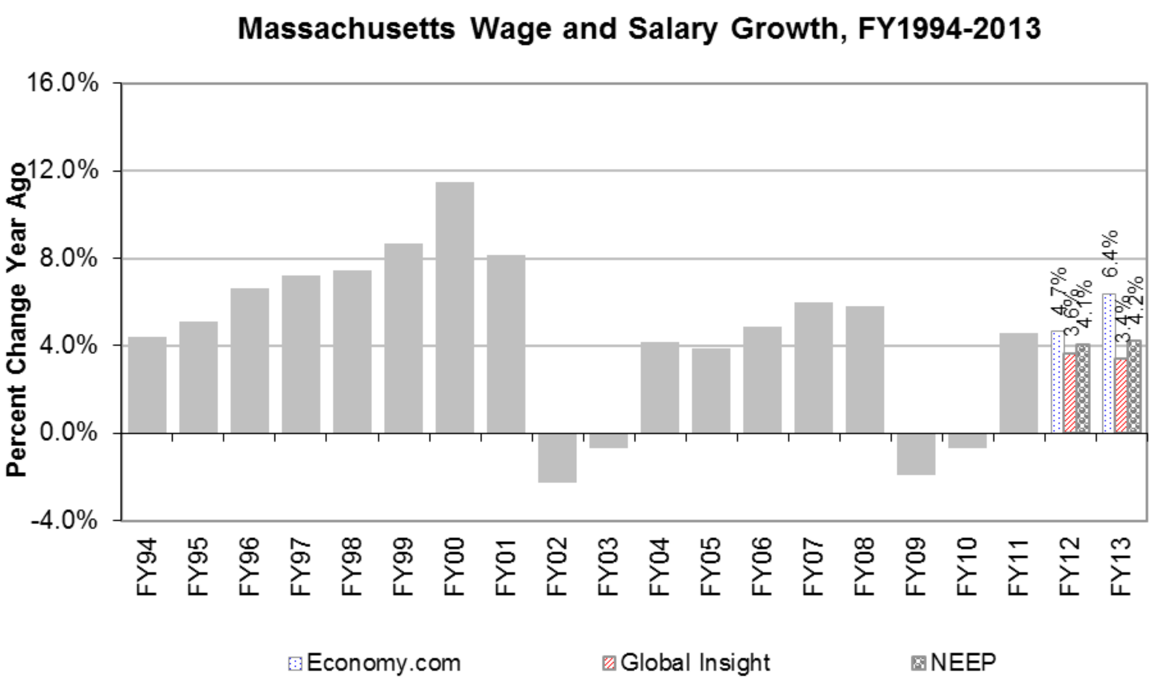
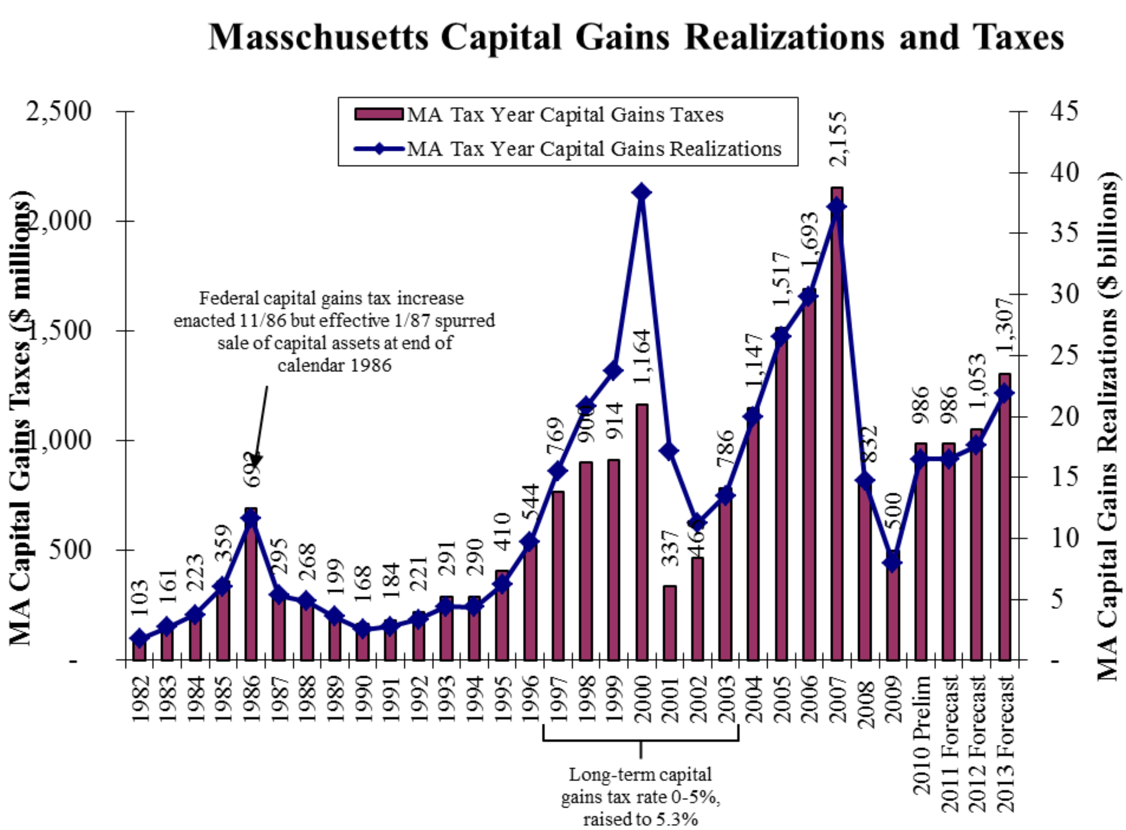
Economy.com
Global Insight
NEEP


Massachusetts Personal Income Growth, FY1994-2013
Percent Change Year Ago
10.0%
8.0%
6.0%
4.0%
2.0%
0.0%
-2.0%
FY94
FY95
FY96
FY97
FY98
FY99
FY00
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09
FY10
FY11
FY12
FY13
6.3%
4.3%
3.2%
3.9%
Economy.com
Global Insight
NEEP


Massachusetts Wage and Salary Growth, FY1994-2013
Percent Change Year Ago
16.0%
12.0%
8.0%
4.0%
0.0%
-4.0%
FY94
FY95
FY96
FY97
FY98
FY99
FY00
FY01
FY02
FY03
FY04
FY05
FY06
FY07
FY08
FY09
FY10
FY11
FY12
FY13
4.7%
3.6%
4.1%
6.4%
4.2%
Economy.com
Global Insight
NEEP



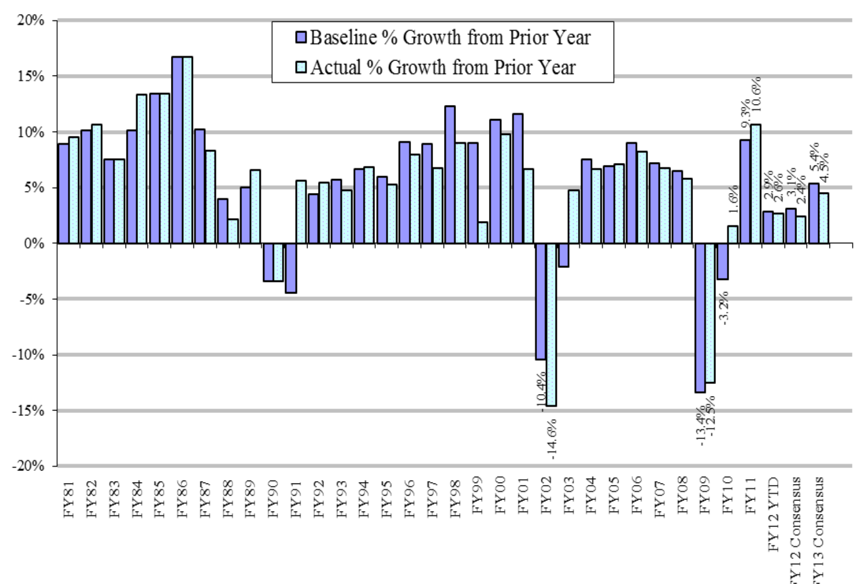
Based on these economic projections and actual tax collections through December 2011, FY 2013 tax collections are projected to grow by $940 M, or 4.5% actual and 5.4% baseline from FY 2012 tax collections, with income tax collections growing by 5.2% actual and 6.2% baseline, sales tax growing by 4.2% actual and 3.7% baseline, and corporate/business taxes growing by 2.5% actual and 6.1% baseline, as shown in the chart below.

FY13 Consensus Tax Revenue Forecast

Tax Type	% Actual Revenue Growth from FY12	% Baseline Revenue Growth from FY12	FY13 Revenue Estimate ($ Millions)	FY13 Growth from FY12 ($ Millions)
Total Income	5.2%	6.2%	12,732	629
Withholding	3.9%	4.3%	10,247	383
Sales	4.2%	3.7%	5,203	207
Corporate/Business	2.5%	6.1%	2,228	54
Other	2.8%	2.9%	1,787	49
Total	4.5%	5.4%	21,950	940
Memo: Capital Gains Taxes	10.0%	10.0%	1,100	100

The chart below shows historical trends in actual and baseline tax revenue growth. Under the FY 2011 reform, $100 M of the projected capital gains receipts (the amount in excess of $1 B) is required to be deposited into the Stabilization Fund and not available for budgetary purposes.

Actual and Baseline Tax Revenue Growth, FY1981-FY2013



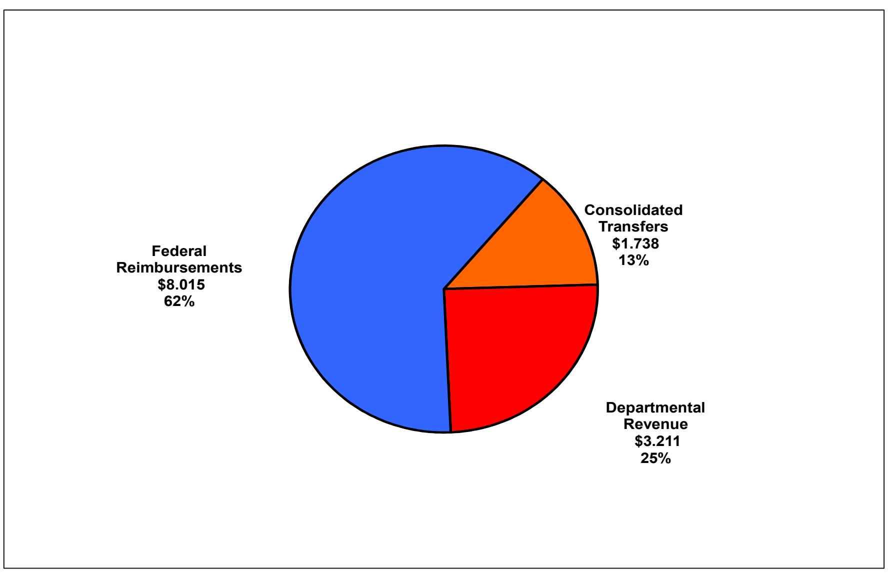
State Corporate Excise Rate
The FY 2013 budget assumes that there will be no changes to the phase down of the corporate tax rate, scheduled in law to decline from 8.25% in tax year 2011 to 8.00% in 2012. Next fiscal year, the Department of Revenue estimates this will save thousands of businesses statewide roughly $15 M from this change. These changes will help to ensure the Patrick-Murray Administration's commitment to support the state's small businesses, and to ensure they are best positioned to continue their economic recovery.

State Income Tax Rate Reduction
The FY 2013 tax projection assumed in the Governor's budget reflects the January 1st, 2012 reduction in the state's income tax rate, which decreased from 5.3% to 5.25%. The FY 2013 value of this reduction in the rate is estimated to total $110 M.

FY 2013 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 FY 2013 budget recommendation assumes approximately $12.96 B in non-tax revenues. Reimbursements from the federal government make up 62% of the Commonwealth's projected FY 2013 non-tax revenue. The remaining non-tax revenues come from departmental revenues (25%) and operating transfers from off budget funds (13%). Sections 1B and 1C of this document detail the different types of non-tax revenues.

House 2 Total Non-Tax Revenues: $12.963 B
(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 A&F work with agencies to project spending levels for these federally-supported programs and the resulting federal reimbursements those expenditures will generate. Federal revenues are projected to increase by $191 M next year, largely reflecting increased Medicaid expenditures, for which the federal government typically reimburses the state $0.50 for every dollar expended.

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. In FY 2013, total departmental revenues are projected to grow modestly ($57 M) before accounting for additional revenue proposals, largely due to increased economic activity and cyclical fee collections.

As mentioned above, the Governor's budget includes two sections that give a detailed overview of projected non-tax revenue for FY 2013. Section 1B details projected FY 2013 non-tax revenue receipts by the department, board, commission or institution that administers and collects the respective revenue source. The online version of the Governor's budget 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 Transfers

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. The Executive Office for Administration and Finance solicits agency feedback and uses historical data to project transfers to and from the budgeted funds for the proposed budget year. Section 1C of this document provides further detail behind this revenue type. In FY 2013, consolidated transfers are projected to decline by $52 M, largely due to reduced unclaimed property and projected decreases in fringe revenue collections, offset by increased lottery revenue collections.

FY 2013 Budget Recommendation

Annual Change in Budgetary Resources, FY 2012 vs. FY 2013 ($s in millions)	FY 2012	FY 2013	Change
Projected Tax Collections (excluding one-time FAS 109 Delay):	20,964.0	21,950.0	986.0
Required Transfers to/from Reserves*:	(268.1)	(238.0)	30.1
Prior Year Funds Used to Support Current Year Non-Recurring Budgetary Spending:	173.9	-	(173.9)
Transfer for Annual Pension Contribution:	(1,478.0)	(1,552.0)	(74.0)
Transfers of Tax Revenue to MBTA, SBA and Workforce Training Fund:	(1,463.0)	(1,506.2)	(43.2)
Federal Reimbursements:	7,823.6	8,014.7	191.1
Departmental Revenues:	3,108.3	3,165.2	56.8
Transfers from Non-Budgeted Sources:	1,833.4	1,781.8	(51.6)
One-Time Sources for Recurring Budgetary Costs (including certain Prior Year Funds and FAS 109 Delay):	573.0	446.0	(127.0)
Proposed New Budgetary Revenues:			
Modernize Bottle Redemption:	-	22.3	22.3
Agency Revenue Initiatives:	-	10.8	10.8
Enhanced Tax Enforcement:	-	22.3	22.3
New Tax Initiatives (not-including one-timers):	-	86.2	86.2
CHANGE IN BUDGETARY RESOURCES (INCLUSIVE OF PENSION CHANGE):			**935.9**
Additional Off-Budget Revenues Dedicated to Health Care Through the Commonwealth Care Trust Fund:	-	72.9	72.9
Additional Off-Budget One-Time Resources:	47.0	95.0	48.0
TOTAL CHANGE, FY 2012 vs FY2013			**1,056.8**

*Includes one-time tax settlements transferred in FY 2012 to Rainy Day Fund, transfer to General Fund of Rainy Day funds for Gaming Oversight Costs, annual Statutory Carry Forward, Capital Gains receipts above $1 B transferred to Rainy Day Fund and FY 2013 transfer of 10% of Master Tobacco Revenue for retiree health care contribution.

Annual Change in Budgetary Spending by Selected Area, FY 2012 vs. FY 2013
$s in millions

Spending Category	FY 2012 Estimated	FY 2013 Projected	Change
Health Care:			
MassHealth (Medicaid)*:	10,619.5	11,137.8	518.3
Commonwealth Care**:	687.4	737.1	49.7
Employee / Retiree Health Care**:	1,577.6	1,582.0	4.4
Safety Net (non Health Care):	3,895.6	3,984.3	88.7
Legal Obligations:			-
Debt Service:	2,257.0	2,435.5	178.5
Pensions:	1,478.0	1,552.0	74.0
Collective Bargaining:	-	174.6	174.6
Chapter 70:	3,990.8	4,136.4	145.6
All Other Spending:	8,346.6	8,122.7	(223.8)
TOTAL ANNUAL SPENDING CHANGES	**32,852.5**	**33,862.5**	**1,009.9**
TOTAL ANNUAL SPENDING CHANGES (EXCLUDING PENSIONS)	**31,374.5**	**32,310.5**	**935.9**

FY 2013 Spending Growth

The Governor's FY 2013 budget is balanced and fiscally responsible, which reflects the fact that state spending must align with the resources available. Total state FY 2013 spending is projected to be $32.310 B, a 2.98% increase from FY 2012 estimated spending. Since FY 2009, total state spending has grown by $3.018 B, an average of 2.58% over the four fiscal years. The year-on-year spending growth of $935.9 M is significantly less than it would have otherwise been without significant program reductions, position eliminations and reforms. Once again a number of efforts will be made in FY 2013 to control the largest cost drivers in the state budget, particularly health care costs. Even with these cost-saving measures, however, funding for these costs drivers will increase and many areas of state government will consequently see flat or reduced funding levels. In the aggregate, total funding for state government outside of health care, safety net and certain legally-obligated fixed costs will be reduced from FY 2012 levels.

Spending Growth, FY 2009 vs FY 2013 ($s in millions)		
	FY 2009	FY 2013
Spending	29,292	32,310
Growth (FY 09 to FY 13)		3,018
AVERAGE ANNUAL GROWTH (4 YEARS)		**2.58%**

Changes to State Revenue
As noted in the preceding section, FY 2013 tax revenues are projected to total $21.950 B, or $940 M greater than the current FY 2012 tax projection. Of the $21.950 B, approximately $1.1 B is estimated to be generated from taxes on capital gains. Under a budget reform proposed by the Governor and adopted by the Legislature in FY 2011, all capital gains receipts in excess of $1 B must be sequestered and deposited directly into the state's rainy day fund, also known as the Stabilization Fund. (Under the same reform 5% of any amount above $1B will be further transferred from Stabilization Fund to the State Retiree Benefits Trust Fund or SRBTF to fund retiree health insurance liabilities).

In addition to the transfer of $100 M in capital gains receipts in FY 2013 to the Rainy Day or Stabilization Fund, other items that impact the amount of available FY 2013 resources include:

- In FY 2012 the state is projected to make $163 M in deposits to the Stabilization Fund corresponding to one-time settlements (tax and non-tax) that are greater than $10 M;
- $5 M in one-time transfer from the Stabilization Fund to the General Fund for the start-up costs associated with the oversight activities of expanded gaming in the Commonwealth;
- $27 M transfer in FY 2013 to the State Retiree Benefits Trust Fund. FY 2013 is the first year in which a portion (10%) of the state's annual master tobacco settlement will not be deposited into the General Fund, but will instead be transferred to the SRBTF to help address the state's unfunded retiree health care liability. While the FY 2013 payment of $27.6 M is only a fraction of the state's liability, the total transfer will grow incrementally by 10 percentage points each year of the master tobacco settlement (e.g., in FY 2014 20% of the settlement will be transferred) until FY 2022 when 100% of the annual tobacco settlement is fully dedicated to meeting the state's OPEB liability; and,
- $5M increase in FY 2013 in required reserves corresponding to the annual Statutory Carry-Forward reserve that must equal ½ of 1 percent of total yearly projected tax revenues.

The net impact of these changes is that in FY 2013, the state budget will have $30 M more in estimated resources than in FY 2012.

As noted in a previous discussion, total FY 2011 spending that was authorized to continue into FY 2012 totaled $380 M, of which all but $4.1 M supports budgetary expenditures. Of this amount, A&F estimates that $174 M supported one-time expenses in FY 2012, with the remaining $202 M treated as one-time resources in FY 2012 since it supports ongoing budgetary expenses.

The state transfer to fund the annual contribution for retiree pensions increases in FY 2013 to $1.552 B from $1.478 B, or $74 M. This amount was determined in FY 2012 budget reforms that identified annual contributions over a 5-year period (FY 2012 – FY 2017). Finally, under current law, a portion of the taxes collected by the state annually are transferred to non-budgetary funds and entities, including the School Building Authority, the Workforce Training Fund and the Massachusetts Bay Transportation Authority (MBTA). For FY 2013, the growth in these transfers equals $43 M.

FY 2013 Tax Consensus Figures ($s in millions)	
Original FY12 Tax Consensus Figure:	20,615
Revised FY12 Tax Projection:	21,010
FY12 Revised vs. Original:	395
FY13 Tax Consensus Figure:	21,950
FY13 Consensus vs. FY12 Revised Estimate	**940**
Required Transfers to Other Funds*:	30
Prior Year Funding used to Support Non-Recurring Costs:	(174)
Transfer for Annual Pension Contribution:	(74)
Transfers to Non-Budgetary Funds or Entities:	(43)
TOTAL INCREASED FY 2013 TAX REVENUE	**679**
**Reflects the net change from FY 2012 to FY 2013 accounting for transfers of tax revenue to Stabilization Fund for capital gains above $1 B; transfer in FY 2012 of one-time settlements to Stabilization Fund; FY 2012 transfer to General Fund for Gaming oversight start-up costs; and, FY 2013 transfer to SRBTF of 10 percent of tobacco settlement revenue.*	

After accounting for these transfers the additional tax revenues (and related resources) available in FY 2013 total $679 M.

Non-tax revenue is projected to grow in FY 2013 by $196 M, which reflects increased federal Medicaid reimbursements and other revenues of $191 M and limited departmental revenue growth of $57 M offset by reduced transfers from non-budgetary sources of $52 M. Transfers were reduced substantially from estimated FY 2012 levels due to the reduction in unclaimed property receipts and the loss of annual fringe costs (i.e., employee benefits such as health care) recovered from federal and other non-budgetary sources.

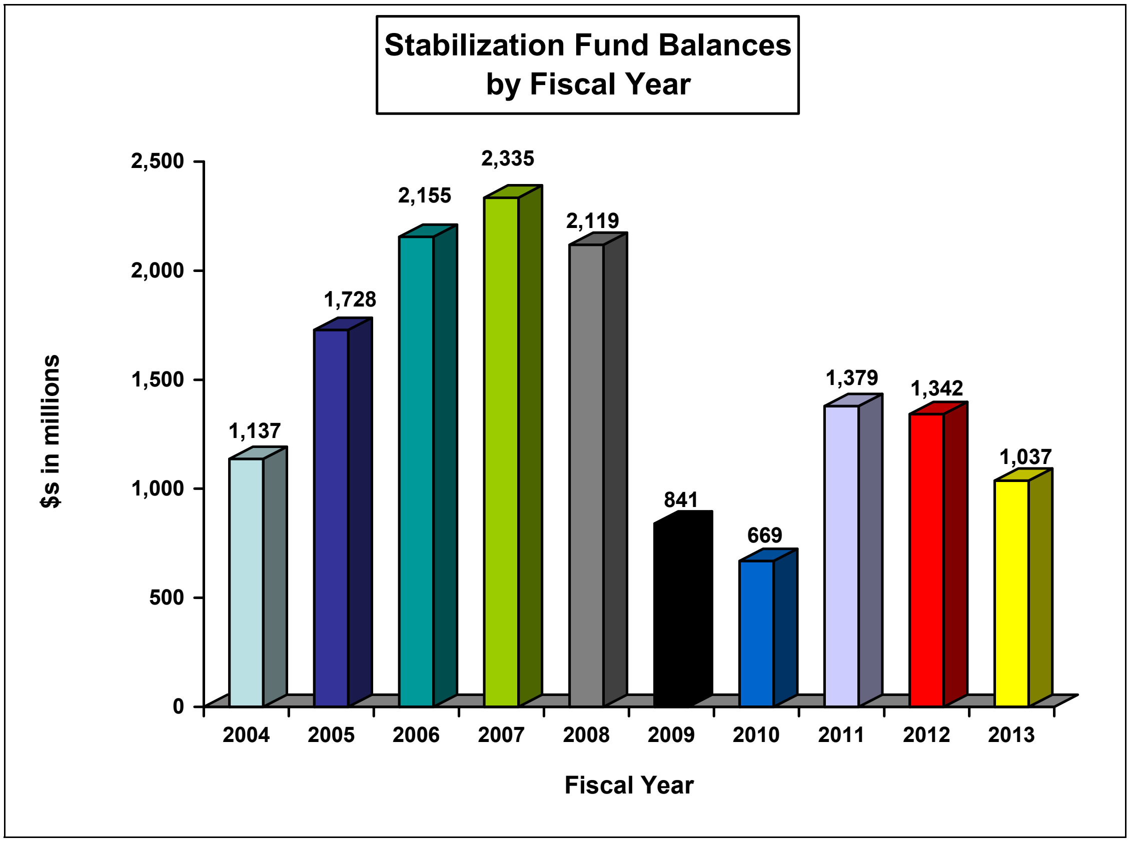
Increase (Decrease) in Non-Tax Revenue, FY 2013 ($s in millions)	
Federal Reimbursements:	191
Departmental Reimbursements:	57
Transfers from Non-Budgetary Sources:	(52)
TOTAL NET CHANGE IN NON-TAX REVENUE	**196**

As noted previously, the FY 2012 budget relies on an estimate $620 M in one-time resources. For the FY 2013 budget, total one-time sources total $541 M. Key one-time items are: $400 M in Stabilization Fund resources (a further discussion follows this section); $11 M in quasi-public contributions to support ongoing programs that would otherwise be funded on the state operating budget; $46 M for continuing the delay of the FAS 109 corporate tax deduction that would otherwise become effective during tax year 2013; and $84 M in one-time non-budgetary fund resources from the Group Insurance Commission and the Commonwealth Health Connector Authority. At $541 M, total FY 2013 one-time sources are $79 M less than the FY 2012 budget. Of the $541 M in one-time sources, $446 M represent budgetary resources, while the remaining correspond to non-budgetary resources that are used to help offset expenditures that occur outside of the annual state operating budget. When compared to FY 2012, which relied on $573 M in budgetary one-time resources, the annual change in FY 2013 in one-time revenues is a reduction of $127 M.

FY 2013 One-Time Resources $s in millions	
Budgetary Resources:	
Stabilization Fund Resources:	400
Delay FAS 109 Deduction:	46
Non-Budgetary Resources:	
Group Insurance Commission Trust Funds:	40
Commonwealth Connector Trust Surplus:	44
Quasi Public Contributions:	11
TOTAL ONE TIME RESOURCES	**541**

The following is a description of the proposed one-time resources to support the FY 2013 budget:

1. Stabilization Fund – The Fund serves as a critical tool in helping the state manage periods during which annual tax receipts have fallen or under-perform with respect to long-term forecasted trends. It is also reasonable and appropriate to use a limited amount of reserves for the preservation of state services when the state is experiencing cyclical tax revenue shortfalls during a recession or while the state economy is growing its way back to recovery. The projected FY 2012 year-end closing balance is $1.342 B. After accounting for the $100 M deposit for taxes on capital gains in excess of $1 B ($5 M of which will be further transferred to the OPEB reduction trust), and assuming a $400 M draw in FY 2013, the total projected closing balance at the end of FY 2013 is $1.037 B. With this amount, it is expected that Massachusetts will still have one of the largest rainy-day funds in the country. (Please see the sections entitled, Specific and General Financial Policies and Long-Term Forecasting, for a more complete description of A&F's policies regarding the use of one-time resources to support the budget and withdrawals and deposits to the Stabilization Fund.)



2. Quasi-Public Contributions – Over the past several years the state has benefited from the commitment by several different quasi-public agencies to preserve state programs that would otherwise have been cut from the operating budget. In FY 2013, the state budget will rely on $11 M in quasi-public contributions, as outlined in the chart below.

FY 2013 Quasi-Public Contributions		
Program or Services Preserved	**Quasi-Public Agency**	**H2**
Energy and Environmental Affairs	Massachusetts Clean Energy Center	$ 1,000,000
Mass Cultural Council Grants	Massachusetts Development Finance Authority	$ 3,000,000
Economic and Business Development	Massachusetts Development Finance Authority	$ 1,000,000
Tourism Promotion and Marketing	Massachusetts Convention Center Authority	$ 5,000,000
Mass Broadband and Economic Development	Mass Tech Collaborative	$ 500,000
International Trade and Investment Promotion	Mass Tech Collaborative / Mass Port Authority	$ 600,000
TOTAL QUASI-PUBLIC CONTRIBUTIONS		**$11,100,000**

3. Delay FAS 109 Deduction - The Governor's FY 2013 budget recommendation delays the implementation of FAS 109 until FY 2014, rather than allowing it to begin. This will increase the amount of taxes collected by the state next year by nearly $46 M. As noted, savings generated from the delay in the implementation of the FAS 109 corporate tax rate deduction would be one-time in nature, since they are only proposed to be delayed until FY 2014. (A further discussion of this item continues in a following section that discusses new revenue proposals for FY 2013).

4. Health Care Trust Fund Resources – The FY 2013 budget assumes that health care expenditures by the Group Insurance Commission (GIC) and the Commonwealth Connector Authority (CCA) can be partially offset by using non-recurring trust funds available to each agency. These funds can be appropriately made available in FY 2013 and one-time savings will

occur by lowering the state's annual budgetary contribution to each agency's health care programs for just FY 2013.

Based on the changes in tax and related revenues, growth in non-tax sources and the impact of the change in budgetary one-time resources, A&F projects that a total of $794 M in additional resources in FY 2013 from FY 2012 projections.

Increase (Decrease) in Available Resources, FY 2013 ($s in million)	
Net Increase in FY 2013 Tax Revenues*:	725
Growth in Non-Tax Sources:	196
Change in Budgetary One-Time Sources*:	(127)
TOTAL CHANGE IN AVAILABLE BUDGETARY RESOURCES:	794
Increased Tax Revenues are increased by $46 M which corresponds to the delay of the FAS 109 corporate rate deduction in FY 2013. For the purpose of comparison this adjustment is reflected in the change in budgetary one-time sources.	

Proposed New Revenue Initiatives

The Governor's FY 2013 budget proposes a responsible and modest level of additional resources, totaling an additional $260 M. The chart below identifies these by major category (please note that $46 M in one-time tax revenue corresponding to the FAS 109 deduction has already been accounted for previously). The four major categories of new revenue proposals include: modernizing the state's bottle-redemption law ($22 M); agency revenue initiatives ($11 M); enhanced tax enforcement by the Department of Revenue ($22 M); and new tax initiatives ($159 M, excluding $46 M for the delay of the FAS 109 corporate rate reduction).

New Revenue Proposals, FY 2013 ($s in millions)	
Modernize Bottle Redemption:	22
Agency Revenue Initiatives:	11
Enhanced Tax Enforcement:	22
New Tax Initiatives (excluding one-time delay of FAS 109 corporate rate deduction):	86
TOTAL NEW BUDGETARY REVENUES	**142**
Additional Off-Budget Revenues Dedicated to Health Care Through the Commonwealth Care Trust Fund:	73
Delay FAS 109 (counted as one-time source)	46
TOTAL ALL NEW REVENUES	**260**

Modernizing Bottle Redemption

The Massachusetts Bottle Bill, enacted in 1982, is designed to encourage consumers to return their empty soda and beer containers by means of a redeemable $0.05 deposit. The $0.05 refundable deposit is placed on all carbonated sodas, beer and malt beverages. Most bottle deposits are redeemed through two types of sites, redemption centers and large retail stores. 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 changed with bottled water, fruit drinks, iced tea and sports drinks now being some of the most popular choices available. However, these non-carbonated beverages are not covered by the Bottle Bill and often end up in landfills or along the side of the road.

By revising the definition of “beverages” in Massachusetts General Law, the Bottle Bill can be brought up to date. Consumers will be required to pay an additional $0.05 cents on water, flavored waters, iced teas, coffee based drinks and sports drinks. The amounts paid for deposits for expanded beverages will be returned to consumers if they return the empty bottles for recycling. The Governor’s FY 2013 budget assumes that by adopting these changes, the state will collect at least $22 M in additional revenues next year, allowing for $5 M in investments in state recycling coordination and redemption efforts.

Agency Revenue Initiatives

In FY 2013 agencies will generate a modest amount of new revenue through efforts to generate at least $5 M in fees by allowing limited types of advertising using state-owned assets, such as vehicles. This effort will build off of similar projects already underway at the Department of Transportation by looking to broaden the opportunity across all areas of state government. In addition, agencies will generate close to $6 M in expanded state revenues by increasing a limited number of fees, including:

- Environmental Protection - Department of Environmental Protection (DEP) permitting and compliance activities ensure that private and public sector development meet Commonwealth environmental standards. The fees that DEP collects for these services have not been raised since 2004. This proposal raises fees by $2.5 M in accordance with the Consumer Price Index from 2004-2011 (17%). All of the new revenue would be retained by DEP to support permitting and compliance activities.
- Adult Day Health - The Adult Day Health Center Program is a new Department of Public Health (DPH) program. The licensing program will involve a series of activities, including regulation writing, license waiver reviews, application processing, provider suitability determination, on-site licensing inspection, provider and consumer information services, incident review and processing, complaint investigations, plan review and enforcement action which may include fines, penalties, and program closure action. Statewide, the total revenue generated from the new fee to cover the cost of this new regulatory responsibility is approximately $750 K.
- Hospital Fees - DPH is required to license health care facilities operating in Massachusetts. A licensing fee is recovered to offset the state's associated costs. Over $1 M will be generated from establishing a new fee charged for satellite locations or license amendments. The fee will be paid by approximately 433 nursing homes, 118 hospitals with 297 satellites and 323 clinics with 330 satellites.
- Other Agency Fees – For a limited number of items, fees at the Division of Standards (DOS) will be increased, including for licenses paid by private gas stations that sell retail motor oil; licenses required of private auctioneers and licenses paid by “peddlers and hawkers”. Fees have not been increased for these licenses since 2003 and are anticipated to generate over $500 K in additional revenues.

Enhanced Tax Enforcement

The Department of Revenue (DOR) will generate an additional $22.3 M ($18.3 M after accounting for investments and offsetting investments) in state tax revenue in FY 2013. The revenue would be generated from DOR’s investment in IT software that will perform advanced analytics to identify tax collection and audit opportunities involving the sophisticated use of historical data, data mining and statistical probability.

New Tax Revenues

The table identifies new tax revenue initiatives that are proposed for the FY 2013 budget. In total, these initiatives will generate an estimated $205 M in additional resources for the Commonwealth next year. All but one of the proposals will require legislative changes to the state’s existing tax laws to implement. This language is provided in an outside section of the FY 2013 budget recommendation.

FY 2013 Tax Initiatives in Governor's Budget Recommendation			
Tax Revenue Initiatives	**FY 2013 Additional Revenue**	**Transfers to Non-Budget Sourcnces**	**FY 2013 After Transfer Revenue**
Increase Cigarette Tax by $0.50*	62,500,000	(62,500,000)	-
Eliminate Sales Tax Exemption on Sales of Candy and Soda**	61,500,000	(9,840,000)	51,660,000
Delay FAS 109 Deductions	45,860,105	-	45,860,105
Update Tobacco Taxes for Other Tobacco Products*	10,400,000	(10,400,000)	-
Market Sourcing for Corporate Excise Sales Factor	10,000,000	-	10,000,000
Enforce Room Occupancy Tax on Hotel Room Resellers	7,213,281	-	7,213,281
Taxation of Non-Insurance Subsidiaries of Insurance Companies	7,000,000	-	7,000,000
Disallow Tax Deductions for Losing Lottery Tickets	500,000	-	500,000
TOTAL TAX INITIATIVES	**204,973,386**	**(82,740,000)**	**122,233,386**
TOTAL TAXES (Excluding FAS 109 Delay)	159,113,281	(82,740,000)	76,373,281
*Additional revenues are transferred directly to the Commonwealth Care Trust Fund.			
**A portion of sales tax revenues are transferred to non-budgetary entities (e.g., School Building Authority).			

1. Increase Cigarette Tax Per Pack by $0.50 – $62.5 M in FY 2013 revenue will be generated by increasing the sales tax on a pack of cigarettes by $0.50 from $2.51 to $3.01. All of these new revenues will be dedicated to the Commonwealth Care Trust Fund, from which the state pays the annual costs of subsidized health care costs to families and individuals under Massachusetts' 2006 health care reform.

2. Eliminate Sales Tax Exemption on Sales of Candy and Soda – $61.5 M in new revenues would be generated by eliminating the current exemption from the sales tax for the sale of candy and soda. These revenues, which will be $51.5 M after accounting for transfers of a portion of the new revenue to off-budget items in accordance with certain statutory requirements, will be dedicated to a new Health and Prevention Trust Fund. Programs and services supported from this fund will consist of those aimed at targeting major health risks in the Commonwealth (e.g., smoking and obesity) through preventative health measures and increasing awareness of risk factors.

3. FAS 109 Deduction - The FAS 109 corporate rate deduction allows publicly traded corporations subject to combined reporting under the 2008 corporate tax reform law to take a deduction of all or some of an amount that will offset the increase in the combined group's net deferred tax liability that would otherwise be shown on its financial statements, as a result of the move to combined reporting. "FAS 109" refers to the financial accounting standards bulletin that requires such corporations to report their deferred tax liabilities (or expected benefits, like credits) to shareholders. **Please Note:** For the purposes of calculating the available resources for FY 2013 (in comparison to FY 2012), the FAS 109 delay is treated as an FY 2013 one-time resource included in the total $541 M of one-time budgetary resources assumed next year.

4. Update Tobacco Taxes for Other Tobacco Products – By updating the state tobacco taxes to apply the proposed rate of taxation on cigarettes to all forms of tobacco, including cigars and "smokeless" products, the state will generated an estimated $10.4 M in additional revenue in FY 2013. All of this new revenue will be dedicated to the Commonwealth Care Trust Fund.

5. Market Sourcing for Corporate Excise Sales Factor – This proposal will modernize the sales factor (one of 3 factors by which the Massachusetts corporate excise is apportioned among states) by sourcing it based on where services are delivered, rather than where they originate, by calculating corporate taxes in a way that more fairly allocates profits of primarily out-of-state companies selling services to Massachusetts customers.

6. Enforce Room Occupancy Tax on Hotel Room Resellers – The proposed change would require an Internet room reseller to register with DOR and collect and remit the existing state and local room occupancy excise on the reseller's mark-up. The hotels and motels in Massachusetts would continue to collect and remit tax on amounts they are actually paid, as is the current

practice. The revenue impact from this proposal in FY 2013 is $7 M with an August 1, 2012 effective date. Cities and towns that have adopted a local option hotel/motel tax would also realize up to $7 M statewide in additional revenue. This change is primarily technical, serving to clarify present law for collecting an existing tax from resellers, as well as hotels.

7. Taxation of Non-Insurance Subsidiaries of Insurance Companies – Insurance companies do not pay tax on their income. Instead, there is a 2% tax on premiums charged. The proliferation of Limited Liability Companies (LLCs) and other pass-through entities have enabled insurance companies to exempt non-insurance businesses that they own from paying any corporate excise tax. For example, if an insurance company owns a subsidiary business operating a brokerage or a hotel, the income of the brokerage or hotel subsidiaries is exempted from the corporate tax if the subsidiary's operations are organized in an LLC, whose income flows through to the insurance company parent for tax purposes. The proposal would subject operating income from non-insurance subsidiaries of insurance companies to the corporate tax as if these subsidiary entities were business corporations. This proposal has been made by the Governor previously (in the 2007 corporate-tax-loophole closing bill) and has been the subject of study by the Multistate Tax Commission.

8. Disallow Tax Deductions for Losing Lottery Tickets – In Massachusetts, there is a cottage industry of so-called "ten percenters" who buy winning lottery tickets at a discount, receive the payout of the winnings and offset that income with losing lottery tickets gathered from multiple locations. This scheme enables the actual ticket winners to avoid intercepts of unpaid tax or child support that would otherwise be withheld by the lottery. It is a form of tax and child support fraud that is difficult to prove in any individual case, and that needs a statutory fix. The proposal specifies that losing lottery tickets cannot be claimed as trade or business expenses.

After accounting for additional tax, non-tax and other one-time sources, the total amount of additional budgetary resources in FY 2013 above FY 2012 levels is $935 M.

FY 2013 Spending Summary

Spending Growth

As noted earlier, year-on-year spending growth must be restrained to fit within available budgetary resources. The Commonwealth's tax revenues are growing, but only modestly, after having experienced an historic drop in tax revenues during the recession. With many of our safety net and health care programs facing all-time highs in demand, the cost to continue our current level of services outpaces our budgetary resources. In addition, the state is legally required to fund certain fixed costs which are increasing next fiscal year, such as pensions, collective bargaining, debt service and K-12 school aid to cities and towns. Consequently, we are unable to support all but a few modest investments and service restorations, and further cuts and cost-controlling measures to many programs and services will be necessary in FY 2013.

FY 2013 Spending

After accounting for growth in tax collections and other non-tax resources, additional revenue initiatives and the change in of one-time sources, total state expenditure growth is limited to $935 M. This need to limit spending growth is particularly challenging due to the cost pressures in our health care and safety net programs and certain fixed costs as described above.

State Budgetary Spending by Governmental Area, FY 2012 and FY 2013					
	FY 2012		FY 2013	FY 2013 Projected vs FY 2012 Spending	
Government Area	GAA Final Enacted Amount	Total Estimated Spending This Year	Total Budgeted Spending Next Year	$ Change	% Change
Labor and Workforce Development	35,589,881	59,418,415	42,815,789	(16,602,626)	-27.94%
Housing and Economic Development	352,509,764	392,096,351	428,367,718	36,271,367	9.25%
Administration and Finance	313,704,101	460,558,926	453,023,331	(7,535,595)	-1.64%
Sheriffs	476,350,497	501,641,668	501,585,381	(56,287)	-0.01%
District Attorneys	97,884,987	98,704,598	97,884,989	(819,609)	-0.83%
Constitutional Officers and Other Independent Agencies	297,709,147	312,442,300	312,392,020	(50,280)	-0.02%
Judiciary	709,223,115	760,717,483	630,963,761	(129,753,722)	-17.06%
Education (except Higher Ed. And Chapter 70)	1,011,404,307	1,023,450,889	1,032,233,299	8,782,410	0.86%
Transportation	362,933,728	363,934,869	348,214,221	(15,720,648)	-4.32%
Debt Service	2,265,308,442	2,257,042,623	2,435,503,391	178,460,768	7.91%
Higher Education	923,962,337	924,462,336	935,732,595	11,270,259	1.22%
Chapter 70	3,990,812,680	3,990,812,680	4,136,391,547	145,578,867	3.65%
Unrestricted Local Government Aid	833,980,293	898,980,293	833,980,293	(65,000,000)	-7.23%
Public Safety	913,090,725	954,113,334	1,069,693,880	115,580,546	12.11%
Energy and Environmental Affairs	187,007,717	194,062,786	206,918,316	12,855,530	6.62%
Health and Human Services	4,713,394,065	4,824,649,768	4,908,566,138	83,916,370	1.74%
MassHealth	10,367,467,834	10,619,492,582	11,137,768,822	518,276,240	4.88%
Transfers to Non-Budgetary Sources	1,122,536,822	1,081,917,074	1,132,647,286	50,730,212	4.69%
Group Insurance	1,623,053,506	1,656,042,754	1,665,775,952	9,733,198	0.59%
TOTAL SPENDING	**30,597,923,948**	**31,374,541,729**	**32,310,458,729**	**935,917,000**	**2.98%**

Reflecting government re-organizations outlined further below, there is a substantial increase in the Public Safety budget and a large decrease in the Judiciary budget. This increase corresponds to funding shifted from the Judicial branch to reflect reforms of the state's Probation Department. After adjusting for this shift and savings adopted in FY 2013 for probation, the actual year on year spending changes are the following:

- Public Safety, 1% Increase
- Judiciary, 0% Increase

Non-Executive Branch Agencies

Non-Executive Branch Spending by Governmental Area, FY 2012 and FY 2013					
	FY 2012		FY 2013	FY 2013 Projected vs FY 2012 Spending	
Government Area	GAA Final Enacted Amount	Total Estimated Spending This Year	Total Budgeted Spending Next Year	$ Change	% Change
Sheriffs	476,350,497	501,641,668	501,585,381	(56,287)	-0.01%
District Attorneys	97,884,987	98,704,598	97,884,989	(819,609)	-0.83%
Constitutional Officers and Other Independent Agencies	297,709,147	312,442,300	312,392,020	(50,280)	-0.02%
Judiciary	709,223,115	760,717,483	630,963,761	(129,753,722)	-17.06%
TOTAL SPENDING	**1,581,167,746**	**1,673,506,049**	**1,542,826,151**	**(130,679,898)**	**-7.81%**

Agencies outside of the Executive branch including Constitutional Officers, the Judiciary, District Attorneys and Sheriffs, among others comprise $1.543 B of the FY 2013 budget recommendations. Some areas of note include –

- ***Judiciary*** –The Governor's FY 2013 budget reflects his proposed legislation to consolidate the Department of Probation within the Executive Office of Public Safety and Security. The funding amount being transferred is $101.6 M, which reflects that probation responsibilities for youths will remain within the state's Trial Court Department. In combination with $19.6 M in fiscal year savings in indigent counsel services (see below), the overall budget for the Judiciary is 17 % below the FY 2012 estimated spending. In fact, the Governor's budget will level-fund all other Judicial agencies to FY 2012 estimated spending levels, while providing salary reserves of $27 M under the Executive Office for Administration and Finance (A&F) to offset increased costs in FY2013 associated with existing or anticipated collective bargaining agreements.

The FY 2013 budget will also continue efforts to reform the Committee for Public Counsel Services (CPCS) within the Judiciary's budget by proposing to shift more cases from private counsel to state public defenders. Current A&F projections assume total FY 2013 CPCS spending will be $165 M. By shifting 50 % of the caseload to public defenders by the end of FY 2013 the state will save $19.6 M next year, and a savings of $33 M from pre-reform levels in FY 2011. Total caseload at CPCS has declined in FY 2012 and the Governor's budget assumes further reductions by improving the way in which client indigency is verified in collaboration with other state agencies as well as continued projected reductions in CPCS caseload in FY 2013.

- ***Sheriffs*** – The Governor's FY 2013 budget proposal level-funds the operations of state sheriffs at FY 2012 estimated spending levels. Additionally, increased costs corresponding to existing or pending collective bargaining agreements is funded under A&F to mitigate a portion of the increased costs next year in sheriffs' facility budgets.

- ***District Attorneys*** – Funding for District Attorneys is level-funded to FY 2012 General Appropriations Act (GAA) levels. This funding level sustains the 5% increase received by the DAs in FY 2012 that was originally proposed by the Governor for FY 2012 in January 2011. This funding includes the additional $500K that was provided in FY 2012 for retention of assistant district attorneys across the state.

- ***Other Constitutional Officers*** – With very limited exceptions, the funding for the Constitutional offices (Attorney General, Treasurer, Auditor, Secretary of State) has been level-funded at FY 2012 levels. Increased funding is provided to meet the projected expenses of the Secretary of State projected to oversee the 2012 elections, including local, state and national presidential elections. In addition, the Governor's budget makes modest investments at the State Attorney General's Office and the State Auditor's Office for expanded activities to prevent, detect or prosecute cases of fraud, waste and abuse of state funds. These investments of roughly $2.3 M will generate at least $11 M in additional revenue from recoveries in FY 2013.

- ***Lottery*** – The state's Lottery Commission oversees the state's various lottery and gaming operations. The Commission generates over $900 M in annual revenue, of which a large portion is used to support unrestricted local aid distributions to the state's cities and towns. Funding in fiscal year 2013 for Lottery operations is level-funded to FY 2012 levels. However, the Governor does propose a $3 M investment to fund the Lottery Commission's effort to expand lottery advertising and marketing, resulting in an additional $7 M in FY 2013 lottery revenues for the state. The Governor's budget also provides a reserve under A&F to fund increased costs associated with Lottery collective bargaining unit members in FY 2013.

- ***Governor*** – Funding for the Governor's office is level-funded to FY 2012 estimated spending levels.

- ***Legislature*** – The funding for the annual operations of the House, Senate and Joint Legislative activities in FY 2013 is level to estimated spending levels in FY 2013, after accounting for one-time investments in legislative redistricting needed in FY 2012.

Debt Service

State Debt Service Spending, FY 2012 and FY 2013

	FY 2012		FY 2013	FY 2013 Projected vs FY 2012 Spending	
Government Area	**GAA Final Enacted Amount**	**Total Estimated Spending This Year**	**Total Projected Spending Next Year**	**$ Change**	**% Change**
Debt Service	2,265,308,442	2,257,042,623	2,435,503,391	178,460,768	7.91%
TOTAL SPENDING	**2,265,308,442**	**2,257,042,623**	**2,435,503,391**	**178,460,768**	**7.91%**

In order to fund the necessary improvements to the state's transportation infrastructure as well as to make investments in our higher education system, housing, high-tech industries, and other job-creating projects, the state borrows money through the issuance of bonds and it and pays the borrowing back with annual debt service appropriations in the operating budget.

State debt service spending in FY 2013 totals $2.435 B, an increase of 7.91% from FY 2012 levels of $2.257 B. This increase compares to the 7.1 % increase adopted in the FY 2012 GAA. Most debt service costs are funded from within the budget of the State Treasurer, who is responsible for the day-to-day oversight of all Commonwealth debt service and debt financing activities. In a limited number of cases, annual debt service payments are paid by A&F.

Executive Branch Agencies

Executive Branch Agency Spending by Governmental Area, FY 2012 and FY 2013

	FY 2012		FY 2013	FY 2013 Projected vs FY	
Government Area	GAA Final Enacted Amount	Total Estimated Spending This Year	Total Projected Spending Next Year	$ Change	% Change
Labor and Workforce Development	35,589,881	59,418,415	42,815,789	(16,602,626)	-27.94%
Housing and Economic Development	352,509,764	392,096,351	428,367,718	36,271,367	9.25%
Administration and Finance	313,704,101	460,558,926	453,023,331	(7,535,595)	-1.64%
Education	1,011,404,307	1,023,450,889	1,032,233,299	8,782,410	0.86%
Transportation	362,933,728	363,934,869	348,214,221	(15,720,648)	-4.32%
Chapter 70	3,990,812,680	3,990,812,680	4,136,391,547	145,578,867	3.65%
Public Safety	913,090,725	954,113,334	1,069,693,880	115,580,546	12.11%
Energy and Environmental Affairs	187,007,717	194,062,786	206,918,316	12,855,530	6.62%
Health and Human Services	4,713,394,065	4,824,649,768	4,908,566,138	83,916,370	1.74%
MassHealth	10,367,467,834	10,619,492,582	11,137,768,822	518,276,240	4.88%
Transfers to Non-Budgetary Sources	1,122,536,822	1,081,917,074	1,132,647,286	50,730,212	4.69%
Group Insurance	1,623,053,506	1,656,042,754	1,665,775,952	9,733,198	0.59%
TOTAL SPENDING	**24,993,505,130**	**25,620,550,428**	**26,562,416,299**	**941,865,871**	**3.68%**

Funding for Executive Branch Agencies for programs and services that fall within each of these government areas totals $26.562 B in FY 2013, which represents an increase of 3.68% from FY 2012 spending. However, after accounting for funding shifted in FY 2013 to the Executive Office for Public Safety and Security from the Judiciary and collective bargaining reserves under A&F for Non-Executive Branch agencies, the total annual growth in FY 2013 is 3.28%. Highlights of major funding changes in the Executive Branch include:

- ***Executive Office of Education (EOE)*** – The budget recommendation for the Secretariat for Education (excluding Chapter 70 and aid to Higher Education campuses discussed below) increases by 0.86%, or $8.7 M above FY 2012 estimated spending.

  The FY 2013 budget level funds or increases almost all education programs, particularly those that will support the Governor's efforts to address the achievement gap among the state's residents with respect to academic achievement and career readiness. These increases in funding include $10 M in funding for programs focused on children in Gateway Cities and $12 M in additional funding to other programs identified to close the achievement gap. The Secretariat for Education will continue to target funding to those programs and services that best position the state to leverage $250 M in federal Race to the Top education aid, provided over a four-year period, to find innovative solutions to improving the state's education systems. The Governor's budget continues to support child care access to quality after school and day care programs for children within the Department of Children and Families, the Department of Transitional Assistance, and other qualified low income eligible families. Funding for early education and care remains a vital component to addressing the achievement gap and, this budget reflects the commitment through level funding the Reach Out and Read, Head Start Grants and Universal Pre-Kindergarten programs.

- ***Executive Office of Health and Human Services (EOHHS)*** – The non-health insurance portion of the EOHHS budget totals $4.9 B in FY 2013. Funding under EOHHS supports a wide range of services, including transitional assistance to families, services to persons with disabilities, care for veterans, public health and disease prevention activities, protection of children at risk of abuse or neglect and the care for youthful offenders. Recognizing the importance of maintaining critical safety net programs and services, the Governor preserved to the greatest extent possible funding within EOHHS for programs and services that affect the state's most vulnerable residents. Key programs for which funding is level in FY 2013 or increased include substance abuse services, cash and nutritional assistance for low income families, early health screenings for children, suicide prevention services and domestic violence prevention treatment. In addition, the Governor proposes to make a $1.7 M investment in smoking prevention and cessation services and increases funding for services and benefits provided to veterans living in Massachusetts. The Governor's budget also provides $10 M in funding for Safe and Successful Youth Initiative grants, which provide assistance to 11 cities for targeted intervention programs with high impact youth and their families providing education, job, trauma and street outreach program services. A $2.9 M investment is proposed for a Children, Youth and Families initiative that enhances data-sharing and coordination of services between EOHHS and other relevant agencies and Secretariats, such as EOE. Finally, the Governor's budget funds the FY 2013 cost increases associated with the Chapter 257 reforms that require updates to human services contracts with respect to the actual costs of providing services under a variety of programs. Across all EOHHS agencies, the FY 2013 additional costs of implementing Chapter 257 totals $32 M.

- ***Executive Office of Public Safety and Security (EOPSS)*** –The Governor's FY 2013 budget achieves targeted savings at the new Department of Re-entry and Community Supervision and the Department of Correction (DOC) through criminal justice reforms and health care savings. The consolidation of large portions of the Office of the Commissioner of Probation into a new department under EOPSS will provide more efficient and effective transition to the community for appropriate offenders with strong monitoring, accountability and support. The budget also invests in re-entry programs to better transition offenders back into the community. At DOC, the Commonwealth will realize the operating cost savings of sentencing reform by closing a medium security facility and stepping down appropriate offenders into less secure facilities. DOC will achieve health care savings through re-negotiation efforts with the inmate health care contractors and maximizing federal reimbursement opportunities. The State Police will train 150 new officers in a cadet class to begin in June 2013, and the State Police Crime Lab will take over the duties of the Department of Public Health Drug Lab, which will reduce the case backlog and accredit the lab to provide more opportunities for federal funding.

- ***Massachusetts Department of Transportation (MassDOT)*** – FY 2013 funding for MassDOT and related transportation purposes is reduced by $15 M from FY 2012 funding levels. The funding provided to MassDOT ($348 M in FY 2013) only represents a portion of the state's annual transportation costs, which are also supported by state capital funds, federal grants for highway maintenance and revenues generated from the Massachusetts Turnpike that are restricted for dedicated purposes. To mitigate this reduction in state funding, MassDOT will need to increase revenues, and has plans underway to best utilize state assets to generate annual operating revenues from non-state parties interested in advertising and other business opportunities using state properties. The agency will continue to leverage its new structure to seek efficiencies and savings in areas such as procurement and personnel spending. If MassDOT is not successful in generating additional revenues, it will likely need to eliminate a number of positions and potentially reduce operations across its various functions, including highway maintenance and motor vehicle registry services.

- ***Executive Office of Energy and Environmental Affairs (EOEEA)*** – FY 2013 funding for EOEEA is approximately 6.6 % above FY 2012 estimated spending. This reflects a $5.25 M investment for increased efforts to promote recycling coordination across the state, which is funded through increased revenues generated by expanding the bottle deposits to include bottled water, juices and sports drinks. With the support of industry stakeholders, a $2.5 M investment in permitting and compliance services at the Department of Environmental Protection was made to reflect the increasing cost of providing critical environmental oversight at the speed of business.

- ***Executive Office of Housing and Economic Development (EOHED)*** – FY 2013 funding for EOHED is approximately $36 M greater than FY 2012 estimated spending, reflecting an increase in the demand for services for homeless families in the Commonwealth. To help control the increased costs, while improving the way in which homeless families are served in the Commonwealth, the Governor's budget proposes to reform the state's emergency shelter and housing programs. The Department of Housing and Community Development (DHCD) will strengthen the state's family homelessness programs by limiting emergency shelter for families that truly need it while providing the remaining families at risk of homelessness with more appropriate and cost-effective housing alternatives. In FY 2013 these reforms will save at least $26 M in homeless services-related spending, allowing for an equal amount to be re-invested for other permanent affordable housing solutions.

- ***Executive Office of Labor and Workforce Development (EOLWD)*** – Compared to the FY 2012 GAA, funding at EOLWD is increased by over $7 M in FY 2013. This corresponds to increased investments proposed by the Governor for the Summer Jobs program, which subsidizes employment opportunities for low-income youth primarily during the summer. Along with supplemental funding proposed by the Governor in FY 2012, the Governor's budget will fund summer 2012 summer jobs opportunities at over $8 M, greater than the summer 2011 funding levels. The Governor's investment will also allow for a similar amount of funding to be expended for the summer of 2013, ensuring funding for this program can be restored to levels prior to the recession.

- ***Executive Office for Administration and Finance (A&F)*** – Annual funding levels under A&F can vary greatly from year-to-year since A&F typically houses reserve or other short-term appropriations that are not continued from year-to-year. In the Governor's budget for FY 2013, roughly $127 M in collective bargaining reserves are funded for existing or pending contracts with state union employees across all areas of state government, including for employees within executive branch departments, higher education campuses, and state sheriffs' facilities. This increased funding is offset by a number of one-time spending measures in FY 2012, such as reserves to offset state costs for emergency response to natural disasters that occurred in 2011 (e.g., the June 1 Tornado and Tropical Storm Irene). Cost increases for A&F agencies continue to be offset by a number of reform initiatives across the Secretariat. The Group Insurance Commission was able to successfully reduce spending in FY 2013 compared to its original projection using several strategies, including leveraging the use of federal Early Retiree Reinsurance Program (ERRP) funds and working closely with its health plans to negotiate a lower premium increase. Also, the Human Resources Division will continue to roll out its Shared Services Time and Attendance initiative that will pool resources and create savings through error reduction and efficiency gains. In addition, the Department of Revenue, through the use of advanced analytics, will continue to refine its auditing techniques to maximize revenue collections.

School Aid for Public K-12 Education

State K-12 Aid, FY 2012 and FY 2013					
	FY 2012		FY 2013	FY 2013 Projected vs FY 2012 Spending	
Government Area	GAA Final Enacted Amount	Total Estimated Spending This Year	Total Projected Spending Next Year	$ Change	% Change
Chapter 70 (K-12 School Aid)	3,990,812,680	3,990,812,680	4,136,391,547	145,578,867	3.65%
TOTAL SPENDING	**3,990,812,680**	**3,990,812,680**	**4,136,391,547**	**145,578,867**	**3.65%**

The FY 2013 budget provides an additional $146 M in Chapter 70 funding to cities and towns, bringing total public K-12 aid to $4.136 B. This represents the highest funding level ever provided for Chapter 70 assistance. The state's contribution to quality education and opportunities for all of its residents is a core priority of the Patrick-Murray Administration. The Governor's budget continues to build off of the state's earlier commitments to preserve Chapter 70 investments in our K-12 education, a fundamental tool in addressing the achievement gap and ensuring that today's students will be prepared to compete for the jobs of tomorrow.

Aid to Higher Education Campuses

State Higher Education Funding, FY 2012 and FY 2013					
	FY 2012		FY 2013	FY 2013 Projected vs FY 2012 Spending	
Government Area	GAA Final Enacted Amount	Total Estimated Spending This Year	Total Projected Spending Next Year	$ Change	% Change
Higher Education	923,962,337	924,462,336	935,732,595	11,270,259	1.22%
TOTAL SPENDING	**923,962,337**	**924,462,336**	**935,732,595**	**11,270,259**	**1.22%**

The state funding provided to the University of Massachusetts (UMASS) and state university systems is level-funded in the Governor's FY 2013 budget to FY 2012 spending levels. In addition, under A&F the Governor proposes collective bargaining reserves corresponding to the increased costs in FY 2013 of existing or pending collective bargaining agreements for higher education employees. The Governor proposes to increase funding for Massachusetts community colleges by 5 % above FY 2012 and consolidate all community college funding under the Department of Higher Education, which will allocate funding to campuses based on cost data, enrollment and other factors. The Governor also proposes reforms to the state's community college system, including better coordination focused on promoting job training and creation across the Commonwealth.

MassHealth (Medicaid) Spending

State Budgetary Spending by Governmental Area, FY 2012 and FY 2013					
	FY 2012		FY 2013	FY 2013 Projected vs FY 2012 Spending	
Government Area	GAA Final Enacted Amount	Total Estimated Spending This Year	Total Projected Spending Next Year	$ Change	% Change
MassHealth	10,367,467,834	10,619,492,582	11,137,768,822	518,276,240	4.88%
TOTAL SPENDING	**10,367,467,834**	**10,619,492,582**	**11,137,768,822**	**518,276,240**	**4.88%**

The Massachusetts Medicaid program (MassHealth) provides comprehensive health insurance to approximately 1.3 million low-income Massachusetts children, adults, seniors and people with disabilities. The Administration's FY 2013 budget includes $11.14 B for the MassHealth program, including $187 M in budgetary resources for the Delivery System Transformation Initiative (DSTI). DSTI payments, which cost the state $82 M after accounting for federal revenues, are made to safety net hospitals in the Commonwealth to reform the delivery of care models to Medicaid members.

Notwithstanding the funding for DSTI, MassHealth's budget allows for approximately 5% spending growth from FY 2012 estimated spending to FY 2013. In FY2012, MassHealth was tasked to maintain an essentially level funded budget at 1.56% growth through a number of aggressive cost containment measures. Between these two fiscal years, MassHealth's budget has been successfully held at an average annual growth of 3.25%. According to a recent report from the CMS Office of the Actuary, Medicaid costs across the country are projected to increase at an average annual rate of 8.3% over the next 10 years.

Governor Patrick's and Lieutenant Governor Murray's FY 2013 budget builds upon ground-breaking progress in health care cost containment – with a vision for maintaining the Commonwealth's historic coverage gains and high-quality care while making health care spending more affordable for the state and taxpayers. In FY 2013, Massachusetts is poised to once again provide a model for the nation by leveraging opportunities to control health care costs that: 1) promote care delivery in lower-cost, high-quality settings; 2) improve the coordination and management of care; 3) expand support for primary care; 4) place a greater emphasis on prevention; and 5) promote innovative payment models that reward high-value care instead of high-volume care.

Budgetary Transfers to Non-Budgetary Funds

Transfers to Non-Budgetary Funds, FY 2012 and FY 2013

	FY 2012		FY 2013	FY 2013 Projected vs FY 2012 Spending	
Government Area	GAA Final Enacted Amount	Total Estimated Spending This Year	Total Projected Spending Next Year	$ Change	% Change
Transfers to Non-Budgetary Sources	1,122,536,822	1,081,917,074	1,132,647,286	50,730,212	4.69%
TOTAL SPENDING	**1,122,536,822**	**1,081,917,074**	**1,132,647,286**	**50,730,212**	**4.69%**

Transfers to Health Care and Other Funds – In total, the state will transfer $1.13 B in FY 2013 to support health care spending in the Commonwealth Care Trust Fund (CCTF) and the Medical Assistance Trust Fund (MATF). These transfers represent the state budgetary contribution to these trust funds, but are not necessarily the only funding source used to support annual spending from these funds. The transfer to the CCTF will increase by $50 M in FY 2013 over estimated spending in FY 2012. The increased funding is necessary to support the increased costs of the Commonwealth Connector programs next year. In addition, the Governor's budget proposes to increase the tax collected on retail cigarette sales and apply the updated sales tax to cigars and smokeless tobacco products. Combined, these revenues will generate over $70 M for the Commonwealth Care Trust Fund.

Unrestricted General Government Aid

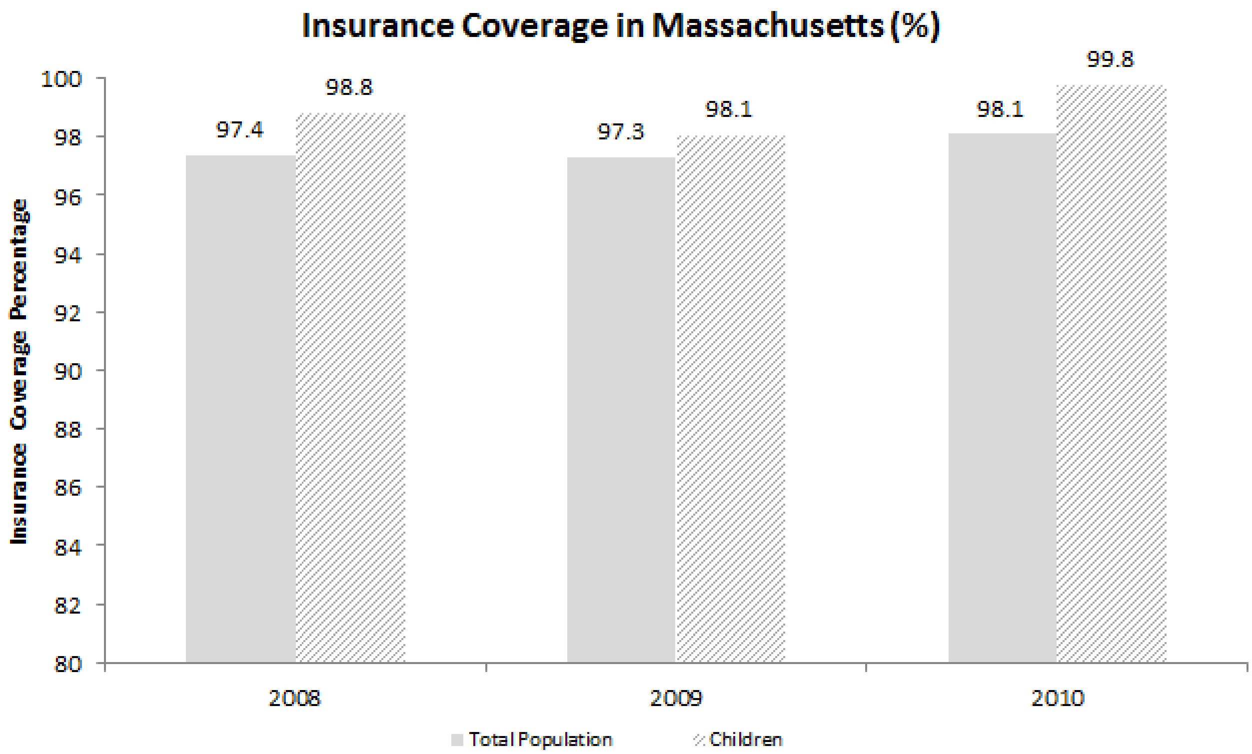
Unrestricted Local Aid, FY 2012 and FY 2012

	FY 2012		FY 2013	FY 2013 Projected vs FY 2012 Spending	
Government Area	GAA Final Enacted Amount	Total Estimated Spending This Year	Total Projected Spending Next Year	$ Change	% Change
Unrestricted Local Government Aid	833,980,293	898,980,293	833,980,293	(65,000,000)	-7.23%
TOTAL SPENDING	**833,980,293**	**898,980,293**	**833,980,293**	**(65,000,000)**	**-7.23%**

Unrestricted General Governmental Aid (UGGA) is funded at $834 M in the Governor's FY 2013 budget, which is equal to the amount funded in the FY 2012 GAA. However, in the GAA, the Legislature authorized that up to $65 M in one time FY 2011 surplus should be made available for one-time additional local aid, bringing actual FY 2012 UGGA spending to $899M. When compared to FY 2012 funding levels, the Governor's FY 2013 recommendation is $65 M, or 7.23% less. The Governor's FY 2013 budget contains a similar provision, however, that would allocate an additional $65 M for UGGA to cities and towns if there is a sufficient FY 2012 surplus. If a sufficient surplus materializes to fund the additional $65 M distributions, unrestricted local will be level-funded in FY 2013.

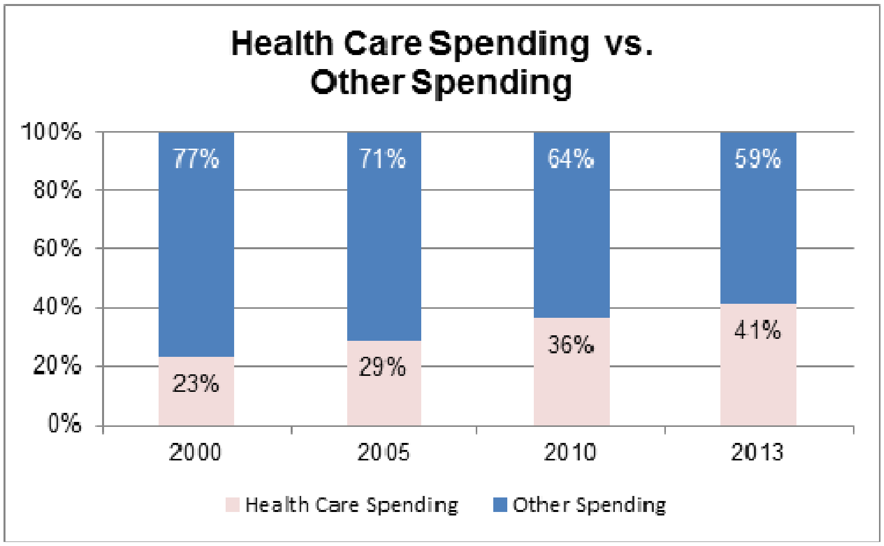
Health Care Cost Containment

Section I: Introduction and Summary
The Commonwealth is a national leader in ensuring access to health insurance. More than 98% of residents have coverage, the highest rate in the nation, with nearly all children (99.8%) and seniors (99.6%) insured. This state has been a model for the nation in expanding access to health care services, and now it is taking the lead in controlling costs and improving quality through payment and delivery system reform initiatives.



Source: Division of Health Care Finance and Policy

The Patrick-Murray Administration has carefully managed the financing of health care reform. Independent, non-partisan analysis underscores that the incremental state costs of health care reform have been moderate and in line with original expectations. Despite this achievement, the total costs of state-subsidized and employee coverage create a difficult challenge for the Commonwealth. These costs are occupying an ever-increasing share of the state budget as state revenues have declined and the recession has increased demand for subsidized insurance. As a result of this growth and declining state revenue, health care spending for subsidized and employee coverage programs now account for close to 41% of the state budget in FY13, up from 23% in FY2000.



Based on long term forecasts conducted by the Executive Office for Administration and Finance, were health care costs to continue to grow at these historic rates, they would consume approximately 50% of state spending by 2020**.** Health care spending has crowded out key public investments that, among other things, likewise significantly impact the health and welfare of the people in the Commonwealth. The historic trends are also unsustainable for local governments, businesses and families, forcing all of these groups to make difficult choices between paying for health care and other areas of potential investment.
The Patrick-Murray Administration has already taken a number of effective steps to control health care costs. Despite the fiscal challenges, this is also a time of great opportunity for health care reform in the Commonwealth. The Administration is moving aggressively to transform the entire health care payment and delivery system to ensure that the people of Massachusetts have access to high-quality, coordinated health care at a cost that is sustainable for government, businesses and families over time. The successful cost containment initiatives implemented to date and planned for FY 2013 with respect to the Commonwealth's subsidized and employee health insurance programs are described below.

In FY 2012, the Administration mitigated dramatic increases in health care costs, but also launched major reform initiatives. Government health care programs faced unprecedented challenges brought on by the impact from the economic recession that drove the caseload to historic peaks, resulting in higher health care costs. Despite these cost pressures, Massachusetts achieved ground-breaking progress in health care cost containment. For many of the state's health care programs – Massachusetts Medicaid program (MassHealth), Commonwealth Care, the Group Insurance Commission (GIC), Municipal Health, and the Medical Security Program (MSP) – the current FY 2012 budget reflects bold changes to achieve significant cost savings while providing continued access to coverage and high-quality care. These programs are on track to reach over $900M in savings in FY2012. Below are just a few examples of our major achievements in FY 2012:

- *MassHealth* – MassHealth is on track to achieve almost $588 M in savings through a variety of initiatives, including but not limited to rate restructuring, program integrity efforts, capitation cost control and payment strategies.

- *Municipal Health* – Municipal health care reform, signed into law by Governor Patrick in July 2011, is already helping municipalities achieve significant savings. The nine communities that have completed the new reform process as of January 15, 2012, have collectively saved more than $30 M – putting this reform on track to far exceed the initial estimate of $100 M for FY 2012 and going forward in savings for local governments statewide.

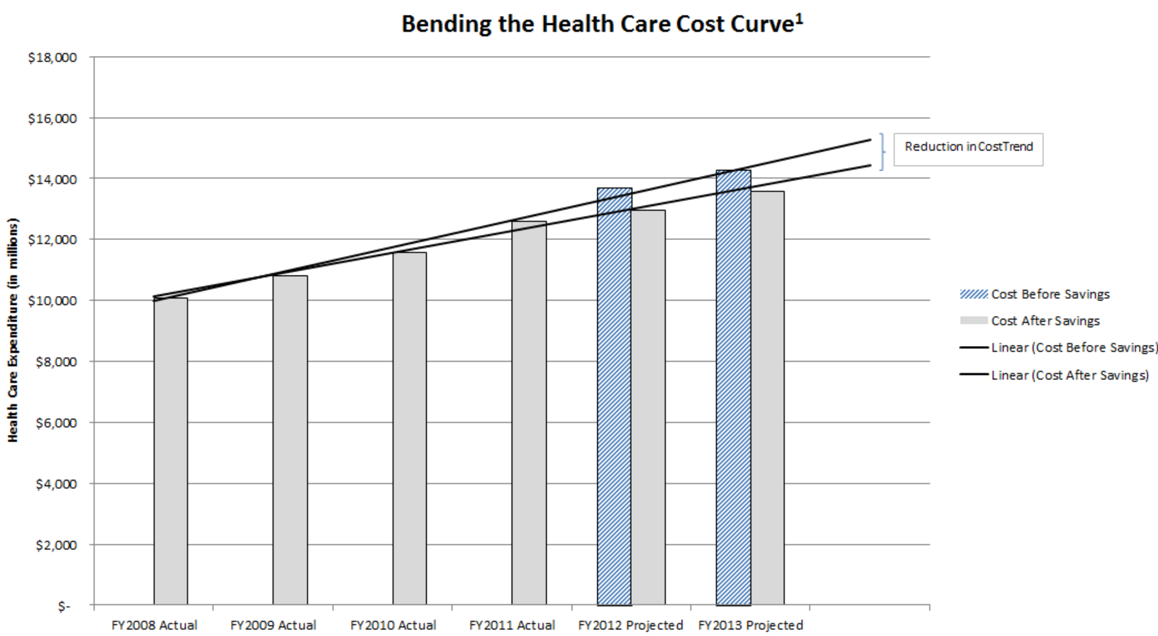
- *Medical Security Plan* – The competitive procurement for a new managed care insurance plan for unemployed individuals resulted in a 30% reduction in costs, generating savings of $16 M in FY 2012 and annual savings of $32 M.

- *Commonwealth Care* – A competitive procurement that provided incentives for *all* MCOs to improve their cost structures by rewarding more aggressive, lower bids with membership allowed the Connector to accommodate projected enrollment increase with a flat budget (saving the program from growing by $80-$100M).

- *Group Insurance Commission (GIC)* – A new policy requiring employees to actively re-enroll in health insurance and incenting employees to switch to more cost-effective limited network plans with three month premium holidays resulted in $20-30 M in savings. In addition, GIC has seen utilization decline and has realized some savings related to that phenomenon in FY 2012.

FY 2012 HEALTH CARE COST CONTAINMENT		
Program	**Gross Savings**	**Net Savings**
MassHealth	$ 588	$ 293.95
Medical Security Program	16	8
MuniHealth	100	100
Commonwealth Care Procurement	100	50
GIC	100	100
Total	**$ 904**	**$ 552**

The Commonwealth will continue to face health care cost pressures in FY 2013. In the FY 2013 budget, the Patrick-Murray Administration proposes a range of reforms that continue to reduce costs but maintain coverage and access to quality health care. From FY 2012 to FY 2013, the administration is limiting increases in health care spending growth for MassHealth, Commonwealth Care and GIC to an aggregate of 5.1%, even after taking into account significant enrollment growth and the expansion of Commonwealth Care resulting from the Finch Decision. The budget summaries for major government health care entities are described below.



1) Costs and savings pertain to MassHealth, Commonwealth Care and Bridge, and the Group Insurance Commission

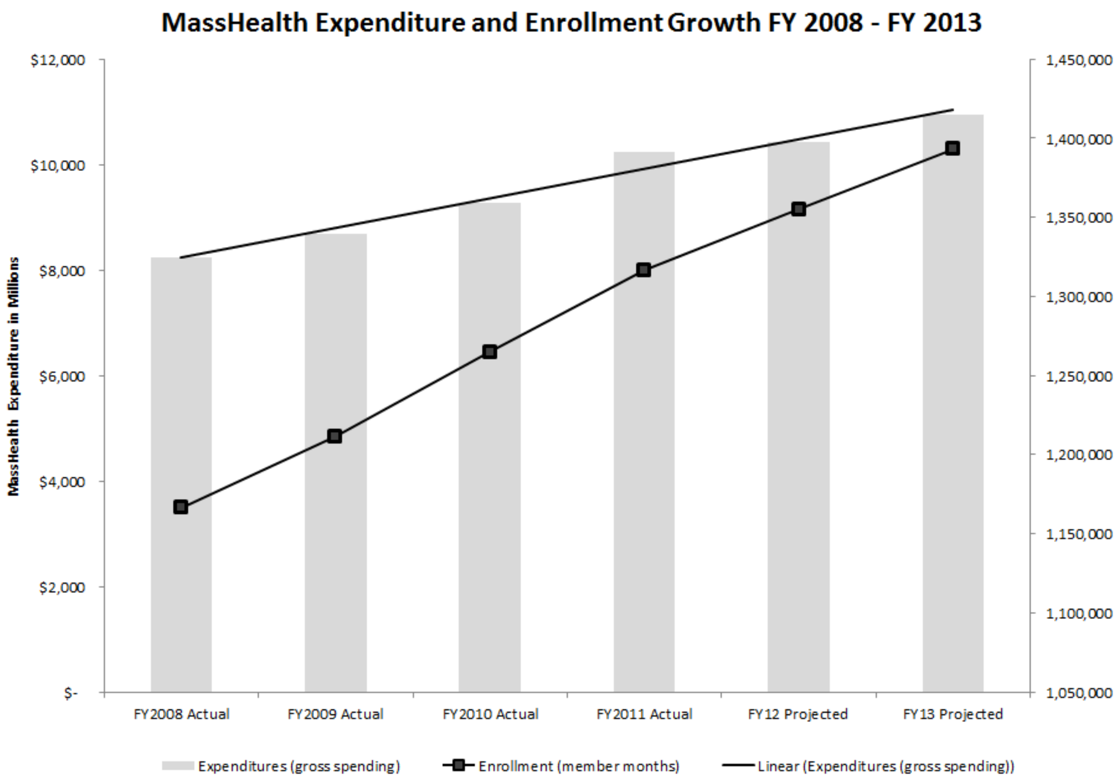
Section II: Health Coverage

MassHealth

MassHealth provides comprehensive health insurance to approximately 1.3 million low-income Massachusetts children, adults, seniors and people with disabilities. The Administration's FY 2013 budget includes $10.951 B for MassHealth, allowing for approximately 5% spending growth from FY 2012 estimated spending to FY 2013. Because Medicaid represents a partnership between the state and federal governments, approximately 50% of all MassHealth spending is financed with federal revenue dollars. The Administration also plans to fund $186 M in incentive payments to hospitals under the Delivery System Transformation Initiative, with the federal government providing half of the revenue to support the initiative. (See section on “Build the Foundation for Payment and Delivery System Reform” for more information.)

Enrollment and utilization account for most of the projected spending in MassHealth and are sensitive to changes in the economic climate. The FY 2013 budget is primarily driven by a projected enrollment increase of 2.8% or 38,000 member months.

Average Member Months	FY2006	Growth %	Est FY2007	Growth %	Proj FY2008	Growth %	Proj FY2009	Growth %	Proj FY2010	Growth %	Proj FY2011	Growth %	Proj FY2012	Growth %	Proj FY2013
Non Disabled Children	409,292	6.39%	435,441	3.63%	451,256	2.37%	461,935	4.54%	482,900	3.27%	498,703	2.13%	509,349	1.66%	517,799
Non Disabled Adults	230,216	10.01%	253,251	6.64%	270,057	4.67%	282,655	2.65%	290,146	4.20%	302,342	1.20%	305,976	1.60%	310,871
Disabled Children	24,501	6.14%	26,005	4.35%	27,137	3.22%	28,010	7.87%	30,215	2.50%	30,972	4.55%	32,381	16.22%	37,634
Disabled Adults	196,947	3.32%	203,482	2.25%	208,064	3.37%	215,084	2.86%	221,238	1.72%	225,038	1.84%	229,185	4.34%	239,128
Long Term Unemployed Adults	60,426	25.03%	75,551	9.92%	83,049	15.05%	95,545	13.85%	108,778	14.54%	124,598	12.96%	140,745	3.16%	145,199
Seniors	122,029	2.80%	125,445	1.07%	126,790	1.11%	128,200	2.52%	131,425	2.70%	134,972	1.79%	137,394	3.51%	142,222
Total	1,043,411	7.26%	1,119,175	4.22%	1,166,353	3.86%	1,211,429	4.40%	1,264,703	4.11%	1,316,625	2.92%	1,355,030	2.79%	1,392,852



In FY 2013, MassHealth plans to once again contain the growth in costs by using a variety of reforms and innovative management and contracting strategies. The program will also move aggressively on several initiatives aimed at transforming the delivery system and payment methods. MassHealth is also implementing a number of organizational and policy changes required for timely and effective implementation of the federal Affordable Care Act and to implement the delivery and payment system changes in the 1115 Medicaid Waiver.

Commonwealth Care

The Commonwealth Health Insurance Connector Authority (Health Connector) administers the Commonwealth Care program. In addition, for FY12 the Health Connector, along with the Executive Office of Administration and Finance and the Executive Office of Health and Human Services, oversees the Commonwealth Care Bridge program. Commonwealth Care provides subsidized health insurance coverage for nearly 160,000 adults under 300% FPL that are not eligible for MassHealth and do not have access to adequately subsidized employer sponsored insurance. The Commonwealth Care Bridge program, which will end in FY12, covers approximately 13,400 legal immigrants that have not met their five year immigration status. Funding for these programs is made

available through the Commonwealth Care Trust Fund (CCTF), which is supported by the general fund and other dedicated revenue sources such as the cigarette tax and fair share and individual mandate penalties.
On January 5, 2012, the Supreme Judicial Court held that the Massachusetts statute limiting the eligibility of many legal immigrants for Commonwealth Care violates the equal protection provisions of the Massachusetts Constitution. The Health Connector is now faced with the challenge of re-integrating the Aliens With Special Status (AWSS) population into the Commonwealth Care program. The Health Connector estimates that over 24,000 new members, in addition to the 13,400 currently enrolled in Commonwealth Care Bridge, will become eligible for the Commonwealth Care program as a result. This may add as much as an additional $150M to the annual cost of covering the AWSS population above the current spending on Bridge. Cost increase will likely begin to take effect in FY12 as AWSS members are reintegrated into the program.
Despite the cost pressure, the Administration is committed to fully funding the re-integration of AWSS. In an effort to close the budget gap for both FY12 and FY13, the Health Connector is developing an aggressive cost containment plan for Commonwealth Care focused on procurement savings and other reforms. The Health Connector's goal is to achieve this once again without relying on benefit cuts, member co-pay increases, or any other strategies that would severely damage the value of Commonwealth Care.

Group Insurance Commission (GIC)

The Group Insurance Commission (GIC) provides high value health insurance and other benefits to employees, retirees, and their survivors/ dependents of the Commonwealth and of certain of its public authorities. The GIC also provides health-only benefits to participating municipalities' employees, retirees, and their survivors/ dependents.

Looking ahead, the GIC will continue its focus on providing high quality health insurance coverage to its members while containing costs for the Commonwealth. Next year, the GIC will embark on a major procurement of its health plans. It will solicit innovative strategies through this procurement to maintain coverage and quality of care while containing costs. This includes implementing the principles of payment reform and incorporating any changes required by national health care reform.

Total GIC spending in FY 2013 is $1.665 B, inclusive of the $435 M transfer from the State Retiree Benefit Trust Fund (SRBTF) which covers the cost of retiree health insurance. Spending specific to health insurance premiums and plan costs for active state employees, retirees, and employees of participating municipalities and authorities is $1.582 B, a decrease of 0.3% from FY 2012 estimated spending. This includes an anticipated rate increase, and the addition of approximately 7,700 enrollees via municipal health reform. GIC has reduced spending for state only active employees premiums by 9% or $66 M from FY 2012. The GIC was able to successfully reduce spending in FY 2013 compared to its original projection using several strategies, including leveraging the use of federal Early Retiree Reinsurance Program (ERRP) funds and working closely with its health plans to negotiate a lower premium increase.

Department of Corrections Health Care (DOC)

The Department of Correction provides medical and mental health care to offenders and civil commitment populations in its care and custody. The Commonwealth has successfully contained the growth in inmate health care costs since FY 2008. Without cost containment measures, the cost of offender healthcare would have increased by 31% since FY 2008, but DOC held that growth to 1% total over those six years. In FY 2013, $98 M in offender healthcare spending is proposed, essentially level funded from FY 2012 estimated spending despite projected maintenance growth of $7.6 M over FY 2012. DOC plans to achieve savings through re-negotiation efforts with the offender health care contractors and maximizing federal reimbursement opportunities for allowable costs.

Health Safety Net Trust Fund

Overseen by the 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. Prior to the enactment of health care reform, this financing mechanism was known as the Uncompensated Care Pool. The Health Safety Net is financed by dedicated revenues from an assessment on hospitals ($160 million) and an insurer surcharge ($160 million), other offsetting revenues ($70 million), and any state contribution from the General Fund.

Although success in expanding enrollment in health insurance through health care reform has resulted in decreased Health Safety Net utilization and payments, economic pressures from the recession have resulted in increased HSN utilization over the past three years. An unstable economy naturally lends itself to individuals 'cycling' in and out of short-term employment and underinsurance; the trends in the HSN from fiscal year 2011 through fiscal year 2012 reflect these natural increases in the burden on safety net care.

Health Safety Net Trust Fund - Sources			
	FY11	FY12 Projection	FY13 Projection
Hospital Assessment & Surcharge Payers	$ 320,000,000	$ 320,000,000	$ 320,000,000
Offset (Medical Assistance Trust Fund)	$ 70,000,000	$ 70,000,000	$ 70,000,000
GAA Contribution	$ 30,000,000	$ 30,000,000	$ 30,000,000
Total	**$ 420,000,000**	**$ 420,000,000**	**$ 420,000,000**

Health Safety Net Trust Fund - Demand			
	FY11	FY12 Projection	FY13 Projection
Hospital Costs	$ 440,800,000	$ 487,506,704	$ 487,209,067
Community Health Centers	$ 56,400,000	$ 60,977,698	$ 60,891,852
Demos (Admin)	$ 6,000,000	$ 6,000,000	$ 6,000,000
Total	**$ 503,200,000**	**$ 554,484,402**	**$ 554,100,919**

To help reduce the burden on hospitals in Health Safety Net fiscal year 2012 (October 2011- September 2012) for providing care to the uninsured and underinsured, the budget provided $30 million in a General Fund contribution to offset 2012 costs.

Despite the unprecedented fiscal challenges of fiscal year 2013, the Administration is maintaining a $30 million General Fund contribution to the Health Safety Net in its fiscal year 2013 budget proposal. We will continue to closely monitor the Health Safety Net and refine projections for fiscal year 2012 and 2013 demand based upon updated information

Section III: FY 2013 Health Care Policy and Savings Initiatives

In FY 2013, Massachusetts is poised to once again provide a model for the nation by leveraging opportunities to control health care costs that: 1) promote care delivery in lower-cost, high-quality settings; 2) improve the coordination and management of care; 3) expand support for primary care; 4) place a greater emphasis on prevention and 5) promote innovative payment models that reward high-value care instead of high-volume care. With the scale of the health insurance coverage it purchases, the state is well-positioned to capitalize on this opportunity to foster innovation in the health care insurance and delivery systems. These efforts will help to contain costs while maintaining coverage and improving the quality of care. The state also has opportunities to achieve greater efficiencies and continuity of coverage within state-subsidized programs by aligning coverage standards and coordinating procurements. The Administration's major FY 2013 policy initiatives are described below.

Leverage Purchasing Power and Maximize Competition In State Health Care Contracts

- *Fully implement an integrated care model for both medical and behavioral health services for MassHealth members:* The FY 2012 behavioral health procurement was a competitive process that challenged bidders to manage costs but also provide innovative care management programs for MassHealth primary care clinician (PCC) members. The procurement provided a framework for medical and behavioral health integration and a targeted care management program for patients with highly complex medical and/or behavioral health conditions. It utilizes core performance management principles to create balanced incentives for the vendor based on improved health outcome for MassHealth members. In FY 2013, MassHealth will oversee the contract's ongoing implementation to assure that the vendor demonstrates not only improved member outcomes, but also greater compliance with evidence-based guidelines for a number of chronic conditions.

- *Promote market competition among Commonwealth Care Managed Care Organizations:* The Health Connector is preparing to launch another aggressive procurement for FY 2013 that builds upon the successes achieved in FY 2012. By harnessing the power of competition, its procurement strategy will again provide strong incentives for health plans to develop innovative coverage models that hold down costs while maintaining comprehensive, affordable benefits for Commonwealth Care members.

- *Re-negotiating State Office of Pharmacy Services Service* Contract: The State Office for Pharmacy Services (SOPS) provides comprehensive pharmacy services to public sector healthcare organizations in a cost-effective, clinically responsible manner. SOPS currently provides clinical and pharmacy services to the following agencies: Department of Public Health, Department of Mental Health, Department of Developmental Services, Department of Correction, Department of Youth Services, the sheriff's departments of Bristol, Essex, Franklin, Hampden, Hampshire, Norfolk, Barnstable, Dukes, Middlesex, Berkshire and Plymouth, and the Soldiers Homes in Holyoke and Chelsea. This encompasses 24,000 patients at 46 sites. The Administration plans to re-align the cost structure and service level of the current pharmacy services contract to achieve the goals of cost savings, maintenance of current clinical initiatives and retaining revenue streams through realigning the cost structure and service level. The current vendor has developed a savings estimate achieved through internal changes at the vendor and increased standardization and reduced service levels for each participating agency.

- *Re-negotiate current medical and behavioral health contracts under the Department of Corrections*: After commissioning a study that **analyzed the current delivery of Department of Correction (DOC) inmate** healthcare **services and cost drivers to identify** options for cost containment in FY 2012, DOC will use recommendations from the study to cut costs for **inmate** healthcare in FY 2013. The Administration proposes to renegotiate current contracts and seek greater transparency in **the** pricing and cost of **inmate health care** services and staffing.

Build the Foundation for Payment and Delivery System Reform

The Patrick-Murray Administration made significant strides in FY 2012 that strengthen the foundation for payment and delivery system reform for the next fiscal year. On February 11, 2011, Governor Patrick filed "An Act Improving the Quality of Health Care and Controlling Costs by Reforming Health Systems and Payments". This bold, comprehensive payment and delivery system reform legislation will promote the transformation of the Massachusetts delivery system into an innovative care delivery and health care financing model. In December 2011, the Commonwealth successfully renewed the 1115 Medicaid waiver. Over three years, the waiver authorizes more than $26.7 B in federally supported expenditures, allowing the Commonwealth to fully fund its landmark health care reform law and to implement integrated delivery system and payment reform initiatives.

In FY 2013, to fully support the goals of payment reform and to promote the transition to integrated care systems, the Administration proposes a number of reform initiatives that support a transition towards value based purchasing, including global capitation and bundled payments, and that promote more integrated, high quality medical and support services. These initiatives represent significant steps forward that replace traditional fee for service arrangements and build the foundation for the next stage of payment and delivery system reform**.**

- *Supporting Integrated Systems of Care for Hospitals:* The Delivery System Transformation Initiative (DSTI) will offer incentive payments to Medicaid safety net hospitals throughout the Commonwealth to fundamentally change the delivery of care to Medicaid members. Payments will be tied to progress on measurable outcomes related to delivery system transformation and quality improvement. The ultimate goal is to prepare these providers for alternatives to fee-for-service payment arrangements that reward high quality care delivered in integrated systems that uniquely focus on safety net populations. Hospitals will be required to promote patient-centered medical homes among their affiliated primary care practices.

The Administration plans to fund $186 M in incentive payments to hospitals, with the federal government providing half of the revenue to support the initiative. Additionally, the Administration proposes $20 M in Infrastructure Capacity Building grants to support delivery system transformation for non-safety net hospitals.

- *Invest in the infrastructure to transition government health care programs to alternative payment methods:* The Administration proposes to invest $2 M in the MassHealth infrastructure to support implementation of payments to Accountable Care Organizations that demonstrate increased care coordination and integration across care settings and to support the development of innovative payment strategies that reward providers for high value, patient-centered care.

- *Integrate care and long term care and support services for dual eligible MassHealth members:* In 2012, the Administration will submit an innovative proposal to the federal government to provide integrated, coordinated care and to expand independent living and long-term services and supports for Medicaid members ages 21-64 that are also eligible for Medicare. The Duals Demonstration will provide a strong foundation for payment and delivery system reform in the Commonwealth by providing dually eligible MassHealth members with access to an integrated, accountable model of care and support services financed jointly with Medicare through global payments.

- *Launch a payment reform pilot program for managed care organization (MCO)s*: A key initiative that MassHealth and the Health Connector are working together to explore for FY 2013 is the opportunity for a payment reform pilot. Specifically, the focus of MassHealth and the Health Connector's planning is on a "shared savings" model that will provide incentives for MCOs and providers to migrate towards alternative payment models that encourage better care coordination and accountability.

- *Build on the Success of the Primary Care Medical Homes Initiative (PCMHI):* Launched in FY 2010, the Administration has committed to assist 46 primary care practices, including community health centers, hospital-affiliated primary care offices, and group and solo practices, to transition into certified medical homes focused on integrated and patient-centered care. The Administration proposes to fully fund the initiative at $10 M. There will also be $3 M dollars in additional funding made available from the 1115 Medicaid waiver Infrastructure and Capacity Building funds to support the establishment of new Patient-Centered Medical Homes at community health centers. $9 M will also be invested in higher rates for primary care providers and $4 M will be invested in higher rates for outpatient behavioral health providers, recognizing the critical role of these providers as the foundation of a transformed delivery system. Finally, qualified "Health Home" expenditures are allowed under the Affordable Care Act for a 90% federal matching rate. Health Homes are designed to be person-centered systems of care that promote access and coordination of health services, behavioral health services, and long-term community services and supports. The Health Home model will expand on MassHealth's patient-centered medical home model by building additional linkages and enhancing coordination and integration of medical and behavioral health care. This initiative will generate $10 M in new revenue for MassHealth due to the enhanced matching rate.

- *All Payers Claims Database:* Since 2010, the Division of Health Care Finance and Policy has been undertaking the development of an All-Payer Claims Database (APCD) to facilitate cost containment and quality improvements in the Massachusetts Health Care System. The Division anticipates significant use of the APCD in FY 2013 to achieve administrative simplification at other state agencies, as well as to help inform policy development and implementation for both public and private health care payers and providers. Over the long term, such policies are anticipated to reduce costs while improving quality. In addition to the health system benefits of the APCD, the Division anticipates additional FY 2013 revenue from APCD activities. This revenue will come from two sources: fees for sharing APCD data for public purposes, and federal financial participation (FFP) for APCD activities that directly benefit the Medicaid program. With respect to FFP, the Division anticipates seeking an agreement (Advance Planning

Document or APD) with the federal Centers for Medicare & Medicaid Services to receive up to 90% match for specific eligible activities.

Leverage National Health Care Reform

The Patrick-Murray Administration is moving aggressively to prepare the Commonwealth to take full advantage of the federal health reform legislation, the Patient Protection and Affordable Care Act (ACA), and the major components of ACA as of January 1, 2014. To date, Massachusetts has received over $186 M in funding as a result of the Affordable Care Act. These funds include $36 M for an "Early Innovators" grant to develop the health information technology infrastructure necessary to launch a real time, integrated eligibility system and to enhance existing Massachusetts systems in order to meet federal guidelines for an ACA-compliant Exchange. Massachusetts hopes to develop reusable technology components that may subsequently be leveraged by one or more of the six New England states participating in this collaboration. Some of the major national health care initiatives underway include:

- Developing strategies to leverage federal support to maintain expanded health care coverage and further decrease the rate of uninsurance through subsidized health insurance;
- Establishment grant applications to support the transition of the Health Connector to an ACA-compliant health benefits Exchange;
- Early Innovators work to develop technological solutions supporting real-time eligibility and determinations for Exchange and Medicaid expansion populations
- In depth analytical work assessing opportunities for Massachusetts to leverage optional programs under the ACA to provide subsidized health insurance to residents;
- Investigating the implications of reinsurance, risk adjustment and risk corridors programs on the Massachusetts small and non-group insurance markets;
- Building a common eligibility system for Medicaid, other subsidized health care programs, and other federal entitlement programs to simplify and streamline eligibility determination and enrollment; and
- Analyzing the impact of the ACA on a range of Massachusetts reform policies including the individual mandate and the employer fair share contribution.

Strengthen Community Long Term Care Services for Elders and Disabled

Long term care is the fastest growing spending category in Medicaid and provides critical services for elderly and disabled populations. Building on its commitment to the principles of Community First, the Patrick-Murray Administration is transforming the long term care services and supports (LTSS) system through the following core initiatives:

- *Duals Initiative:* The Duals Demonstration described above will enhance members' access to community providers of independent living and long term supports and services and provide a seamless, person-centered care experience that reflects members' goals and supports independent living.

- *Money Follows the Person:* This $110 M demonstration grant, made possible by the Affordable Care Act, will support Massachusetts's efforts to transition over 2,000 individuals from long-term care facilities to community settings by 2016 through the provision of resources for home and community based services, housing supports, and infrastructure development.

- Additionally, MassHealth will implement internal policies to ensure that members are being served in cost-efficient community settings that promote independence, consistent with the administration's commitment to Community First, and to increase utilization management and auditing activities in fee for service long term care programs. Innovative, performance-based payment methodologies will also be implemented in some community based long-term care programs.

Continue Program Integrity Efforts and Expand Audit Activities To Tackle Fraud, Waste And Abuse

MassHealth is undertaking a number of initiatives focused on ensuring that only eligible members receive services and that providers are only paid for appropriate services provided to eligible members. These efforts leverage enhanced data and field-based audit activities with a focus on program areas that have experienced rapid growth.

Reduce the Health Care Cost Burden for Small Businesses

- *Expand eligibility for the Small Business Wellness Subsidy offered through the Health Connector's Business Express program:* Currently, certain small businesses that purchase health insurance through Business Express and enroll their employees in a wellness program created by the Health Connector may be able to obtain a 15% rebate for the cost of their share of health insurance premiums for their employees. Eligibility for the wellness rebate is tied to eligibility for federal tax credits offered to small businesses under national health care reform. The Administration is proposing to maintain the rebate at 15% (a temporary increase in FY 2012 over the originally authorized level of 5%) and expand eligibility for the wellness rebate to include sole proprietors and small business employees that are family members of the business owners, so that more small businesses are able to take advantage of the wellness program while saving money on their health insurance.

- *Control health insurance costs through Division of Insurance's rate review process:* The Division of Insurance (DOI) will continue its efforts to examine the underlying factors driving health care costs when examining small group rate filings. To date, DOI has actively set appropriate limits to premium rate increases and prevented rates from increasing at an unaffordable pace for small group insurance purchasers. In the rate filing for the 2nd quarter of 2010, carriers filed for average weighted rate increases of 16.3%. DOI disapproved the rates as unreasonable, settled with carriers for much lower rates, and saved small group purchasers approximately $106 M in insurance premium costs. In DOI's second year of rate review, the average weighted rate increases fell to 9%. Recently, DOI published the third year rate review and the average weighted rate increases fell to 2.3%. DOI has also taken steps over the past year to foster the development of more affordable health insurance products that will be more widely available in FY 2013. The majority of small group carriers will be required to offer select or tiered provider network products that have rates at least 12% less than the carriers' full network products. Certain carriers will also be offering health insurance through certified group purchasing cooperatives, which will offer wellness programs and negotiated small group rates that previously have not been available to small employers.

- *Medical Security Plan Procurement:* The success of the competitive medical security plan procurement completed in FY 2012, will annualize into FY 2013 at $32 M in savings for the Medical Security Trust Fund (MSTF), and in turn, savings for small business employer who are the main contributors to the trust fund and program.

Improve the Health Technology Infrastructure

The Executive Office of Health and Human Services (EOHHS), Information Technology Division (ITD), the Health Connector and the Massachusetts e-Health Institute are developing a strategic implementation plan to align IT resources for national health care reform readiness and transition to payment reform. IT systems are evolving from segmented to integrated based payment methodologies. The Administration proposes three major components in the health care IT strategic plan:

- *Coordinate and facilitate the dissemination of Electronic Health Record (EHR) systems throughout the Commonwealth:* The Administration plans to continue the distribution of provider incentive payments through the Health Information Technology Trust Fund, which is funded at 100% federal reimbursement to encourage Medicaid health care providers to adopt, implement, upgrade or meaningfully use certified EHR technology. EOHHS plans to distribute $125 M in funding in FY 2013;

- *Develop a secure and interoperable health information infrastructure that will allow providers, consumers and others involved in supporting health and healthcare to share clinical information securely and reliably (network of networks approach):* Leveraging both state and federal funds the Administration is building technology infrastructure and services with the active participation of a multi-stakeholder Advisory Committee to enable secure end-to-end transmission of clinical and public health data. The goal is to better support patient care coordination as well as public health and quality reporting in order to improve outcomes and contain costs; and

- *Develop a Health Insurance Exchange (HIX) and Integrated Common Eligibility System (IES):* The creation of an integrated Health Insurance Exchange is a major undertaking in the Administration's national health care reform efforts. The Health Insurance Exchange will help individuals and small businesses identify and purchase affordable coverage and provide the IT infrastructure to insure individuals with means based needs by providing Medicaid coverage or tax credits. The Exchange will also integrate eligibility and enrollment with Medicaid and other state health subsidy programs.

Promote Wellness

- *Investment in wellness programs for Commonwealth employees:* Promoting wellness is a further opportunity for the Commonwealth to manage health care spending by encouraging healthy choices among its employees and retirees. In the FY 2012 budget, the GIC was tasked with developing a wellness program for its members. After a competitive procurement, the GIC has selected a wellness vendor and has developed a plan to implement this initiative in FY 2012 and FY 2013. The GIC will leverage federal Early Retirement Reinsurance Program (ERRP) funds to expand the reach of this initiative beyond the initial FY2012 investment.

- *Expand Smoking Cessation programs:* The Administration proposes to invest a total of $5 M toward smoking cessation programs in government health care programs. The GIC plans to invest $2 M of its federal Early Retiree Reinsurance Program (ERRP) funds toward smoking cessation programs. Commonwealth Care will receive an additional $2 M and the Department of Public Health will receive $1 M. A recent study published by the George Washington University School of Public Health shows that for every $1 invested in the Massachusetts Medicaid (MassHealth) smoking cessation benefit led to an average savings of $3.12 in cardiovascular-related hospitalization expenditures, so there was a net return of $2.12 for every dollar invested.[1] The Governor's FY 2013 budget also proposes to increase the cigarette tax by 50 cents and to tax other tobacco products at the same rate as cigarettes.

- *Commonwealth Health and Prevention Fund:* The Governor's FY 2013 budget proposes eliminating the sales tax exemption for soda and candy. In addition to generating $51.25 M for public health programs, the repeal of the sales tax exemption is an important step in discouraging overconsumption of these unhealthy products. The revenue will be directed to the new Commonwealth Health and Prevention Fund. Please see the Issue in Brief, "Health Promotion and Wellness Investments" for further information on the details on this proposal.

[1] Richard P, West K, Ku L (2012) The Return on Investment of a Medicaid Tobacco Cessation Program in Massachusetts. PLoS ONE 7(1): e29665. doi:10.1371/journal.pone.002966

The spending reductions related to the policy and savings initiatives highlighted above total $730M in FY13. This is a combination of costs reductions in MassHealth, Commonwealth Care, the Group Insurance Commission, the Department of Corrections and the Department of Public Health. Below is a chart that highlights those savings.

Savings Initiative	Gross	Net
Leverage Purchasing Power and Maximize Competition In State Health Care Contracts	$ (144)	$ (82)
Build the Foundation for Payment and Delivery System Reform	$ (21)	$ (11)
Leverage National Health Care Reform	$ (40)	$ (40)
Strengthen Community Long Term Care Services for Elders and Disabled	$ (37)	$ (18)
Continue Program Integrity Efforts and Expand Audit Activities To Tackle Fraud, Waste And Abus	$ (44)	$ (22)
Other Savings	$ (188)	$ (109)
Payment Strategies	$ (256)	$ (141)
Total	**$ (730)**	**$ (423)**

State Workforce

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 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 Governor’s budget recommendation includes budgeted Full Time Equivalency (FTE) counts summarized at the Government area level. Additional detail is included throughout the Budget Recommendations to indicate the employee level within specific departments.

Effect of the Budget on Personnel to Date

Annually, the Executive Office for Administration and Finance (ANF) provides FTE caps to the Executive Branch Departments, prioritizing hiring in areas where positions are critical for public health and safety or where a position results in additional revenue or cost savings for the Commonwealth. FTE caps are implemented at the department level and reviewed regularly by ANF budget analysts to ensure agencies are taking the necessary steps to live within capped levels. It is important to note that FTEs correspond to budgeted level of staffing during any given fiscal year. For a number of reasons, particularly timing of planned hire dates, actual state employee head count and the number of budgeted FTEs may vary within state agencies. In addition, FTE counts typically are less than employee headcount or jobs, since a portion of state employees do not work full-time schedules.

EXECUTIVE BUDGETARY JOBS			
BENCHMARK*	01/20/07	*Jobs:*	37,473
BENCHMARK*	10/11/08	*Jobs:*	38,285
PREVIOUS PAY PERIOD	12/17/11	*Jobs:*	34,822
CURRENT PAY PERIOD	12/31/11	*Jobs:*	34,815
VARIANCES VS. CURRENT			
YTD VARIANCE FROM*	01/20/07	*Jobs:*	(2,658)
YTD VARIANCE FROM*	10/11/08	*Jobs:*	(3,470)
PREVIOUS VS. CURRENT		*Jobs:*	(7)
BENCHMARK VS. CURRENT*	10/11/08		38,285
**1269 jobs adjusted for MassDOT reform as of 11/01/2009*	12/31/11		34,815
		Job Variance	**(3,470)**

Between the fall of 2008 and December 2011, the state workforce for jobs in the Executive Branch funded with operating dollars has declined by 3,470 jobs. The reduction can be attributed to layoffs, attrition and retirement across all agencies in the Executive Branch. This trend has been mirrored in the Non-Executive Branch, even after accounting for an increase of 2,770 positions in January 2010 corresponding to the transition of seven county sheriffs' offices to state agencies, total non-Executive budgetary jobs have declined by over 2,300 jobs. When considering employees paid in both branches, from all funding sources, the total state FTEs have decreased by more than 6,100 since FY 2008, as reported in the FY 2011 Statutory Basis Financial Report.

H.1 Employment Levels

In reviewing the funding levels available to them for 2013, agencies must critically evaluate their employee level and determine further reductions are necessary to maintain a balanced budget. The Governor's FY 2013 budget recommendation projects a total of 64,120 budgetary 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.

FY 2012 and FY 2013 FTEs Levels by Government Area	Estimated FY 2012	Proposed FY 2013	Annual Change
Executive Branch Secretariats:			
Administration and Finance	2,733	2,719	(14)
Education	506	533	27
Energy and Environmental Affairs	1,982	1,976	(6)
Housing and Economic Development	712	706	(6)
Health and Human Services	19,669	19,908	239
Transportation	0	0	-
Labor and Workforce Development	264	259	(5)
Public Safety*	8,130	10,070	1,940
Budgetary Position Eliminations	-	*(400)*	*(400)*
sub-total	33,996	35,770	1,774
Non-Executive Branch:			-
Judiciary*	7,333	5,304	(2,029)
District Attorneys	1,439	1,439	-
Sheriffs	5,673	5,666	(6)
Constitutional Officers and Independents	3,077	3,042	(35)
Campuses	12,899	12,899	-
sub-total	30,421	28,350	(2,071)
TOTAL STATE BUDGETED FTEs	**64,417**	**64,120**	**(297)**

*Reflects the shift of nearly 1,900 FTEs from the Judiciary to Public Safety as part of the Governor's proposed reforms related to community supervision.

The FY 2013 projected budgeted FTEs reflects the Governor's proposal to consolidate the Probation Department under the Executive Branch in the new Department of Community Supervision. In addition, the Governor's budget assumes targeted investments in Education and Health and Human Services, which will call for modest amounts of additional staffing to oversee and execute the Governor's strategic priorities. Over 120 additional FTEs are projected within Health and Human Services for additional state caseworkers to address substantial caseload growth in the federal Medicaid program and Supplemental Nutritional Assistance Program (SNAP). Fifty percent of these costs are paid for by the federal government. The Governor's budget does propose to hire up to 180 new state troopers in FY 2013 through a new police officer class that begins in the spring of 2013. Finally, the Governor's FTE assumptions reflect that the state will hire up to 500 additional staff at the Committee for Public Counsel Services (CPCS), continuing the FY 2012 reform to shift legal representation of indigent persons from more expensive private attorneys that bill for hourly services to less costly salaried state employees.

The Governor's proposal also calls for the elimination of an additional 400 budgetary FTEs across the Executive Branch. Outside Section 22 authorizes the Secretary of Administration and Finance to identify and sequester up to $30 M in FY 2013 savings generated by eliminating 400 FTEs, including salary and fringe costs.

Workforce Planning Goals

The Executive Office for Administration and Finance (ANF) and the Human Resources Division have worked together to implement clear policies surrounding employees. Each fall, ANF 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 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 manage hiring within available funding levels. 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.