

BUDGET MONITOR

House Floor Action on the FY 2007 Budget

OVERVIEW

During five days of deliberations, the House of Representatives made relatively modest changes to the FY 2007 budget proposed by the Committee on Ways and Means, increasing spending by a total of \$188.4 million or approximately seven tenths of one percent of the budget.

Over \$100 million of this new finding is for education programs: \$81.4 million is for Chapter 70 state aid for local schools; \$19.8 million is for targeted grant programs such as early literacy initiatives, METCO, and regional school transportation costs; and \$5.6 million is for early education programs. Even after the increase, however, the level of funding proposed for Chapter 70 education aid in FY 2007 is still \$197.5 million or 5.4 percent below the level in FY 2002, after adjusting for inflation.

On May 1st, the Department of Revenue announced state tax collection totals for April. These numbers continued the trend of the past eight months: total tax revenues are approximately 8 percent above last year. While taxes, as a share of income, are still \$2 billion lower than they were a decade ago, this new revenue growth creates some opportunities for the Commonwealth.

First, in FY 2006, faster than expected revenue growth could allow the budget to be brought into structural balance. The current year's budget relied on a \$600 million transfer from the Stabilization Fund. Because revenues are significantly exceeding projections, that withdrawal will be able to be repaid and the state should finish this fiscal year with a modest surplus.

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Second, the FY 2007 budget adopted by the House will likely not require the use of Stabilization money to be balanced. If current revenue trends continue in FY 2006 and tax revenue grows at 5 percent in FY 2007, then there will be enough permanent revenue to support the House budget proposal. It is important to note, however, that even with the dramatic FY 2006 revenue growth there will not be a large structural surplus in FY 2007 unless revenue growth continues to proceed at rates that have proven historically to be unsustainable.

In the Revenue section of this *Monitor* we project the magnitude of potential surpluses in the current and the coming fiscal year. We show that over the past 20 years, sustainable revenue growth has not exceeded 5 percent per year. While there are cycles when revenue grows more quickly than this, those times are followed by periods of very slow or negative growth and severe fiscal crisis.

In considering the possibility of surpluses that could be caused by continued revenue growth of eight or nine percent a year, it is important to recognize that those would be temporary surpluses that could quickly be transformed into deficits in the next economic downturn. During the 1990s, the state enacted over three billion dollars of permanent tax cuts in response to temporary surpluses. The result was a structural budget gap that became apparent when the recession of 2001 arrived. Much of that gap has now been closed by cuts to local aid, education, and basic state government services like public health, environmental protection, and housing.

While the House's version of the FY 2007 budget leaves in place many of those deep cuts, it rejects the suggestion that it would be appropriate to repeat the cycle of

enacting costly tax cuts in good times and, ultimately, forcing the government to pay for those tax cuts by cutting support for education, local aid, and other basic public services the next time our economy weakens.

This *Budget Monitor* examines both the revenue and spending policies put forward by the House, describing the impact of floor amendments and comparing proposed spending levels to FY 2006, to the Governor's recommendations, and to levels before the fiscal crisis.

LOCAL AID

The House budget for unrestricted local aid is \$2.0 million more than the recommendation by the House Committee on Ways and Means. The amount in the house budget – \$1.324 billion – is \$164.6 million or 14 percent higher than current appropriations for this purpose.

FY 2006	\$ 1,159,746,098
FY 2007 House	\$ 1,324,296,219
Increase (decrease)	\$ 164,550,121
Percentage Change	14.2%

The House Committee on Ways and Means proposed \$20.0 million to the Payments in Lieu of Taxes (PILOT) program. The House raises this amount to \$22.0 million, which is higher than the \$16.1 million that is currently allocated for PILOT, but lower than the Governor's \$25.3 million proposal.

The House, like the Governor, removes the cap on lottery revenues to increase distributions to cities and towns by \$158.7 million. In this proposal, funding for additional assistance would remain level at \$379.8 million. Although overall funding

for unrestricted local aid would grow by \$164.6 million over FY 2006, the proposed amount is, in real terms, still \$156.2 million or 10.5 percent below its level in FY 2001.

K-12 EDUCATION

The House budget funds K-12 education at \$3.988 billion, \$101.2 million higher than the proposal by the House Committee on Ways and Means. The House budget for K-12 education provides a \$212.2 million or 5.6 percent increase over FY 2006.

Total K-12 Education

FY 2006	\$	3,775,789,300
FY 2007 House	\$	3,987,983,978
Increase (decrease)	\$	212,194,678
Percentage Change		5.6%

Note: The numbers in this section do not include appropriations or debt service for the School Building Assistance program. Figures for grants and reimbursements include support for the Office of Educational Quality.

Chapter 70 Aid

FY 2006	\$	3,288,931,062
FY 2007 House	\$	3,461,749,605
Increase (decrease)	\$	172,818,543
Percentage Change		5.3%

Chapter 70 aid is distributed to cities and towns for public education. The House budget includes a \$3.462 billion appropriation for Chapter 70 aid, \$81.4 million more than the recommendation by the House Committee on Ways and Means.

In increasing Chapter 70 aid, the House budget would implement three specific changes:

- The House proposal would remove an arbitrary cap in current law and allow the foundation budget (the amount the state defines as the minimum that should be spent on education in each district) to increase by the rate of inflation, as defined in Chapter 70. This has the result of increasing state aid to communities that need that aid to be able to spend at the new foundation level.
- The House also changed the calculation of foundation aid to allow communities that are determined to be relying on excessive local contributions to receive additional aid more quickly than they would have in the plans proposed by the Governor and the House Committee on Ways and Means.
- Finally, the House adopted a provision providing that every community would receive at least \$50 per student more than in FY 2006.

The Chapter 70 proposal by the House stands \$172.8 million over the current appropriation, and is \$9.2 million more than that offered by the Governor in the House 2 budget. However, after adjusting for inflation, the proposed amount is below its level in FY 2002. Using the Consumer Price Index to adjust for inflation, the House budget for Chapter 70 is \$197.5 million or 5.4 percent below its amount in FY 2002.

Grants and Reimbursements

FY 2006	\$	486,858,238
FY 2007 House	\$	526,234,373
Increase (decrease)	\$	39,376,135
Percentage Change		8.1%

The House budget appropriates \$526.2 million for the Department of Education's

grants and reimbursement programs. This proposal would boost funding by \$39.4 million or eight percent compared to FY 2006.

The House proposal adds \$19.8 million to the House Ways and Means budget for grants and reimbursements, including increases in the following areas:

- The House proposes \$55.0 million to fund reimbursements for regional school transportation, \$5.0 million more than the amounts offered by the House Committee on Ways and Means and the Governor. The amount in the House budget is \$10.0 million more than the current amount appropriated for this purpose.
- The House proposal includes \$3.5 million for the foundation budget reserve in FY 2007. This funding would aid school districts in meeting their local contribution toward the foundation budget. The House Committee on Ways and Means and the Governor left this line item un-funded. The current appropriation totals \$6.9 million.
- The House budget appropriates \$2.0 million to a program which would allow high school students with disabilities to earn both high school and college credit through coursework at local public colleges. This budget account was not included in the proposals by the House Committee on Ways and Means or the Governor.
- The House budget provides more funding for literacy programs. The House Committee on Ways and Means consolidated two budget accounts into one line item, and level-funded them. The House maintains the separate

accounts for early literacy and targeted tutorial literacy programs and boosts overall funding by \$1.7 million. The Governor kept the two programs separate, and offered level funding for FY 2007.

- The House budget for the METCO program is \$1.2 million higher than the House Ways and Means budget, and would provide a \$2.0 million increase over FY 2006. The Governor proposed to level fund METCO at \$17.6 million.
- Under the House plan, funding for programs for gifted and talented students would rise from \$500,000 in FY 2006 to \$750,000 in FY 2007. The House Committee on Ways and Means and the Governor recommended level funding.

Overall, the amount proposed for the Department of Education's grants and reimbursement programs is higher than the current appropriation, but well below its level before the fiscal crisis began. After adjusting for inflation, the budget for grants and reimbursements is \$38.5 million or seven percent below where it was in FY 2001.

HIGHER EDUCATION

The House budget adds close to \$780,000 to the budget offered by House Ways and Means, bringing the total for FY 2007 to \$1.018 billion.¹ The House proposal for higher education is \$66.8 million or seven percent more than the budget approved in July of 2005. However, \$24.7 million in supplemental funding has been appropriated

¹ Totals for higher education include tuition revenue retained by certain campuses for out-of-state students. In previous year, these amounts had been appropriated through the budget.

since then. Hence, after accounting for this additional funding, the final House budget would increase funding for higher education by \$42.1 million or four percent over the current budget for FY 2006.

FY 2006	\$	975,906,491
FY 2007 House	\$	1,018,042,042
Increase (decrease)	\$	42,135,551
Percentage Change		4.3%

The House budget increases funding in the follow areas:

- Support for state scholarships is \$79,060 more than the recommendation by the House Committee on Ways and Means. The \$89.9 million appropriation is \$5.2 million higher than the current level. The Governor proposed to level-fund this budget account at \$84.7 million.
- This budget increases the Ways and Means \$1.0 million recommendation for the Bay State Reading Institute to \$1.5 million. Funding for this initiative, administered by Middlesex Community College and Fitchburg State College, would support literacy based intervention in public schools and districts that are at risk of or are determined to be underperforming. The House 2 budget did not include funding for this initiative.
- Funding for the community college workforce training incentive grant program rises from \$2.1 million in the Ways and Means proposal to \$2.3 million in the final House budget, but is below the \$2.9 million currently appropriated for these grants. The Governor level-funded budget account in the House 2 budget. Support for this grant program is designed to encourage

community college training opportunities in order to promote workforce development, minimize the shortage of skilled workers, and raise economic opportunity.

The House Ways and Means proposal would increase the nominal allocation to the higher education campuses, but after adjusting for inflation the proposed increases are small. Comparing the House budget to the current FY 2006 budget and to the General Appropriations Act (GAA) enacted last July shows the following:

- Funding for UMass campuses would grow by \$16.5 million or four percent, compared to the budget enacted last July. Compared to the current budget for UMass, the House budget is \$5.3 million or one percent higher.
- Appropriations to state colleges would increase by \$11.1 million or six percent when compared to the General Appropriations Act (GAA). Compared to the current budget, the House Ways and Means budget for state colleges is \$5.3 million or three percent higher.
- Support for community colleges would rise by \$11.1 million or four percent over the GAA. Compared to the current budget for FY 2006, the proposed level of funding is \$4.3 million or two percent higher.

While the overall budget would boost funding for higher education in FY 2007, the total amount proposed is lower than the \$1.051 billion recommendation by the Board of Higher Education (BHE). Moreover, the final House budget for higher education is still \$245.7 million or 19 percent below the FY 2001 level, after adjusting for inflation.

EARLY EDUCATION AND CARE

The House budget for early education and care programs is \$5.6 million higher than the proposal by the House Committee on Ways and Means. The additional funding brings the House budget for early education to \$495.7 million, but after adjusting for inflation, adds no new funding.

FY 2006*	\$	481,309,479
FY 2007 House	\$	495,736,545
Increase (decrease)	\$	14,427,066
Percentage Change		3.0%

* All FY 2006 numbers include allocations from the Purchase of Service reserve.

The House budget provides \$10.0 million in a reserve account which would increase providers' reimbursement rates in FY 2007, \$5.0 million more than the appropriation in the House Ways and Means budget. The Governor did not offer new funding for FY 2007. Funding from this reserve would go toward increasing salaries, expanding benefits, and providing professional development to providers across the state.

In the budget proposed by the House Committee on Ways and Means, line items for three separate programs that each are designed to improve parenting skills were consolidated into one budget account. The House adopted this recommendation, but offered a specific earmark (\$4.5 million) for the Mass Family Networks program, and increased the amount allocated to the Reach out and Read program from \$500,000 to \$800,000.

The House Committee on Ways and Means recommended level funding for Community Partnerships for Children (CPC), but the \$68.7 million that is currently appropriated in one line item would be divided among

several different line items. Although the net result would provide level funding in FY 2007, it is not certain to what extent local councils would maintain control over how funding would be spent. The House budget moves \$5.0 million from the Universal Pre-kindergarten Program, from which CPCs would receive a portion of their funding, to the main budget account which funds CPCs.

INCOME SUPPORT PROGRAMS

The House budget adopts the House Ways and Means funding level for income support programs. These appropriations are lower than in FY 2006 primarily because, as the economy begins to improve, the caseloads

A Brief Explanation of the POS Reserve

The FY 2006 budget included a \$20.0 million reserve to fund salary increases to low-wage workers for providers that deliver human and social services under contracts with the Department of Early Education and Care, the Executive Office of Elder Affairs, and various departments within the Executive Office of Health and Human Services. The Governor's budget for FY 2007 distributes the amounts for these salary increases to their respective budget accounts, but does not provide new funding. The House provides comparable funding in its budget, and appropriates an additional \$28.0 million in new funding for FY 2007. In this *Budget Monitor*, we adjust the relevant FY 2006 numbers to reflect the allocation of the \$20.0 million reserve in that year. The additional \$28.0 million in FY 2007 would accordingly raise the bottom-line budgets for individual agencies, but is not yet known how that funding would be allocated.

for certain income support programs are declining.

FY 2006*	\$	631,629,138
FY 2007 House	\$	613,706,301
Increase (decrease)	(\$	17,922,837)
Percentage Change		-2.8%

* All FY 2006 numbers include allocations from the Purchase of Service reserve as discussed on p. 6.

The House budget leaves in place the current regulations for Transitional Aid to Families with Dependent Children (TAFDC), the state's main income support program for low-income families. In the House 2 budget, the Governor proposed to implement new work requirements and time limits for individuals who are currently exempt from such regulations because they are disabled, are caring for a disabled family member, or have a child less than two years of age. That budget also reduced the appropriation for TAFDC from \$312.9 million to \$291.7 million, a \$21.1 million decline. The House also reduces the appropriation, but offers a smaller decline – \$16.0 million below FY 2006. The smaller appropriations in both budgets reflect a projected decline in the caseload; as the economy begins to improve more families are moving off of TAFDC and into the workforce. The much lower appropriation in the Governor's budget is primarily due to the reforms outlined in the House 2 budget.

Although the House leaves in place the current structure of the TAFDC program, two versions of House and Senate bills that would restructure the program to meet federal standards and safeguard vulnerable families are currently in conference.

During budget deliberations, the House failed to approve an \$8.0 million reserve that would fund employment services and cash

assistance for families should the Commonwealth not meet new federal TANF requirements effective October 2006. This contingency account would only be used if Massachusetts was at risk of failing to meet federal law, and would save the state \$70.0 million or more in federal penalties.²

MEDICAID/MASHEALTH AND OTHER HEALTH PROGRAMS

The House budget recommendations for Medicaid/MassHealth and other Health Care Programs closely follow the budget as recommended by the House Committee on Ways and Means, but the House takes the proposed \$200.0 million set aside as a reserve for the implementation of health care reform (Chapter 58 of the Acts of 2006), and allocates those dollars mostly throughout the Medicaid program.

The House proposed budget recommends \$7.515 billion to cover existing health care programs as well as health care reform (a 2.3 percent increase over FY 2006). However, FY 2006 actual spending in the Medicaid/MassHealth program is likely to be \$200.0 million less than budgeted, so the real increase between FY 2006 and FY 2007 would be closer to \$365.9 million, or a 5.1 percent increase.

FY 2006	\$	7,349,068,387
FY 2007 House	\$	7,514,967,214
Increase (decrease)	\$	165,898,827
Percentage Change		2.3%

Included in the totals for these health care programs are funding for

² For more, refer to Massachusetts Law Reform Institute. April 2006. *House Ways and Means for FY 2007 Preliminary Analysis of Selected Cash Assistance, Housing, and Health Issues*. Available at: <http://www.masslegalservices.org/docs/hwmsummary.pdf>

Medicaid/MassHealth, funding for other health care programs for persons ineligible for Medicaid, and funding for uncompensated care. These totals also include the anticipated program costs associated with health care reform.

Figure 1.

Medicaid/MassHealth and Other Health Care Programs			
<i>In Millions of \$</i>			
	FY 2006	FY 2007	FY 2007
	Current	HW&M	House
Medicaid/MassHealth	6,999.5	7,223.2	7,418.1
Pharmacy Programs	96.0	59.6	62.7
Other Health Care Programs	37.6	34.2	34.2
Uncompensated Care Pool	206.0	0.0	0.0
Health Care Reform	10.0	200.0	0.0
Total	7,349.1	7,517.0	7,515.0

"Medicaid/MassHealth" includes the Medicare "Clawback" but does not include the \$288.5 million Health Care Quality Improvement Trust. "Other Health Care Programs" includes the Healthy Start and Children's Medical Security Plan programs, as well as funding for the Betsy Lehman Center. "Uncompensated Care Pool" only includes money budgeted from the General Fund, not other sources of funding. "Health Care Reform" does not include funding directed to the Division of Insurance.

Medicaid/MassHealth

The House budget recommendation includes \$7.418 billion for the Medicaid/MassHealth programs. This \$194.9 million increase over the House Ways and Means budget recommendation is a redistribution of most of the \$200.0 million that had been set aside for the implementation of health care reform, and includes the estimated programmatic costs of Medicaid expansion. (In FY 2006, a portion of the funding for the MassHealth Essential program had been funded for part of the year out of "off-budget" funds. We include those dollars in our FY 2006 Medicaid totals for year-to-year comparison purposes. There is also \$288.5 million funded off-budget for enhanced nursing home rates through the Health Care Quality Improvement Trust, but because this transaction does not include the

expenditure of state funds, we do not include those dollars in our totals.)

The House Medicaid budget distributes the money associated with health reform by adding to the levels recommended in the House Ways and Means budget in several areas. The House budget amendments include:

- \$80.6 million more to cover costs that include the expansion of benefits such as the restoration of dental services, eyeglasses, chiropractics, and prosthetics for adults; and the expansion of eligibility for children up to 300 percent of the federal poverty level.
- \$4.3 million more for the CommonHealth program in order to increase program membership. The House also recommends that the enrollment cap on that program increase from 14,000 members to 15,300 members.
- \$20 million more for the MassHealth Senior Care Plan. The House budget includes language that would allocate this increase towards rate adjustments for providers.
- \$2.2 million more for the MassHealth Family Assistance Plan, in part to accommodate the increased costs of membership expansion.
- \$10.0 million more for the Premium Assistance and Insurance Partnership programs. Language in the House budget recommendation would increase the income limit for eligibility from 200 percent to 300 percent of the federal poverty level. These programs, which provide

public subsidies in the private insurance market for eligible low- and moderate- income persons, are a cornerstone of the Commonwealth's health reform legislation.

- \$77.8 million more for the MassHealth Essential program. The language in the House budget recommendation would increase the program's enrollment cap from 44,000 to 60,000 persons, effectively eliminating the waiting list. The House budget would also ensure program coverage for elderly or disabled legal immigrants, and, like in the House Ways and Means budget recommendation, would explicitly prohibit the Office of Medicaid from "deeming" the income of immigration sponsors as a way of limiting eligibility for the program.

The House amendments also add language that would lift the enrollment cap on the MassHealth program for persons who are HIV-positive from 1,050 members to 1,300. New language also requires a public hearing prior to implementing changes in eligibility or benefits, and there is also language that expands Medicaid eligibility until the age of twenty to children aging out of custody of the Department of Social Services.

Pharmacy Programs

On January 1, 2006, the federal Medicare Prescription Drug Improvement and Modernization Act (Medicare Part D) went into effect. Medicare Part D is intended to provide prescription drug coverage for persons on Medicare, and accordingly the House budget recommendations assume that neither the Medicaid program nor the Prescription Advantage program will be

necessary as a primary provider of health insurance coverage for medications for most elders.

Because of presumed savings to state Medicaid programs associated with this new federal program, the Commonwealth must pay a "Clawback" to the federal government to offset a portion of these savings associated with persons who are dually-eligible for Medicare and Medicaid. The "Clawback" amount in the House budget proposal is \$239 million, \$119 million more than in FY 2006 when this payment only covered half of the fiscal year.

In FY 2007, the House budget proposes that the Prescription Advantage program cover Medicare Part D co-payments, premiums and other out-of-pocket costs for eligible enrollees, and continue to provide primary prescription coverage for persons not eligible for Medicare.

The House recommends \$62.7 million for the Prescription Advantage program, \$3.1 million more than recommended by the House Committee on Ways and Means. The House also includes language recommending an open enrollment period for the program.

Other Health Care Programs

The House budget follows the recommendation of both the House Committee on Ways and Means and the Governor for the funding of other health care programs, including \$16.0 million for the Healthy Start program and \$18.2 million for the Children's Medical Security Plan. Because FY 2006 spending has been less than budgeted, these proposed funding levels may be sufficient to cover the costs of the programs in FY 2007. Unlike the Governor's budget recommendation, the

House budget does not include budgetary language to ensure restructured premiums for the Children’s Medical Security Plan.

Uncompensated Care and Health Reform

The House budget recommendation assumes that comprehensive health care reform will reduce the need for an Uncompensated Care Pool as currently configured, so the House budget recommendation does not appropriate state dollars for uncompensated care. In FY 2006, \$206 million had been appropriated to cover a portion of the costs of uncompensated care. The House budget does not change the House Ways and Means recommendation that total assessments to cover the costs of uncompensated care remain at \$320 million as in FY 2006, rather than revert to the statutory level of \$315 million as proposed by the Governor.

Because the Legislature already enacted comprehensive health reform legislation, the House does not include a \$200 million reserve set-aside to support anticipated costs of the implementation of health care reform, but instead recommends the allocation of that money across the Commonwealth’s health care programs.

PUBLIC HEALTH

The House added \$4.8 million to the recommendation of the House Committee on Ways and Means for public health services. The final budget proposed by the House totals \$466.4 million for public health, a \$17.2 million or 3.8 percent increase over FY 2006 funding. This amount is an increase barely over inflation; however, there would be additional dollars available for public health from the proposed \$28.0 million reserve to fund salary increases for low-wage human service

workers. In FY 2006, the salary reserve added \$555,000 to the public health bottom line.

FY 2006*	\$	449,186,238
FY 2007 House	\$	466,350,794
Increase (decrease)	\$	17,164,556
Percentage Change		3.8%

* All FY 2006 numbers include allocations from the Purchase of Service salary reserve as discussed on p. 6.

Even though the House budget continues to restore funding for the public health services that had been deeply cut during the state’s fiscal crisis, this recommendation is still 23 percent below funding in FY 2001 when adjusted for inflation.

The House amendments add funding in several areas, including:

- \$1.9 million more for universal immunizations, for a total of \$36.7 million. This is a \$7.7 million increase over FY 2006. The Governor’s budget had recommended \$34.9 million.
- \$1.0 million more for teen pregnancy prevention, for a total of \$2.0 million. The House does not follow the Governor’s recommendation to eliminate funding for existing programs and establish a new \$4.0 million “prevention curriculum” focusing on violence prevention, substance abuse and teen pregnancy. Funding in FY 2006 for teen pregnancy prevention was \$2.0, with \$1.0 million more added by the recently-passed health reform legislation (Ch. 58 of the Acts of 2006) which will be available for spending in FY 2007. In FY 2001, when adjusted for inflation, funding for teen pregnancy prevention programs was \$6.3 million.

- \$350,000 more for school health services, for a total of \$16.1 million. The House recommendation includes the House Ways and Means earmark of \$300,000 for mental health and substance abuse services in school-based health centers. The total funding for school health services represents a \$1.4 million increase over FY 2006. When compared to funding in FY 2001, however, there has been a dramatic reduction in funding for school health. School health services had been funded partially within the Department of Public Health and partially within the Department of Education. Since FY 2001, when adjusted for inflation, even with recommended increases, school health services have been cut 69 percent.
- \$281,000 more to support staffing and other administrative costs at the Department of Public Health, for a total of \$17.1 million. The Governor's budget had also recommended \$17.1 million.
- The House budget recommendations increase funding beyond what had been recommended by the House Committee on Ways and Means in several other public health line items. These increases include: \$350,000 more for family health centers for a total of \$5.9 million (the Governor had recommended \$5.8 million); \$500,000 more for early intervention services for a total of \$33.0 million (the Governor had recommended \$31.5 million); \$55,000 more for colorectal cancer screening services for a total of \$240,000 (the Governor had recommended \$185,000); \$100,000 more for Hepatitis C programs for a total of \$662,900 (the Governor had recommended \$562,900); \$158,000 more for domestic violence services for

a total of \$5.0 million (the Governor had recommended \$4.9 million); and \$107,500 more for early breast cancer detection screening for a total of \$3.4 million (the Governor had recommended \$3.3 million).

There were other areas where the full House followed the recommendations of the House Committee on Ways and Means, including:

- \$38.7 million for AIDS prevention and treatment (which includes \$36.8 direct funding for services and \$1.9 million available from drug rebates). This amount is still 36 percent below FY 2001 funding when adjusted for inflation. The Governor had recommended \$37.5 million for these services.
- \$59.2 million for substance abuse services, as well as a \$5.0 million line item for substance abuse step-down recovery services. The House also earmarks approximately \$5.6 million of the funding for specific organizations and services. This recommended funding level for substance abuse services is a 31 percent increase since FY 2006, even when adjusted for inflation. The Governor had recommended \$37.6 million for AIDS prevention and treatment.
- \$4.3 million for smoking prevention programs, just under what had been recommended by the Governor. The recently-passed health reform legislation included \$4.0 million for smoking prevention and treatment programs, to supplement the \$4.3 million previously appropriated in FY 2006. The health reform legislation specifies that the amounts included for public health programs may be spent in FY 2007, so

the total amount of funding available for year could be more than the \$4.3 million recommended by the House.

Nevertheless, funding for smoking prevention programs has been cut dramatically over the years – adjusted for inflation, funding in FY 2001 was \$58.4 million.

MENTAL HEALTH

The House budget adds \$725,000 to the House Ways and Means proposal for mental health services. Under the House budget, funding for these services would increase by at least \$10.0 million or 1.6 percent compared to FY 2006. While overall funding for the Department of Mental Health would increase, the proposed amount would not keep pace with the rate of inflation. It is important to note that the \$28.0 million reserve to fund salary increases to low-wage human service workers would provide additional funding to this department in FY 2007. In FY 2006, this reserve provides \$3.4 million to the Department of Mental Health’s budget for contracted services.

FY 2006*	\$	633,029,664
FY 2007 House	\$	643,047,054

Increase (decrease)	\$	10,017,390
Percentage Change		1.6%

* All FY 2006 numbers include allocations from the Purchase of Service reserve as discussed on p. 6.

The House budget changes very little in support of mental health services. By adding \$725,000 to the budget account for adult mental health and support services, the House brings its budget for these services to \$302.9 million, which is \$6.8 million more than in FY 2006. The Governor proposed

\$301.8 million or \$5.7 million more than the current amount.

In the following areas, the House budget adopts the funding proposal by the House Committee on Ways and Means:

- The budget appropriation for adult mental health and support services would rise by \$6.1 million or 2.1 percent. The Governor offered a \$5.7 million or 1.9 percent increase.
- The line item which funds state psychiatric hospitals and inpatient services would grow by \$4.1 million or 2.6 percent. The House 2 budget included a \$4.4 million or 2.7 percent increase.
- The budget account for children and adolescent mental health services would increase by \$636,000. The Governor proposed a \$518,000 rise over FY 2006. Both recommendations offer increases that are just under one percent.
- The administrative line item would grow from \$37.1 million in FY 2006 to \$39.0 million FY 2007, a \$1.9 million or five percent boost. The Governor proposed the same amount in the House 2 budget. The Department of Mental Health, like other areas of human services, experienced considerable reductions to its workforce due to budget cuts during the fiscal crisis. Since FY 2002, the entire operations staff has been reduced by 30 percent.³

³ Based on statements by Elizabeth Childs, Commissioner of the Department of Mental Health, as reported in: O’Sullivan, Jim. 2006. Mental health parity a law, but not a reality, witnesses say. *State House News Service*, April 3.

MENTAL RETARDATION

The House budget is just \$150,000 more than the House Ways and Means budget for the Department of Mental Retardation. Under this proposal, total appropriations in this area would grow by \$33.4 million or roughly three percent compared to FY 2006. Increases in these areas primarily reflect the rise in the cost of providing services, not new expansions. It worth noting, however, that the Department of Mental Retardation would receive a portion of the \$28.0 million reserve to fund salary increases to low-wage human service workers, which would boost funding in FY 2007. The FY 2006 budget provides \$9.4 million to this department for this purpose.

FY 2006*	\$	1,137,059,567
FY 2007 House	\$	1,170,470,567
Increase (decrease)	\$	33,411,000
Percentage Change		2.9%

* All FY 2006 numbers include allocations from the Purchase of Service reserve as discussed on p. 6.

Under this budget, funding for state facilities for individuals who are mentally retarded is \$150,000 higher than in the House Ways and Means budget. The \$172.0 million in the House budget is \$2.9 million more than the \$169.1 million that is currently appropriated. The Governor's budget provided \$167.4 million.

Other than the increase in funding for state facilities, the House budget closely follows the funding recommendations by the House Committee on Ways and Means. In each of the areas below, the House proposal also matches the Governor's budget.

- The House, like the Governor, meets the legal requirement for the Boulet settlement (which mandates that the state

provide interim services for individuals on the wait list for residential placements) by appropriating \$86.4 million for this purpose. Current funding for these services totals \$85.6 million.

- This budget includes a \$2.0 million appropriation for a new line item designed to address rate disparities in residential contracts.
- Under the House proposal, funding for community based residential supports would grow from \$506.9 million in FY 2006 to \$524.5 million in FY 2006, a \$17.6 million or 3.5 percent difference.
- The budget account for community based day and work programs would rise from \$114.7 million to \$117.4 million, a \$2.7 million or 2.4 percent difference.
- The appropriation for respite family supports would increase from \$51.7 million to \$53.1 million, a \$1.4 million or 2.6 percent boost in funding.

The House increases funding in areas which the Governor provided level funding.

- The line item for the Division of Autism would grow from \$1.2 million in FY 2006 to \$2.2 million under the House budget.
- This budget would also increase the appropriation for Turning 22 Services, which provides supports to individuals with severe disabilities who require continued services after aging out of the public school system. Funding for these services would rise from \$6.5 million in FY 2006 to \$7.5 million in FY 2007.

SOCIAL SERVICES

The House budget for the Department of Social Services is \$525,000 more than the budget offered by the House Committee on Ways and Means. The House appropriates \$767.8 million in this area, close to three percent more than FY 2006. However, the \$28.0 million salary reserve for low-wage workers would provide additional funding to the FY 2007 bottom-line for social services. The FY 2006 budget provides \$1.7 million for this purpose.

FY 2006*	\$	745,876,925
FY 2007 House	\$	767,849,456
Increase (decrease)	\$	21,972,531
Percentage Change		2.9%

* All FY 2006 numbers include allocations from the Purchase of Service reserve as discussed on p. 6.

Of the \$525,000 that the House budget adds to the House Ways and Means budget for the Department of Social Services, \$425,000 goes toward the line item which funds services for children and families, and \$100,000 is for domestic violence services. In other areas, the House follows the recommendation by the House Committee on Ways and Means:

- The House budget provides \$3 million in new funding for the Family Networks System. Funding for these services is designed to supplement existing personnel and resources to improve coordination of care.
- This budget also includes \$4.9 million (seven percent) more for the Department's administrative costs and an extra \$6.8 million (five percent) for social workers. The Governor's budget offered comparable figures for FY 2007. While these amounts would boost

funding for FY 2007, funding for the department's personnel was cut considerably during the fiscal crisis, and the budget account for social workers has been persistently under-funded.

ELDER AFFAIRS

The House added \$2.5 million to the recommendation of the House Committee on Ways and Means for services for elders. The final budget proposed by the House totals \$220.8 million for elder affairs, a \$3.8 million or 1.8 percent increase over FY 2006 funding, an amount that does not keep pace with inflation. However, there would be additional dollars available for elder affairs from the proposed \$28.0 million reserve to fund salary increases for low-wage human service workers. In FY 2006, the salary reserve added \$2.3 million to the elder affairs bottom line. (These numbers do not include the funding for the Prescription Advantage pharmacy program, discussed in the "MassHealth/Medicaid and Other Health Programs" section of this *Budget Monitor*.)

FY 2006*	\$	216,955,945
FY 2007 House	\$	220,786,039
Increase (decrease)	\$	3,830,094
Percentage Change		1.8%

* All FY 2006 numbers include allocations from the Purchase of Service salary reserve as discussed on p. .

The House amendments add \$50,000 earmarked for a home health pilot program, for a total of \$103.0 million for elder home care purchased services, just under the Governor's recommendation of \$103.1 million. The House budget – as did the Governor's budget – recommends level funding of \$39.3 million for home care administration and casemanagement.

There are two new line items in the House budget for elder affairs. The House recommends \$350,000 for a new geriatric mental health services program to help divert elders with mental illness from institutionalization. The House also recommends \$500,000 for a new line item for a family caregivers program.

OTHER HUMAN SERVICES

Most of the increase in the larger category of “other human services” is contained in the \$28.0 million reserve account that would fund salary increases for low-wage human service workers. Ultimately, this amount will be distributed to the individual budget accounts in various departments which contract with private or nonprofit providers. Once this amount is allocated to the respective agencies, the increase in funding compared to FY 2006 will mostly cover increasing costs due to inflation and caseload composition.

FY 2006*	\$	541,514,952
FY 2007 House	\$	590,794,108
Increase (decrease)	\$	49,279,156
Percentage Change		9.1%

* All FY 2006 numbers include allocations from the Purchase of Service reserve as discussed on p. 6.

The House Ways and Means budget included a \$20.0 million reserve account which would fund salary increases for low-wage workers who are employed by providers that deliver services under contracts with the Department of Early Education and Care, departments within the Executive Office of Health and Human Services, and the Executive Office of Elder Affairs. The House raises this appropriation to \$28.0 million. The Governor did not

include funding for this line item in his FY 2007 budget proposal.

The House added funding in number of other areas, including the following:

- The House budget adds \$2.2 million to the \$2.0 million House Ways and Means appropriation for grants to fund youth development. The Governor offered \$2.0 million for this budget account which currently totals \$3.6 million.
- The House budget also includes \$1.5 million for a new line item in the Executive Office of Health and Human Services that would provide for the Executive Office to contract with Project Bread/The Walk for Hunger to administer a community-based anti-hunger initiative, including the expansion of participation in the federal nutrition programs. This budget account was not included in the House Ways and Means budget, nor was it in the Governor’s proposal for FY 2007.
- The House proposal includes \$500,000 for programs which help immigrants obtain citizenship and receive instruction in other areas to facilitate their ability to attain citizenship (civics classes, assistance with the citizenship application process, etc.). This item, which was not in the Ways and Means budget, was in Governor’s budget proposal.

ENVIRONMENTAL AFFAIRS

The House budget for environmental affairs is \$7.2 million higher than the proposal by the House Committee on Ways and Means. The additional funding brings the House budget in this area to \$218.4 million, a \$14.5

million increase over current appropriations.⁴

FY 2006	\$	203,922,663
FY 2007 House	\$	218,430,368
Increase (decrease)	\$	14,507,705
Percentage Change		7.1%

Of the \$7.2 million that the House added to the House Ways and Means budget, \$5.4 million is added to the recommendation for the Department of Conservation and Recreation, though much of that additional funding is restricted by specific earmarks that may not support the core functions of the parks system. Under the House proposal, total funding for the Department of Conservation and Recreation would rise from \$83.3 million in FY 2006 to \$91.5 million in FY 2007. The Governor offered a smaller increase of roughly \$930,000 or one percent.

Under the House budget, other departments within the Executive Office of Environmental Affairs would experience more funding in FY 2007.

- The budget for the Department of Environmental Protection grows by \$3.8 million or seven percent. The Governor proposed a \$2.6 million or five percent increase.
- Funding for the Department of Agricultural Resources rises by about \$375,000 or four percent. The Governor proposed an increase of nearly \$210,000 or two percent.

⁴ This total includes funding for the Commonwealth Zoological Corporation, which the House Committee on Ways and Means funds through a line item in the Department of Business and Technology, but is currently funded in the Department of Conservation and Recreation.

- Support for the Department of Fish and Game increases by roughly \$1.0 million or six percent. Under the Governor's budget, funding for this department would fall by approximately \$285,000 or nearly two percent.

The House follows the House Ways and Means budget by appropriating \$512,476 to support a new Office of Dam Management. The House budget also includes the Ways and Means proposal to provide \$1.4 million in new funding to operate and maintain the Central Artery parks. Funding for both of these items was also included in the Governor's budget.

While House Ways and Means budget would increase funding for environmental affairs in FY 2007, the total amount is significantly below the total before the fiscal crisis began. After adjusting for inflation, the budget recommendation for environmental affairs is \$59.3 million or 21 percent below its level in FY 2001.

HOUSING

The House budget for the Department of Housing and Community Development is \$10.3 million higher than in the House Ways and Means budget, which would bring the total amount for FY 2007 to \$110.9 million. The proposed amount shows a slight decline when compared to current appropriations because the current FY 2006 budget includes \$20.0 million in funding for energy assistance for low-income families. Should the same amount of supplemental funding for energy assistance re-occur in FY 2007, the budget would stand higher than it does in FY 2006.

FY 2006	\$	111,872,001
FY 2007 House	\$	110,940,723
Increase (decrease)	(\$	931,278)
Percentage Change		-0.8%

The \$10.3 million which was added to the House Ways and Means budget provides increases in a number of areas, including the following:

- The line item which supports subsidies to Public Housing Authorities is \$2.0 million higher than in the proposal by the House Committee on Ways and Means. The House budget increases funding from \$34.9 million in FY 2006 to \$45.1 million in FY 2007, a \$10.2 million or 29 percent rise over the current appropriation. The House Committee on Ways and Means and the Governor both proposed to increase funding to \$43.1 million.
- Under the House budget, funding for Rental Assistance for Families in Transition (RAFT), which provides assistance to families at risk of homelessness, would remain level at \$5.0 million. The House Committee on Ways and Means proposed \$4.0 million for this program. The Governor's budget provided \$3.0 million for RAFT, but indicated that \$2.0 million that had been used for RAFT would be transferred to new initiatives, including \$1.0 million to support the Tenancy Preservation Program and \$500,000 for Individual Development Accounts.
- The House budget adds \$250,000 to the House Ways and Means budget for the Massachusetts Rental Voucher Program (MRVP), a housing program which helps low-income families secure housing in the private rental market.

Under the House budget, funding would grow from \$26.3 million to \$27.5 million, a \$1.2 million difference. The House Committee on Ways and Means proposed a smaller increase (\$950,000), and did not adopt the restrictions on benefits that were outlined in the House 2 budget. The Governor proposed to reduce funding by \$2.0 million and to implement new work requirements and time limits on the receipt of benefits though this program (a 36 consecutive time limit and a 60 month lifetime limit).

PUBLIC SAFETY

The House approved the \$4.8 million more than was provided in the House Ways and Means budget for public safety. Under the House budget, funding for public safety totals \$1.364 billion in FY 2007, which is nearly level with current appropriations.

FY 2006	\$	1,380,553,044
FY 2007 House	\$	1,387,386,462
Increase (decrease)	\$	6,833,418
Percentage Change		0.5%

Much of the \$4.8 million increase over the House Ways and Means budget for public safety is in a \$2.5 million appropriation for fire safety grants. The budget proposals by the House Committee on Ways and Means the Governor did not provide funding for this budget account. The House budget provides several smaller increases over the House Ways and Means proposal, including \$500,000 for fire education programs and \$100,000 for a local dispatch center in Norfolk County.

The House budget for public safety follows many of the recommendations by the House

Committee on Ways and Means, including the following.

- Funding for state police operations would rise from \$211.2 million to \$220.5 million, a \$9.3 million difference. The Governor proposed a smaller increase of \$7.2 million.
- The appropriation for the state police crime lab would increase from \$14.0 million to \$16.2 million. The Governor increased this line item to \$18.7 million.
- The House also budgets \$1.0 million in new funding for community re-entry programs designed to reduce recidivism. The House 2 budget did not allocate funding for this purpose.

This proposal, like the one by the Governor, increases overall funding for public safety, but the additional amount is not enough to keep pace with inflation.

JUDICIARY

The House budget for the Judiciary is \$5.2 million higher than the proposal by the House Committee on Ways and Means. The House appropriates \$739.6 million for the Judiciary, an \$88.5 million increase over the current level of funding.

FY 2006	\$	651,093,156
FY 2007 House	\$	739,612,639
Increase (decrease)	\$	88,519,483
Percentage Change		13.6%

Of the \$5.2 million that the House budget adds to the House Ways and Means proposal for the Judiciary, \$4.8 million goes toward increasing the budget for the Office of the Commissioner of Probation. The House

Committee on Ways and Means offered \$124.2 million, which the House budget boosts to \$129.0 million. Under the House budget, funding for this office would increase by \$11.2 million or 9.5 percent compared to FY 2006.

The House budget follows the recommendation by the House Committee on Ways and Means to provide \$7.1 million to expand the public defender division and \$19.0 million to increase trial court personnel salaries. Because the Governor proposed to consolidate functions by merging the operations of various courts, it is difficult to discern whether comparable funding is included in the House 2 budget for these purposes. The House budget does not adopt the Governor's proposal to consolidate functions by merging operations for the Superior, District, Family, Probate and Juvenile Courts.

GROUP INSURANCE

The House added \$11.5 million to the recommendation of the House Committee on Ways and Means for the Group Insurance Commission. The final budget proposed by the House totals \$1.066 billion for the Commission, a \$43.4 million or 4.2 percent increase over FY 2006 funding.

FY 2006	\$	1,023,190,489
FY 2007 House	\$	1,066,608,119
Increase (decrease)	\$	43,417,630
Percentage Change		4.2%

Following the recommendation by the House Committee on Ways and Means, the House proposes line item language that would restrict the Group Insurance Commission from paying FY 2007 bills with FY 2007 appropriations during the

period referred to as the “accounts payable period.” Currently, the Group Insurance Commission has what in effect is a “grace period” for paying bills after the end of the fiscal year. This proposed change would require that bills paid in July 2007 for services rendered in June 2007 be funded out of the FY 2008 budget. The effect of this shift is to push approximately three weeks’ worth of bills into FY 2008. The estimated impact of this cost shift is approximately \$43 million.

The full House budget proposal does not include a recommendation from House Ways and Means to modify the existing cost-sharing structure for public employees’ health premiums. The House maintains the existing structure, in which employees hired before July 1, 2003 pay 15 percent of their health insurance premiums, and employees hired after June 30, 2003 pay 20 percent. The estimated cost of maintaining the current cost-sharing structure as opposed to the shift proposed by House Ways and Means is \$11.5 million, the amount by which the House recommendation exceeds the budget recommendation from the House Committee on Ways and Means.

The Governor’s \$1.039 billion budget recommendation for the Group Insurance Commission, on the other hand, was based on a proposal to increase the share of health care premiums paid by state workers.

REVENUE

Budget Proposals

During its deliberations over the FY 2007 budget, the House of Representatives adopted two amendments that would reduce the amount of tax revenue the Commonwealth collects each year. One

would provide a tax reduction for commuters and would reduce annual tax collections by \$3.5 million, while the other reinserts a number of changes in tax law originally contained in the House of Representatives’ version of last fall’s economic stimulus initiative and, if enacted, would reduce tax collections by up to \$65 million per year, once fully implemented.

More specifically, the first tax-related amendment adopted by the full House would provide a tax deduction for commuters who use FastLane transponders or who purchase weekly or monthly MBTA passes. The deduction would permit taxpayers to subtract any commuting expenses in excess of \$150, up to a maximum of \$750, from their incomes in determining the taxes they owe; as a result, the maximum tax reduction anyone could receive in a given year would be \$39.75 (that is, the maximum deduction of \$750 multiplied by the personal income tax rate of 5.3 percent). Commuting expenses would include all MBTA bus, subway, and commuter rail passes as well as tolls paid for through a FastLane account. Thus, an individual who bought a monthly MBTA bus pass (which costs \$31 per month) for the entire year would receive a tax break of \$11.77; anyone who purchased a monthly MBTA subway pass (\$44 per month) for the entire year would receive a tax break of \$20.03; and anyone using a monthly MBTA commuter rail pass (all of which cost more than \$106 per month) would receive the maximum tax break of \$39.75. To receive the maximum tax break available through this deduction, an individual commuting to work by car on a daily basis and using a FastLane transponder would need to pay tolls in excess of \$1.80 per trip. This amendment reprises an identical deduction that was enacted into law as part of a FY 2005 supplemental budget but that was available for 2004 only.

According to the Department of Revenue, during 2004, 142,000 taxpayers claimed the commuter deduction, reducing tax revenue by a total of \$3.5 million. The revenue impact is expected to be the same on an annual basis if this amendment were to become law.

The second amendment is actually a set of changes in tax law that were originally contained in the version of the economic stimulus legislation that the House of Representatives adopted last October and that still awaits approval by conference committee. During floor debate, the House of Representatives added, as part of a consolidated amendment, its entire economic stimulus proposal to the FY 2007 budget. Among the changes in tax law that this amendment would make are the creation of a tax credit for the federal user fees paid by medical device manufacturers, an increase in the value of the historic rehabilitation tax credit, and an expansion of the eligibility criteria for the investment tax credit so that research and development corporations could claim it. This set of changes would likely reduce tax revenue by about \$15 million in FY 2007 and by \$65 million per year after the initial phase-in. It is worth noting that, if included in the final version of the FY 2007 budget, these two amendments would follow several tax cuts that were enacted in the last few months of 2005. As the MBPC's *January 17 Budget Monitor* observed, changes in tax law adopted at the close of last year – such as tax credits for motion picture production companies, a tax deduction for home heating fuel purchases, a tax credit of purchases of energy efficient building materials and equipment, and refunds of certain capital gains taxes paid in 2002 – will reduce tax revenue by \$199 million in FY 2006 and by \$74 million in FY 2007. While the Legislature also acted to close a range of tax

loopholes at the end of last year, the revenue generated by those reforms will not offset the effect of such tax cuts on an annual basis until FY 2010.

Tax Collections and FY 2007 Balance

On May 1, the Department of Revenue announced that tax collections totaled \$2.215 billion for the month of April and \$15.078 for the first ten months of FY 2006 as a whole. Consequently, year-to-date tax collections for FY 2006 are now 1.5 percent above the most recent benchmark calculated by the Department of Revenue. If tax collections continue at this pace, then they will reach \$18.432 billion for the whole of FY 2006 or roughly \$1.3 billion more than the tax revenue figure on which the FY 2006 budget was based. However, as the [*MBPC's January 17 Budget Monitor*](#) discussed, higher than anticipated FY 2006 tax revenue will be needed to meet a variety of costs, including the \$600 million withdrawal from the Commonwealth Stabilization Fund that was part of the original FY 2006 budget, portions of the recently enacted health care reform package, and the economic stimulus and FY 2006 supplemental appropriations bills added to the FY 2007 budget during House deliberations. Consequently, claims of a substantial FY 2006 surplus are still premature at this time.

FY 2006 tax collections are, of course, relevant to the FY 2007 budget as well, since they help to determine how much revenue will be available in the coming year. More specifically, the consensus tax revenue estimate of \$18.975 billion for FY 2007 – on which the House's budget is based – assumes that FY 2006 tax collections will total \$18.158 billion and then grow 4.5 percent. As noted above, though, if FY 2006 tax collections continue at their current

pace, they will reach \$18.432 billion. If this were to occur – and if tax revenue grew 4.5 percent as is now expected – then FY 2007 tax revenue will amount to \$19.261 billion.

Yet, as Figure 2 suggests, even if this were to occur, it appears that the House’s version of the FY 2007 budget would fall just short of structural balance. That is, assuming that tax revenue were to total \$19.261 billion and that federal reimbursements and other revenue are roughly the same under the House’s version of the budget as under the Governor’s version, total expenditures under the House’s version of the budget appear to exceed total on-going revenue by approximately \$78 million. This difference would be more than covered by the House’s proposed \$275 million withdrawal from the Commonwealth Stabilization Fund in FY 2007, but it suggests that faster tax revenue growth than is now officially projected would be necessary to bring the House’s version of the FY 2007 budget into structural balance. Specifically, as Figure 3

indicates, tax revenue growth of 5 percent would be sufficient to bring anticipated revenue slightly above the House’s proposed expenditure level.

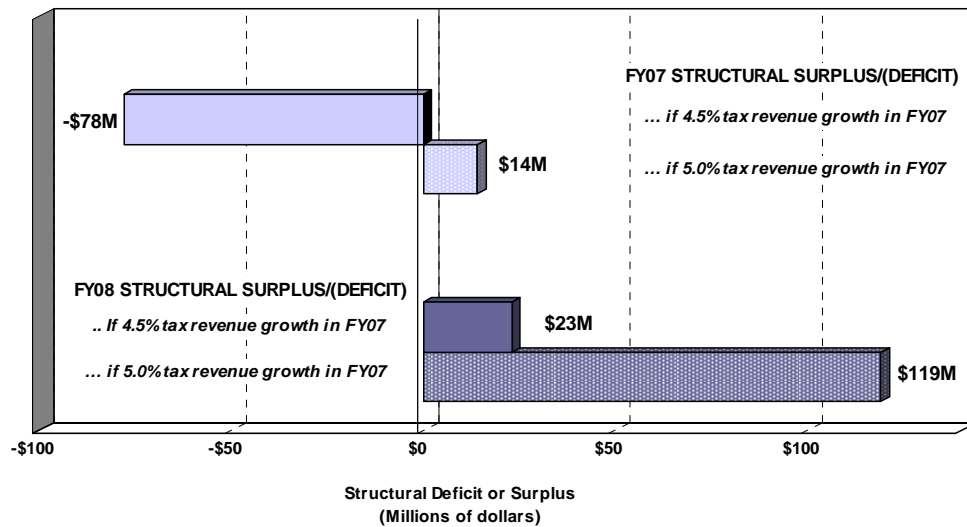
Figure 3 also includes projections of anticipated surpluses in FY 2008. That is, the figures in Figure 3 reflect projections of the spending levels recommended by the House of Representatives for FY 2007 into FY 2008. (Such spending projections largely only adjust for inflation, but assume larger increases in areas where more sizable increases are dictated by law, such as school building assistance, or where costs tend to rise more quickly than the general rate of inflation, such as health care.) They also take each of the two tax revenue scenarios for FY 2007 described above and then assume that tax revenue will grow by 5.0 percent in FY 2008. The end result is a relatively modest surplus in either case.

Figure 2.

FY 2007 HOUSE BUDGET - FISCAL IMPACT	
	<u>AMOUNT (\$M)</u>
TOTAL EXPENDITURES	27,398.6
Direct Appropriations & Retained Revenue	25,458.9
"Off-Budget" Expenditures	1,939.7
Pension Funding	1,335.7
School Building Debt Assistance	572.5
Other	31.5
TOTAL REVENUE	27,320.8
Tax Revenue	18,431.0
YTD FY06 tax revenue growth; 4.5% growth in FY07	19,261.0
Transfer to MBTA	(734.0)
Adjustments (e.g. Stabilization Fund set-aside)	(96.0)
Federal Reimbursements	5,263.5
Departmental Revenue and Consolidated Transfers (adj.)	3,626.3
STRUCTURAL SURPLUS (DEFICIT)	(77.8)

Figure 3.

Estimated Fiscal Outlook under the FY 2007 House Budget
assumes continued YTD FY06 growth and 5.0% growth in FY08



Faster Revenue Growth – and Larger Surpluses – Possible, But Likely Unsustainable

Tax revenue growth in excess of the rates discussed above is, of course, possible and, by extension, would yield surpluses larger than those found in Figure 3. For instance, given the expenditure levels recommended by the House of Representatives, tax revenue growth of 6.5 percent in FY 2007 would likely produce a surplus of more than \$275 million.

Tax revenue growth in excess of the rates discussed above is probably not sustainable, however. In particular, two relatively volatile sources of revenue – taxes from capital gains income and corporate income taxes – may be driving the recent growth in tax collections, while a more general review of Massachusetts' experiences over the last fifteen years suggests that tax collections should not be expected to grow faster than the long-term rate of economic growth for extended periods of time.

Capital gains income has increased sharply in recent years and capital gains tax revenue in FY 2006 and FY 2007 is now expected to comprise a larger share of state tax revenue than at any time in the last 20 years. Documents distributed by the Department of Revenue at the December 2005 Consensus Revenue Hearing show that, in tax year 2000, capital gains taxes amounted to \$1.16 billion or 7.2 percent of the \$16.2 billion the Commonwealth collected that year. For FY 2006, capital gains taxes are projected to constitute 7.9 percent of total tax collections; for FY 2007, they may reach as high as 9 percent of total tax collections. In fact, not since tax year 1986 have capital gains taxes constituted more than 9 percent of total taxes. Because capital gains are a much more volatile source of income than

wages, surpluses that rely on dramatically increasing capital gains can vanish very quickly if the stock market falters. Of note, the documents distributed by the Department of Revenue also show that capital gains collections fell by more than 50 percent in the years immediately following each of these two prior peaks – 1986 and 2000. This, in turn, suggests that the Commonwealth should proceed cautiously with any budget surplus that is highly dependent on this source of revenue.

In addition, the Department of Revenue's May 1 announcement indicates that, through the first 10 months of FY 2006, tax collections are 8.2 percent above the first 10 months of FY 2005, a difference of more than \$1.1 billion. Yet, more than a third of that dollar difference is attributable to the growth in corporate and business taxes, even though such taxes are expected to make up only about one-tenth of all taxes collected. More to the point, through the first 10 months of FY 2006, corporate and business taxes have risen 33.5 percent relative to the same period in FY 2005. While corporate income taxes can also be a somewhat volatile source of revenue, this recent run-up may prove particularly unsustainable, since such growth may, to some extent, be artificially inflated by the repatriation of profits permitted by the federal American Jobs Creation Act of 2004.

Over the long term, it is reasonable to expect that tax revenue will grow roughly in line with the economy. State economic growth is often measured by the growth in personal income; in Massachusetts, personal income has grown by slightly more than 5 percent per year on average over each of the last ten-, fifteen-, and twenty-year periods. It is unlikely that over the long term, tax revenue will grow much faster than this rate. Because the economy is cyclical, however, it

is possible to have short term tax revenue growth that exceeds that underlying rate of economic growth, but such growth can not be sustained indefinitely.

During the economic boom of the 1990s, Massachusetts reacted to a period of unsustainable tax revenue growth and temporary surpluses with a series of permanent tax cuts that reduced tax revenue by over \$3 billion a year. Because of the economic bubble it appeared as though the Commonwealth could afford to cut taxes without cutting spending on basic services. When the economy cooled, however, it became clear that, after cutting taxes by \$3 billion, the Commonwealth faced a structural budget gap of roughly that amount. Deep cuts in education, local aid, and essential state services as well as some new taxes have now closed that gap. If unsustainable tax revenue growth continues, there will be growing temptations to repeat the mistakes of the 1990s.

Massachusetts could, of course, break this pattern by not treating temporary surpluses as if they can finance permanent tax cuts. Instead, the Commonwealth could use temporary surpluses to build a larger Stabilization Fund to protect the state in the next recession. Alternatively, the Commonwealth could use tax revenue growth to pursue priorities such as expanding access to affordable healthcare or to restore some of the funding for education, local aid, public health, and other essential services that has been cut to pay for the last round of tax cuts of the 1990s. It should be recognized, however, that funding that is restored as a result of unsustainable tax revenue growth will be difficult to maintain in the next economic downturn. As these choices are made, it is important to consider not only what looks affordable each year, but also how tax and spending decisions will affect the long term fiscal health of the state.

Spending by Program Area

(in Millions of \$)

Program	FY06*	H.2	HWM	House	House vs. HWM	House vs. H.2	House vs. FY06			
							Nominal		Real	
Local Aid - Lottery	761.4	920.0	920.0	920.0	0.0	0.0	158.7	21%	139.6	18%
Local Aid - Additional Assistance and PILOT	398.4	407.6	402.3	404.3	2.0	(3.3)	5.9	1%	(4.1)	-1%
Local Education Aid (Ch. 70)	3,288.9	3,452.6	3,380.4	3,461.7	81.4	9.2	172.8	5%	90.6	3%
K-12 Education (non Ch. 70)	486.9	594.9	506.4	526.2	19.8	(68.6)	39.4	8%	27.2	5%
School Building Debt Assistance ¹	488.7	572.5	572.5	572.5	0.0	0.0	83.8	17%	71.6	14%
Higher Education ²	975.9	995.2	1,017.3	1,018.0	0.8	22.8	42.1	4%	17.7	2%
Early Education and Care ³	475.3	483.3	490.1	495.7	5.6	12.5	20.4	4%	8.5	2%
Income Support Programs	637.6	601.4	613.7	613.7	0.0	12.4	(23.9)	-4%	(39.9)	-6%
Medicaid and Other Health Care Programs ⁴	7,339.1	7,489.1	7,517.0	7,515.0	(2.0)	25.9	175.9	2%	(7.6)	0%
Public Health	449.2	455.7	461.5	466.4	4.8	10.7	17.2	4%	5.9	1%
Mental Health	633.0	642.1	642.3	643.0	0.7	1.0	10.0	2%	(5.8)	-1%
Mental Retardation	1,137.1	1,163.9	1,170.3	1,170.5	0.2	6.6	33.4	3%	5.0	0%
Social Services	745.9	762.4	767.3	767.8	0.5	5.4	22.0	3%	3.3	0%
Elder Affairs	217.0	218.9	218.3	220.8	2.5	1.9	3.8	2%	(1.6)	-1%
Other Health & Human Services ⁵	541.5	568.3	577.9	590.8	12.9	22.5	49.3	9%	35.7	6%
Environmental Affairs ⁶	203.9	207.8	210.9	218.4	7.5	10.6	14.5	7%	9.4	5%
Transportation	175.6	156.0	194.7	195.3	0.7	39.4	19.7	11%	15.4	9%
Housing & Community Development	111.9	97.2	100.7	110.9	10.3	13.7	(0.9)	-1%	(3.7)	-3%
Economic Development	146.0	134.8	133.4	147.6	14.2	12.8	1.6	1%	(2.1)	-1%
Public Safety	1,380.6	1,366.4	1,382.6	1,387.4	4.8	21.0	6.8	0%	(27.7)	-2%
Judiciary	651.1	692.1	734.4	739.6	5.2	47.5	88.5	14%	72.2	11%
District Attorneys	85.3	87.7	88.1	88.5	0.4	0.8	3.2	4%	1.1	1%
Attorney General	37.5	37.6	38.2	38.6	0.4	1.0	1.1	3%	0.2	1%
Libraries	29.6	30.0	30.5	30.5	0.0	0.5	0.9	3%	0.2	1%
Debt Service	1,793.2	1,924.6	1,955.5	1,955.5	0.0	30.9	162.3	9%	117.5	6%
Pensions ⁷	1,275.2	1,335.7	1,335.7	1,335.7	0.0	0.0	60.5	5%	28.6	2%
Group Insurance	1,023.2	1,038.7	1,055.1	1,066.6	11.5	28.0	43.4	4%	17.8	2%
Other Administrative	751.4	687.1	693.1	697.3	4.2	10.2	(54.1)	-7%	(72.9)	-9%
Total	26,240.1	27,123.4	27,210.2	27,398.6	188.4	86.8	970.1	4%	314.1	1%

Notes:

- (1) The FY 2006 budget reduces available revenue by \$488.7 million to cover the costs of School Building Assistance. In FY 2007, revenue would be reduced by \$572.5 million. The table includes these amounts as appropriations.
- (2) The higher education totals include \$31.5 million in tuition revenue retained by the campuses.
- (3) The FY 2006 budget for Early Education and Care includes \$6.0 million from a \$12.0 reserve account created to comply with changes to federal welfare regulations. That amount is included in the total for that year. The remaining \$6.0 is incorporated in the FY 2006 figure for Income Support Programs.
- (4) As explained in the text of this Budget Monitor, the percentage increase from FY 2006 to FY 2007 is higher than suggested by this table because actual FY 2006 spending is expected to be less than the amount appropriated. Totals include "on-budget" and "off-budget" Medicaid, senior pharmacy, other state health care programs, off-budget state payments into the Uncompensated Care Pool, and a proposed FY 2007 reserve for health care reform. Totals do not include \$288.5 million off-budget funding for the Health Care Quality Improvement Trust.
- (5) The FY 2006 budget includes a \$20.0 million reserve to fund salary increases to low-wage human services providers. The proposals by the House and the Governor distribute the amounts for these salary increases in FY 2007 to their respective budget accounts. The House provides an additional \$28.0 million in new funding for FY 2007, which is reflected in this category since it is not yet determined how this funding would be allocated to each agency.
- (6) The House creates a new line item for the Commonwealth Zoological Corporation in the Department of Business and Technology. Since this appropriation typically falls under the purview of the Department of Conservation and Recreation, the House figure includes this amount here rather than in the Economic Development category.
- (7) Off-budget pension funding in FY 2006 totals \$1.273 billion; the FY 2007 budget includes \$1.335 billion for this purpose. These amounts are treated as appropriations for these years.

*The totals for FY 2006 reflect total amounts appropriated to date, including supplemental funding and prior appropriations that are continued for this year. The totals also incorporate off-budget spending for certain areas as noted above.

