

# ***Budget Development***

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## **Introduction**

The state budget is the foundation for responsible government spending. It has a wide-ranging and far-reaching impact on the well-being of the citizens of the Commonwealth. It is the vehicle through which we as a citizenry make investments together for the benefit of us all – investments for the “Commonwealth.” Serving as a blueprint for the activities and obligations of the year, the budget reflects our collective judgment about the state’s role in our society, obligations to serve its people and strategic investments to secure its future prosperity. Each line item represents a critical service, program or responsibility that the state will provide throughout fiscal year 2010.

The Patrick-Murray Administration’s fiscal year 2010 budget is a balanced, responsible budget that reflects the tremendous financial challenges confronting the Commonwealth during a time of international economic uncertainty. Today, the nation faces the greatest economic downturn since the Great Depression, and the Commonwealth is experiencing unprecedented challenges as a result. State and national economists believe this economic downturn will be the deepest and longest the country faces since World War II. This Administration’s budget reflects that difficult reality.

The Administration submits its fiscal year 2010 budget proposal amidst continued economic challenges that have required two rounds of mid-year budget solutions to be implemented in fiscal year 2009 totaling more than \$2.5 billion. Given the magnitude of this fiscal crisis, the aggressive level of investment in priorities that the Administration and Legislature made over the last two years must be dramatically slowed. Simply to maintain our current level of commitment to existing services and programs would require an additional \$1.2 billion more (after factoring in the first round of budget cuts) in fiscal year 2010 than in fiscal year 2009. Exacerbating that challenge is a decline in tax revenues of nearly \$1.9 billion in fiscal year 2009 with no real growth in fiscal year 2010. In addition, we continue to grapple with a longstanding structural deficit caused by a reliance on one-time revenue sources to fund recurring expenses.

In combination, sharply declining tax revenues and a recurring structural budget deficit have posed an unprecedented fiscal challenge for the Commonwealth. Within just five months, the Administration has had to wrestle with closing projected budget deficits totaling approximately \$6 billion over two fiscal years (fiscal years 2009 and 2010).

In times of recession, additional pressure is created as counter-cyclical needs emerge. The demand for government-supported services increases as revenues decrease and our resources are strained. This gap has required the Administration to make difficult decisions. While the Administration continues to seek out savings and efficiencies wherever possible, the magnitude of our economic challenges will require us this year to make difficult cuts to programs and services. Cuts and savings will make up almost half of our approach to solving our budget problem. Reductions in programs, administrative budgets and local aid were necessary to cover the most basic and vital services. To the extent possible, the Administration’s budget maintains critical investments in key areas like health care, education and public safety that help secure our safety net, help stimulate economic growth and opportunity and position the Commonwealth to emerge strong and competitive when the nation cycles out of the current downturn.

The following sections describe the challenges faced by the Administration and the process that was used to develop the Governor’s Emergency Recovery Plan for the fiscal years 2009 and 2010. Also included is a “Resource” section which contains a user guide and glossary to assist in navigating this budget document.

## **Massachusetts Government Structure**

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

### **Executive Branch**

*Governor* – The Governor is the chief executive officer of the Commonwealth. Other elected members of the executive branch are the Lieutenant Governor (elected with the Governor), the Treasurer and Receiver-General (State Treasurer), the Secretary of the Commonwealth (State Secretary), the Attorney General and the State Auditor. All are elected to four-year terms. The terms of the current office holders began in January 2007.

The Executive Council, also referred to as the “Governor’s Council,” 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.

Also within the Executive Branch are certain independent offices, each of which performs a defined function, such as the Office of the Comptroller, the Office of the Inspector General, the State Ethics Commission and the Office of Campaign and Political Finance.

*Governor’s Cabinet* – The Governor’s Cabinet, which assists the Governor in administration and policy-making, is comprised of the secretaries who head the eight Executive Offices, which are the Executive Office for Administration and Finance, the Executive Office of Health and Human Services, the Executive Office of Transportation and Public Works, the Executive Office of Public Safety and Security, the Executive Office of Housing and Economic Development, the Executive Office of Labor and Workforce Development, the Executive Office of Education and the Executive Office of Energy and Environmental Affairs. Finally, the Governor chairs an informal Development Cabinet to coordinate business development in the Commonwealth. It includes the Secretaries of Administration and Finance, Housing and Economic Development, Transportation and Public Works, Energy and Environmental Affairs and Labor and Workforce Development. Cabinet secretaries and executive department chiefs serve at the pleasure of the Governor. Most other agencies are grouped under one of the eight Executive Offices for administrative purposes.

The Governor’s chief fiscal officer is the Secretary of Administration and Finance. The activities of the Executive Office for Administration and Finance fall within six broad categories: (i) administrative and fiscal supervision, including supervision of the implementation of the Commonwealth’s annual budget and monitoring of all agency expenditures during the fiscal year; (ii) enforcement of the Commonwealth’s tax laws and collection of tax revenues through the Department of Revenue for remittance to the State Treasurer; (iii) human resource management, including administration of the state personnel system, civil service system and employee benefit programs and negotiation of collective bargaining agreements with certain of the Commonwealth’s public employee unions; (iv) capital facilities management, including coordinating and overseeing the construction, management and leasing of all state facilities; (v) the development and implementation of the Commonwealth’s 5 year capital plan; and (vi) administration of general services, including information technology services.

In addition to these responsibilities, the Secretary of Administration and Finance serves as Chairperson of the Commonwealth Health Insurance Connector Authority and Co-Chairs the Massachusetts Life Sciences Center. The Secretary of Administration and Finance also serves as a member of numerous other state boards and commissions.

*State Treasurer and Receiver General*– The State Treasurer has four primary statutory responsibilities: (i) the collection of all state revenues (other than small amounts of funds held by certain agencies); (ii) the management of both short-term and long-term investments of Commonwealth funds (other than the state employee and teacher pension funds), including all cash receipts; (iii) the disbursement of Commonwealth monies and oversight of reconciliation of the state’s accounts; and (iv) the 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.

*State Auditor* – 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 contract compliance of private vendors doing business with the Commonwealth.

*Attorney General* – 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 Attorney General 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 Comptroller* – Accounting policies and practices, publication of official financial reports and oversight of fiscal management functions are the responsibility of the Comptroller. The Comptroller also administers the Commonwealth's annual state single audit and manages the state accounting system. The Comptroller is appointed by the Governor for a term coterminous with the Governor's and may be removed by the Governor only for cause. The annual financial reports of the Commonwealth, single audit reports and any rules and regulations promulgated by the Comptroller must be reviewed by an advisory board. This board is chaired by the Secretary of Administration and Finance and includes the State Treasurer, the Attorney General, the State Auditor, the Chief Administrative Justice of the Trial Court and two persons with relevant experience appointed by the Governor for three-year terms. The Commonwealth's audited annual reports include audited financial statements on both the statutory basis of accounting (the Statutory Basis Financial Report, or SBFR) and the GAAP basis (the Comprehensive Annual Financial Report, or CAFR).

*State Secretary* – The Secretary of the Commonwealth 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.

## **Legislative Branch**

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

Lawmaking begins in the House or Senate Clerk's office where petitions, accompanied by bills, resolves, etc., are filed and recorded in a docket book. The clerks number the bills and assign them to appropriate joint committees. There are 26 of these committees, each responsible for studying the bills which pertain to a specific area (i.e., taxation, education, health care, insurance, etc.). Each committee is composed of six senators and eleven representatives, except the committees on Economic Development and Emerging Technologies, Health Care Financing and Transportation which consist of seven members of the Senate and thirteen on the part of the House.

The standing committees schedule public hearings for the individual bills, which afford citizens, 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 with 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 agencies within the Commonwealth, the budgets of which are not included in the Commonwealth's annual budget. These include the Massachusetts Bay Transportation Authority (MBTA), Massachusetts Turnpike Authority (MTA), 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 is in 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 regional school districts established by them also provide elementary and secondary education. Cities are governed by several 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. Various local and regional districts exist for schools, water and wastewater administration and certain other governmental functions.

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"), although the amount of aid received varies significantly among municipalities.

The cities and towns of the Commonwealth are also organized into 14 counties, but 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. The Governor proposes to move the seven remaining County Sheriffs to the state in this budget. *See Budget Narrative. Also, more detail regarding the Administration's Local Aid proposal can be found in Section 3 ("Local Aid") of this budget document.*

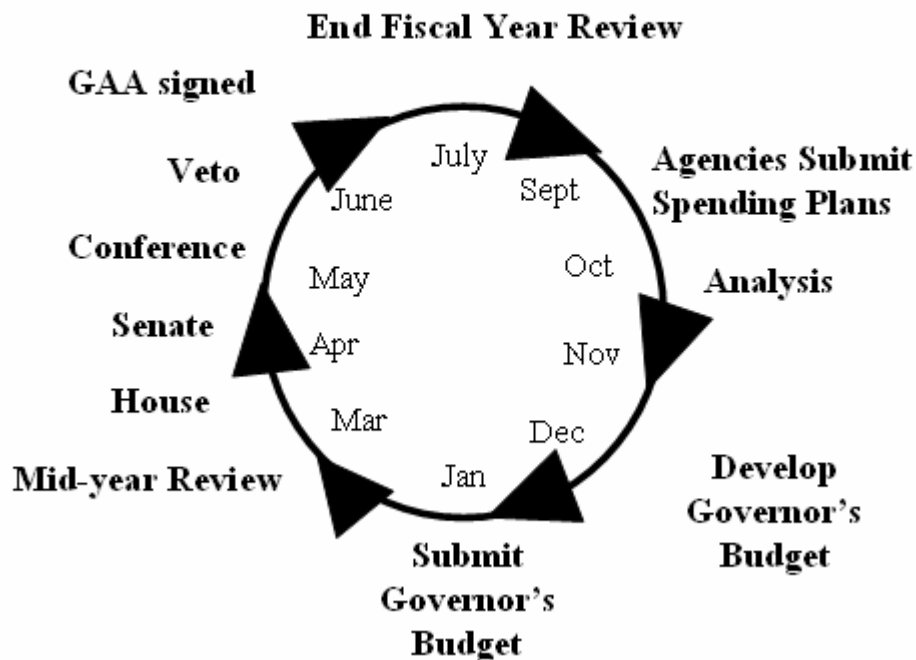
## **Overview of the Operating Budget Process**

Generally, funds for the Commonwealth's programs and services must be appropriated by the Legislature. The process of preparing a budget begins with the Executive branch early in the fiscal year preceding the fiscal year for which the budget will take effect.

The Massachusetts Constitution requires that the Governor recommend to the Legislature a budget which contains a statement of all proposed expenditures of the Commonwealth for the upcoming fiscal year, including those already authorized by law, and of all taxes, revenues, loans and other means by which such expenditures are to be defrayed. 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. Further, during the fiscal year, the Governor may approve no supplementary appropriation bills that would result in an unbalanced budget.

Fiscal year is a commonly used annual budgeting period. State fiscal year 2010 extends from July 1, 2009 to June 30, 2010. After working with agencies to analyze spending plans submitted in the fall of 2008 and under the direction of the Governor's Office, the Executive Office of Administration and Finance prepares the Governor's budget recommendations, otherwise known as House 1 (H.1) in odd years and House 2 (H.2) in even years. 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. 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. Accordingly, the fiscal year 2010 budget will be filed on January 28, 2009. The budget recommendations are filed with the House of Representatives. More detailed information regarding the budget development process for fiscal year 2010 can be found in the "Expenditure Development" section.

### **Commonwealth's Budget Calendar**



The Governor's budget is referred for consideration to the House Ways and Means Committee, which in turn proposes a budget to the full House of Representatives. Once approved by the House, the budget is referred to the Senate Ways and Means Committee, which in turn proposes a budget to be considered by the full Senate. In recent years, the legislative budget review process has included joint hearings by the Ways and Means Committees of the Senate and the House. After Senate action, a legislative conference committee develops a joint budget recommendation for consideration by both houses of the Legislature, which upon adoption is sent to the Governor.

Before signing the appropriations act, the Governor may veto the budget in whole or disapprove or reduce specific line items (line-item veto). The Legislature may override the Governor's veto or specific line-item vetoes by a two-thirds vote of both the House and Senate. The annual budget legislation, as finally enacted, is known as the General Appropriations Act (GAA).

### **Specific Budget Policies**

This budget document provides the Governor's budget recommendations for the fiscal year beginning July 1, 2009 and ending June 30, 2010. The budget is balanced, with the projected revenues from taxes and other

sources being sufficient to cover recommended expenses. The Commonwealth uses a statutory basis of accounting to define balance where actual revenues received within the fiscal year must meet or exceed actual expenditures.

The state's finance laws are contained 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) be in balance. Any supplemental budget bill cannot impair the overall fiscal balance. One method of achieving balance may be through drawing from the Commonwealth's Stabilization Fund, also known as the Rainy Day Fund.

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

Prior to the Governor's submission of the budget, the Secretary of Administration and Finance and the House and Senate Committees on Ways and Means are required to agree on a "consensus tax revenue forecast" from which to build their spending projections. The consensus revenue process for fiscal year 2010 is discussed in more detail later in this section.

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

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

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

## **General Fiscal Policies of the Commonwealth**

The following principles and policies were used to guide the development of the fiscal year 2010 budget. Above all else, state finance law requires the Governor's budget and all later versions to be in balance; expenditures must not exceed available revenues. In addition, H.1 includes the following principles and goals:

### **Strategic Fiscal Policies**

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

- Protect high-priority government functions
  - Preserve social safety net to cushion impacts of economic downturn and meet new caseload pressures. Includes preserving state-subsidized health insurance programs expanded under the Commonwealth's historic health care reform law.
  - Protect education funding to maximum extent possible as cornerstone of long-term economic growth.
  - Mitigate impact on aid to cities and towns.
- Identify government reforms that promote efficiency and sustainability of services. Streamline government wherever possible.

- Identify additional recurring revenues to support worthwhile programs.
- Reduce reliance on volatile tax receipts like capital gains.
- Strike careful balance on the temporary use of one-time resources to balance the budget.

### **Financial Reporting**

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

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

### **Revenue**

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

### **Cash Flow**

- The Cash Management Division of the State Treasurer's office accounts on a daily basis for cash received into over 600 separate accounts of the Department of Revenue and other Commonwealth agencies and departments.
- The State Treasurer, in conjunction with Comptroller and the Executive Office for Administration and Finance, monitors cash to maximize the Commonwealth's return on investment and minimize the use of borrowing.
- Formal cash flow projections for the then current fiscal year are submitted to the House and Senate Committees on Ways and Means on or before each August 31, November 30, February 28 and May 31. The projections include estimated sources and uses of cash, together with the assumptions from which such estimates were derived and identification of any cash flow gaps.
- The State Treasurer's office, in conjunction with the Comptroller and the Executive Office for Administration and Finance, develop quarterly and annual cash management plans to address any gap identified by the cash flow projections and variance reports.
- The State Treasurer's office oversees the issuance of short-term debt to meet cash flow needs, including the issuance of commercial paper

### **Expenditures**

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

### **Expenditure Controls**

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

### **Internal Controls**

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

### **Reserves**

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

### **Debt affordability**

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

### **Capital Budget**

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

### **Pensions**

- The Commonwealth will continue to follow a pension funding schedule to address our unfunded liability.

### **Other Post-Employment Benefits**

- The Commonwealth will continue to pursue adoption of a funding schedule to fully fund public employee retiree health care benefits.

### **Performance Management**

- Overall measures of government performance will be tracked regularly through the MassGOALS initiative.
- The priorities developed during the MassGOALS discussions will be reflected in the Governor's budget.

## **Overview of Budget Funds**

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

*Budgeted Funds* are the primary operating funds of the Commonwealth. They account for all budgeted governmental transactions. The main budgeted funds include the General Fund, the Commonwealth Stabilization Fund, the Commonwealth Wellness Fund, and the Commonwealth Highway Fund, which are identified by the Comptroller as the operating funds of the Commonwealth.

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

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



Legislature and federal reimbursements. Deficit balances in the Capital Projects Funds represent amounts to be financed.

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

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

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

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

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

### **Individual Budgeted Funds**

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

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

The *Highway Fund* accounts for highway user taxes including the gas tax and registry fees. The fund is used to finance highway maintenance and safety services and provide matching funds for federally sponsored highway projects as required. For fiscal year 2010, the Governor recommends restructuring the fund to ensure that all transportation-related revenues are directed to the Highway Fund, and that all funding for transportation-related expenses (including debt service on bonds issued for transportation purposes) are paid from this fund. This reform would provide the Commonwealth and the public with a more transparent and true accounting of our transportation revenues and expenses and the extent to which transportation expenses need to be subsidized by non-transportation-related General Fund receipts.

*Infrastructure Fund (Sub-fund of the Highway Fund)* details specific components of gas tax revenue and expenditures related to the Highway Fund segregated per instructions in section 20 of Chapter 29 of the General Laws. Currently funds received are pledged to bonds for transportation related capital improvements.

The *Workforce Training Fund*, authorized by section 2RR of Chapter 29 of the General Laws and administered by the Executive Office of Labor and Workforce Development, provides employers with matching grants of up to \$1 million over two years to help train new and incumbent workers. It was established in July 1998, and is financed entirely by Massachusetts employers. In fiscal year 2008, the Fund was financed by an employer surcharge of .075% on employees' wages, paid concurrently with payments into the Unemployment Insurance Trust Fund. Annual state revenues from employer contributions total approximately \$18 million, and the state appropriation for training grants is typically rolled forward into the next fiscal year to provide for the second year of each grant award.

The *Massachusetts Tourism Fund*, authorized in section 35J of Chapter 10 of the General Laws, is funded with 35 percent of the State's annual revenues received from the hotel occupancy tax authorized in section 3 of Chapter 64G. In fiscal year 2010, Tourism Fund revenues are estimated to total \$41 million. The Fund's use is prescribed in Chapter 10, which includes a formula that assigns various funding levels for tourism promotion programs and activities, including the Massachusetts Office of Travel and Tourism, regional tourism promotion agencies, the Massachusetts Office of International Trade and Investment and the Cultural Facilities Fund. While funding for

the purposes prescribed in the section are being made in this budget, the specific requirements of the fund have been suspended through an outside section for the last several years.

The *Commonwealth Wellness Fund* is being created to collect revenues generated from the elimination of the existing sales tax exemptions on the purchase of alcoholic beverages consumed off-premises, sweetened beverages and candy. This policy initiative aims to encourage healthy lifestyle choices. Monies appropriated from this fund will support programs and services that augment the health and well-being of the citizens of the Commonwealth.

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* – As part of a larger reform, this fund is being eliminated and replaced by the Capital Gains Holding Fund described below. The fund was used to account 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.
- *Bay State Competitiveness Investment Fund* – to account for funds received as part of the calculation of the consolidated net surplus for fiscal year 2007 and available for appropriation in fiscal year 2008. This fund expired on June 30, 2008.
- *Capital Gains Holding Fund* – to account for capital gains tax revenues that exceed the amount determined to be available for the budget as stipulated in the annual consensus revenue estimate. Any balance in the fund at the end of the fiscal year will be transferred to the Stabilization Fund.

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.

## **Fiscal Year 2009 Update**

The evolving fiscal situation has been a constant focus for the Administration for the past year, involving close consultation with economic experts and a strong partnership with the Legislature. Given the difficulty in predicting the exact course and magnitude of this unprecedented economic downturn, the Administration has continuously monitored revenue forecasts and collections and has refined its approach as information about the economy has evolved.

The Administration had begun taking a number of steps to address our budget and economic challenges in the early months of 2008. When Governor Patrick signed the fiscal year 2009 budget into law in July, he signed into law changes to the corporate tax code that closed a series of tax loopholes that had allowed some large multi-state corporations to avoid paying their fair share. In addition, he issued a management plan that included \$122.5 million in vetoes, shared responsibility health care solutions and a request for expanded budget cutting authority. The Governor also implemented cost-savings measures across agencies through spending and hiring controls and the suspension of merit pay raises. Additionally, he put in place a no-new-net hires policy that requires state agencies to continue to provide the same level of services without adding employees to the overall total.

As the housing crisis continued and the stock market began to collapse, the depth of our economic challenges became more apparent. Economists indicated to the Administration that capital gains taxes were likely to fall by

30 percent, while sales and corporate/business taxes would also begin a substantial slide. Later forecasts would indicate that capital gains taxes were more likely to fall by 48 percent.

The fiscal year 2009 General Appropriation Act was predicated on a tax forecast of \$21.402 billion. On October 15, 2008, the Governor revised that forecast downward to \$20.302 billion and implemented a fiscal action plan to close a \$1.4 billion budget gap. The centerpiece of that package was \$1.053 billion in cuts and spending controls. Additionally, the Governor sought additional reforms to improve the state's long-term fiscal health, specifically directing the Secretary of Transportation to prepare legislation to dismantle the Turnpike Authority and merge the remaining transportation agencies. He also called for an administration-wide effort to consolidate departments and agencies and their offices and to develop means of delivering state services with the quasi-public agencies in a more efficient and coordinated fashion. The Administration also began working to develop a legislative proposal to reform the state pension system and the Massachusetts Bay Transportation Authority (MBTA) pension system.

The Administration has continued to make investments in our economy to support immediate and long-term job creation and growth. Work continues on an accelerated bridge program to repair structurally deficient bridges that both addresses a critical public safety issue and creates jobs. The Administration also completed its second five-year capital plan that makes much-needed investments in our schools, environment and other facilities. The Governor has readied the Commonwealth to receive federal economic stimulus funds by identifying projects Commonwealth-wide that can be initiated within 180 days of the President signing a stimulus package.

Since October, however, the Massachusetts economy has further deteriorated and is expected to contract during the last three quarters of fiscal year 2009, as a result of the unfolding national recession. On January 15, 2009 the Secretary of Administration and Finance informed the Governor and the Legislature that the Commonwealth will face a further decline in revenues and anticipated spending exposures, resulting in a new gap of \$1.1 billion. The Governor has proposed to close this gap using \$533 million in anticipated federal stimulus funds and \$191 million in additional budget cuts. While the Governor was able to spare Local Aid during his first round of mid-year cuts, a second round of cuts, including in Local Aid, will be necessary to ensure that the fiscal year 2009 budget is in balance.

<b>Fiscal Year 2009 Recovery Plan</b>			<b>Total For Fiscal Year 2009</b>
	<b>(\$1.4 Billion)</b>	<b>(\$1.1 Billion)</b>	<b>(\$2.5 Billion)</b>
<b>Spending Cuts and Controls:</b>	<b>\$ 1,053</b>	<b>\$ 191</b>	<b>\$ 1,244</b>
Governor's Budget Cuts	\$ 755	\$ 191	\$ 946
Governor's Spending Controls	\$ 146		\$ 146
Voluntary Cuts	\$ 52		\$ 52
Pension Savings	\$ 100		\$ 100
<b>Additional Revenue:</b>	<b>\$ 168</b>	<b>\$ 50</b>	<b>\$ 218</b>
New Federal Funds	\$ 55		\$ 55
DOR Tax Settlements	\$ 100	\$ 25	\$ 125
Eliminate Sales Tax Exemptions	\$ -	\$ 25	\$ 25
Telecom Loophole Repeal	\$ 13		\$ 13
<b>Stabilization Fund:</b>	<b>\$ 200</b>	<b>\$ 327</b>	<b>\$ 527</b>
<b>Federal Recovery Aid:</b>	<b>\$ -</b>	<b>\$ 533</b>	<b>\$ 533</b>
<b>Total Solutions:</b>	<b>\$ 1,421</b>	<b>\$ 1,101</b>	<b>\$ 2,522</b>

## **Fiscal Year 2010 Budget**

### **Revenue Development**

#### **Tax Revenues**

Tax revenues comprise over 60% of all revenues (including new revenues proposed in the H.1 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. Guided by that information, they project state tax revenue for use in the state budget. The following is a general description of the consensus revenue process.

### **General Information Regarding Consensus Revenue**

The consensus revenue process is required under M.G.L. c.29, s.5B and requires that on or before January 15<sup>th</sup>, the Secretary of Administration and Finance meet with the House and Senate Committees on Ways and Means and 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 15, 2008, the Secretary of Administration and Finance and the House and Senate Committees on Ways and Means held a public hearing in Boston and heard testimony from a number of the Commonwealth's noted economists and public finance experts from the Massachusetts Department of Revenue (DOR), the Federal Reserve Bank of Boston, Massachusetts Taxpayers Foundation, the Beacon Hill Institute, the University of Massachusetts-Boston, and Harvard University. The three branches subsequently agreed upon a fiscal year 2010 tax revenue estimate of \$19.530 billion, consistent with testimony presented at the hearing, as well as a revised fiscal year 2009 estimate of \$19.450 billion.

As part of the statutorily required consensus revenue process, the Secretary of Administration and Finance, House and Senate also agree on the amount of tax revenues that will need to be transferred to support the State's Pension Fund, the School Building Authority and the MBTA (Massachusetts Bay Transportation Authority). For fiscal year 2010, these transfers are estimated to total \$2.784 billion and will be directed to the following funds:

• MSBA - School Modernization & Reconstruction Trust Fund	=	\$641 million
• MBTA State and Local Contribution Fund	=	\$767 million
• Pension Reserves Investment Trust Fund	=	<u>\$1.376 billion</u>
		\$2.784 billion total
		\$16.746 billion remains

### **Basis for the Fiscal Year 2010 Consensus Revenue Forecast**

Fiscal year 2009 tax revenues are estimated to be \$19.450 billion, representing a decline of 6.8% actual and 8.0% baseline from fiscal year 2008 collections (the baseline calculation adjusts for the impact of tax law and processing changes, and thus is a better indicator of underlying economic activity). Through December of 2008, fiscal year 2009 year-to-date tax revenues are down 0.7% actual and 1.4% baseline, and were \$55 million above the year-to-date benchmark based on the October 15, 2008 Executive Office for Administration and Finance fiscal year 2009 estimate of \$20.302 billion. The amount over benchmark is the result of one-time settlement revenues received in December 2008 that were not included in the official benchmarks but were expected to be paid sometime during the fiscal year (these revenues were assumed in the Governor's fiscal action plan in October). It is expected that due to economic deterioration and a decline in capital gains tax collections, tax collections for the remainder of fiscal year 2009 will decline by \$1.36 billion, or 11.6% actual, and \$1.6 billion, or 13.6% baseline, from the same period in fiscal year 2008.

The fiscal year 2010 consensus tax revenue estimate is \$19.530 billion, representing revenue growth of 0.4% actual, but a decline of 0.1% baseline from the fiscal year 2009 estimate of \$19.450 billion. The fiscal year 2010 estimate assumes that the national and state economies will remain in recession at least through the middle of calendar year 2009 and then begin a slow recovery. In developing the consensus estimate, the Commonwealth relies on economic forecasts from Moody's Corporation, 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:

- As measured by real Gross Domestic Product (GDP), the economy declined in both the third and fourth quarters of calendar year 2008 and is projected to decline through at least the second quarter of calendar year 2009. GDP growth for the full fiscal year 2009 is projected to be between 0% and negative 1.0% compared to growth of 2.0% in FY07 and 2.4% in FY08. In fiscal year 2010, GDP growth is projected to range from -0.1% to +1.6%.

- Massachusetts employment is expected to decline by 1.1% to 1.8% over the remainder of fiscal year 2009, and by 0.5% to 1.1% for fiscal year 2009 as a whole. For fiscal year 2010, Massachusetts employment is expected to decline by 1.0% to 2.2%.
- Massachusetts personal income (excluding capital gains) is expected to grow by only 1.0% to 2.5% over the remainder of fiscal year 2009 and 1.9% to 3.1% for fiscal year 2009 as a whole. For fiscal year 2010, Massachusetts personal income is projected to grow by 1.6% to 2.3%.
- Massachusetts wages and salaries are projected to grow by between 0.6% and 2.0% for the remainder of fiscal year 2009 and 2.0% to 3.2% for the year as a whole. For fiscal year 2010, the growth in Massachusetts wages and salaries is projected to range from -0.7% to +1.3%.
- Massachusetts retail sales are expected to decline by 6.3% to 6.8% over the remainder of fiscal year 2009 and by 4.3% to 5.5% for the fiscal year as a whole. (A significant portion of the fiscal year 2009 retail sales decline is the result of falling fuel prices, which do not affect sales tax revenue.) For fiscal year 2010, Massachusetts retail sales are projected to grow by 1.4% to 1.5%.
- Corporate profits at the national level are expected to decline by 4.9% to 13.3% over the remainder of fiscal year 2009, and by 6.0% to 18.9% for the fiscal year as whole (there are no forecasts for state corporate profits). For fiscal year 2010, growth in corporate profits is projected to range from -3.5% to +16.3%.

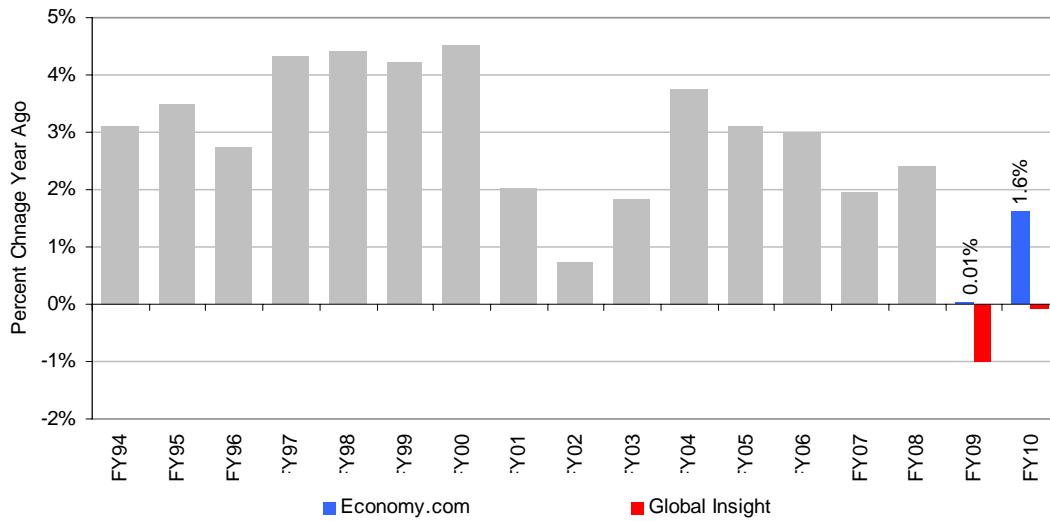
In addition to the economic forecasts described above, the consensus revenue estimate takes into account forecasts for capital gains realizations and taxes. The consensus agreement capital gains forecast is based on the following considerations:

- Preliminary tax year 2007 data indicates that Massachusetts capital gains realizations increased by approximately 23% in tax year 2007, to \$35.9 billion. Fiscal Year 2008 taxes on those capital gains totaled approximately \$2.080 billion, an increase of approximately \$426 million, or 26%, from fiscal year 2007 (taxes on tax year 2007 capital gains realizations were paid mostly in fiscal year 2008).
- The stock market, as measured by the average of the S&P 500 over the entire year, declined by 17.6% in calendar year 2008 (which largely determines fiscal year 2009 capital gains taxes) and is expected to decline by an additional 13.6%-19.4% in calendar year 2009 (which largely determines fiscal year 2010 capital gains taxes). Economy.com, the only economic forecasting firm to project capital gains, estimates that capital gains realizations declined approximately 40.5% in tax year 2008 compared to 2007 and will decline by an additional 1.1% in tax year 2009. After considering more conservative scenarios developed by the Massachusetts Department of Revenue, the consensus agreement assumes that Massachusetts capital gains realizations will decline by 47.5% in calendar year 2008 and an additional 20% in calendar year 2009.

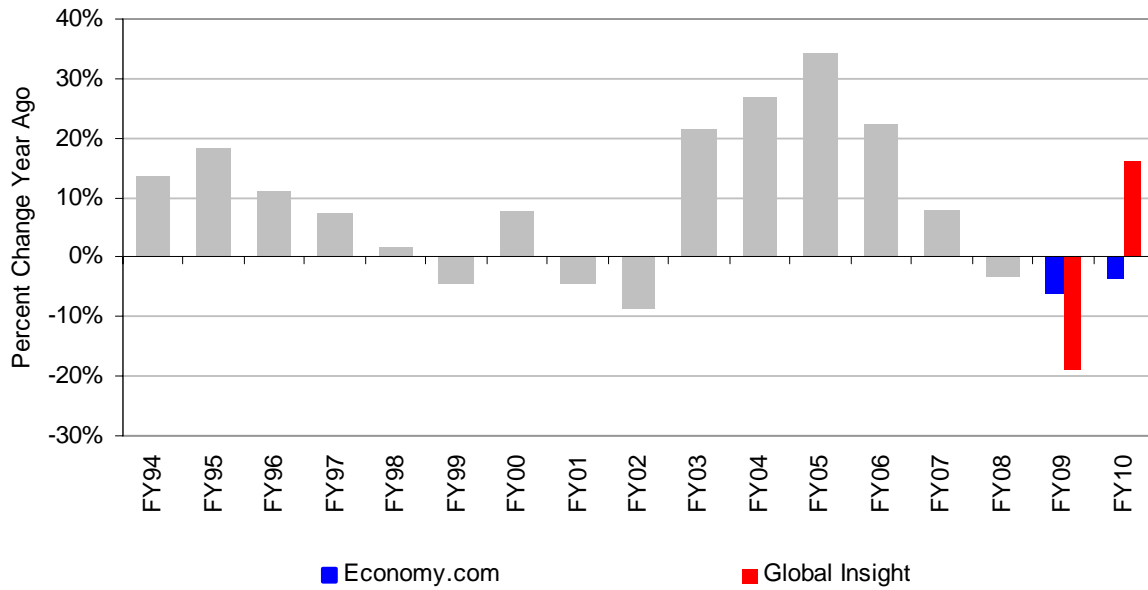
Because most of the recent asset market declines occurred in the second half of calendar 2008, many taxpayers did not adjust their estimated capital gains tax payments downward in the first half of 2008. Capital gains tax payments over the remainder of fiscal year 2009 will be reduced below what would ordinarily be consistent with a 48% decline in capital gains realizations, as taxpayers now adjust their payments downward to align them with their full tax year 2008 capital gains tax liabilities. The fiscal year 2009 estimate assumes that these adjustments will result in a reduction in fiscal year 2009 capital gains taxes of 59% from fiscal year 2008. Furthermore, because capital gains taxes will be reduced by more than 48% in fiscal year 2009, the consensus estimate assumes that fiscal year 2010 capital gains taxes will decline by only 1.5% from fiscal year 2009, despite a much larger 20% decline in tax year 2009 capital gains realizations.

The charts below reflect the national and state economic forecasts presented at the December 15, 2008 consensus revenue hearing and the consensus estimate assumption for capital gains realizations and taxes, all of which were taken into consideration in developing the fiscal 2009 and 2010 consensus revenue estimates.

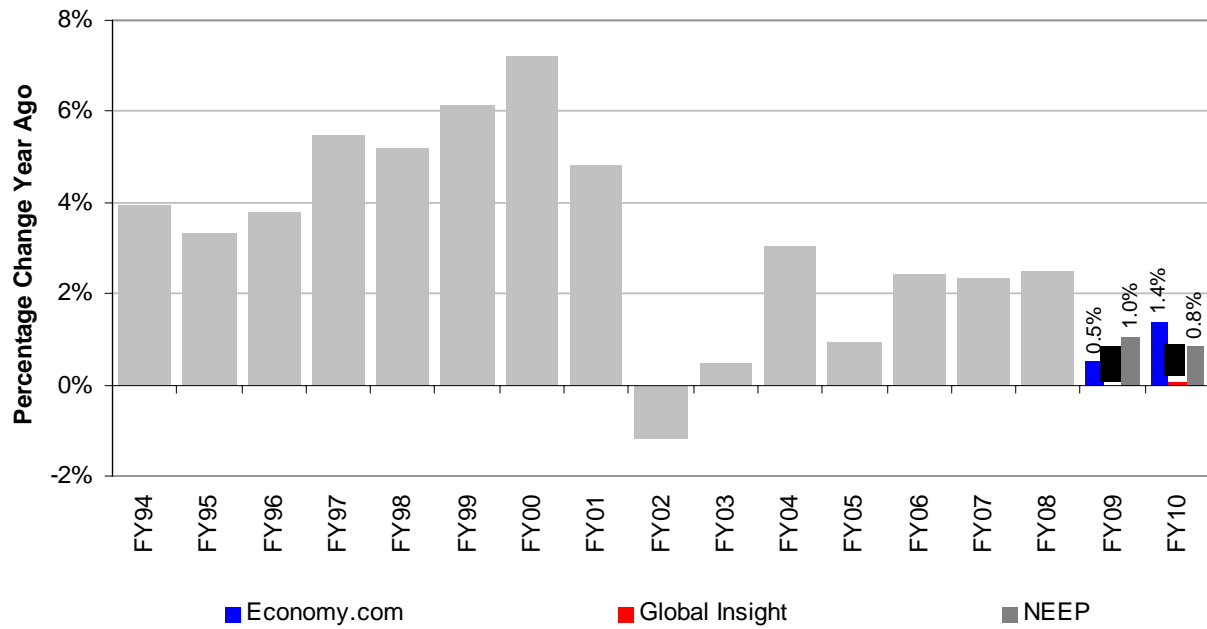
**Real U.S. GDP Growth, FY1994-2010**



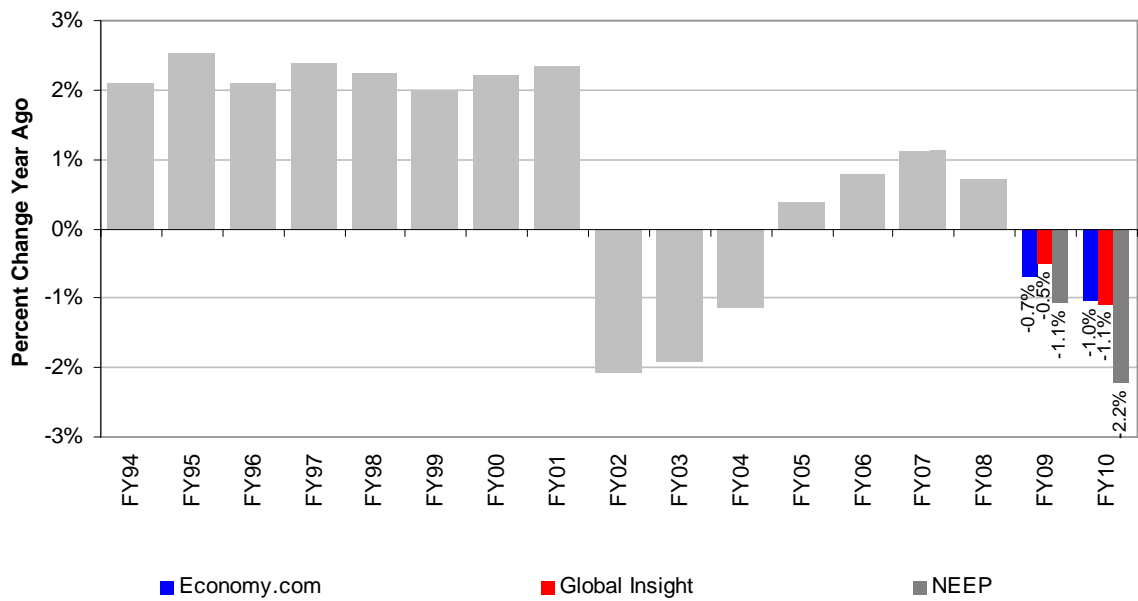
**U.S. Corporate Profit Growth, FY1994-2010**



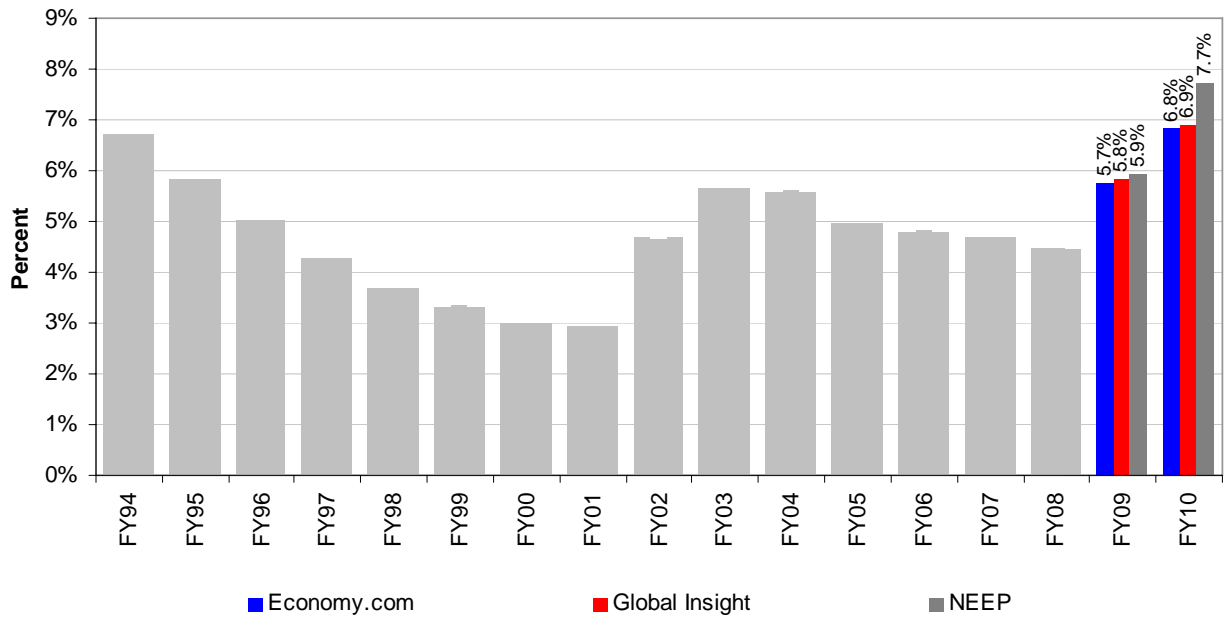
### Massachusetts GDP Growth, FY1994-2010



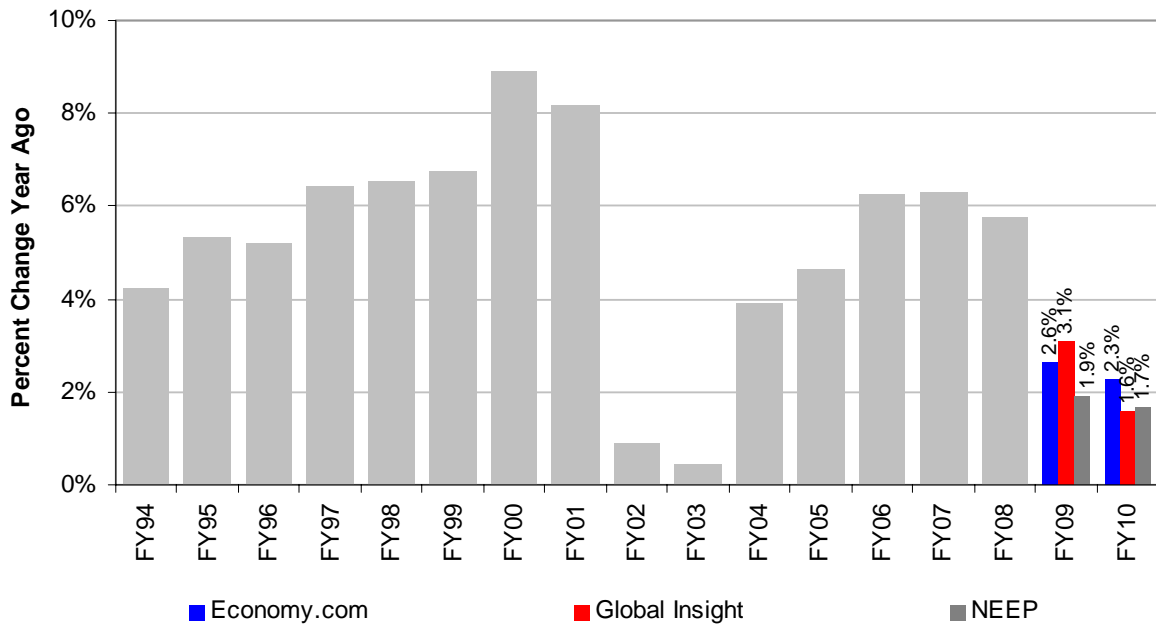
### Massachusetts Employment Growth, FY1994-2010



### Massachusetts Unemployment Rate, FY1994-2010

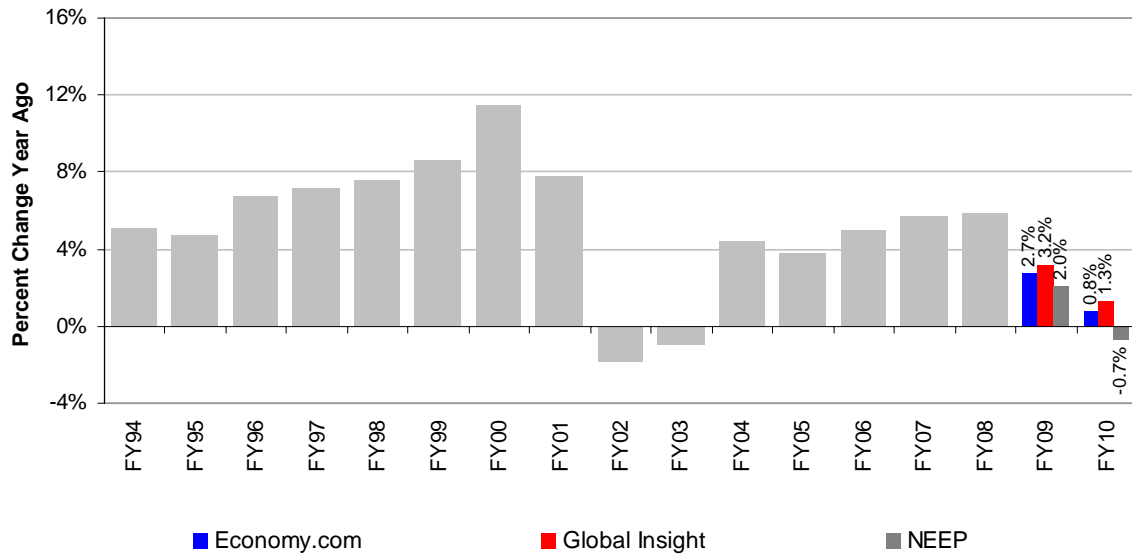


### Massachusetts Personal Income Growth, FY1994-2010

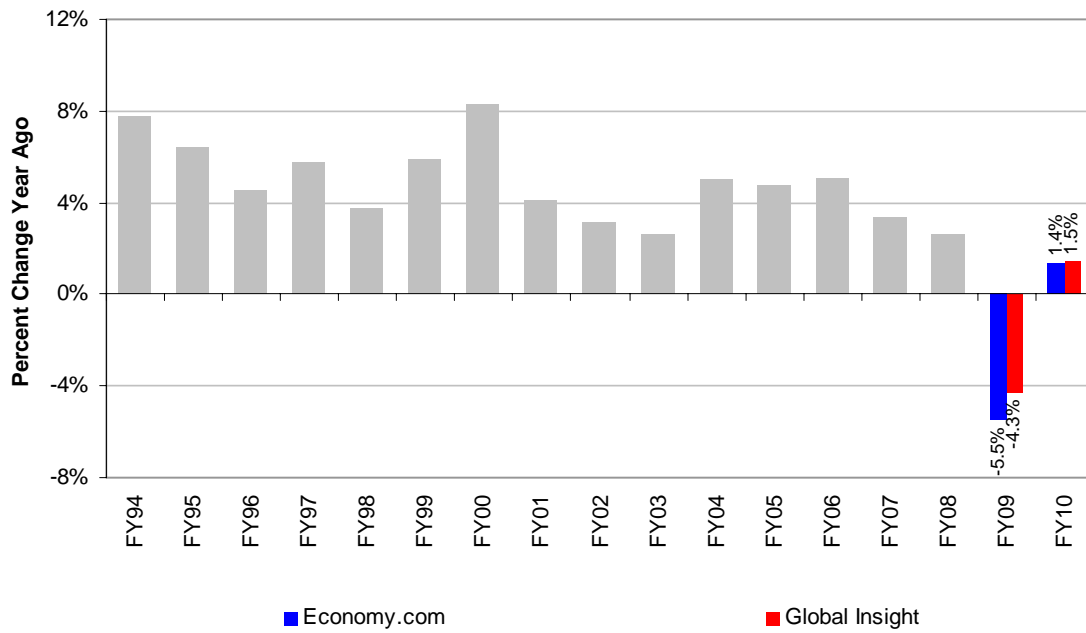




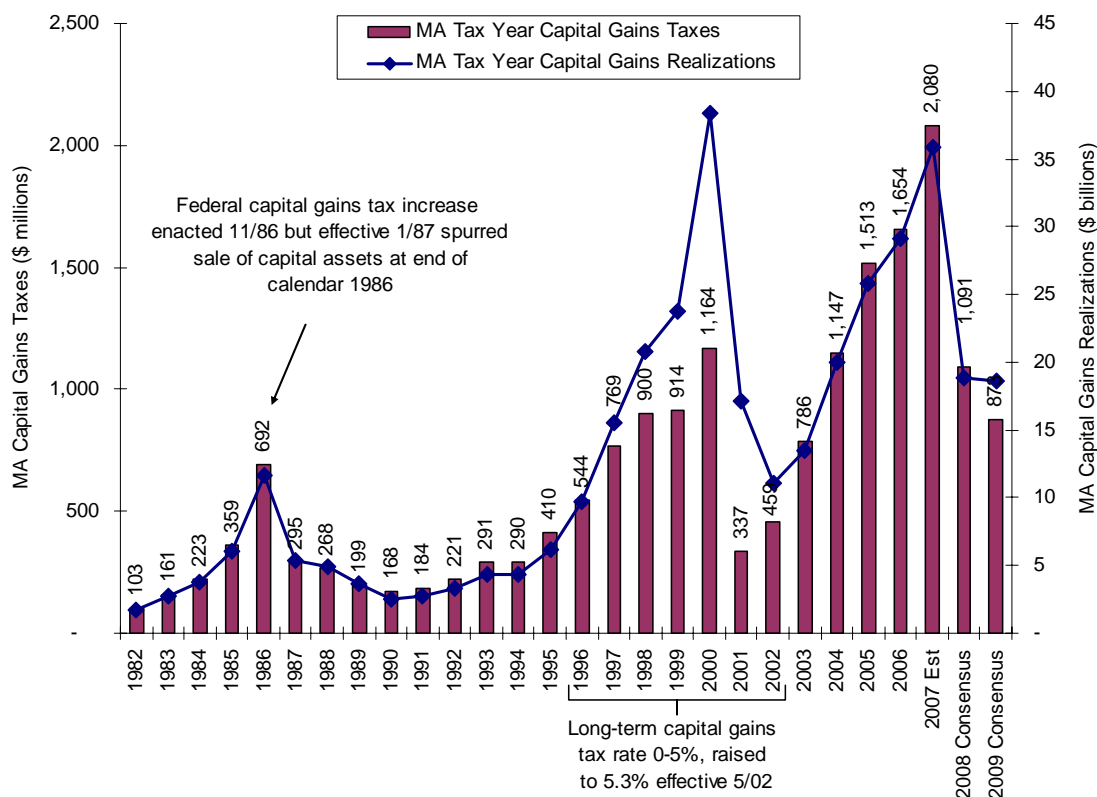
### Massachusetts Wage and Salary Growth, FY1994-2010



### Massachusetts Retail Sales Growth, FY1994-2010



Capital Gains Taxes, Tax Years 1982 to 2009

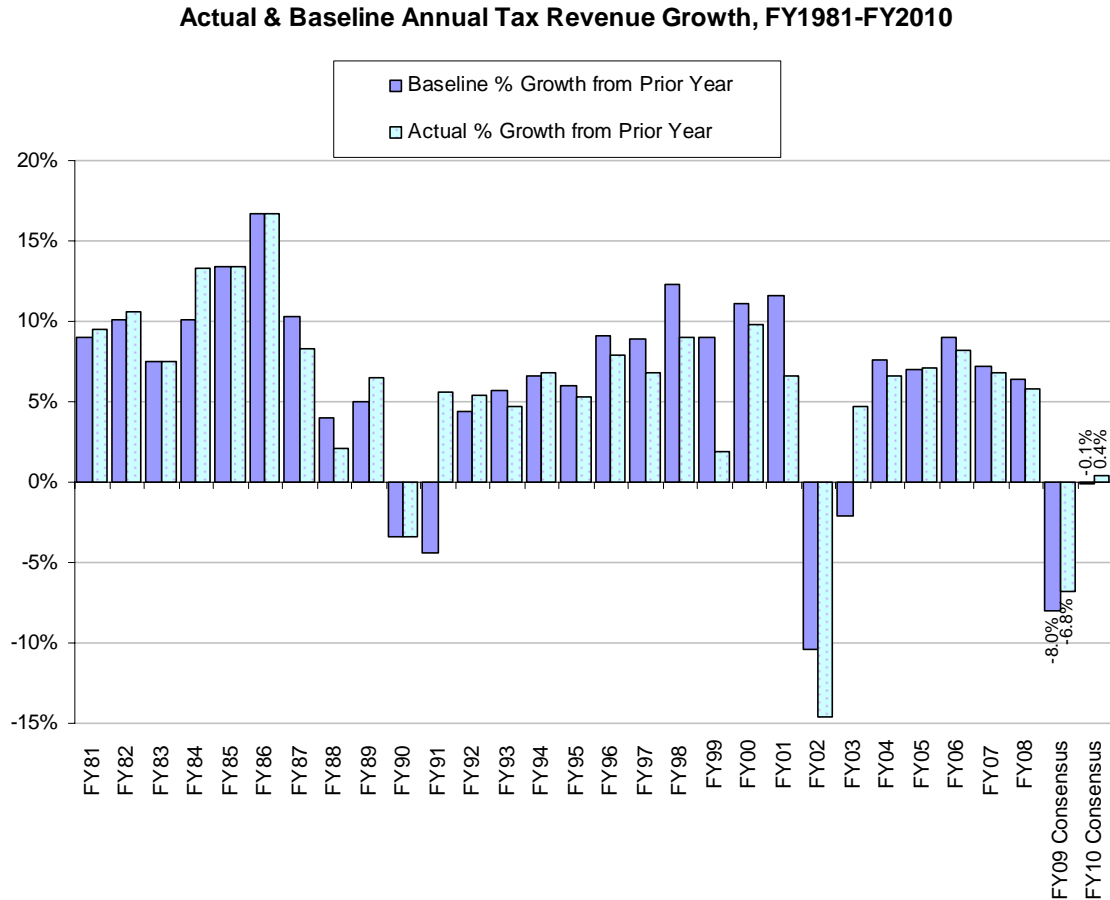


Based on these economic projections and actual tax collections through December 2008, fiscal year 2010 tax collections are projected to grow by \$80 million, or 0.4% actual, but decline by 0.1% baseline from fiscal year 2009 tax collections, with income tax collections growing by 0.3% actual and 0.4% baseline, sales tax growing by 2.3% actual and 1.9% baseline, and corporate/business taxes declining by 3.2% actual and 6.5% baseline, as shown in the chart below.

FY10 Consensus Tax Revenue Forecast  
(\$ Millions)

Tax Type	Actual Revenue Growth from FY09	Baseline Revenue Growth from FY09	FY10 Revenue Estimate	FY10 Growth from FY09
Total Income	0.3%	0.4%	11,432	34
Withholding	0.5%	0.5%	9,139	44
Sales	2.3%	1.9%	4,021	92
Corporate/Business	-3.2%	-6.5%	2,308	-75
Other	1.7%	0.3%	1,769	29
<b>Total</b>	<b>0.4%</b>	<b>-0.1%</b>	<b>19,530</b>	<b>80</b>
Memo: Capital Gains	-1.5%	-1.5%	846	-13

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

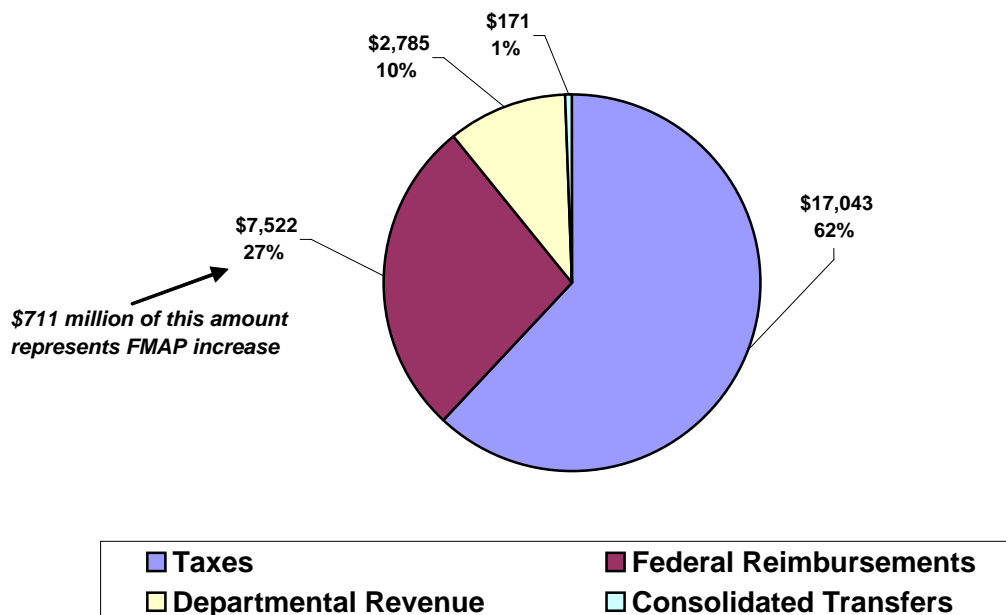


## Non-Tax Revenue Assumptions

In order to fund its programs and services, the Commonwealth collects a variety of taxes and receives revenues from other non-tax sources, including the federal government, and various fees, fines, court revenues, assessments, reimbursements, interest earnings and transfers from its non-budgeted funds. These revenues are deposited in the General Fund, the Highway Fund and other operating budgeted funds. The Governor's fiscal 2010 budget recommendation assumes that approximately 62% of the Commonwealth's budgeted operating revenues and other financing sources were derived from state taxes. In addition, the federal government provided approximately 27% of such revenues, with the remaining 11% provided from departmental revenues and transfers from non-budgeted funds.

House 1 Total Revenues: \$27.521 Billion

(\$s in million)



### 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). The amount of federal reimbursements to be received is determined by state expenditures for these programs. The Commonwealth receives reimbursement for approximately 50% of its spending for Medicaid programs. Generally, block grant funding is received quarterly and is contingent upon maintenance-of-effort spending levels determined by the federal government. Staff from the Executive Office for Administration and Finance work with agencies to project budget year spending levels for these federally supported programs.

### Departmental Revenues

Departmental revenues are derived from licenses, tuition, fees, 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. 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 and whether fees and charges:

- cover the full cost of providing a service;
- have been updated recently; and
- are comparable to what other states charge for similar services.

House 1 includes two sections that give a detailed view of projected non-tax revenue for fiscal year 2010. Section 1B details projected fiscal year 2010 non-tax revenue receipts by the department, board, commission or institution that administers and collects the respective revenue source. The online version of House 1 allows the user to

further drill down into 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 include a number of operating transfers to and from non-budgeted funds of the Commonwealth. These include transfers to support spending to implement the Commonwealth's Health Care Reform law through including the Commonwealth Care Trust Fund and the Medical Assistance Trust Fund. These inflows and outflows also 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 details the budgetary impact of these sources and uses of funds.

### **Expenditure Development**

Agencies prepared "spending plans" during the summer of 2008 and filed them with the Executive Office for Administration and Finance (A&F) for review in September. Each year, agencies present spending plans to delineate how funds appropriated for the current fiscal year (in the General Appropriations Act) will be spent.

Agencies use current-year spending as a base to inform their recommendations for the following fiscal year. A critical component for development of the budget recommendation is defining a "maintenance" level of funding for an agency or program. A maintenance budget is defined as *the level of funding necessary to provide the same level of services in a fiscal year as those provided for in the prior fiscal year and to cover expenses which the Commonwealth will be obligated to pay*. In developing maintenance budgets and ultimately budget recommendations, agencies incorporate projected changes in the programs they provide, such as 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.

#### *Fiscal Year 2009 Spending Plans and Fiscal Year 2010 Budget Development*

Recognizing signs of a deteriorating economy, the Administration anticipated early on that it would be necessary to prepare for a revenue shortfall in fiscal year 2009 and slow revenue growth in fiscal year 2010. To prepare for this inevitability, agencies were asked to submit strategies that could be implemented mid-year to achieve savings if fiscal year 2009 revenue fell below benchmark. In addition, A&F set caps on the growth in spending that would be allowed in fiscal year 2010, agencies were asked to ensure that spending fell below fiscal year 2009 appropriated levels by 1.5%.

After spending plans had been submitted, it became clear that the revenue shortfall in fiscal year 2009 would be much larger than originally anticipated. So while agencies had already submitted plans to reduce spending by almost \$230 million, A&F worked to develop a much longer list of potential reductions. On October 15, 2008, after the A&F Secretary notified the Governor that available revenues were insufficient to meet authorized expenditures by \$1.4 billion, A&F implemented \$1.053 billion in spending reductions and controls. These reductions, combined with other solutions presented at the time (including voluntary reductions from public entities not subject to reductions under Ch.29, S.9C, additional non-tax revenues not previously recognized, and the use of additional stabilization funds) were implemented to bring the fiscal year 2009 budget in balance.

After revising fiscal year 2009 revenue downward in October, A&F asked agencies to begin identifying additional opportunities to reduce fiscal year 2010 spending even further. In mid-November, 2008, A&F formally launched a process whereby agencies were asked to revisit their fiscal year 2010 budget requests. New fiscal year 2010 targets reflected the need for growth in some areas of the budget, including Medicaid (MassHealth), the Group Insurance Commission (which provides state employee health benefits), and the Commonwealth's debt service line items. After accounting for growth in each of these areas, the spending targets distributed to Secretariats

reflected a \$38 million decrease below fiscal year 2009 appropriations and only 1% growth above fiscal year 2009 projected spending.

Just as agencies were completing their work on revising fiscal year 2010 budget requests that would meet new spending targets released in November, the Administration began the process to develop consensus with the House and Senate Committees on Ways and Means regarding the fiscal year 2010 tax revenue estimate. While the intent of this hearing was to come to consensus regarding fiscal year 2010 revenues, it became clear during expert testimony that, despite having revised revising fiscal year 2009 revenue projections downward by 5% only two months earlier, an additional decline should be expected. And because the impact could be expected through at least the first half of fiscal year 2010, tax revenue would be approximately \$1 billion below what A&F had assumed only a month earlier in distributing new spending targets.

Based on the information gained during the consensus revenue process, a second round of mid-year reductions was necessary. A&F developed reduction targets based on the remaining funding available, and agencies were given the opportunity to review and revise the line items from which reductions would be taken in fiscal year 2009. However, at this point in the expenditure development process, it was not feasible or practical to ask agencies to again identify specific actions they would take to achieve further reductions in their fiscal year 2010 budget requests. It became clear that there was a level of spending that revenue would support, and that it was most important to ensure that funding did not exceed this level. This meant that, in some cases, fiscal year 2010 budget recommendations reflect reduced spending for programs but that agencies have not yet determined how to implement these reductions.

#### *Fiscal Year 2010 Post House 1 Process*

Recognizing that the revenue picture is not likely to improve before the second half of fiscal year 2010, immediately after releasing H.1, A&F will guide agencies through a fiscal year 2010 planning process. In most cases, agencies have identified areas to cut back or to reform current programs and capitalize on efficiencies. However, due to the rapidly changing revenue projections, in some cases agencies have not yet been able to determine exactly how they will restructure programs to live within funding levels recommended in H.1.

During the post-H.1 planning process, agencies will refine the details of the initiatives to which they have already committed in order to achieve savings in fiscal year 2010. In some cases where there is uncertainty as to how savings will be achieved, agencies will use the several months before the start of the fiscal year to finalize the details of their reduction plans.

#### *Policy Recommendations*

While the fiscal year 2009 and 2010 expenditure development process evolved significantly in a short period of time, there were several core policy recommendations that were incorporated into Governor Patrick's budget recommendation. Below are several examples of the types of policy reports upon which many of the fiscal year 2010 budget recommendations were developed. Additional reports and policy papers can be found at [www.mass.gov/budget/governor](http://www.mass.gov/budget/governor).

*Special Commission Relative to Ending Homelessness* – Governor Patrick authorized the Commission to End Homelessness to design a strategic plan to end homelessness in Massachusetts by 2013. On January 9, 2008, the Commission released its report, and charged the Interagency Council on Housing and Homelessness (ICHH) with implementing the Commission's recommendations. A major component of this plan was to transform the state's existing system for helping homeless individuals and families by transitioning from a system that emphasizes shelters as the first solution to one that deploys shelter as an emergency assistance tools, and places greater emphasis on prevention and permanent housing activities as solutions. It was contemplated by the commission that this would result in drastically diminished use of emergency shelters. Governor Patrick's budget recommendation for fiscal year 2010 transfers homelessness spending currently funded through at the Department of Transitional Assistance to the Department of Housing and Community Development. Utilizing the expertise within DHCD will help the Commonwealth develop a "Housing First" model to end homelessness.

*Readiness Finance Commission Report* - In June of 2008 Governor Patrick assembled the Readiness Finance Commission and charged it with presenting a variety of alternative means to achieve sustainable education funding for current needs and the sequenced investments necessary for a ten-year Readiness Project implementation plan. Due to the dramatic economic downturn, the Commission's report, therefore, concentrated on the urgent need to find opportunities for cost savings and to maintain support for our education system in a

time of inadequate resources. Governor Patrick's fiscal year 2010 budget recommendation continues support for education, most prominently by maintaining Chapter 70 education funded in fiscal years 2009 and 2010 at its current, all-time high of \$3.948 billion.

*Massachusetts Health Insurance Survey* - In April 2006, the Commonwealth launched unprecedented efforts to reduce the number of uninsured. Out health care reform law focuses on creating greater access to health insurance by expanding eligibility for MassHealth and offering a new subsidized program, Commonwealth Care, for individuals who are not eligible for MassHealth. There are also new commercial products available through the Commonwealth Connector Authority for individuals who do not qualify for publicly-subsidized coverage. Greater access to coverage, coupled with a new individual mandate to obtain affordable health insurance, has resulted in the lowest rate of uninsured in the country. In November 2008, the Division of Health Care Finance and Policy released its report to assess the impact of health care reform, *Health Care in Massachusetts: Key Indicators*. The report indicates that over 97% of individuals in the Commonwealth have insurance, including nearly all elderly individuals and children. Governor Patrick's fiscal year 2010 continues to build on this progress by funding continued expansion of health insurance coverage through MassHealth and Commonwealth Care.

### **Fiscal Year 2010 Budget Challenge**

The economic downturn has left us with unprecedented fiscal challenges and a projected \$3.5 billion shortfall for fiscal year 2010. There are 3 main drivers that contribute to the projected shortfall: a reoccurring structural deficit from previous fiscal years, natural growth in spending to maintain existing programs and declining tax revenues.

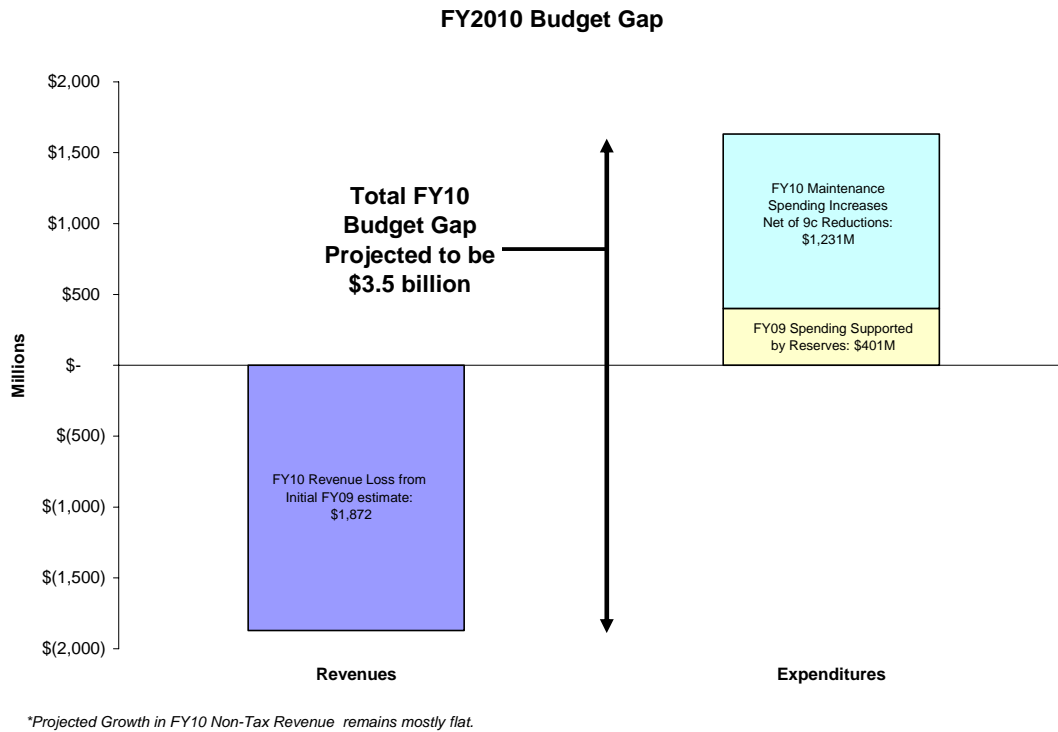
Tax revenues have fallen precipitously below original projections for the current fiscal year (fiscal year 2009) and for what was assumed at the time the Administration developed its maintenance estimates for fiscal year 2010. Revenues are now projected to be about \$1,872 billion below the amounts on which this year's budget was built – and over \$1.4 billion below revenues from the previous fiscal year (fiscal year 2008). According to the latest consensus revenue estimate, virtually no revenue growth is anticipated for the coming fiscal year (fiscal year 2010).

This problem of declining revenues is compounded by a structural budget deficit, with natural growth in spending outpacing growth in recurring revenues. For some years, only strong growth in our most volatile source of tax revenue – capital gains tax revenue – filled this structural gap. In fiscal year 2008, however, even growth in capital gains revenues was not sufficient to fill the gap, and the state budget was ultimately balanced using over \$500 million in one-time revenues (including \$315 million from our Stabilization Fund, and \$194 million from the Health Care Security Trust Fund). Thus, for the first time since 2001, the balance in our Stabilization Fund fell – even before the current recession hit.

The current fiscal year's budget was predicated on using \$401 million of Stabilization Funds to support current year expenditures. This means that a structural deficit of \$401 million was the starting point for developing a fiscal year 2010 budget, before accounting for growth in spending and the dramatic decline in revenues.

The fiscal year 2010 budget challenge is further compounded by the fact that there are significant pressures on expenditures in fiscal year 2010 for a relatively small number of cost items, including Medicaid, Chapter 70 education aid, and other programs. Expenditures needed to provide the same level of services that were provided in fiscal year 2009 would require an increase of nearly \$1.7 billion. After factoring in the October 9C reductions, increases are still expected to cost approximately \$1.2 billion.

In combination, the use of reserves in 2009, the projected growth in costs to maintain programs and services and a precipitous decline in tax revenues have resulted in a projected shortfall for fiscal year 2010 of approximately \$3.5 billion.



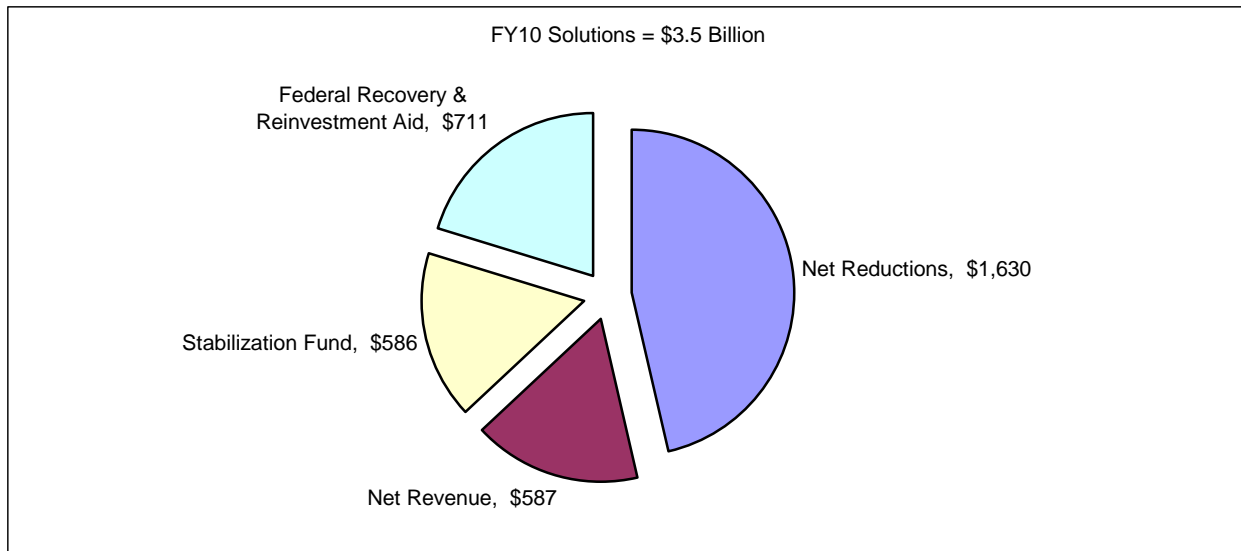
## Fiscal Year 2010 Budget Solutions

The fiscal year 2010 budget authorizes spending of \$27.973 billion, a decrease of about 0.7% from the fiscal year 2009 General Appropriations Act. When compared to fiscal year 2009 estimated spending which includes 9C reductions and after accounting for County Sheriffs being brought on budget, the House 1 recommendation is for a 0.5% increase over current year spending levels.

	FY08 GAA (Actuals)	FY09	FY10 House 1	House 1 vs. FY09	% change
<b>Projected Spending</b>					
GAA	26,711	28,166	27,973	(193)	-0.7%
Supplemental Appropriations Net of Surpluses	516				
9C Reductions		(851)			
Prior Appropriations Continued from FY08		156			
Recognized Deficiencies		292			
County Corrections Adjustment			(71)		
<b>Total Projected Spending</b>	<b>27,227</b>	<b>27,763</b>	<b>27,902</b>	<b>139</b>	<b>0.5%</b>
<b>Projected Revenue</b>					
Consensus Tax Revenue Forecast	20,879	21,402	19,855	(1,547)	-7.8%
Federal Reimbursements	6,429	7,071	6,811	(260)	-3.8%
FMAP			711	711	100.0%
Departmental Revenue	2,491	2,477	2,785	308	11.1%
Consolidated Transfers	266	(513)	(318)	195	-61.3%
Stabilization Fund Draw	315	401	489	88	18.0%
<b>Subtotal</b>	<b>30,380</b>	<b>30,838</b>	<b>30,333</b>	<b>(593)</b>	<b>98.4%</b>
Less MBTA	(756)	(767)	(767)	0	0.0%
Less SBA	(635)	(702)	(669)	33	-4.9%
Less Pensions	(1,399)	(1,314)	(1,376)	(62)	4.5%
<b>Total Projected Revenue</b>	<b>27,590</b>	<b>28,055</b>	<b>27,521</b>	<b>(622)</b>	<b>-2.2%</b>

As people throughout the Commonwealth have to tighten their belts, so too must state government. Nearly half of the solutions to our fiscal year 2009 and fiscal year 2010 budget deficits are spending cuts and savings, totaling approximately \$2.8 billion. With these restraints, the fiscal year 2010 budget is essentially level-funded from fiscal year 2009 spending levels.





The Governor's fiscal year 2010 budget recommendation relies on a balanced set of solutions to close the projected shortfall described earlier. The Governor's budget recommendation is balanced and transparent. The Administration restrained spending through a variety of initiatives that resulted in gross reductions of \$1.820 billion (\$1.630 billion net). This combined with revenue initiatives, spending controls, and a rational approach to the use of reserves closed a \$3.5 billion gap as projected from Maintenance.

To protect key functions of government, we are using an appropriate amount of one-time resources in our budget blueprints, including temporarily enhanced federal Medicaid matching funds and state Stabilization funds.

Fiscal Year 2010 Solutions		(millions)
<b>A. Net Cuts, Spending Reductions &amp; Savings from Maintenance</b>		<b>\$ 1,630</b>
State Employee Health Care Contributions	\$	60
Medicaid Cost Controls and Savings - (net of FFP loss)	\$	178
Local Aid Reductions	\$	220
Maintain C.70 at Current Year Funding Levels	\$	300
Executive Branch Cuts (net of revenue loss)	\$	674
Non Executive Branch Cuts	\$	197
<b>B. Net Revenue Initiatives</b>		<b>\$ 587</b>
Meals and Hotel & Motel Tax Dedicated to Local Aid	\$	148
Elimination of Sales Tax Exemptions - Dedicated to the Commonwealth Wellness Fund	\$	150
Other Departmental Revenue Initiatives	\$	289
<b>C. *Stabilization Fund Use</b>		<b>\$ 586</b>
<b>D. Federal Recovery Aid</b>		<b>\$ 711</b>
<b>Total Solutions:</b>		<b>\$ 3,513</b>

\*includes \$97 million from suspending the statutorily required deposit for fiscal year 2010

### **Net Cuts, Spending Reductions & Savings from Maintenance**

#### *State Employee Health Care Contributions (\$60.4 million)*

The budget offers comprehensive, affordable health insurance coverage to state employees through the Group Insurance Commission, while including reforms to improve the fairness and sustainability of health coverage for state employees. The budget changes employee contributions from a system based on date of hire to a more rational system based on salary levels and affordability. The following table shows the proposed employee contribution level, which could result in \$60.4 million of budget savings in fiscal year 2010:

Salary Level	Employee Contribution
<\$35,000	15%
\$35,000-\$50,000	20%
>\$50,000	25%

This reform would *reduce* contributions for 6,400 state employees – and for another 15,200 state employees, contribution levels would not change. For many other state employees, contribution levels would increase modestly based on salary and affordability. In the aggregate, these reforms would reduce system costs by \$60.4 million in fiscal year 2010, better positioning the Commonwealth over time to continue to provide comprehensive health insurance to state workers.

**Medicaid Cost Controls and Savings (\$357 million gross / \$178 million net)**

The fiscal year 2010 House 1 budget includes a total of \$357 million in gross savings (\$178 million in net savings) which include \$25 million in gross (\$12.5 million net) targeted investments in the MassHealth program. The targeted investments are necessary to achieve many of MassHealth's savings initiatives in fiscal year 2010. Savings are achieved through on- and off budget reductions in the MassHealth program. When accounting for off-budget reductions, the total savings is \$374 million gross (\$187 million net) including \$25 million in gross investments (\$12.5 million net). These savings support cost control efforts in the MassHealth program and will manage the overall growth from a projected 7.3% increase to a 3.14% increase over fiscal year 2009 projected spending levels.

FY09 GAA	FY09 Estimated Spending	FY10 Maintenance with Off-budget Consolidations	Total Off-Budget Spending	Total FY10 Maintenance Excluding Off-budget Consolidations	Percent Increase in Maintenance over FY09 Estimated Spending	Savings and Investments	FY10 House 1 Recommendation	FY10 House 1 Recommendation Excluding Off-budget Consolidation	Percent Increase in House 1 over FY09 Estimated Spending*
\$ 8,472	\$ 8,416	\$ 9,323	\$ (290)	\$ 9,033	7.3%	\$ (357)	\$ 8,970	\$ 8,680	3.14%

\* dollars in millions

Note: The FY10 total used to calculate this percentage excludes off-budget spending that will be moved on-budget in FY10.

MassHealth savings and investment initiatives are included in the chart below:

Savings Initiative Title	Gross Amount FY10	Net Amount FY10
<b>On-Budget Savings</b>		
Rates	\$ (178)	\$ (89)
Pay-for-Performance (P4P)	\$ (62)	\$ (31)
Service Program changes	\$ (38)	\$ (19)
Payment and Pricing Strategies	\$ (43)	\$ (22)
Utilization Management	\$ (31)	\$ (16)
Pharmacy	\$ (20)	\$ (10)
Other	\$ (10)	\$ (5)
<b>Subtotal On-Budget Savings</b>	<b>\$ (382)</b>	<b>\$ (191)</b>
<b>On-Budget Investments</b>		
Specialty Hospital Rate Adjustment	\$ 12	\$ 6
Pay-for-Performance (P4P) Administration	\$ 3	\$ 2
Primary Care/Medical Home/Chronic Care Model Rate Inc	\$ 10	\$ 5
<b>Subtotal On-Budget Investments</b>	<b>\$ 25</b>	<b>\$ 13</b>
<b>Total Savings and Investments On-Budget</b>	<b>\$ (357)</b>	<b>\$ (178)</b>
<b>Off-Budget Savings</b>		
CCTF Savings	\$ (17)	\$ (9)
<b>Subtotal Off-Budget Savings</b>	<b>\$ (17)</b>	<b>\$ (9)</b>
<b>Total Savings and Investments On- and Off-Budget</b>	<b>\$ (374)</b>	<b>\$ (187)</b>
* dollars in millions		

**Examples of MassHealth Savings:**

- *Provider Rates* - MassHealth providers and health plans were held to a minimal increase in fiscal year 2010. The average increase (over fiscal year 2009 rates) for many MassHealth providers and health plans are at or below 1%.
- *Pay-for-Performance (P4P)* - This savings initiative achieves cost savings by delaying payments to providers until quality benchmarks are met. This offers incentives for providers to meet and exceed quality of care standards established by MassHealth.
- *Service Program Changes* - MassHealth will achieve cost reductions by offering MassHealth members coordinated care in appropriate settings. The purpose is to provide patients with a broad spectrum of care particularly focused on preventative care which should result in more effective treatment, better health outcomes and corresponding savings. This savings will also allow for members to participate in cash counseling programs which will permit members that are getting services in the community to get cash to cover 95% of historical cost.
- *Utilization Management* - MassHealth has recently enhanced its Service Utilization Review System (SURS) and developed the capacity to expedite claims review. Furthermore, the savings will increase clinical reviews across many provider groups to ensure members receive the most appropriate level of care.
- *Pharmacy Savings* - This initiative centers upon drug utilization management and works to substitute medically appropriate generic drugs for high-cost brand drugs whenever possible.
- *Other/Off-budget Savings* - These proposals eliminate enrollment outreach grants and non-effective pilot programs as well as reduce pay-for-performance payouts to providers that do not meet quality measures.

**Examples of MassHealth Targeted Investments:**

- *Specialty Hospital Rate* – This investment will allow for MassHealth to examine their hospital rate structure to provide some specialty hospitals with higher reimbursements due to the acuity level of patients served.
- *Primary Care/Medical Home/Chronic Care Rate Increase* – This will be directed toward paying primary care doctors higher rates. Care management is focused on primary and preventative care which will lower cost by helping to keep people out of emergency rooms and acute care settings.
- *Pay-for-Performance Administration (P4P)* – This will enable MassHealth to contract with a vendor to collect data from providers and to analyze and develop reports for P4P payout.

**Reorganizing the way MassHealth is budgeted:**

In the fiscal year 2010 House 1 budget the Administration has reformed the way that it will budget for MassHealth. The budget moves previously off-budget items (totaling \$290 million gross) on-budget in fiscal year 2010 such as hospital and physician rates and pay-for-performance payouts as well as the Essential Community Provider Trust Fund (ECPTF). In addition, MassHealth line items have been consolidated from 20 line items in fiscal year 2009 to 6 line items in fiscal year 2010 and will be categorized by payment or provider type (examples are managed care organization, primary care clinician plan and fee-for-service) rather than by population (examples are Essential, CommonHealth and Breast and Cervical Cancer).

**Local Aid Reductions (\$234 million)**

The fiscal year 2010 House 1 proposal recommends \$5.3 billion in local school and general municipal spending (all Cherry Sheet and Local Aid accounts), a decrease of \$220 million or 4.22% below the fiscal year 2009 GAA. Although this 4.22% decrease is necessary to achieve budgetary balance, the Administration has worked hard to maintain certain investments at levels provided in fiscal year 2009 such as Chapter 70 aid and Payment in Lieu of taxes (PILOT). More detail regarding the Governor's Local Aid proposal can be found in section 3 of this budget document.

**Maintain Ch.70 at Current Year Funding Levels (\$300 million – estimated value).**

The decision to hold Chapter 70 funding harmless at fiscal year 2009 levels (an all-time high of \$3.948 billion), in a budget characterized by many deep cuts in other important programs, demonstrates the Governor's commitment to education and maintaining a level course in difficult times. Running the Chapter 70 formula for fiscal year 2010 would have cost between \$150 and \$400 million depending on the formula parameters used in the calculation. For the purpose of developing a maintenance estimate, for fiscal year 2010, \$300 million was used as a baseline estimate. This level of spending is unaffordable in the current economic climate and would

## ***FY2010 Governor's Budget Recommendation***

have required unsustainably deep cuts in municipal aid or other programs in the budget. Consistent with this commitment is the belief that the recommendation to freeze funding at fiscal year 2009 levels – which, it should be remembered, meet or exceed the foundation criteria for every district in the current fiscal year -- is vastly better than creating “winners and losers” during the current economic climate

### ***Non-Executive Branch Agencies – Comparison to FY09 GAA***

<b>Government Area Name</b>	<b>GAA</b>	<b>Estimated Spending</b>	<b>House 1</b>	<b>H.1 %+- GAA</b>
Lottery	99,412,070	97,412,070	96,664,701	-2.8%
Judiciary	824,589,660	800,284,778	751,648,512	-8.8%
District Attorneys	102,183,303	99,789,206	93,070,798	-8.9%
Other Constitutionals	205,002,354	198,626,590	177,413,648	-13.5%
Legislature	59,603,655	82,236,715	59,659,898	0.1%
Debt Service	2,110,575,557	2,108,007,126	2,172,114,214	2.9%
Sheriffs	481,400,427	474,606,827	552,950,917	14.9%
<b>Total Non-Executive</b>	<b>3,882,767,026</b>	<b>3,860,963,312</b>	<b>3,903,522,688</b>	<b>0.5%</b>

### ***Non-Executive Branch Agencies***

Agencies outside of the Executive branch including the Constitutional Officers, the Judiciary, District Attorneys and Sheriffs, among others, make up \$3.9 billion of the H.1 budget recommendations. These amounts have been reduced by \$197.5 million from the maintenance level of funding. Our constitutional requirement for debt service increases \$61.5 million in FY10 or 3% above FY09 appropriated levels. In addition, the transition of County Sheriffs into the state system distorts the increase. Sheriffs account for \$71 million in new spending; however, revenue is being counted in the bottom line that was not previously included. Other decreases among the non-executive departments range from 8-13% and will have varying impacts on services and employee levels.

### ***Executive Branch Agencies – Comparison to FY09 GAA***

<b>Government Area Name</b>	<b>GAA</b>	<b>Estimated Spending</b>	<b>House 1</b>	<b>H.1 %+- GAA</b>
Labor & Workforce Development	76,739,154	84,537,942	65,076,364	-15.2%
Administration and Finance	378,449,872	358,754,565	345,124,990	-8.8%
Energy & Environmental Affairs	241,347,928	221,427,483	223,752,800	-7.3%
Health and Human Services	5,115,755,000	5,012,653,514	4,778,183,925	-6.6%
Education	6,241,920,352	6,134,585,410	5,977,488,733	-4.2%
Public Safety	1,039,935,722	1,043,638,803	1,013,607,379	-2.5%
Transportation	183,752,243	231,226,325	183,888,384	0.1%
Housing & Economic Development	260,736,373	230,421,070	351,286,119	34.7%
Mass Health	8,472,473,450	8,415,822,272	8,970,235,518	5.9%
Group Insurance	927,729,152	895,999,216	1,035,335,228	11.6%
<b>Total Executive</b>	<b>22,938,839,246</b>	<b>22,629,066,600</b>	<b>22,943,979,440</b>	<b>0.0%</b>

### ***Executive Branch Agencies***

Overall the Executive Branch agencies are level funded at the fiscal year 2009 level of \$22.9 billion. However, this masks varying levels of growth and reductions among Secretariats and agencies. To achieve growth in areas such as MassHealth and employee health insurance through GIC, deeper reductions were needed in other areas of the Executive Branch. It should also be noted that the fiscal year 2010 recommendations include \$351.3 million in spending for the Executive Office of Housing and Economic Development (EOHED) and the agencies under the EOHED Secretary's leadership. In comparison to the fiscal year 2009 estimated EOHED spending of \$230.4M, this represents an increase of nearly 35 percent from the GAA. However, the growth in EOHED spending is entirely attributed to the transfer of \$133.7 million in homeless-related spending from the Department of Transitional Assistance to the Department of Housing and Community Development. After accounting for this increase, EOHED's spending actually declines from the fiscal year 2009 GAA by 16.5 percent in the H.1 recommendation. The ranges in reductions across the Executive branch are from 2-15% below the fiscal year

2009 GAA. Reductions in Public Safety and Education were limited in order to maintain priority investments made during the last two years.

***Dedicated New Tax and Departmental Revenues***

The Governor's budget includes enhanced revenue and enforcement initiatives that are expected to generate \$587 million in additional revenue in fiscal year 2010. These initiatives are described below:

***1% Statewide Meals and Hotel & Motel Tax to Support Local Aid (\$149 million)***

The current fiscal crisis makes it imperative to consider making new revenue sources available to communities and to shield cities and towns from even larger Local Aid cuts and limit harmful impacts on core services for our citizens. Raising the existing statewide meals and room occupancy taxes by one penny on the dollar and dedicating the proceeds to municipal aid will reduce Local Aid cuts for all communities in fiscal year 2010. Further, this proposal creates a recurring revenue source to help provide predictable and adequate Local Aid in the future. More detail regarding the Governor's Local Aid proposal and the impact that these new revenues will have on local aid can be found in section 3 of this budget document.

***Commonwealth Wellness Fund (\$150 million gross)***

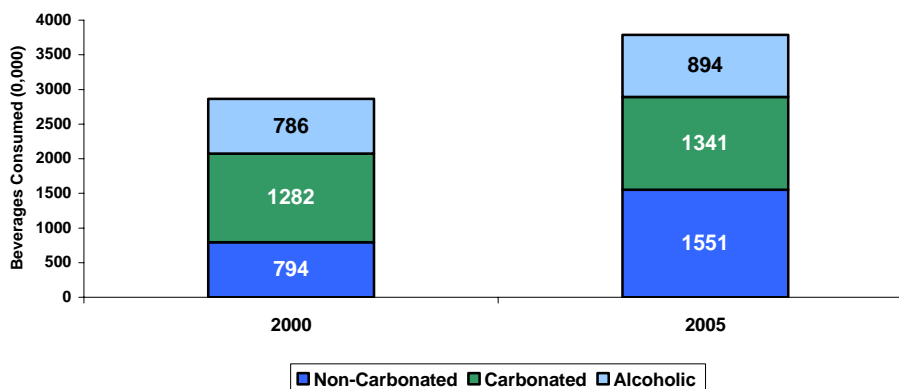
Alcohol purchased in a grocery or package store, sweetened beverages and candy have historically received the exemption from the Massachusetts state sales tax that is designated for non-prepared food products. Removing the tax exemption on these three non-nutritional food categories will yield \$25 million in fiscal year 2009 and \$150 million in additional revenue in fiscal year 2010. In fiscal year 2010, the Commonwealth Wellness Fund will receive \$121.5 million of the \$150 million in estimated new revenue collections. Monies appropriated from this fund will support programs and services that augment the health and well being of the citizens of the Commonwealth.

<b>Wellness Fund: FY10</b>					
<b>\$121.5 Million</b>					
<b>Account Distribution</b>	<b>Acct #</b>	<b>FY10 Allocation</b>	<b>% Wellness Fund</b>	<b>% GF</b>	<b>Total Wellness Fund Spend</b>
Addiction and Tobacco Control Services	4510-0700	\$90,468,857	86%	14%	\$ 78,000,000
Health Promotion, Violence Prevention and Workforce Expansion	4510-2500	\$49,938,924	87%	13%	\$ 43,500,000
					<b>\$ 121,500,000</b>

***Bottle Bill (\$20 million)***

The Massachusetts Bottle Bill, enacted in 1982, was designed to promote recycling by encouraging consumers to return their empty soda and beer containers by offering a \$0.05 deposit. In the FY10 budget, Governor Patrick proposes to expand the \$0.05 deposit to include water, flavored waters, coffee based drinks, juices and sports drinks. Discarded cans and bottles are a major source of trash that impacts our communities while wasting precious natural resources and energy. 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. Since 2000 non-carbonated beverages have experienced near double-digit growth and industry experts expect this trend to continue. However, these non-carbonated beverages are not covered by the bottle bill, often ending up in landfills or along the side of the road.

**Beverage Consumption in Massachusetts, 2000 and 2005**



By revising the definition of “beverages” in outside section 15, the bottle bill can be brought up to date with modern trends. Consumers will be required to pay an additional \$0.05 cents on water, flavored waters, iced teas and sports drinks. Of the estimated \$20 million in additional revenue generated through this change, \$5 million will be dedicated to the Department of Environmental Protection recycling and solid waste management programs with an additional \$5 million pledged to other priority programs. Additionally, \$10 million is provided for the Massachusetts Water and Sewer Rate Relief Fund, which allocates rate reductions to communities and residents served by the Massachusetts Water Resources Authority (MWRA).

**Registry Fees (\$74.5 million)**

The Administration is proposing a number of steps to update and consolidate Registry of Motor Vehicle (RMV) fees to improve customer service by offering online discounts and streamlining the existing fee structure. In Fiscal Year 2010, Governor Patrick proposes to reform Registry of Motor Vehicle fees by consolidating the number of fees from 201 to 40. This will:

- Improve customer service at branches by offering online discounts and streamlining the current fee structure.
- Keep things simple; the new fees are easy to understand.
- Bring the RMV into the 21<sup>st</sup> century by moving transactions online and automating functions.
- Decrease costs at the RMV by automating processes and data gathering.

Comparison to Surrounding States			
	Registration (Two year)	Licensing (per year)	Title (One time)
MA (Existing)	\$41.00	\$8.00	\$50.00
MA (Proposed)	\$50.00	\$10.00	\$75.00
Last Increase	2002	2002	1989
ME	\$70.00	\$5.00	\$33.00
NH	\$43.00	\$10.00	\$25.00
CT	\$85.00	\$11.00	\$25.00
VT	\$120.00	\$10.00	\$28.00
NY	\$25.00	\$7.00	\$50.00
RI	\$60.00	\$6.00	\$27.00
Fees are estimates only and will be changed through the regulatory process, including public hearings.			

The proposed changes to the RMV fee schedule will raise \$74.5 million dollars. Fees will be changed through the State's regulation process and are subject to public input prior to implementation. These funds are pledged to the Highway Fund for the operation of transportation agencies (e.g. regional bus services, highway department) and to pay debt service for road and bridge construction.

**Additional Tax Auditors Initiative (\$23 - \$26 million)**

The Audit Division at the Department of Revenue (DOR) is responsible for fostering voluntary compliance and narrowing the tax gap by identifying, educating, and auditing noncompliant taxpayers. The Audit Division audits

the tax returns of businesses and individuals filed, including sales/use, meals, rooms' occupancy and special fuels are subject to examination by the Audit Division staff. Making investments in audit staff over the past several years has been an important part in maximizing tax revenue collections. For FY09 the hiring of additional auditors is expected to result in \$60 million in new revenue. The FY10 recommendation for DOR represents a fully staffed Audit Division with 14 additional auditors to generate an additional \$23 - \$26 million on top of our current collections. Overall, this investment in auditors along with mitigating reductions taken at DOR will allow us to maintain our tax collection and enforcement levels.

*Nursing Home User Fee (\$75 million net)*

The nursing home user fee is an assessment on nursing homes based on certain reimbursed patient days. In fiscal year 2009 the total amount of the nursing home assessment was \$145 million. That amount is directed to the general fund and the Commonwealth appropriates \$288.5 million to pay nursing home rates and then draws down federal financial participation (FFP) on rate expenditures. The fiscal year 2010 budget proposes to increase the assessment by \$75 million (increasing the total aggregate assessment to \$220 million) which will be directed to maintain current rates, fund a small rate increase and to fund performance-based incentive payments.

*TANF (Temporary Assistance for Needy Families) Contingency Funds (\$73 million)*

The Governor's H.1 recommendation estimates that the State will be able to draw down \$73 million in TANF Contingency funding in fiscal year 2010, which compares to roughly \$87 million in estimated revenues in fiscal year 2009. The funding is in addition to Massachusetts' annual TANF block grant funding, which will be fully drawn in both fiscal year 2009 and fiscal year 2010.

The Fund was established by Congress to allow states that experienced substantial increases in caseloads or unemployment rates to access additional federal resources to mitigate these spikes. Massachusetts was found by the federal Administration for Children and Families to be eligible based on a large increase in the number of its recipients accessing benefits under the food stamps program. The amount a state is eligible to receive is determined by its annual expenditures on objectives aligned with the federal TANF program. Based on current H.1 spending projections for these purposes, the Governor's budget assumes an additional \$73 million will be available. These additional federal funds have prevented deeper cuts to transitional assistance programs funded in H1.

**Stabilization Fund**

The Administration strikes a careful balance in using one-time revenues in our fiscal year 2009 and fiscal year 2010 budget blueprints.

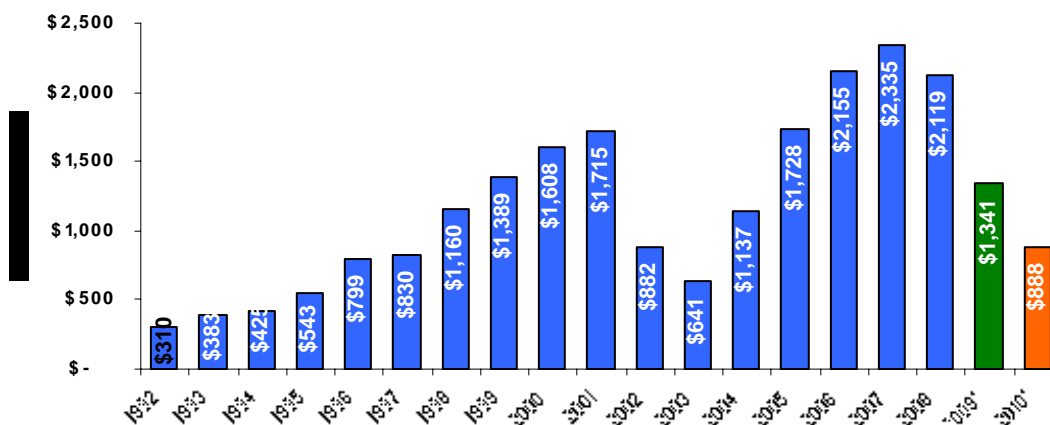
As part of the balanced approach to solving the fiscal year 2010 budget challenge, the Governor's budget proposal includes a \$489 million transfer from the Stabilization Fund. It also includes suspending the annually required deposit into the Stabilization Fund saving an additional \$97 million. The following is a general description of the Stabilization Fund and of the Administration's recommended use of it for balancing the fiscal year 2010 budget

*General Information regarding the Stabilization Fund*

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

The following table shows the amount on deposit in the Stabilization Fund at the end of each of the last 16 fiscal years and the projected balance for fiscal years 2009 and 2010.

**Massachusetts Stabilization Fund Ending Balances**



\* FY09 and FY10 Stabilization Fund totals are estimates based on current revenue projections

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

The Administration plans to use \$1.417 billion in Stabilization Funds over fiscal years 2009 and 2010: \$601 million has already been authorized for the current fiscal year and an additional \$325 million is recommended to help close the remaining shortfall for fiscal year 2009. The fiscal year 2010 budget will rely on an additional \$489 million, not including the suspension of the statutorily required deposit. At the end of fiscal year 2010, the balance of the Stabilization Fund will be approximately \$850 - \$888 million depending on investment earnings.

### **Federal Recovery Assistance**

The federal aid amounts included in our fiscal year 2009 and 2010 budget blueprints are based on current projections of temporarily enhanced federal Medicaid matching funds that will be available to Massachusetts in those years.

The Governor and his Administration have been active participants in the formulation of the federal recovery plan. Massachusetts is well-positioned to receive additional funding to support critical programs that help protect key functions of government and build a bridge to a better economy. Given the unprecedented nature and size of the projected budget deficit, the Governor has proposed to use some of this funding to help avoid deeper cuts in critical programs and services. Among several types of federal stimulus under consideration, the FMAP (Federal Medical Assistance Percentage) provision of the federal recovery bill is the one that is likely to be received soonest and have the most flexibility to address the immediate challenges facing this budget.

The most recent version of the federal bill recommends approximately \$87 billion in FMAP funding. Based on our reading and understanding of the bill, Massachusetts could receive between \$1.5 and \$1.7 billion in additional FMAP over the 27-month period beginning October of 2008 and ending January of 2010. Thus we expect 9 months of fund to be available during fiscal year 2009 and a full 12 months would be available during fiscal year 2010. That amounts to approximately \$533 million and \$711 million respectively. The balance of FMAP funds, approximately \$335 million, would be received during fiscal year 2011.

Consistent with this expected cash flow, the Administration plans to use \$1.244 billion (of the projected \$1.600 billion) of FMAP funds over fiscal years 2009 and 2010. \$533 million is recommended to help close the remaining shortfall for fiscal year 2009. The fiscal year 2010 budget will rely on an additional \$711 million. The balance of \$355 million remaining, when combined with the expected Stabilization Fund balance at the end of fiscal year 2010, will ensure that we have the equivalent levels of reserves in fiscal year 2011 that we used in 2010.

### **Cuts Avoided Through the Use of Additional Resources**

Over-reliance on one-time revenues to balance the budget in the near-term can lead to further cuts down the road. It is therefore important to strike the right balance between cuts and the use of reserves. Judicious use of



reserves avoids misguided cuts that would dismantle needed programs and services by building a bridge to a better economy. The chart below shows the cuts avoided through our judicious use of reserves: Stabilization Funds were used to avoid cuts across state government and FMAP funds were used to avoid cuts to health care related expenditures.

		Cuts Avoided Through Use of Additional Resources	
Government Area Name	House 1	Federal Aid (FMAP)	Stabilization (Allocated in Proportion to Total Budget)
Judiciary	751,648,512		(34,283,776) -7.0%
District Attorneys	93,070,798		(4,245,094) -0.9%
Sheriffs	552,950,917		(25,220,891) -5.2%
Debt Service	2,172,114,214		
Lottery	96,664,701		(4,409,017) -0.9%
Other Constitutionals	177,413,648		(8,092,093) -1.7%
Legislature	59,659,898		(2,721,174) -0.6%
<b>Total Non-Executive</b>	<b>3,903,522,688</b>		
Administration and Finance	345,124,990		(15,741,650) -3.2%
Group Insurance	1,035,335,228	(45,354,787) -4.4%	
Energy & Environmental Affairs	223,752,800		(10,205,689) -2.1%
Health and Human Services*	4,778,183,925	(105,631,856) -2.2%	(217,939,879) -44.6%
Mass Health	8,970,235,518	(560,013,357) -6.2%	
Transportation	183,888,384		(8,387,415) -1.7%
Housing & Economic Development	351,286,119		(16,022,668) -3.3%
Labor & Workforce Development	65,076,364		(2,968,227) -0.6%
Education	2,028,664,672		(92,530,329) -18.9%
Public Safety	1,013,607,379		(46,232,098) -9.5%
<b>Total Executive</b>	<b>18,995,155,379</b>		
Chapter 70	3,948,824,061		
Local Aid*	1,125,634,360		
<b>Total Local Aid</b>	<b>5,074,458,421</b>		
<b>Total H1 Spending:</b>	<b>27,973,136,488</b>	<b>(711,000,000)</b>	<b>(489,000,000)</b>

## Other Financial Assumptions Used In House 1

### Challenges of Capital Gains Revenues

During periods of economic growth, witnessed by increases in the major stock indexes, Massachusetts experiences substantial growth in annual collections of capital gains tax. Conversely, during market contractions, in which stock values plunge considerably, the State witnesses a dramatic decline in capital gains proceeds as investors no longer can sell their assets for profits. Prior to the current economic downturn, the last period during which the State witnessed a substantial decline in its capital gains revenue was the two-year period during tax years 2000 to 2002. In 2000, the State collected \$1.164 billion. However, in 2001, this amount shrank, declining to \$337 million, and only returning to \$459 million by 2002. Consequently, while other State revenues declined by more moderate amounts, total State capital gains proceeds fell by 71 and 60 percent in 2001 and 2002, respectively, when compared to the 2000 base.

In fiscal year 2009, the State has witnessed another precipitous decline in its capital gains tax. On October 15, 2008, A&F released its tax revenue estimate which assumed that tax year 2008 capital gains realizations (which affect FY09 capital gains collections) would decline by 28%, and projected that FY09 capital gains taxes would decline by about 30%. Furthermore, the most recent consensus revenue estimate for fiscal year 2009 assumes a reduction in capital gains taxes of 59% from fiscal year 2008.

#### *The Governor's H.1 Recommendation*

The Governor is proposing legislation in H.1 (Outside Section 8) that would provide that all unanticipated increases in the State's annual capital gains tax estimate shall be deposited directly into a newly-established fund, the Capital Gains Revenue Holding Fund (CGRHF), which would be held separately from the State's general revenues. At the end of any given fiscal year the annual proceeds put aside in the CGRHF, would be deposited directly into the State's Stabilization Fund.

Under the Governor's legislation, the amount of capital gains proceeds to be deposited into the CGRHF would be determined quarterly by the Commissioner of Department of Revenue, who is responsible for reporting to the Administration and Legislature on current year revenue collection as they compared to the consensus revenue benchmark projections. In cases where it is determined that the current State revenues exceed benchmark estimates the Commissioner will determine how much of the above-benchmark revenue is attributable to growth in capital gains. All unanticipated capital gains revenues would be then transferred from the General Fund to the CGRHF.

This proposal would help to minimize the short-term reliance on capital gains increases to fund budgetary growth, while providing the necessary resources the State needs to offset budgetary pressures during the next period of economic downturn.

## **Debt Service**

Debt service is a significant component of the operating budget and arises from the issuance of debt to finance the Commonwealth's capital investment plan. The Patrick-Murray Administration recognizes the need for increased capital investment as a means to create jobs in the near term and create the environment needed to support job creation and economic growth over the long term. The Administration also recognizes that the level of annual borrowing to support these capital investments must be set at affordable levels.

### **Debt Service Generally**

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

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

### **Fiscal Year 2010 Debt Service Budget**

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

<b>Line Item</b>	<b>Description</b>	<b>FY10 Budget</b>
0699-0015 Consolidated Long-Term Debt Service	Includes debt service for general obligation bonds (secured by a pledge of the full faith and credit of the Commonwealth) and special obligation bonds (secured by a pledge of receipts credited either to the Highway Fund or Convention Center Fund).	\$1.87 billion
0699-9100 Short Term Debt Service	Covers interest and related costs associated with borrowing to cover temporary cash shortfalls which may arise due to a mismatch of when revenues are received and when expenses are due. These short-term borrowings may take the form of a fixed rate revenue anticipation note and/or commercial paper. In either case, any borrowing for cash flow needs must be paid off within the same fiscal year in which the short-term debt was issued.	\$52.1 million
0699-2004 Central Artery/Tunnel Debt Service	Covers principal and interest on bonds issued to finance the Central Artery/Tunnel project.	\$91.7 million

0699-9101 Grant Anticipation Notes Debt Service	Amounts are deposited in a trust account to pay interest due on federal grant anticipation notes. The principal of such notes is paid by future federal highway construction grants.	\$52.1 million
1599-0093 Water Pollution Abatement Trust Contract Assistance	Funds the Commonwealth's commitment to make matching grants to capitalize the state revolving funds. These funds in turn are leveraged with the issuance of bonds by the Trust to make loans to local governments to finance eligible water pollution abatement and water treatment projects. The commitment to make matching grants is a general obligation of the Commonwealth for which its full faith and credit is pledged.	\$70.0 million
0599-1970 Massachusetts Turnpike Authority Contract Assistance	Compensates the Turnpike Authority for the financial burden imposed on the Authority by virtue of its assumption of the responsibility for operation and maintenance of certain roadways in the Metropolitan Highway System that were formerly maintained by the Commonwealth. The Commonwealth's obligation to make these annual payments is a general obligation for which the full faith and credit of the Commonwealth is pledged for the benefit of the Authority and its bondholders.	\$25.0 million
1599-0050 Route 3 North Contract Assistance	Funds the Commonwealth's payment obligations associated with bonds issued to finance Route 3 North improvements.	\$9.6 million
1599-1970 Massachusetts Information Technology Center Rent	Funds rent and associated costs at the Massachusetts Information Technology Center in Chelsea.	\$0.6 million
1599-3856 Star Store Reserve	Funds a reserve for the facilities costs associated with the college of visual and performing arts of the University of Massachusetts at Dartmouth	\$2.7 million
0699-0016 Accelerated Bridge Program	Covers principal and interest on bonds issued to finance the Accelerated Bridge Program to rehabilitate structurally deficient bridges.	\$12.0 million

### **Limitation on Commonwealth Debt**

**Statutory Debt Limits** – Legislation enacted in December 1989 restricts the amount of the Commonwealth's outstanding direct debt (M.G.L. Chapter 29, Section 60A). This legislation imposed a "statutory debt limit" of \$6.8 billion in fiscal year 1991 and set the limit for each subsequent year at 105% of the previous fiscal year's limit. The statutory debt limit is calculated according to certain rules and excludes several direct and contingent obligations of the Commonwealth. The statutory debt limit on "direct" debt during fiscal year 2008 was approximately \$15.6 billion, and the Commonwealth's outstanding direct debt subject to the limit at June 30, 2008 was \$13.5 billion.

Legislation enacted in January 1990 imposes a limit on debt service appropriations in Commonwealth operating budgets (M.G.L. Chapter 29, Section 60B). No more than 10% of total budgeted appropriations may be spent on debt service (both interest and principal) on Commonwealth general obligation debt in any fiscal year. Payments on debt not subject to the statutory debt limit described above are also excluded from the debt service limit. In fiscal year 2008, budgeted debt service on debt subject to this limit was approximately \$1.6 billion, representing 4.9% of total budgeted expenditures, which were approximately \$32.8 billion.

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

### **Debt Affordability**

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

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

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

The table below has been extracted from the Debt Affordability Analysis – FY2009-2013 which was published in December 2008. The table lists the annual bond cap (including unused bond cap amounts from FY08 that have been carried forward into future fiscal years); total annual debt service, which includes existing debt service, contract assistance payment obligations and new debt service from the annual bond cap and the Bridge Program; projected budgeted revenue; and total debt service as a percent of budgeted revenues. Note that this table is based on an affordability analysis which has been modified to better reflect current fiscal conditions – i.e., lower revenue growth and higher interest costs. The Administration will revisit the debt affordability analysis each year to reflect fluctuations in interest rates, revenues, and other changes impacting the Commonwealth’s debt capacity.

Projected Annual Debt Service as a Percentage of Budgeted Revenues Fiscal Years 2009-2013 (in millions)					
Fiscal Year	Annual Bond Cap	Total Existing Obligations	Total Annual Debt Service	Budgeted Revenue Growth	Total Annual Debt Service as % of Revenues
2009	\$1,727.3	\$2,117.8	\$2,174.4	\$30,324.6	7.17%
2010	\$1,726.1	\$2,015.0	\$2,226.5	\$30,324.6	7.34%
2011	\$1,762.6	\$1,970.4	\$2,341.6	\$31,234.3	7.50%
2012	\$1,800.0	\$1,793.7	\$2,333.5	\$32,171.4	7.25%
2013	\$1,900.0	\$1,813.7	\$2,532.3	\$33,136.5	7.64%

The Governor’s fiscal year 2010 budget proposal includes debt service appropriations to cover the payment obligations on outstanding bonds and to cover expectations regarding upcoming bond issues developed in accordance with the debt affordability analysis and policies described above. Note that the debt service projections in the table above will not correspond perfectly to actual debt service because assumptions used to project future debt service will vary from actual experience. For example, for the Debt Affordability Analysis, it is conservatively assumed that all bonds are issued on July 1 of each fiscal year, when in fact it is not uncommon to issue a series of bonds over the fiscal year.

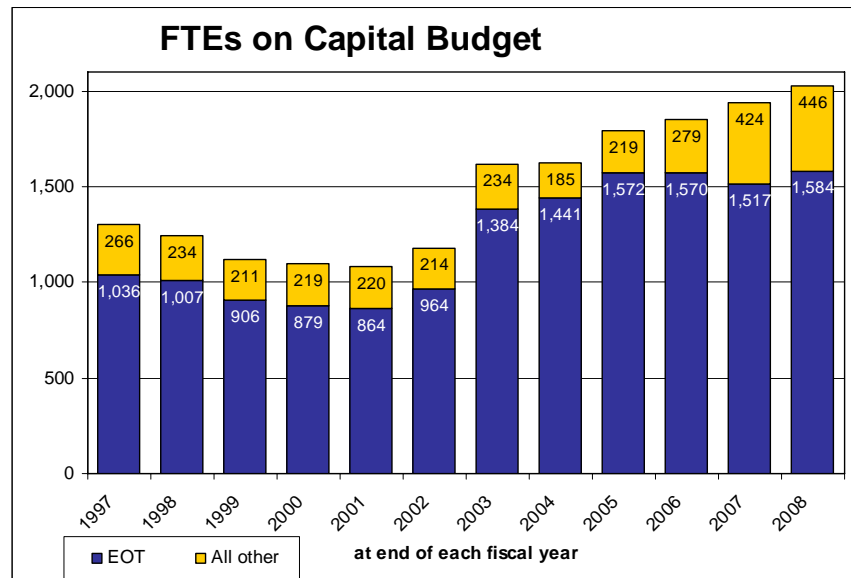
See “Debt Affordability Analysis” at [mass.gov/capital](http://mass.gov/capital) for more information.

## Transfer of State Personnel from the Capital Budget to Operating Budget

For a number of years personnel and other goods (paper, utilities) have been charged to capital accounts - resulting in millions of additional dollars in interest payments while reducing the amount of money available for statewide construction projects. The practice of shifting operating costs to the capital budget was born years ago during tough economic times like those we are currently experiencing.

In 2008, the Legislature authorized (Chapter 304 of the Acts of 2008) the borrowing of \$50 million a year to fund the acquisition of equipment on the capital budget instead of the operating budget. This was part of Governor’s Patrick’s no-cost mechanism for taking hundreds of employees and other budgetary expenses off of the capital budget with the goal of significantly scaling back the fiscally imprudent practice of funding these expenses with debt.

However, to fully implement the Governor’s proposal the Administration needed to have the authority to transfer money between line items in the operating budget. If a line-item funded the acquisition of durable equipment, the Executive Office for Administration and Finance would transfer that amount to another line-item to fund the cost of personnel that would have otherwise been funded from the capital budget. Line item transferability was not approved by the Legislature.



Section 34 of the Governor’s Fiscal Year 2010 budget completes the reforms started in 2008 by reauthorizing this no-cost mechanism for taking hundreds of employees and other budgetary expenses off of the capital budget. The Administration is committed to monitoring transfers to ensure their appropriateness, while also looking for fiscally responsible ways to bring proper costs back onto the operating budget. The total amount of such transfers cannot exceed \$50 million, and A&F will be required to give the Senate and House Committee on Ways and Means a schedule of all such transfers. Outside section 34 is required to implement the proposed transfer of personnel from the capital budget to the operating budget. With line item transferability, the Governor can ensure that the initiative is cost neutral.

## FTE Assumptions

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

## ***FY2010 Governor's Budget Recommendation***

To address this requirement, the House 1 recommendations include employee counts summarized at the Government area level. Additional detail is included throughout the Budget Recommendations to indicate the employee level within specific departments.

Beginning in FY09, A&F and the Human Resources Division have worked together to implement clear policies surrounding employees. In the fall, A&F engaged each agency in a spending plan process in which each account was evaluated to determine how funds would 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. Since this review was conducted in the fall of 2008 when it became apparent that the state revenues were declining from original assumptions, A&F was able to set employee limits or "caps" to restrict hiring and spending on new staff. The goals of the employee caps and the subsequent review of all employee spending are to:

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

It was estimated that the 9C reductions taken in October 2008 would impact approximately 1,000 employees across the Commonwealth including layoffs, delayed hiring or leaving positions open. To date, the Human Resources Division has reported a reduction in force of over 350 FTEs since July. FTE reductions to meet the caps set by A&F are still being implemented by Agencies in order to restrain spending within reduced budget levels.

The FY10 House 1 budget recommendations provide funding for 70,259 FTEs across state government. Although this appears to be an increase from FY09 and our current employee counts, an adjustment must be considered. The House 1 recommendations include line items for the 7 Sheriffs Departments that are currently County Departments. Bringing these departments and their staff onto the state system accounts for an additional 2,958 employees requiring, totals to be adjusted to complete a true comparison. The total FTEs adjusted for Sheriffs is 67,301, or a decrease of 1,282 from January 2009 employee levels.

<b>Historical Employment Levels</b>					
<b>Government Area</b>	<b>June FY2006</b>	<b>June FY2007</b>	<b>June FY2008</b>	<b>Jan. FY2009</b>	<b>Projected FY2010</b>
Judiciary	7,630	7,993	8,021	7,955	7,373
Independents	6,775	7,101	7,415	7,389	9,896*
Administration and Finance	2,917	2,778	2,901	2,905	2,937
Energy & Environmental Affairs	2,201	2,168	2,236	2,222	2,265
Health and Human Services	21,055	21,117	21,496	21,185	20,649
Transportation	1,078	1,087	1,245	1,207	1,221
Housing & Economic Developm	581	610	650	637	732
Labor & Workforce Developmer	323	320	307	316	463
Education	13,374	13,790	13,784	15,110	14,930
Public Safety	8,430	8,457	8,627	8,623	8,732
Legislature	1,076	1,062	1,047	1,035	1,062
<b>TOTAL</b>	<b>65,439</b>	<b>66,483</b>	<b>67,729</b>	<b>68,583</b>	<b>70,259</b>
<b>TOTAL (Adjusted for Sheriffs)</b>					<b>67,301</b>

In reviewing the reductions needed to live within fiscal year 2010 available funding, each agency will be required to critically evaluate their employee level and determine if a reduction in this area is needed to maintain a balanced budget. The Administration continues to evaluate employee levels and has instituted strict caps for each Secretariat in fiscal year 2009 in an effort to constrain spending and growth, which are being routinely monitored.

<b>Comparisons to Adjusted FTEs</b>		
	<b>#</b>	<b>%</b>
Variance to Jan. FY09 Levels	-1,282	-1.9%
Variance to June FY08 Levels	-428	-0.6%
Variance to June FY07 Levels	818	1.2%
Variance to June FY06 Levels	1,862	2.8%

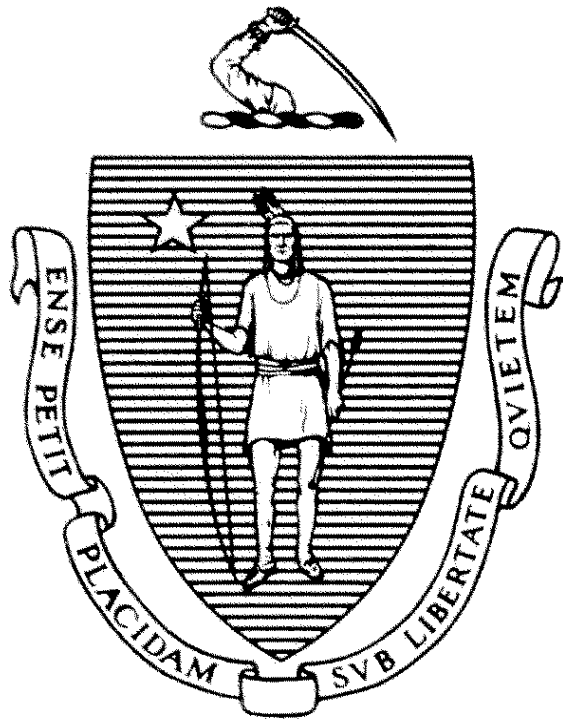
There are, however, some areas that should be considered when making historical employee comparisons such as

- **Prior Year Targeted Investments** – During the course of the Patrick Administration, specific investments have been made that require more staff. Some examples of these include of these investments would include implementation of the Beaches Commission recommendation; the implementation of regulations passed in FY08 for a Regional Greenhouse Gas initiative; enhancements to our tax enforcements unit at the Department of Revenue; and a class of Corrections Officers at our Department of Corrections to help alleviate high overtime expenses.
- **Contractor / Capital Conversions** – Given the cost associated with paying for employees from capital funds and the renewed focus on wage enforcement efforts, every effort continues to be made to convert contract employees to full-time equivalents, and to transfer employees onto the operating budget. Along with conversions that have already been made, H.1 includes an outside section that allows for certain capital and operating costs to be exchanged so that appropriate operating dollars spent on capital needs can be shifted to the capital budget and vice versa. This section will have an impact on our budgeted employee level but it should be noted that these are not new state employees, they are just new to the operating budget.
- **Information Technology Realignments** – Because of an initiative to transfer all information technology employees to secretariats, those employees that have routinely been funding from off-budget sources are being transferred into Intragovernmental Service Fund accounts where they will report to staff at the secretariat-level, but continue to be paid from the off-budget sources. This represents an “increase” of nearly 300 FTEs on the overall totals.
- **Other Considerations** – Like all departments, the non-executive branch agencies will be working to evaluate impacts on employees. Additionally, because funding at the Higher Education campuses comes from various sources, some employee impacts may be mitigated. Additionally, certain FTE increases due to compliance with legal settlements and to address needs around public health and safety must be considered.





## Fiscal Year 2010 Budget Recommendation



## Health Care in the Commonwealth



## Health Care in the Commonwealth

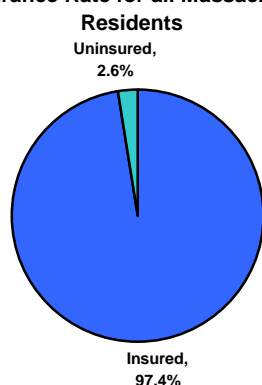
### Expanding Health Insurance Coverage

With the enactment of Chapter 58 of the Acts of 2006, Massachusetts embarked on a historic, first-in-the-nation initiative to expand health insurance coverage to virtually all of its residents. Health care reform expands health insurance coverage by:

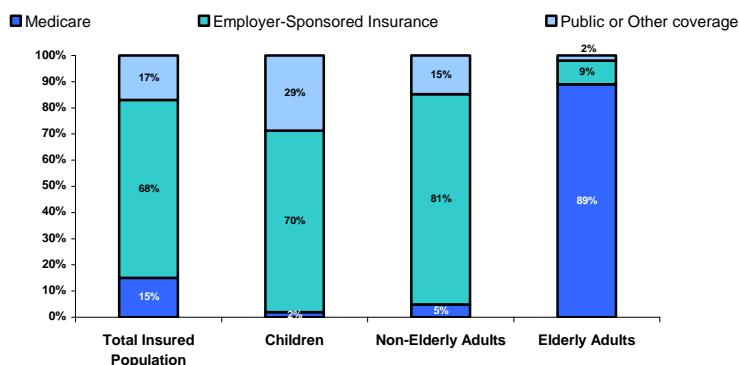
- requiring individuals who can afford health insurance to enroll in coverage;
- offering individuals a greater choice of affordable private health coverage plans through insurance reform and the creation of the Commonwealth Health Insurance Connector Authority;
- providing low-income individuals with new opportunities for affordable, government-subsidized coverage through Commonwealth Care and expanded Medicaid coverage; and
- asking employers to do their “fair share” by offering health insurance to their employees or otherwise contributing to the cost of covering their employees through state health programs.

Health care reform has already been a dramatic success. The most recent state survey results indicate that over 97 percent of our state’s residents were enrolled in health insurance in 2008. Insurance coverage is high for Massachusetts residents at all income levels, ranging from 95 percent for those with family incomes under 300 percent of the federal poverty level to nearly all of those with incomes above 500 percent of the federal poverty level. Nearly all elderly adults (>99 percent) and children (>98 percent) are insured, as are more than 96 percent of non-elderly adults ages 19 to 64.

Uninsurance Rate for all Massachusetts Residents



Type of Health Insurance Coverage by Age Group



Source: Division of Health Care Finance and Policy, Health Insurance Coverage in Massachusetts: Estimates from the 2008 Massachusetts Health Insurance Survey, December 2008. Prepared by the Urban Institute.

More than 440,000 people are newly insured in Massachusetts with over 42 percent in private health insurance, the first significant increase in commercial insurance in Massachusetts in decades.

Number of Members as of June 30, 2008 (rounded to the nearest 1,000)	30-Jun-06	31-Dec-06	30-Jun-07	31-Dec-07	30-Jun-08	changes since 6/30/06
Private Group	4,274,000	4,338,000	4,378,000	4,406,000	4,421,000	147,000
Individual Purchase	40,000	39,000	36,000	65,000	80,000	40,000
MassHealth	705,000	741,000	732,000	765,000	785,000	80,000
Commonwealth Care	-	18,000	80,000	158,000	176,000	176,000
Total	5,020,000	5,136,000	5,226,000	5,394,000	5,462,000	442,000

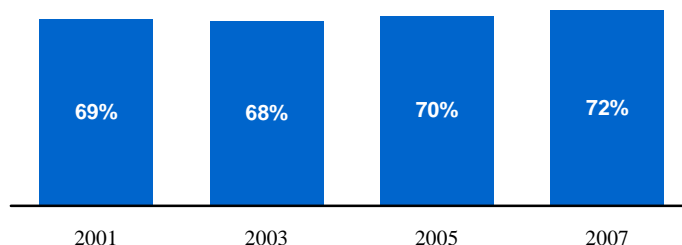
Source: Division of Health Care Finance and Policy, Health Care in Massachusetts: Key Indicators, 4<sup>th</sup> Edition, November 2008.

Note: Excludes Medicare enrollees and certain other insured individuals. Moreover, MassHealth total enrollment is over 1.1 million; the number in the above chart reflects only members with MassHealth as primary insurance.

The most recent national health insurance survey results from the U.S. Census Bureau indicate that Massachusetts has the lowest rate of uninsured residents in the country. Importantly, employer-sponsored coverage is holding steady with nearly three-quarters of Massachusetts employers offering health insurance to

their employees, while the employer offer rate has declined nationally from 68 percent to 60 percent between 2001 and 2007.

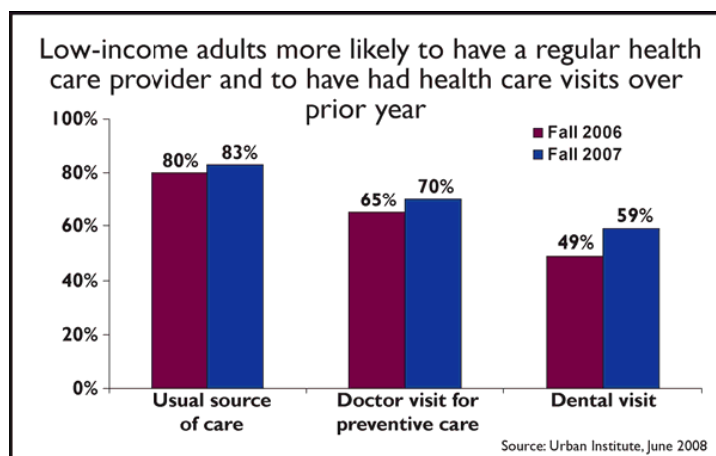
### Employers Offering Health Insurance in Massachusetts



Source: Division of Health Care Finance and Policy, Health Care in Massachusetts: Key Indicators, 4<sup>th</sup> Edition, November 2008.

Recent insurance reform has made health coverage more affordable. Before reform, a healthy 37-year-old living in Boston – the median age for uninsured adults in Massachusetts – paid \$335 per month in premiums and had few market options. Post-reform, that 37-year-old had a broad range of options, including at least one plan for a little over half that price with twice the benefits.

These expansions in health insurance coverage are breaking down barriers to needed care. More people (including racial and ethnic minorities) report having a regular medical provider, and individuals are accessing more preventive care and other services such as dental care.

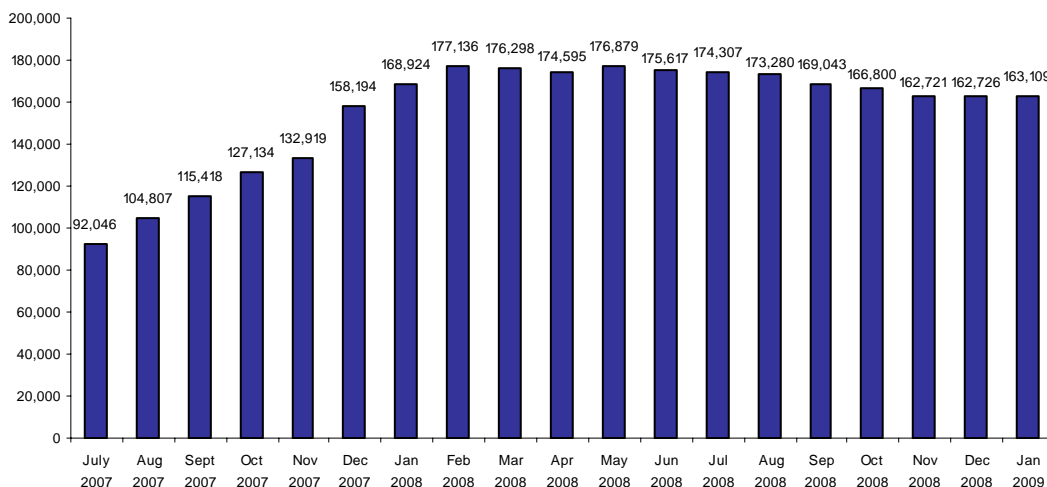


The Administration's fiscal year 2010 budget continues to fully fund expansions in coverage through state health insurance programs for low- and moderate-income families. These investments reflect a continuing commitment to health care reform and the recognition that the MassHealth and Commonwealth Care programs are core components of the safety net for low-income residents of our state, including individuals who may have recently lost their jobs or private health insurance due to the economic downturn. Despite the significant fiscal pressures facing the Commonwealth, the budget does not cap enrollment or cut benefits for state health insurance programs, as has been done in prior fiscal crises.

### Commonwealth Care

Commonwealth Care was created by the enactment of the health care reform. It offers subsidized health insurance to adults whose incomes are at or below 300 percent of the federal poverty level and who are not eligible for other government-subsidized or employer-sponsored health insurance. The program is designed as a mixed Medicaid/commercial model, with full subsidies for individuals at or below 100 percent of the federal poverty level and a progressive scale of increasing cost-sharing for individuals above 100 percent of federal poverty level but at or below 300 percent of the federal poverty level. As of January 1, 2009, there were over 163,000 adults enrolled in Commonwealth Care.

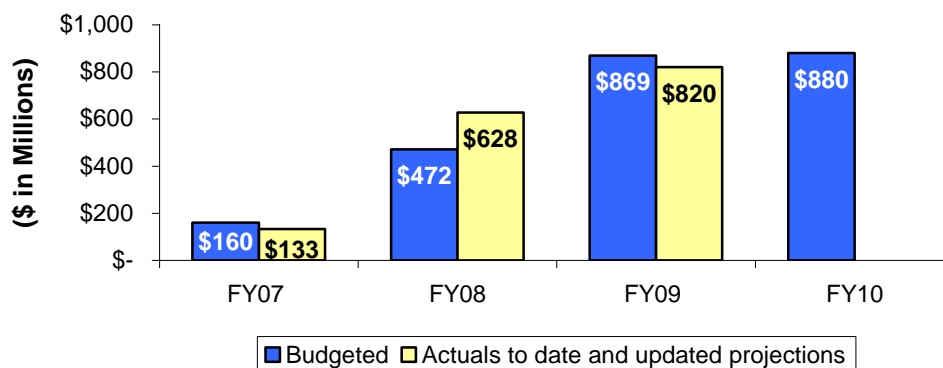
Commonwealth Care Enrollment Trend  
July 2007 through January 2009



Source: The Commonwealth Connector Authority, January 2008.

The Commonwealth had greater-than-expected success in enrolling individuals in Commonwealth Care during fiscal year 2007 and fiscal year 2008, which resulted in corresponding increases in spending (see chart below). Cost trends have recently begun to moderate as enrollment and per-member price increases have leveled. Commonwealth Care is a fully-capitated program, in which the Connector Authority employs commercial-like processes to contract with participating health plans.

Commonwealth Care Spending



**Fiscal year 2007:** Commonwealth Care was launched in November of 2006. The program cost \$133 million in fiscal year 2007, with almost 80,000 people enrolled by the end of the fiscal year.

**Fiscal year 2008:** Commonwealth Care cost \$628 million, \$146 million over originally budgeted amounts. This cost increase was entirely due to faster-than-expected enrollment: year-end enrollment totaled over 175,000, compared to original projections of 135,000.

**Fiscal year 2009:** Commonwealth Care is currently projected to cost \$820 million, over 30 percent above fiscal year 2008 levels (due largely to increased total member months for the year compared to fiscal year 2008) but also slightly lower than budgeted amounts. Cost reductions relative to the fiscal year 2009 budget and earlier estimates are due to lower-than-projected enrollment for the fiscal year. Total enrollment has slightly declined to date in fiscal year 2009, as new sign-ups have been fully offset by members leaving the program on their own and due to newly instituted eligibility verification processes.

## ***FY2010 Governor's Budget Recommendation***

Fiscal year 2010: The Administration's fiscal year 2010 budget proposal includes \$880 million for Commonwealth Care, a 7.3 percent increase over current fiscal year 2009 projections, to provide coverage to approximately 180,000 residents. Enrollment is expected to resume moderate growth in fiscal year 2010, on account of additional sign-ups due to negative economic conditions and a slight decrease in people leaving the program. Under a new payment methodology, rate increases have been limited well below medical inflation.

In addition to general state revenues and federal matching funds, Commonwealth Care is supported by a number of dedicated revenue sources in fiscal year 2010.

- The "Fair Share" test requires employers with over 11 full time employees to either make a "fair and reasonable" contribution to health insurance for their full-time employees or pay a \$295 per employee assessment to the state. Recent revisions to the "Fair Share" test are projected to increase net revenue collections (accounting for collection costs and timing) to over \$20 million in fiscal year 2010.
- Starting in fiscal year 2009, the state raised taxes in cigarettes by \$1 per pack and dedicated the increased revenues to the Commonwealth Care Trust Fund. These revenues are projected to total \$145 million in fiscal year 2010.
- Adults who can afford health insurance but fail to purchase coverage are required to pay monetary penalties when filing their tax returns. Revenues from calendar year 2007 tax filings have totaled over \$16 million to date. This includes \$12.3 million received in fiscal year 2008 and approximately \$4 million received to date in fiscal year 2009. The Administration is conservatively assuming \$12.3 million in tax penalty revenues for fiscal year 2010, equal to the known amount collected in fiscal year 2008. While some penalties for lacking coverage have increased from calendar year 2007, health insurance coverage levels have likewise increased – suggesting that a conservative budget estimate is appropriate.

Health Care Tax Penalties per Individual						
Income (% FPL)	0-150%	150.1-200%	200.1-250%	250.1-300%	Above 300% Age 18-26	Above 300% Age 27+
2008 Penalty	\$0	\$17.50/month \$210/year	\$35/month \$420/year	\$52.50/month \$630/year	\$56/month \$672/year	\$76/month \$912/year
2007 Penalty	\$219					

### **MassHealth**

The Massachusetts Medicaid (MassHealth) program provides health insurance to more than one million low- and moderate-income Massachusetts children, adults, seniors and people with disabilities. MassHealth is the second largest health insurer in the state. Health care reform expanded MassHealth eligibility coverage to children with incomes up to 300 percent of the federal poverty level (from 200 percent). It likewise broadened eligibility for the Insurance Partnership Program (which makes health insurance more affordable for small businesses and their employees) to individuals up to 300 percent of the federal poverty level (also up from 200 percent). Health care reform also restored benefits that had previously been cut, such as adult dental coverage and eyewear.

MassHealth program spending for fiscal year 2010 will grow by approximately 3 percent. This includes anticipated enrollment growth in the program as described below, and reflects anticipated savings and costs from new initiatives and investments. It does not include moving \$290 million in previously off-budget spending on budget (including the Essential Community Provider Trust Fund, certain hospital and physician rate payments, and pay-for-performance payouts). Including that formerly off-budget spending, MassHealth program spending will grow by approximately 6.6 percent.

MassHealth's slim 3 percent increase is made possible by a number of factors. One is MassHealth's administrative and overhead costs of 2.9 percent, including employee benefits, overhead and outreach. Another reason for the slim increase are limits that MassHealth has put on provider and health plan rates for both fiscal year 2009 and fiscal year 2010. At the same time, MassHealth has examined their hospital rate structure and made improvements to reward providing the right care in the right setting, which has resulted in some overdue rate increases to some cost-efficient hospitals. Through these and numerous other measures, MassHealth is leading the way in controlling health care cost growth

FY09 Estimated Spending *	FY10 Total**	% growth from FY09 Estimated Spending	Total off-budget spending coming on-budget	New Total FY10***	% growth from FY09 Estimated Spending
\$ 8,415,822,272	8,970,235,518	6.6%	\$ (290,100,000)	\$ 8,680,135,518	3.14%

\* FY09 estimated spending reflects emergency spending reductions as well as a deficiency within the MassHealth program.

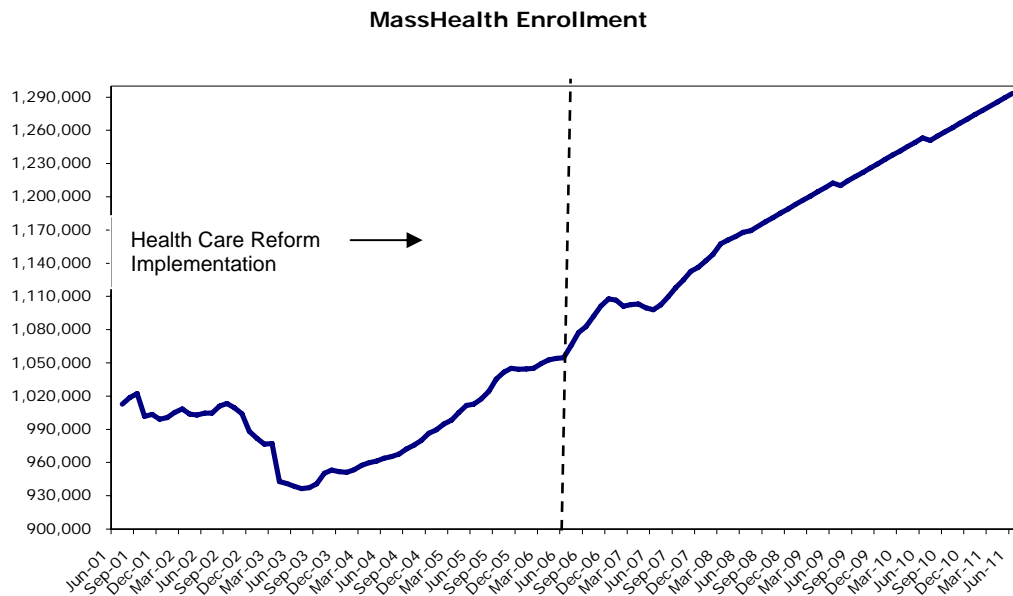
\*\* This FY10 total includes off-budget spending that will be moved on-budget in FY10.

\*\*\* This FY10 total excludes off-budget spending that will be moved on-budget in FY10.

As a result of the eligibility expansions through health care reform and efforts to enroll eligible individuals through the Virtual Gateway, MassHealth has seen caseload increases in recent years. The Administration's fiscal year 2010 budget continues to fund projected enrollment growth in the MassHealth program.

<b>MassHealth Average Enrollment</b>					
	<b>FY06</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>
<b>HMO</b>	329,723	349,407	373,684	403,381	426,580
<b>PCC</b>	290,351	294,035	303,623	315,197	324,462
<b>TPL</b>	150,463	158,556	161,185	164,174	166,203
<b>SENIORS</b>	121,946	124,607	125,690	127,439	128,541
<b>FFS</b>	149,862	168,238	174,542	180,732	185,991
<b>Total</b>	1,042,345	1,094,844	1,138,725	1,190,923	1,231,777
<b>% Change</b>	5.5%	5.0%	4.0%	4.6%	3.4%

Source: Massachusetts Office of Medicaid, December 2008.



Source: Massachusetts Office of Medicaid, December 2008.

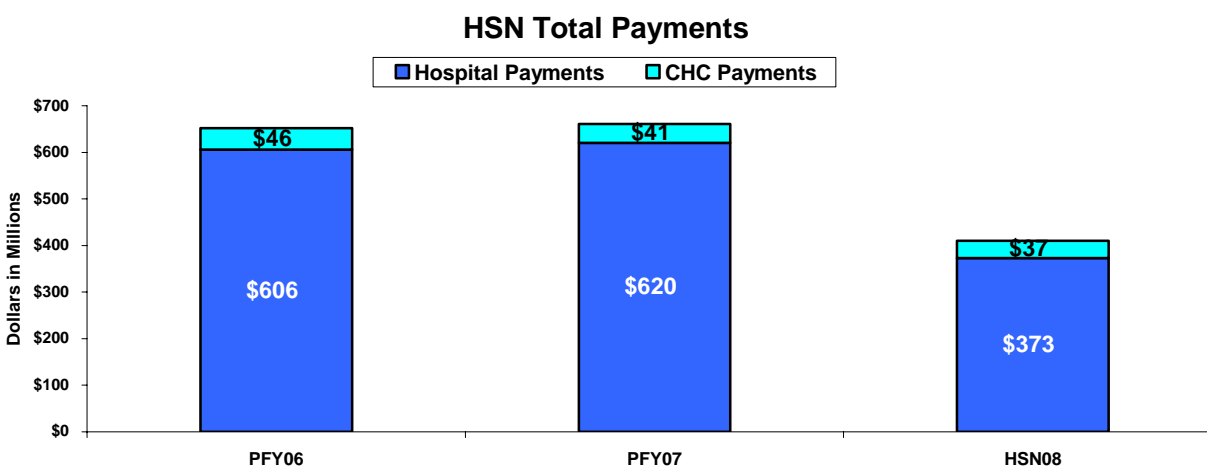
### Health Safety Net

The Health Safety Net is the successor to the state's Uncompensated Care Pool, effective October 1, 2007. Overseen by the state's Division of Health Care Finance and Policy (DHCFP), it ensures access to essential health care services for low- and moderate-income uninsured or underinsured residents, by making payments to hospitals and community health centers for allowable services provided to this population.

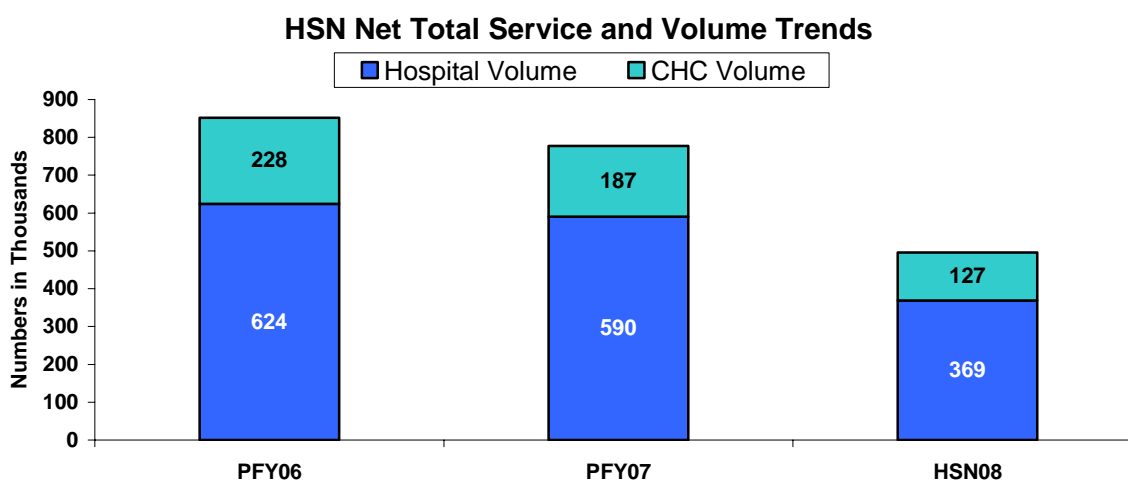
The transition of the Uncompensated Care Pool to the Health Safety Net included several initiatives to promote health insurance and align policies with those of state health insurance programs (MassHealth and Commonwealth Care), most notably:

- **Access:** DHCFP issued regulations defining eligibility for health services funded through the Health Safety Net. The regulations promote enrollment in health insurance by those who can afford public or private coverage while preserving HSN eligibility for other low-income individuals lacking access to affordable coverage. Between October of 2006 and September of 2008, more than 90,000 individuals who were formerly eligible for the Uncompensated Care Pool determined eligible for Commonwealth Care.
- **Payment:** Previously, Uncompensated Care Pool payments were made using block grants based upon prior period hospital charges, resulting in a wide variation of payment rates among hospitals. The Health Safety Net now pays hospitals based on adjudicated claims, after verifying the patient is eligible and services are covered.

As intended under health care reform, our efforts to promote enrollment in health insurance coverage have resulted in decreased Health Safety Net utilization and payments. Notably, as compared to Uncompensated Care Pool fiscal year 2007, Health Safety Net payments decreased dramatically by 38 percent in Health Safety Net 2008 (from \$661 million to \$410 million).



Source: Division of Health Care Finance and Policy, [Health Safety Net 2008 Annual Report](#), December 2008



Source: Division of Health Care Finance and Policy, [Health Safety Net 2008 Annual Report](#), December 2008

For current budget planning, Health Safety Net spending assumptions for fiscal year 2009 and fiscal year 2010 are based on spending assumptions submitted in connection with the recent renewal of the Commonwealth's Medicaid waiver for fiscal years 2009-11. Based on these spending assumptions:



- The Health Safety Net would have a \$47 million surplus in its fiscal year 2009, as a previously appropriated general fund contribution of \$63 million is larger than needed to fund this spending.
- The fiscal year 2010 budget does not include a general fund contribution to the Health Safety Net, as assessments from insurers and providers and offset funding (totaling \$390 million) are sufficient to fund this spending.

#### Health Safety Net Trust Fund- Sources

	FY08	FY09	FY10
Assessments & Offsets	\$380,000,000	\$390,000,000	\$390,000,000
General Fund Contribution	\$ 49,600,000	\$ 62,996,382	\$ -
Previous Year Balance Transfer	\$ 24,000,000		
<b>Total Sources</b>	<b>\$453,600,000</b>	<b>\$452,996,382</b>	<b>\$390,000,000</b>

#### Health Safety Net Trust Fund- Uses\*

	FY08	FY09	FY10
Hospital Payments	\$ 372,600,000	\$ 368,658,801	\$ 346,000,000
CHCs	\$ 37,000,000	\$ 31,341,199	\$ 29,000,000
Demos (Admin)	\$ 6,000,000	\$ 6,000,000	\$ 6,000,000
<b>Total Uses</b>	<b>\$ 415,600,000</b>	<b>\$ 406,000,000</b>	<b>\$ 381,000,000</b>
<b>Sources less Uses</b>	<b>\$38,000,000**</b>	<b>\$ 46,996,382</b>	<b>\$ 9,000,000</b>

\* Health Safety Net payments for fiscal years 2009 and 2010 based on waiver spending projections.

\*\* Carried as a reversion on state balance sheet for fiscal year 2009 to minimize need for further emergency spending cuts to other health care programs.

The Administration does acknowledge that there is uncertainty around Health Safety Net fiscal year 2009 and fiscal year 2010 program costs, due to our economic downturn, evolving enrollment dynamics in state health insurance programs and lags in available data about Health Safety Net trends.

On that account, the budget currently retains fiscal year 2009 funding in excess of waiver spending assumptions within the Health Safety Net Trust Fund as a "cushion" that can be applied to support actual spending needs. We will continue to closely monitor the Health Safety Net and, based on updated information, refine our projections of its fiscal year 2009 and 2010 needs.

## Cost Containment

"Bending the trend" on health care costs is a top priority for the Administration. Cost containment is essential to achieving and sustaining near-universal health insurance coverage under health care reform and enabling government, businesses and families to afford high-quality health care and meet their *other* needs and priorities.

### MassHealth

MassHealth program eligibility has historically been expansive as compared to other states. Meanwhile, over the last decade, Massachusetts has experienced a rate of per capita health care spending that is 25 percent higher than the U.S. average. These factors have forced MassHealth to maximize efficiencies in the program as a standard business practice. As one example, MassHealth led the nation in finding savings in prescription drug utilization, implementing sensible clinical interventions long before other states recognized the need for, and efficacy of, such programs. When compared to yearly spending growth prior to comprehensive clinical and programmatic interventions, the savings within the pharmacy program total \$1 billion over the last five years. Likewise, the MassHealth program has developed care management and benefit coordination efforts that focus on high-cost, medically complex populations.

The Administration's fiscal year 2010 budget includes a wide range of cost containment initiatives designed to further restrain state costs, promote higher quality and more cost-effective care, advance reform of our health care payment system and improve coordination of benefits and payments. In addition to savings from limits on provider and health plan rates, key initiatives include:

- **Continued shift toward provider payments tied to performance improvement and achievement:** Spurred by health care reform's hospital pay-for-performance requirement, MassHealth has moved aggressively to implement performance-based payments for hospitals, nursing homes, physicians and health plans. MassHealth will continue this initiative in fiscal year 2010 by increasing the proportion of payments subject to performance improvement and achievement.
- **Non-payment for hospital-acquired infections and preventable readmissions:** MassHealth will stop paying for certain hospital-acquired infections (infections that patients acquire while receiving treatment for medical or surgical conditions) and preventable readmissions. This proposal will provide a financial incentive to improve patient care and avoid unnecessary costs. It builds upon an earlier announcement through the Administration's *Healthy Massachusetts* Initiative that MassHealth, Commonwealth Care, the Group Insurance Commission and the Department of Corrections – which collectively insure or purchase care for 1.6 million lives – would no longer pay for costs associated with 28 serious reportable health care events.
- **“Medical Home” and care management:** MassHealth is continuing to enhance its Primary Care Clinician (PCC) plan to encourage more patient-centered and coordinated care. A key focus of these efforts will be promoting movement to “medical home” models that offer continuous, uninterrupted care managed and coordinated by primary care providers. The goal is to provide patients with a broad spectrum of coordinated care, particularly preventative care, resulting in more effective treatment, better health outcomes and corresponding savings.
- **Alternative payment:** As an alternative to “fee for service” payments to providers that can promote “over-delivery” of care without better results for patients, MassHealth plans to develop alternative payment demonstrations with interested hospitals, physician groups and nursing homes. This project will establish an aggregate prospective payment to cover the total cost of a defined set of health care services delivered by a provider or provider system. The goal of the global payment demonstration is to enhance incentives for providers to manage costs and utilization, integrate services and focus on quality, as opposed to volume. Development of this model will be informed by the work of the newly created state commission on payment reform.
- **Program integrity efforts:** MassHealth continues to be a national leader in ensuring that funds provided by the taxpayers of Massachusetts are used properly and effectively. MassHealth is procuring a state-of-the-art augmented service utilization and review system that will use advanced analytical techniques to ensure fraud and abuse are addressed aggressively. It will also be increasing clinical reviews across many provider groups to ensure members receive the most appropriate level of care. Furthermore, it will continue to lead efforts to ensure that Medicaid is the payor of last resort and all third-party liability opportunities are identified.

### **Group Insurance Commission**

The Administration continues to support reforms to improve the fairness and sustainability of health coverage for state employees. Massachusetts state employees' health insurance contributions are currently tied to their dates of hire, with most employees hired before June 30, 2003 contributing 15 percent of the costs of to their health coverage and employees hired after that date contributing 20 percent. As part of its fiscal year 2010 budget, the Administration is proposing to change active state employee contributions to health insurance coverage through the Group Insurance Commission from a system based on dates of hire to a more rational system based on salary levels and affordability.

Furthermore, in fiscal year 2010, more municipalities will take advantage of the option to provide health insurance for their employees through the Group Insurance Commission (GIC). Increases in employee health care costs have placed significant strains on municipal budgets. According to a Massachusetts Municipal Association survey, municipal health care costs rose by a total of 99 percent during the six years from 2001 to 2007 – nearly four times greater than the growth in local budgets over the same period.

This reform, enacted as part of the Administration's Municipal Partnership Act, gives cities and towns more options for cost savings in offering high-quality health insurance to their employees. In the next fiscal year, fifteen additional municipalities plan on joining the GIC, bringing the total number of local participants to 25. The GIC expects to cover over 45,000 people through its partnership with municipalities. This reform has also spurred the

creation of more competitively priced health insurance options *outside* of the GIC for municipalities and their employees.

### **Commonwealth Care**

As part of its ongoing procurement of health plans to provide health insurance through Commonwealth Care, the Connector has not only set an aggressive rate ceiling but also adopted a number of innovative incentives to encourage even lower bids. These incentives reward low bidders with more enrollment – by assigning the lowest enrollee premium to the least expensive plan and automatically enrolling certain members who do not select specific plans in the least expensive plan.

The Connector has also reserved a portion of the administrative fees that it pays Commonwealth Care health plans as an incentive pool to leverage improvements in the quality of care provided to members. The incentives encourage health plans to promote stronger relationships between members and primary care physicians through annual comprehensive primary care visits and to report on emergency room visits by members (and thus provide data to help craft policy responses to unneeded emergency room visits).

### **Systemic Cost Containment**

The Administration's cost containment agenda encompasses not merely cost-saving innovations in state health insurance programs but, more broadly, comprehensive reform of our state's health care system to improve the affordability and quality of health care.

Payment reform is a centerpiece of the Administration's comprehensive cost containment strategy, consistent with a broad consensus that this is the *most effective* way to control health care costs. We are committed to replacing outdated payment approaches that reward "too much" or "too little" care with models that promote *effective* and *appropriate* treatment. Furthermore, the Administration will continue promoting other components of a comprehensive cost containment agenda, including administrative simplification, advances in e-health technology, greater transparency of health care costs, public education, improved care management and other proven approaches to providing the right care at the right price.

Key initiatives, many of which were included in comprehensive cost containment legislation enacted by the Legislature in 2008, include:

- **Payment Reform Commission:** The Secretary of Administration and Finance and the Commissioner of the Division of Health Care Finance and Policy are co-chairing a Special Commission on the Health Care Payment System to reform and restructure current health care payment systems to provide incentives for efficient and effective care. This Commission will examine and propose alternatives to the "fee for service" approach to paying for health care, which can reward providers for volume of care instead of outcomes and skew treatment away from the most effective approaches.
- **State Payments Study:** The Secretary of Health and Human Services and Secretary of Administration and Finance will develop a report that examines state payments to providers such as hospitals, community health centers and managed care organizations. This report will focus on payments over the past five years, to examine the impact of health care reform on state, insurer and hospital finances.
- **Cost Trends Report and Hearings:** The Division of Health Care Finance and Policy will develop a report on health care cost trends in Massachusetts and hold public hearings to examine factors that contribute to cost growth in our health care system.
- **Health Care Quality and Cost Council:** The Administration is providing \$1.1 million for the Health Care Quality and Cost Council in fiscal year 2010. These funds will build upon the Council's recently launched "My Health Care Options" website promoting transparency of costs in our health care system. The Council is also developing a "Roadmap to Cost Containment" to help identify high-impact approaches to health care cost containment and propose a strategy for their implementation.
- **Public Health Council DoN and Cost Quality Measures:** The Public Health Council issued regulations within the last twelve months that strengthened the Determination of Need (DoN) Program by guaranteeing proper review of any proposed major outpatient capital project or costly equipment

purchase. Regulations were also issued requiring public reporting of medical mistakes and hospital infection. Billing by any insurer for care associated with a significant medical mistake was also prohibited.

## **Wellness**

The Administration is dedicated to promoting good health not only by expanding access to health care and coverage but also by promoting healthier lifestyles. Making the right health choices – such as exercising, eating healthy foods and avoiding smoking – yields other important societal benefits as well, including lower health care costs and greater economic productivity.

### **“Mass in Motion”**

The Administration has recently launched “Mass in Motion,” the most comprehensive effort to date to address the serious problem of overweight and obesity in the Commonwealth. While Massachusetts compares favorably to other states with respect to overweight and obesity, our rates are increasing more quickly than the nation as a whole. The Commonwealth has seen a 47 percent increase in overweight and obesity over the past two decades, compared to a national increase of 40 percent. Overweight and obesity place individuals at higher risk of serious health conditions, such as heart disease, stroke, diabetes and certain kinds of cancer. Those conditions impose enormous burdens not only on our residents but also on our entire health care system.

“Mass in Motion” is comprised of a number of policy and program elements, including:

- The release of a report documenting the extent of the obesity epidemic in Massachusetts and its consequences.
- Nearly \$750,000 in grants to cities and towns to help municipal and community leaders establish wellness initiatives at the local level, including providing healthier meals in schools, establishing farmers' markets in low-income areas and encouraging walking and bike-riding.
- Body Mass Index (BMI) testing of students in all public schools in the Commonwealth.
- Caloric menu labeling for large chain restaurants.
- An Executive Order requiring state agencies responsible for large-scale food purchasing (for example, Department of Public Health and the Department of Mental Health) to follow healthy nutritional guidelines in their food service operations. In the spirit of shared responsibility, all major state-operated facilities will ensure that nutritional options are listed on each of their menus.
- The expansion of a state-sponsored Workplace Wellness program throughout the state to help employers create work sites which encourage healthy behaviors and reduce absenteeism and health insurance costs.
- The launch of a state sponsored “Mass in Motion” web site that promotes healthy eating and physical activity at home, work and in the community.

### **Wellness Grants**

The Wellness Grants campaign builds upon several other public health initiatives that have begun or been strengthened in the last year. \$1 million in new multi-year wellness grants were distributed to 25 different organizations around the state at the start of fiscal year 2009. These grants support a wide array of activities from municipal employee wellness efforts to neighborhood-level walking and exercise groups for the elderly to healthy cooking classes for individuals with diabetes.

### **Commonwealth Wellness Fund**

The Administration is proposing to eliminate existing sales tax exemptions on the purchase of alcohol beverages consumed off-premises, sweetened beverages and candy. This policy initiative aims to encourage healthy lifestyle choices. It will also generate revenues that will help to preserve most funding for public health programs in fiscal year 2010 and provide a dedicated revenue stream for these programs in subsequent years.

## Alcohol

While we have made significant progress in curbing alcohol abuse, Massachusetts still ranks in the top ten percent of states with the highest rates of both underage drinking and adult binge drinking. Research has shown that ending sales tax exemptions for off-site consumption of alcohol will decrease underage consumption and frequency of use – and may also delay the first use of alcohol for some teenagers.

## Sweetened Beverages and Candy

More than a third of middle- and high-school students and half of the adult population in Massachusetts are overweight, causing dramatic, costly increases in chronic diseases like diabetes. Indeed, the number of adults with diabetes has doubled in a little more than ten years. This emerging public health crisis has been fueled by skyrocketing soda consumption (doubling between 1970 and 1999) and steady increases in candy consumption. Eliminating sales tax exemptions for these products would encourage consumption of healthier alternatives, particularly among young people whom research has shown are particularly price-sensitive. It would also follow the lead of seventeen other states that tax foods of low nutritional value.

Net fiscal year 2010 proceeds from eliminating these sales tax exemptions – projected to be \$121.5 million – will be deposited directly into the Commonwealth Wellness Fund and dedicated to support critical public health programs such as alcohol and tobacco addiction services, health promotion, violence prevention and workforce expansion services.

Wellness Fund: FY10					
\$121.5 Million					
Account Distribution	Acct #	FY10 Allocation	% Wellness Fund	% GF	Total Wellness Fund Spend
Addiction and Tobacco Control Services	4510-0700	\$ 90,468,857	86%	14%	\$ 78,000,000
Health Promotion, Violence Prevention and Workforce Expansion	4510-2500	\$ 49,938,924	87%	13%	\$ 43,500,000
					\$ 121,500,000

## MassHealth Wellness Program

Governor Patrick's fiscal year 2010 budget also continues to fund wellness initiatives through the MassHealth program. The MassHealth Wellness Program encourages members to adopt and maintain a healthy lifestyle. In collaboration with our state's Department of Public Health, the Wellness Program designs print materials that help members learn about healthy lifestyle choices and the benefits of those actions. The MassHealth Wellness Program also works with providers to design training programs and forums to promote culturally appropriate communication with members about the importance of regular preventive health care and health risk factors.

The MassHealth Wellness Program, in collaboration with the Department of Public Health, is exploring the viability of developing a reward program for MassHealth members participating in wellness-related activities. The reward would consist of coupons for fruits and vegetables that would be used in participating grocery stores and at farmers' markets. Distribution of reward information educational materials about good nutrition practices would occur through the existing provider (grocery stores and farmers markets') and staff networks for the WIC program.

## Long-Term Care Supports/Community First

The Administration's long-term care policy is *Community First*, a commitment to supporting elders and individuals with disabilities of all ages to live with dignity and independence in the community as a *first* choice and to assuring ongoing access to skilled nursing and other needed institutional care across the lifespan. Demographic projections regarding expanding numbers of Commonwealth residents likely to be in need of long-term support highlight the importance of this policy commitment.

### **Community First Initiatives**

The Administration's fiscal year 2010 budget includes an investment of \$21 million for the "Community First" waiver policy initiative. A demonstration waiver, submitted to the federal Centers for Medicare and Medicaid Services (CMS) in December of 2006, seeks to encourage flexible service options in the community for those who might otherwise need to seek services in a facility setting. The proposed strategies will enable some individuals to continue to live independently in community settings and support others in returning to community settings from institutions.

The Community First 1115 Waiver implementation will be phased in, beginning in fiscal year 2010, initially serving people with disabilities under the age of 60. The waiver will provide participants with access to a range of services, including personal care, residential habilitation, behavioral health services and medication management. Elders, who currently have access to home- and community-based services through an existing MassHealth waiver, will be phased into the new, more expansive waiver beginning in fiscal year 2011.

Other important Administration decisions over the course of the last year will further shift utilization and certain costs into less expensive community-based alternatives. The projected closure of four facility Department of Developmental Services (DDS) intermediate care facilities is projected to result in up to \$80 million in savings, most of which are associated with MassHealth facility-based payments. In fiscal year 2010 alone, there are \$13 million of savings from facility consolidation projected within the DDS budget. Settlement of the *Rolland* case will reduce MassHealth liability in nursing facility-based care for over 650 current residents with mental retardation and developmental disabilities, and settlement of the *Hutchinson* case will expand important community alternatives for brain-injured adults and seniors.

The Administration's fiscal year 2010 budget also permits MassHealth to implement a "cash and counseling" program to allow members the flexibility to get a cash budget to be used to make arrangements for their long-term care that best fits their circumstances, needs, and preferences.

### **MassHealth Community Long-Term Care Services**

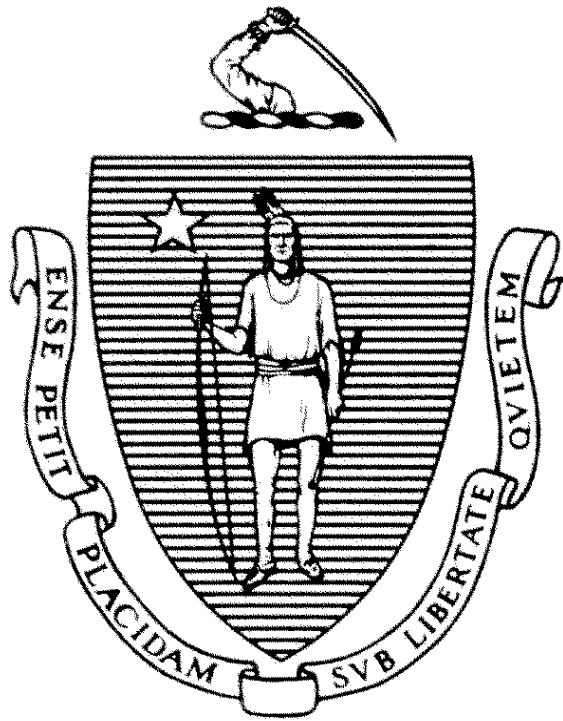
The Administration's fiscal year 2010 budget increases Personal Care Attendant (PCA) funding by \$73 million over fiscal year 2009 spending. Personal Care Attendants provide important in-home services to people with disabilities and elders. The budget also funds anticipated increased utilization of other community-based services through a \$180 million increase over last year's budget, including over \$75 million in anticipated growth in adult day health utilization.

### **Children's Behavioral Health Initiative (CBHI)**

Beginning on June 30, 2009, several new services will be implemented as part of the Children's Behavioral Health Initiative (CBHI). This initiative incorporates a broad array of services and supports for youth and their families. CBHI is organized into a coordinated network and integrates care planning and management across multiple levels. It is culturally and linguistically competent and builds meaningful partnerships with youth and their families at service delivery, management and policy levels.

These services promote behavioral health of youth and their families. Behavioral health services are provided through a comprehensive array of accessible formal and informal services and individualized service planning. The services are delivered in ways that actively engage youth and families in the context of their unique cultures and work to ensure the least restrictive and least intrusive community-based services that can meet identified needs. The fiscal year 2010 budget funds anticipated expansion in CBHI.

# Fiscal Year 2010 Budget Recommendation



## Economic Overview





## ***Economic Overview - January 2009***

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