

# BUDGET MONITOR

## Governor Patrick’s FY 2008 Budget

### OVERVIEW

There are three ways to close a budget gap: reduce spending, increase revenue, or use reserve funds. Each one of these strategies can generate loud and strong criticism.

Wishing for an easy solution brings to mind the story about when Yogi Berra was asked whether he wanted his pizza cut into six or eight slices. He responded “you better make it eight, I’m feeling hungry.” Sadly, budget writers are forced to function in the real world, not in Yogi’s world.

The Governor’s budget adopts several real, but not painless, strategies: spending cuts, reforms to reduce tax avoidance, limited use of reserves, and the forgoing of expected new spending. This *Budget Monitor* examines those strategies and provides information to help readers understand the choices made in this budget and how they relate to the fiscal challenges faced by the state.

### ***The Budget Gap***

In projecting whether there is a budget deficit or surplus for the coming year the question public finance analysts are actually asking is: If there are no changes in tax or revenue policy, will there be enough money to provide the same level of services as the prior year and to meet any other legal obligations? We call the cost of providing

these services the baseline cost and the revenue available, if there are no tax policy changes, we call baseline revenue.

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If the state is not projected to have enough baseline revenue to pay for the baseline costs next year, it faces a deficit. If there will be more baseline revenue than is needed for the existing level of services, that is a surplus.

How can we estimate baseline costs? Depending on what each state agency does (pays health care bills, builds roads, pays social workers, manages the state's computer system) it faces different cost increases due to inflation – since different costs rise at different rates. Some state programs are also affected by caseloads. If a program is an entitlement provided to everyone below certain income levels, such as Medicaid, then the agencies also need to project future year caseloads in order to determine their baseline costs.

From the Governor's budget proposal and related materials we are able to determine increases in baseline costs between FY 2007 and FY 2008.

### ***Baseline Spending Growth***

Medicaid/MassHealth and related programs: Baseline Medicaid costs are increasing at close to 9 percent. This amount includes health care inflation, the costs of increasing enrollments, and other costs associated with last year's health reforms. Close to 9 percent growth works out to about \$700 million dollars. Because the federal government reimburses the state for half of Medicaid costs, the cost to the state of this increase is about \$350 million.

Group Insurance Commission: The Group Insurance Commission pays for health care for state employees. The cost of health care for these employees is expected to grow by about 3 percent in FY 2008, which will cost \$37 million. In addition, an accounting change artificially reduced the GIC cost number for FY 2007 by about \$50 million. This amount will have to be accounted for in FY 2008. Therefore baseline costs will rise by \$87 million.

### Education:

Many estimates of the budget gap have included an assumption that state aid for education (Chapter 70) would increase by \$255 million. That is an estimate of the amount by which Chapter 70 Aid would have to increase to fund the second year of a five-year plan to increase education aid that the Legislature initiated in FY 2007. That is not an unreasonable assumption, but the five-year plan was not written into law and the increase does not represent the cost of providing current services; therefore, we do not use this number. The new cost in FY 2008 of paying for inflation and enrollment changes is \$127 million. That is the number that our analysis uses as the baseline education cost increase.

### Pensions:

The state has unfunded liabilities in its pension fund and is required by law to make increasing payments each year to pay down those unfunded liabilities. The required increase in FY 2008 is \$63.4 million.

### SBA:

The state School Building Assistance program was reformed several years ago and a schedule of funding increases was put into law. The cost of meeting the legally required increase this year is an additional \$77.7 million.

### General Inflation:

Throughout the rest of state government costs rose at about 3 percent due to inflation, caseload changes in entitlement programs and similar factors. This adds another \$322 million in spending.

### FY 2007 Structural Gap:

In FY 2006 the state had a temporary surplus and carried over \$935 million in one-time revenue into FY 2007. Most of that money, about \$734 million, was used to

pay for one-time spending in FY 2007. About \$200 million, however, was used to fund ongoing expenses in FY 2007. Because those expenses will remain in FY 2008, but the revenue is gone, this \$200 million adds to the structural gap in FY 2008. In the chart on this page, we show this \$201 million as new spending because it is spending that will now need to be funded by ongoing revenue. There is debate about how much of the new spending paid for with the FY 2006 surplus was intended to be one-time spending. If less of it were considered to be one-time, then this number would grow.

Documents that the administration released with the budget indicate that the gap, which we estimate at about \$200 million, could actually be as high as \$300 million. This difference is due to the fact that defining “one-time” is a judgment call. When the Legislature appropriates money it doesn’t usually state whether it is for a one-time or ongoing expense. Sometimes it is clear. For example, in several cases collective bargaining agreements that had not been renewed for several years were finally resolved in FY 2007. In these cases the Legislature appropriated money to fund the new agreements including payments for prior years. Clearly, the payment for prior year’s wages is a one-time expense. Similarly, if a specific capital project is funded in the budget, that should be a one-time expense – it will not have to be built again in near future years. But if a new program is created it is often unclear whether it is intended to be a temporary or permanent program. Our analysis tends to classify things as temporary unless it was clear that they were not intended to be.

Together these items add up to \$1.23 billion. In addition, the Governor proposed about \$150 million in new spending, on education, police, local aid, expedited permitting for

new businesses and other items described later in this *Monitor*. The new spending above the baseline (\$150 million) is a little more than half of one percent of the state budget.

<b>FY 2008 Budget Gap</b> (millions of dollars)	
<b>Baseline spending growth</b>	
MassHealth and related programs	348.4
Group Insurance	87.0
Chapter 70	127.0
Pensions	63.4
School Building Asst.	77.7
All else	322.4
FY 07 Structural Gap	201.1
<b>Sub-total maintenance spending</b>	<b>1,227.0</b>
Estimated new tax revenue	579.0
Estimated new federal revenue	(150.0)
<b>Baseline budget gap</b>	<b>798.0</b>
Estimated new spending	148.2
<b>Budget gap before solutions</b>	<b>946.2</b>

### ***Baseline Revenue Growth***

#### Tax Revenue

Baseline Tax Revenue is expected to grow by \$579 million. That represents three percent growth.

#### Federal Grants and Reimbursements

It appears from the FY 2008 budget documents that, after adjusting for new Medicaid spending, there was a significant decline in federal revenue between FY 2007 and FY 2008. In FY 2008, MassHealth spending increased by about \$400 million dollars. Because half of this new funding is reimbursed by the federal government, the balance sheet should show an increase of \$200 million in federal revenue. In fact, it appears that Medicaid revenue available for the budget increased by only \$55 million between FY 2007 and FY 2008. This suggests that the amount of Medicaid



revenue that would have been received absent any new spending fell by close to \$150 million. There are several possible explanations for this: there may have been one-time federal revenues received in FY 2007, there may have been changes in federal policies or previously scheduled reductions, or something else may explain the drop. While the cause of this decline is not clear in the budget documents, it does appear that this decline in revenue contributed about \$150 million to the initial FY 2008 gap. While overall federal revenues increased due to new Medicaid spending, the federal revenue related to the new spending is netted off of the spending numbers we use and therefore is not also counted as new revenue.

### ***Preliminary Budget Gap***

The preliminary FY 2008 structural budget gap is the difference between baseline spending and baseline revenue. The full gap that the Governor's budget (also known as House 1) must fund must also account for new spending.

Subtracting the revenue growth from the baseline spending growth shows a gap of \$798 million; however, when new spending is added the gap becomes \$946 million.

These numbers are close to, but somewhat lower than numbers the administration has used at various times. These discrepancies have to do with timing and with different judgments. For example, the administration's initial estimates were made before the adoption of the joint revenue estimate, and assumed an estimate \$174 million lower than that which was eventually adopted. Similarly, lottery revenue is now expected to be about \$60 million higher than original estimates. Both of these developments reduce the size of the deficit. The difference in treatment of

Chapter 70 funding is an example of a judgment call where the administration characterized a cost as part of the baseline and this analysis treats part of that increase as new spending.

House 1 proposes the following solutions to the budget gap.

### ***Eliminating Earmarks***

The Governor's budget eliminates earmarks in numerous accounts across the budget. Earmarks are language in general appropriations that direct funding for specific purposes that the Legislature requires the money to be spent on. By reducing earmarks the Governor's budget reduces spending by \$86 million.

### ***Spending Reductions in MassHealth***

The Governor implements a series of spending reductions in the state's Medicaid/MassHealth program. These reductions (which are described in the Medicaid/MassHealth section of this *Monitor*) would cause state Medicaid spending to fall by close to \$179 million below the baseline level. The actual amount cut would be significantly higher than this, but up to half of the savings has to be returned to the federal government because it pays for half of the spending.

### ***Spending Reductions in Other Areas***

House 1 cuts programs and administrative spending in a wide range of state programs. This budget monitor provides examples in the sections on various spending categories. These reductions total \$195 million.

### ***Reforms to Reduce Tax Avoidance***

The Governor's budget recommends a series of reforms to the tax laws that will

strengthen the state's ability to prevent corporate tax avoidance. These changes, which are described in the Revenue section of this *Monitor*, are projected to increase revenue by \$290 million in FY 2008.

**Improved Revenue Enforcement**

By adding additional auditors at the Department of Revenue and other staff at the Appellate Tax Board the Administration anticipates \$23 million in additional revenue.

**Transfers from Other Funds**

The budget transfers \$50 million from the Health Care Security Trust Fund and \$75 million of the interest earned in the Stabilization Fund to the General Fund to cover FY 2008 expenses.

<b>Closing the FY 2008 Budget Gap</b> (millions of dollars)	
<b>Gap closing strategies</b>	
Eliminated earmarks	86.0
Medicaid spending reductions	179.0
Other spending reductions	195.0
Tax reforms	290.0
Revenue enforcement	23.0
One-time transfers	125.0
Bond-ahead	48.0
<b>Sub-total gap closing strategies</b>	<b>946.0</b>

**Bond-Ahead**

By switching to a system in which the state sells bonds before beginning a capital project rather than after it has incurred expenses, the state is anticipating saving \$48 million. As explained later in this *Monitor*, this change makes sense in a period like the current one in which the short term rates that the state can earn on its bond proceeds are higher than the long-term rates that the state has to pay bondholders.

Together these seven initiatives account for \$946 million of the gap closing measures in House 1.

**ANALYSIS OF SPENDING BY PROGRAM AREA**

In the descriptions of spending by program areas that follow, FY 2008 spending is compared to FY 2007 ongoing spending. FY 2007 ongoing spending is the total amount appropriated (in the original FY 2007 budget and supplemental budgets) reduced by any one-time spending that was paid for in FY 2007. It is important to note that the costs of providing government services rise with inflation – and in some areas, like healthcare, faster than overall inflation. Therefore appropriation increases of only one or two percent are likely to require actual cutbacks in services and do not represent real increases in resources.

**LOCAL AID**

The Governor's budget would provide \$1.345 billion for unrestricted local aid to cities and towns in FY 2008. This total does not include aid designated for particular purposes, such as career incentive compensation for police officers.

<b>FY 2007 Total</b>	<b>\$1,327,596,219</b>
<b>FY 2007 Ongoing</b>	<b>\$1,327,596,219</b>
<b>FY 2008 Gov.</b>	<b>\$1,345,096,219</b>
<b>Increase (decrease)</b>	<b>\$17,500,000</b>
<b>Percentage Change</b>	<b>1.3%</b>

Lottery aid to cities and towns remains uncapped for FY 2008 and the Governor proposes increasing lottery distributions to cities and towns by \$15 million. This assumes that lottery revenues will increase



by at least this amount over the next fiscal year.

The additional assistance category is level funded at \$379.8 million, unchanged since FY 2004. The Governor proposes to increase funding to the Payment in Lieu of Taxes (PILOT) program, for communities with state-owned land, by \$3 million or 11.9 percent. In inflation-adjusted terms, unrestricted local aid to cities and towns will be \$187.8 million below the FY 2001 level.

## K-12 EDUCATION

For FY 2008 the Governor proposes appropriating \$4.258 billion for K-12 education operations, a \$213.7 million increase over the current level of funding in FY 2007. In addition to appropriated funds, a portion of all sales tax revenue (\$634.7 million), will be used for the school building assistance fund. This is a \$77.7 million, or 13.9 percent, increase over the FY 2007 level.

<b>FY 2007 Total</b>	<b>\$4,610,415,845</b>
<b>FY 2007 Ongoing</b>	<b>\$4,601,249,845</b>
<b>FY 2008 Gov.</b>	<b>\$4,892,650,331</b>

<b>Increase (decrease)</b>	<b>\$282,334,486</b>
<b>Percentage Change</b>	<b>6.1%</b>

Note: This chart includes school building assistance fund spending, increased by \$77.7 million in FY 2008.

### **Chapter 70 Aid**

Chapter 70 Aid is provided to cities and towns for public education purposes. This budget would provide \$3.705 billion; a \$200 million or 5.7 percent increase over FY 2007.

<b>FY 2007 Total</b>	<b>3,505,520,040</b>
<b>FY 2007 Ongoing</b>	<b>\$3,505,520,040</b>
<b>FY 2008 Gov.</b>	<b>\$3,705,486,690</b>

<b>Increase (decrease)</b>	<b>\$199,966,650</b>
<b>Percentage Change</b>	<b>5.7%</b>

In FY 2007, the Legislature first implemented a new formula for funding Chapter 70 that was designed primarily to provide additional aid to communities that were paying locally for a high percentage of their foundation budget and to provide additional funding to high-growth communities. The House 1 budget continues these reforms.

The new funding can be broken into several categories.

#### Baseline Foundation Aid

The state education funding law sets a minimum amount that each school district has to spend (of state and local resources combined) on a per pupil basis. The law also sets minimum required local contributions. To ensure that every district can spend the required amount per student, the state provides aid that covers the difference between required local contributions and required total spending. Each year this aid is adjusted to account for inflation, enrollment changes, and changes in required local contributions due to local revenue growth. The additional aid needed in FY 2008 to make sure that each district can spend the foundation budget amount after accounting for inflation, enrollment and local capacity changes is \$127 million. That amount is part of the \$200 million in new Chapter 70 Aid in the budget.

#### Aid to Allow Local Spending Reductions

The funding formula adopted in FY 2007 sets new targets for the amount that each municipality should spend of its own resources on education. These targets are

based on local incomes and property values. The new formula provides additional foundation aid to allow districts that are spending more than their target amount to move down towards the target. In FY 2007 towns were allowed to move 20 percent of the way to the new target and received aid that would make up for that reduction. When last year's budget was enacted there was an expectation that 20 percent of that gap would be closed each year for five years. While there are changes over time that complicate the numbers, the gap this year should be roughly 80 percent of the initial gap. Therefore, to close the same share of the initial gap as was closed last year, the state should provide enough aid to allow districts to reduce their local spending by 25 percent of the current gap (25% of 80% is 20% of the initial 100%).

In fact, the House 1 budget provides more than that amount of aid. It appears that the initial calculation of aid for House 1 assumed that the target would be to close 40 percent of the current gap (rather than an additional 20% of the initial gap). Because closing that much of the gap would cost more than the resources available, the actual House 1 recommendation is to close 30 percent of the remaining gap. While this 30 percent reduction has been presented as closing less of the gap than was closed in FY 2007, in fact closing 25 percent of the remaining gap would likely have closed the same share of the initial gap as was closed in FY 2007. The cost of providing state aid to allow towns to close 30 percent of the current gap between their otherwise required spending and their target is \$33 million, and that amount of "effort reduction aid" is included in the House 1 budget.

Down Payment Aid

The FY 2007 reforms also created a category called down payment aid to help communities that would eventually benefit

from the effort reduction aid, but would not otherwise receive their additional aid until later years. This change, and the others made last year is explained more completely in the MBPC publication available at this link: [www.massbudget.org/SchoolFunding.pdf](http://www.massbudget.org/SchoolFunding.pdf). The budget provides less in this form of aid than would have been provided in the original formula. While it follows the practice on effort reduction of initially calculating the cost of closing 30 percent of the remaining gap, the budget then reduces that amount by 53 percent to reduce the cost to the state. The budget includes funding for almost \$15 million in down payment aid.

<b>Chapter 70 Education Aid</b>		
<b>(millions of dollars)</b>		
<b>Component</b>	<b>Funding</b>	<b>Percent</b>
Foundation aid	127.2	63.7%
Effort reduction	33.3	16.6%
Downpayment aid	14.7	7.3%
Growth aid	7.4	3.7%
Minimum per pupil	17.3	8.6%
<b>Total</b>	<b>199.8</b>	

Note: Calculating the amount of Chapter 70 aid attributable to each component of the formula is done by starting with baseline foundation aid and then adding, one at a time, each component of the formula in the same order in which the Department of Education makes their calculations. Therefore, we attribute to each component of the formula the incremental increase in Chapter 70 aid that results when that component is added to the calculation. For example, base foundation aid in FY 2008, without any additional formula components, would be \$127 million. Total aid increases to \$160 million when effort reduction is added; therefore, we consider effort reduction to increase total Chapter 70 aid by \$33 million.

Growth Aid

The new funding formula also provides new funding for districts where the total foundation budget is increasing (primarily as a result of increasing enrollment). The formula provides more per pupil growth aid to districts with lower incomes and property values and less to communities with greater fiscal capacity. As with down payment aid, the House 1 budget reduces these amounts, this year, by 53 percent to reduce the cost to



the state. The total amount distributed in growth aid in House 1 is \$7.7 million.

Minimum Aid

Finally, all communities receive enough aid to guarantee a \$50 per pupil increase in state aid. The cost of this minimum aid is \$17 million.

In the 1993 Education Reform Act a particular measure of inflation was identified as the appropriate measure of inflation for education costs and for Chapter 70 Aid. If this measure of inflation is used to account for increasing costs of providing education, the funding proposed in the Governor’s FY 2008 budget would be about \$375 million less than the amount of funding provided in FY 2002.

**Other K-12 Education Funding**

<b>FY 2007 Total</b>	<b>\$547,895,805</b>
<b>FY 2007 Ongoing</b>	<b>\$538,729,805</b>
<b>FY 2008 Gov.</b>	<b>\$552,463,641</b>
<b>Increase (decrease)</b>	<b>\$13,733,836</b>
<b>Percentage Change</b>	<b>2.5%</b>

The Governor also proposes to increase funding for the Department of Education’s operations, grant, and reimbursement programs from \$538.7 to \$552.5 million, a 2.5 percent increase.

The modest increase in K-12 spending reflects both the significant expansion of several programs and substantial cuts to others. Following are some of the key increases proposed in the Governor’s budget.

- The kindergarten expansion grants program, which funds schools to convert from half- to full-day kindergarten, is proposed to increase by \$12.2 million or 44.8 percent.

- Funding for grants to extend the school day is proposed to double, from \$6.5 to \$13 million.
- The Governor proposes increasing funding for targeted intervention in schools and districts at-risk of being identified as under-performing by \$1.1 million or 22.5 percent.

These increases are, to some degree, offset by cuts to other K-12 education programs. For example, the Governor’s budget reduces funding for early literacy grants by \$410,000 or 11.2 percent. Similarly, funding for dual enrollment programs, allowing high school students to enroll in local colleges, is cut by 50 percent or \$1 million.

Some Department of Education grant programs that were eliminated or drastically reduced in recent years are not restored in the FY 2008 proposal. For example, grants to reduce class sizes in districts serving low-income students, funded at \$18 million in FY 2003, are not funded in the Governor’s proposal. Similarly, additional support for students scoring poorly on the MCAS is proposed to be funded at \$10.8 million in FY 2008 compared to \$50 million as recently as FY 2003.

**HIGHER EDUCATION**

This proposed budget includes \$1.038 billion for public higher education. This amount is a \$6.4 million or 0.6 percent increase over FY 2007 ongoing spending.

<b>FY 2007 Total</b>	<b>\$1,191,320,401</b>
<b>FY 2007 Ongoing</b>	<b>\$1,031,541,911</b>
<b>FY 2008 Gov.</b>	<b>\$1,037,954,557</b>
<b>Increase (decrease)</b>	<b>\$6,412,646</b>
<b>Percentage Change</b>	<b>0.6%</b>



Funding for the University of Massachusetts system, the state college system, and the community college system is increased by \$11.1 million, \$1.6 million, and \$3.7 million, respectively (increases of 2.5, 0.8, and 1.6 percent).

<b>Spending by Higher Education Institutional Level</b>		
	<b>FY07 Ongoing</b>	<b>FY 08 Gov.</b>
University of Massachusetts	450.9	462.0
State Colleges	210.5	212.1
Community Colleges	231.3	235.0
<b>Total</b>	<b>892.8</b>	<b>909.1</b>

One of the Governor's most significant proposed changes would eliminate individual line items for each state college and community college, replacing them with a single line item, allowing the Board of Higher Education to distribute funds among the institutions. The Governor's budget also eliminates line-item earmarks for programs and projects at particular institutions.

The Massachusetts State Scholarship Program, the primary budget item for financial aid, is essentially level-funded in the Governor's proposal. The \$89.9 million provided for financial aid in FY 2008 is, after adjusting for inflation, \$30 million or 25 percent below the level of funding provided in FY 2001.

Two modest new initiatives are also included in the Governor's higher education proposal. First, a \$6 million fund is established for a higher education efficiency incentive program. Under this program the Secretary of Administration and Finance can provide funding to higher education institutions implementing innovative management or policy changes that improve efficiency. Second, \$200,000 is set aside to launch a school-to-college initiative.

The Governor's proposal eliminates \$13 million in funding implemented in FY 2007 to create an incentive for higher education institutions to engage in private fundraising. The funds were provided as a match on private dollars raised.

Despite modest increases in higher education funding over the past several fiscal years, the Governor's proposed FY 2008 higher education budget remains \$270.8 million or 20.7 percent below FY 2001 levels, after adjusting for inflation.

## **EARLY EDUCATION AND CARE**

Funding for early education and care shows a slight decline in the Governor's budget. The total amount appropriated for these programs is \$509.9 million.

<b>FY 2007 Total</b>	<b>\$510,296,241</b>
<b>FY 2007 Ongoing</b>	<b>\$510,296,241</b>
<b>FY 2008 Gov.</b>	<b>\$509,854,321</b>

<b>Increase (decrease)</b>	<b>(\$441,920)</b>
<b>Percentage Change</b>	<b>-0.1%</b>

Income-Eligible Child Care, the main program funding child care for low-income families, is funded at \$200.2 million. It is consolidated with the Community Partnerships for Children Grant Program, which includes community councils that work collaboratively with local programs and services to develop a local system of early care and education. In FY 2007, Community Partnerships for Children was funded at \$47.6 million. The amount proposed would increase funding for this combined item by \$1.9 million.

Mass Family Networks and Reach Out and Read were combined into one line item. The amount proposed for this one item would reduce funding by \$708,000. The

combined appropriation was \$9.395 million in FY 2007; the amount proposed for FY 2008 is \$8.687 million. Mass Family Networks provides educational services (including family literacy activities) and family supports (including home visits, developmental screenings and parent support groups) to families with infants and toddlers. Reach Out and Read trains pediatricians and nurses to advise parents about the importance of reading aloud to their children and provides books for medical professionals to distribute to children at pediatric checkups.

The Healthy Families program (a home visiting program for teen mothers and their children) would experience a cut of \$508,000.

## INCOME SUPPORT PROGRAMS

The proposed spending level for income support programs in FY 2008 is \$6.4 million below spending in FY 2007. This reduction reflects an expectation of lower caseload levels in FY 2008.

<b>FY 2007 Total</b>	<b>\$625,261,358</b>
<b>FY 2007 Ongoing</b>	<b>\$608,261,358</b>
<b>FY 2008 Gov.</b>	<b>\$601,845,370</b>
<b>Increase (decrease)</b>	<b>(\$6,412,646)</b>
<b>Percentage Change</b>	<b>-1.1%</b>

The primary source of this drop is the decline in funding for Transitional Aid to Families with Dependent Children (TAFDC), which would be funded at \$277.1 million, compared to final FY 2007 funding of \$289.1 million.

In situations where the appropriation is insufficient to meet costs, the Department of Transitional Assistance can make benefit cuts to keep spending within the

appropriation. Prior budgets have required 60-day notice before cuts are implemented to allow consideration of alternatives; this budget does not.

*Job Training and Employment Services* Funding for the Employment Services Program, which is available to individuals receiving cash assistance, shows a slight increase in the Governor's budget. The current appropriation for this program would climb from \$27.087 million to \$27.162 million.

In addition, \$7 million would be available in FY 2008 from federal reimbursements for specific education and job training/readiness services for food stamp recipients. In FY 2007, the maximum amount of federal reimbursements that the Department of Transitional Assistance could retain was \$5 million. The additional \$2 million reflects potential federal reimbursements from trainings provided by non-state agencies, such as community colleges and private foundations.

## HEALTH CARE

The Governor's House 1 budget recommendation includes a total of \$9.254 billion for health care programs. The total funding for health programs in House 1 is 3.6 percent higher than in FY 2007.

Unlike in past years, this *Budget Monitor* total includes funding for health care from non-budgeted special trusts as well as on-budget appropriated line items supporting health care. The non-budgeted special revenue funds are integral to the implementation of health reform, and the implementation of health reform is integral to the funding of on-budget health programs such as Medicaid/MassHealth. Furthermore, because of the greater level of transparency

in the FY 2008 House 1 budget, we are able to make these comparisons and include off-budget health funding in our analysis.

<b>FY 2007 Total</b>	<b>\$8,958,190,795</b>
<b>FY 2007 Ongoing</b>	<b>\$8,930,690,795</b>
<b>FY 2008 Gov.</b>	<b>\$9,254,582,321</b>
<b>Increase (decrease)</b>	<b>\$323,891,526</b>
<b>Percentage Change</b>	<b>3.6%</b>

The analysis in this *Budget Monitor* divides health care funding totals into several sections (see detailed chart on next page) in order to break down the various components of the House 1 health care budget. We make various adjustments to the totals as listed in the budget, in order to make more accurate year-to-year comparisons.<sup>1</sup>

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<sup>1</sup> "Medicaid/MassHealth" includes the funding for the Healthy Start Program and the Medicare "Clawback." We have added into the FY 2007 amount the off-budget \$288.5 million funding in the Health Care Quality Improvement Trust, because House 1 recommends bringing this funding on-budget for FY 2008. In order to make accurate comparisons with FY 2008 totals, we have also added approximately \$70.9 million in off-budget funding for hospital rate adjustments to the FY 2007 figure in order to mirror \$140.9 million in funding for rate adjustments that are now included in the FY 2008 House 1 budgeted MassHealth recommendations. These "Medicaid/ MassHealth" totals also include the administrative costs associated with the Executive Office and the Office of Medicaid.

The totals for "Other Health Care Programs" include the Children's Medical Security Plan program, as well as the Betsy Lehman Center and certain health care grants. "Health Care Reform" does not include funding directed to the Division of Insurance in FY 2007, but does include other budgeted administrative costs associated with the implementation of health care reform. Funding transferred into the Uncompensated/Health Safety Net Care Pool is included in the discussion of non-budgeted health care funding.

There are several important elements in the Governor's House 1 budget proposal for the Commonwealth's health programs. Although the details are not readily discernible from the budget documents, the Governor states that his budget incorporates \$179 million in savings from the Medicaid/MassHealth programs, but does this without any changes in benefits or eligibility. The Governor also states that his budget fully funds the implementation of last year's health reform legislation. Below are some highlights within each category of the health care budget.

### ***Medicaid/MassHealth***

The Governor estimates that the House 1 budget includes approximately \$310.2 million in savings on Medicaid/MassHealth programs. In most instances, each of these savings on spending within MassHealth would also reduce federal Medicaid reimbursements for the program. (The federal government reimburses the Commonwealth for approximately fifty percent of MassHealth spending.) The net budgetary impact of these \$310.2 million in reduced costs, once we add back in the impact of federal revenue foregone, would be \$179.2 million. Had the Governor not proposed these cost reduction initiatives, the MassHealth budget would have increased close to nine percent over the FY 2007 budget. These savings initiatives built in to the Governor's House 1 budget hold the budget growth in the program down to close to 4.6 percent.

The single largest portion of these savings comes from an administrative change. MassHealth plans to tighten the schedule for eligibility redeterminations from 60 to 45 days. The Administration estimates that this change (by more quickly eliminating coverage for persons no longer eligible) would save \$70 million in spending, and

<b>Health Care Programs</b> <i>(in Millions of Dollars)</i>			
	<b>FY 2007 Current</b>	<b>FY 2007 Ongoing</b>	<b>FY 2008 Gov.</b>
Medicaid/MassHealth*	7,906.2	7,905.2	8,268.7
Pharmacy Programs	63.6	63.6	60.5
Other Budgeted Health Care Programs	20.2	18.7	15.2
Health Care Reform	43.0	18.0	2.4
<b>Sub-Total</b>	<b>8,033.0</b>	<b>8,005.5</b>	<b>8,346.8</b>
Medical Assistance Trust	236.0	236.0	251.0
Essential Community Provider Trust	38.0	38.0	28.0
Commonwealth Care Trust*	651.2	651.2	628.8
<b>Total other non-budgeted health care</b>	<b>925.2</b>	<b>925.2</b>	<b>907.8</b>
<b>Grand Total</b>	<b>8,958.2</b>	<b>8,930.7</b>	<b>9,254.6</b>

*\*In FY 2007, the Medicaid/MassHealth total includes \$288.5 million associated with nursing home rate adjustments. These adjustments are included in the FY 2008 Medicaid/MassHealth appropriated totals. In FY 2007, \$70.9 million is taken from the Commonwealth Care Trust Fund and added to the Medicaid/MassHealth total in order to mirror \$140.9 million brought on-budget from the Commonwealth Care Trust Fund in FY 2008.*

cost \$35 million in foregone federal revenue. The net impact on the state budget of this administrative change would be \$35 million.

The Governor’s budget also estimates that there would be significant savings from reducing rates paid to providers. The Governor estimates that by reducing the rate of increase in nursing home reimbursements, the Commonwealth would save a net \$28 million in FY 2008.

Other large MassHealth rate reductions proposed include the following.

- \$10.0 million net from the implementation of pay-for-performance in hospital rates;
- \$6.3 million net from reducing a special rate methodology for a particular rehabilitation facility;
- \$6.0 million net from a rate increase for day habilitation programs;
- \$5.5 million net from laboratory rates;

- \$1.0 million net from acute and behavioral health providers; and,
- \$1.0 million net from substance abuse and detox services.

The Governor’s MassHealth budget also incorporates savings associated with programmatic “efficiencies”, such as nursing home discharge planning and increased capacity to implement program audits.

In addition to these reductions associated with savings, the Governor’s budget would eliminate \$25.9 million for certain hospitals that provide a large share of care to low-income individuals and \$11.0 million in earmarks from the Senior Care program. The net budgetary impact of these savings would be \$13.0 and \$5.5 million respectively.

There are two other large savings built into the Governor’s budget proposal that affect the rates paid to health care providers. The House 1 budget estimates that by changing

the timing of payments to hospitals, and re-aligning the state fiscal year (July to June) payments to the hospital fiscal year (October to September) the Commonwealth could save \$38.3 million in FY 2008. This is a one-time savings associated with an accounting change.

Another one-time savings in FY 2008 is the implementation of what is referred to as “pay-for-performance” reimbursements to hospitals. Again, by changing the timing of when hospitals would receive reimbursements for their Medicaid/MassHealth costs, the state estimates that it can save \$20.0 million total in FY 2008, with a budgetary impact of \$10.0 million.

Another major change in the Medicaid/MassHealth totals for FY 2008 is that the Governor recommends bringing on-budget (i.e. including in appropriated budget totals) certain rate adjustments paid to providers as mandated in the Commonwealth’s health reform legislation. The total amount included in the FY 2008 totals for these rate adjustments is \$140.9 million. In order to do an accurate comparison with FY 2007, we have added the total for these off-budget rates in FY 2007 (\$70.9 million) into our FY 2007 Medicaid/MassHealth totals.

The Governor similarly recommends bringing nursing home rate supplements, formerly funded through a non-budgeted special revenue trust, into the on-budget MassHealth appropriations. Although this might appear to be a \$288.5 million increase in the MassHealth budget, the now on-budget amount is the same as the FY 2007 off-budget amount. In order to do an accurate comparison with FY 2007, we have added the total for these off-budget rates in FY 2007 (\$288.5 million) into our FY 2007 Medicaid/MassHealth totals.

Along with these various cost containment efforts, the Governor’s budget recommends consolidating the funding of a number of MassHealth programs. The Governor’s budget would consolidate several programs under a new line item called “MassHealth Special Populations.” This new line item encompasses the CommonHealth program for persons with disabilities, the Basic program, the program for persons with breast or cervical cancer, the program for persons with HIV, the premium assistance programs and the Healthy Start program. Combined, the Governor recommends \$304.7 million for these programs.

Another consolidation in House 1 is the “MassHealth – Managed Care Plans” line item. The Governor would consolidate funding for Managed Care, Standard Care, and the Family Assistance (S-CHIP) plans. His FY 2008 recommendation for these programs is \$2.983 billion.

Although not included in these particular totals above, the Governor’s budget would expand funding for Medicaid program fraud prevention and auditing within the Attorney General’s office – increasing from \$3.1 million in FY 2007 to \$3.4 million in FY 2008. The Governor anticipates that the Commonwealth would be able to net \$6.0 million from increased fraud control efforts.

Other changes proposed by the Governor include the following.

- Codifying (adding to General Law) the MassHealth Essential program for very low income long-term unemployed persons. The Administration would still have the authority to set a limit on participation in the program based on caseload and the budgeted appropriation for the program.

- Allowing the MassHealth program to reduce co-payments or premiums for participants in the program who comply with wellness goals.

### ***Pharmacy Programs***

Funding for the Prescription Advantage program in House 1 would drop to \$60.5 million, a five percent decrease from the FY 2007 budget. The Governor states that these reductions are administrative cuts and would not affect eligibility or benefits. The Governor's budget does not, however, include language that would have reinstated the Prescription Advantage program as a provider of a one-time thirty day emergency supply of prescriptions for individuals having problems transferring into Medicare Part D prescription coverage.

### ***Other Budgeted Health Programs***

The Governor would fund the Children's Medical Security Plan at \$15.2 million, a \$3.4 million decrease from FY 2007 total funding. This reduction would adjust for a decline in caseload anticipated as more children receive health insurance through the new programs associated with health reform. Language in an outside section of the budget would remove the former statutory premium structure for the program, but would not substitute specific new premiums. MassHealth would be allowed, under new language, to set premiums by regulation.

### ***Health Reform***

In order to administer health reform, the Governor's budget includes funding within the Department of Workforce Development and within the Division of Insurance designated for implementation of the "fair share assessment" and a "health care access bureau."

### ***Non-Budgeted Health Funding***

In addition to the funding listed above, the Governor's budget recommendation includes information about non-budgeted health care funding associated with certain trust funds. These trusts receive funds transferred from the General Fund for specified purposes, but their spending is not subject to legislative appropriation.

- \$251.0 million for supplemental payments to certain hospitals, a six percent increase from the FY 2007 total.
- \$28.0 million for the Essential Community Provider Trust Fund, down from \$38.0 million in FY 2007. This \$10.0 million reduction is one of the savings the Governor includes in his Medicaid savings total. These funds would be available in the form of grants to acute care hospitals and community health centers for care for needy populations.
- \$628.8 million allocated to the Commonwealth Care Trust Fund, \$471.9 of which would be available for the costs associated with subsidized health insurance premiums for the Commonwealth's health reform programs.

In FY 2007, the \$70.9 million in provider rate enhancements came from the Commonwealth Care Trust Fund, but in FY 2008, these rate increases were moved into the Medicaid/MassHealth appropriation totals. The totals in this *Budget Monitor* subtract \$70.9 from the FY 2007 Commonwealth Care Trust Fund total in order to generate a more accurate comparison of Medicaid/MassHealth totals between the two years. Without this reduction, the FY 2007 total for the Commonwealth Care Trust Fund would have been \$722.1 million.

One of the administrative changes made under the state’s health reform law and implemented through the Governor’s budget recommendation is changing the Uncompensated Care Pool into the Health Safety Net Care Pool, and moving the authority for administering these funds from the Office of Medicaid into a Health Safety Net Office within the Division of Health Care Finance and Policy. The Governor’s budget recommendation would transfer \$33.9 million from the Commonwealth Care Trust Fund into this pool to support its operations.

There is also language in an outside section of the budget that would allow for flexibility in transferring funds from the Health Safety Net Pool into the Commonwealth Care Trust Fund if demand for uncompensated care drops once more people have health insurance.

## PUBLIC HEALTH

The Governor’s budget recommendations in House 1 include \$547.0 million for public health, a \$34.5 million – or 6.7 percent – increase over the ongoing FY 2007 budget. The Governor’s budget would fund non-hospital based public health services at \$390.4 million – a 5.9 percent increase over FY 2007 – and hospital-based public health services at \$156.7 million – a 9.0 percent increase over FY 2007.

When compared to public health funding levels only from the FY 2007 General Appropriation Act (GAA), however, the Governor’s budget recommendation represents a larger increase – \$73.6 million, or 15.5 percent. To-date in FY 2007, however, there has been \$41 million added to the appropriations in the GAA for public health. Some of these additional funds were for one-time expenditures; while some were

intended to increase the ongoing budget of the Department of Public Health. This *Budget Monitor* compares the FY 2008 House 1 recommendations to the FY 2007 ongoing public health budget, including supplemental funding, unless otherwise noted. Even with the increases for public health funding proposed by the Governor, when adjusted for inflation, public health funding is still twelve percent below funding levels in FY 2001.

<b>FY 2007 Total</b>	<b>\$514,463,185</b>
<b>FY 2007 Ongoing</b>	<b>\$512,495,185</b>
<b>FY 2008 Gov.</b>	<b>\$547,036,991</b>
<b>Increase (decrease)</b>	<b>\$34,541,806</b>
<b>Percentage Change</b>	<b>6.7%</b>

The Governor’s budget narrative emphasizes a strong commitment to funding public health programs, in part as a means to prevent disease and work in the long-run to control health care costs. The Governor would consolidate several of the public health budgetary accounts, stating that this would help coordination of health promotion and disease prevention activities.

The Governor’s recommendations include the following.

- \$24.8 million more for universal immunizations, for a total of \$61.6 million. This increased funding level is intended to cover the costs of three new vaccines: Rotavirus vaccine for approximately 71,000 infants, Meningococcal Conjugate vaccine for approximately 108,000 children, and Human Papilloma Virus Vaccine for approximately 72,000 pre-teen and teenage girls.
- \$8.0 million more for smoking cessation programs, for a total of \$16.3 million. This recommended amount is \$12.0 million more than the level funded in the

FY 2007 GAA. The Governor's recommendation also expands on the increased support provided over the course of the fiscal year from supplemental funding. Although the proposed House 1 budget does not yet return to the Commonwealth's FY 2001 level of support for anti-smoking efforts (\$60.1 million in inflation-adjusted dollars), this recommended increase in funding would allow for a significant step towards recovering the services lost during the state's fiscal crisis. Nevertheless, funding is still 73 percent below where it was in FY 2001.

- \$11.8 million for a consolidated health promotion and disease prevention line item. The Governor's budget recommendation compares this new line item to funding in previous years for osteoporosis screening, prostate cancer screening, colorectal cancer screening, Hepatitis C screening and prevention services, stroke awareness services, and early breast cancer screening. Including all supplemental funding, the total combined FY 2007 budget for these particular line items was \$11.9 million, so the Governor's recommendation is a slight decrease. When compared to the funding for these line items at the beginning of FY 2007 (without including supplemental funding available from FY 2006 surplus dollars) the Governor's budget represents a \$5.9 million increase.
- \$3.0 million more for combined early intervention program line items, for a total of \$41.7 million. This is an increase of close to eight percent over total FY 2007 levels.
- \$8.2 million less for substance abuse services compared to total FY 2007 funding, for a total of \$78.5 million. The FY 2007 GAA had funded substance abuse services at \$66.6 million, and then there was \$20.1 million

in additional funding made available over the course of the year. The Governor's budget recommendation would not continue into FY 2008 the full amount of this additional funding, putting in jeopardy several new programs for adolescents and young adults funded with these supplemental dollars.

- \$432,000 less for school health services, for a total of \$16.3 million. School health services, including funding for school nurses and school-based health centers, continue to struggle. In FY 2001, school health services were partly funded in the Department of Education, and partly funded in the Department of Public Health. The combined total funding at that time was \$54.0 million (adjusted for inflation into FY 2008 dollars), so the Governor's recommended funding level is still 70 percent below FY 2001 funding.

## MENTAL HEALTH

Funding for mental health services would increase by \$17.5 million or about 2.7 percent

<b>FY 2007 Total</b>	<b>\$646,529,706</b>
<b>FY 2007 Ongoing</b>	<b>\$646,529,706</b>
<b>FY 2008 Gov.</b>	<b>\$664,037,326</b>
<b>Increase (decrease)</b>	<b>\$17,507,620</b>
<b>Percentage Change</b>	<b>2.7%</b>

The Governor's proposal consolidates several accounts such as emergency services and statewide homelessness support services with the overarching adult mental health services account. Together funding for these services is increased by \$8.8 million or 2.4 percent. Support for child and adolescent mental health services is essentially level-funded; however, this

masks an increase in community services that is possible because of the closure of a clinically-intensive residential treatment program. Finally, funding for state psychiatric hospitals and inpatient care is proposed to increase by \$6.7 million or 4.1 percent.

## MENTAL RETARDATION

Under the Governor’s proposal, funding for the Department of Mental Retardation would increase by \$39.9 million or about 3.4 percent.

<b>FY 2007 Total</b>	<b>\$1,175,919,006</b>
<b>FY 2007 Ongoing</b>	<b>\$1,175,919,006</b>
<b>FY 2008 Gov.</b>	<b>\$1,215,833,577</b>
<b>Increase (decrease)</b>	<b>\$39,914,571</b>
<b>Percentage Change</b>	<b>3.4%</b>

The Governor proposes to increase funding in two particular areas within the Department of Mental Retardation. First, funding for state facilities for the mentally retarded is proposed to increase by \$7.7 million or 4.5 percent over FY 2007 levels. Second, the Governor proposes to increase funding for community residential programs by \$32.6 million or 4.4 percent.

Department of Mental Retardation administration and operations funding is proposed to increase by 2.4 percent, while funding for community support programs is essentially kept level.

Finally, the Governor proposes a reduction in funding for turning 22 services for the mentally retarded by \$3 million, which is a cut of 35.3 percent from FY 2007 funding levels. This account provides resources supporting the transition of mentally retarded individuals who turn 22 during FY 2008. This reduction largely will result

from changes to the process of enrolling individuals for services, though eligibility criteria will not change.

## SOCIAL SERVICES

The Governor’s budget for the Department of Social Services totals \$790 million in FY 2008, a \$20.3 million or 2.6 percent increase over FY 2007.

<b>FY 2007 Total</b>	<b>\$769,900,112</b>
<b>FY 2007 Ongoing</b>	<b>\$769,900,112</b>
<b>FY 2008 Gov.</b>	<b>\$790,253,582</b>
<b>Increase (decrease)</b>	<b>\$20,353,470</b>
<b>Percentage Change</b>	<b>2.6%</b>

In the FY 2008 budget, the Governor proposes consolidating the budget account for services to children and families with the account for group care services.

Collectively, these are accounts are proposed to increase by \$16.8 million or 3.2 percent. The Governor also proposes a 4.5 percent, \$3.4 million, increase in the Department of Social Services’ administrative line item.

Funding for social workers is proposed to increase by \$4.1 million or 2.9 percent, while the Department’s other accounts are funded at a relatively flat level.

## ELDER AFFAIRS

The Governor’s budget recommendations in House 1 include \$227.0 million for elder affairs, a \$4.0 million or 1.8 percent increase over the current FY 2007 budget. (For a discussion of the MassHealth senior care programs, nursing home rates, and the pharmacy programs, see the “Medicaid/ MassHealth and Other Health Programs” section of this *Budget Monitor*.)

<b>FY 2007 Total</b>	<b>\$223,061,057</b>
<b>FY 2007 Ongoing</b>	<b>\$223,061,057</b>
<b>FY 2008 Gov.</b>	<b>\$227,024,995</b>

<b>Increase (decrease)</b>	<b>\$3,963,938</b>
<b>Percentage Change</b>	<b>1.8%</b>

The Governor’s House 1 recommendations consolidate funding for several line items, including elder home care purchased services, elder home care case management and administration, and the Elder Enhanced Community Options program. Total funding recommended for these community-based long-term care programs is \$189.0 million, \$2.4 million more than total FY 2007 funding. Although not explicitly stated in the budget, the Governor has expressed a commitment to shifting budget priorities towards community-based long term care.

The Governor’s budget would also consolidate funding for the elder housing programs, combining funding for the congregate housing program and supportive senior housing. Total funding for these programs is \$5.3 million, \$400,000 less than in FY 2007.

The Governor recommends an eight percent increase in funding for the elder protective services program, for a total of \$15.0 million. The House 1 budget also continues funding for the geriatric mental health services program and the family caregivers program at their FY 2007 levels.

**OTHER HUMAN SERVICES**

The Governor’s budget proposes a total of \$599 million for all other human services programs, a \$7.8 million or 1.3 percent decrease over the FY 2007 ongoing funding level.

<b>FY 2007 Total</b>	<b>\$607,723,788</b>
<b>FY 2007 Ongoing</b>	<b>\$607,223,788</b>
<b>FY 2008 Gov.</b>	<b>\$599,431,450</b>

<b>Increase (decrease)</b>	<b>(\$7,792,338)</b>
<b>Percentage Change</b>	<b>-1.3%</b>

Included in other human service programs are the Departments of Veterans’ Affairs and Youth Services, as well as the Massachusetts Commission for the Blind, the Massachusetts Rehabilitation Commission, the Division of Health Care Finance and Policy, the state’s soldiers’ homes, and health and shelter programs for the homeless.

Overall, the Governor’s budget proposes increasing funding for veterans’ services, combining both veterans’ affairs and the soldiers’ homes, by \$3.9 million. The Veterans Affairs budget appears to decline because \$5.8 million in FY 2007 funding for services to homeless veterans is consolidated in a new single line item for all health and shelter services for the homeless.

The Governor’s proposed budget for homelessness prevention and elimination services increases funding over FY 2007 levels by \$3.7 million or 3.1 percent. Among line items consolidated into this new item were accounts for assistance to the individual homeless as well as the account for family shelters and services.

Funding for the Massachusetts Commission for the Blind and the Massachusetts Rehabilitation Commission is generally maintained at FY 2007 levels. The administrative budgets for each Commission are increased by 1.4 and 1.2 percent respectively.

The Governor proposes to fund the state’s Division of Health Care Finance and Policy



at \$14.0 million, an increase of \$1.1 million or 8.9 percent over FY 2007 levels.

Finally, the proposal includes an increase of \$2.4 million or 1.6 percent in funding for the Department of Youth Services. A \$4.8 million increase in services for the detained youth population is offset by \$1.4 million and \$1.0 million cuts in residential services and non-residential services respectively for the committed youth population.

### ***Human Services Reserve***

Part of total spending for other human services is the Governor's proposed FY 2008 budget of \$12 million for the human services reserve account. This amount represents a \$16 million decline from the FY 2007 level and a decline of \$8 million from the FY 2006 level.

Ultimately, the \$12 million proposed for the reserve account will be spent across all health and human services departments to fund salary increases for low-wage service providers. Because the budget proposal does not distribute the reserve among agencies, the reserve account funding is included in the other human services comparison between FY 2007 and FY 2008.

## **ENVIRONMENTAL AFFAIRS**

The budget recommendation for environmental affairs would increase funding from FY 2007 ongoing levels by \$3.5 million or 1.6 percent. This is without considering \$43.7 million in FY 2007 spending that is not ongoing.

<b>FY 2007 Total</b>	<b>\$258,742,733</b>
<b>FY 2007 Ongoing</b>	<b>\$214,979,677</b>
<b>FY 2008 Gov.</b>	<b>\$218,504,688</b>

<b>Increase (decrease)</b>	<b>\$3,525,011</b>
<b>Percentage Change</b>	<b>1.6%</b>

While the budget provides for a \$6.9 million or 3.4 percent increase in funding for the Executive Office of Environmental Affairs, the administrative budget for the Department of Environmental Protection is cut by \$787,667, or 2.3 percent.

While environmental protection line items are generally held at or slightly below FY 2007 levels, funding for hazardous waste site clean-up is increased by 3.5 percent or \$546,326.

The Governor proposes increasing funding for the operation of state and urban parks by \$1.9 million or 3.6 percent. In addition, the Governor proposes allowing the Department of Conservation and Recreation to retain \$1 million more in revenue from fees collected at parks, a 21.5 percent increase over FY 2007.

The environmental affairs programs of the Commonwealth were among the hardest hit by recent budget cutting. Even with the Governor's FY 2008 budget proposal, environmental affairs funding will remain at \$72.3 million, or 24.9 percent below FY 2001 levels, after adjusting for inflation.

## **HOUSING**

The Governor proposes increasing funding for housing and community development activities by about \$78,000 or 0.1 percent. This increase is premised on the exclusion of \$61.6 million in one-time spending from FY 2007 totals.

<b>FY 2007 Total</b>	<b>\$186,478,835</b>
<b>FY 2007 Ongoing</b>	<b>\$124,842,388</b>
<b>FY 2008 Gov.</b>	<b>\$124,920,361</b>

<b>Increase (decrease)</b>	<b>\$77,973</b>
<b>Percentage Change</b>	<b>0.1%</b>

One of the Governor's most significant proposals is the consolidation of a series of line items that provided housing assistance to low-income or homeless families and individuals into a single account for homelessness prevention and elimination. Previously distinct programs now included under the new account are housing services to low-income families in private housing, tenancy preservation services, the Massachusetts Rental Voucher Program, residential assistance to families in transition, and the asset-building individual development accounts program. The Governor proposes increasing funding for these combined programs by \$2.6 million or 7.5 percent.

Also increased are subsidies for public housing authorities, proposed to increase by \$4.1 million or 7.4 percent. Interest subsidies for the private development of affordable housing are reduced by \$1 million or 18.2 percent.

Through the elimination of a number of earmarks found in the FY 2007 legislation, the Governor proposes reducing funding for the Department of Housing and Community Development by \$3.5 million or 30.8 percent.

A number of housing programs, such as the home ownership opportunity affordable housing program and the alternative rental voucher program, are funded at the same level as FY 2007.

## **PUBLIC SAFETY & CORRECTIONS**

Funding for public safety in the Governor's proposal totals \$1.467 billion, a \$33.9 million or 2.4 percent increase over FY 2007 ongoing levels. However, the Executive Office of Public Safety component of this spending will decline by \$7.8 million or 1.5 percent, while spending on correctional services will increase by \$41.7 million or 4.6 percent.

<b>FY 2007 Total</b>	<b>\$1,463,850,919</b>
<b>FY 2007 Ongoing</b>	<b>\$1,432,628,354</b>
<b>FY 2008 Gov.</b>	<b>\$1,466,529,180</b>

<b>Increase (decrease)</b>	<b>\$33,900,826</b>
<b>Percentage Change</b>	<b>2.4%</b>

The Governor's proposed public safety budget would increase funding in several areas. Notably, the Governor proposes increasing police grants to municipalities allowing them to hire new officers. This program replaces the community policing grant program and increases funding by \$9.3 million or 43.5 percent. An additional \$3 million in municipal police training grants are also included in the budget as a new program.

Funding for state police operations is also increased, rising by \$3.6 million or 1.7 percent, after accounting for a collective bargaining supplemental budget passed in FY 2007. However, funding for state police overtime is eliminated in the Governor's proposal, a reduction of \$13 million.

With respect to correctional services, the Governor's budget would significantly increase funding for correctional facility operations by increasing state facility operations by \$34.8 million or 7.7 percent and by increasing county correctional operations by \$5.8 million or 3.1 percent.

The Governor's budget also includes cuts to or the elimination of funding for several programs.

- The \$1.8 million funded in FY 2007 for new state police classes is eliminated in the FY 2008 budget.
- A budget of \$1.1 million in FY 2007 for the SAFE fire prevention program is eliminated from the Governor's proposal.
- Funding for the state police crime lab is proposed to be cut by 3.1 percent.
- The state's funding of the municipal police officers' career incentive program (commonly called the Quinn Bill) is proposed to be cut by \$2.1 million or 4 percent. This may result in municipalities having to cover additional costs for police officers' education incentive compensation.
- The administrative budget for the Executive Office of Public Safety is proposed to be cut by nearly \$1 million or 28.6 percent.

Most other accounts within public safety are funded at a level similar to that of FY 2007.

## JUDICIARY

The Governor's budget provides \$745 million for the Judiciary in FY 2008, a \$41.3 million or 5.3 percent decrease compared to FY 2007 ongoing expenditures.

<b>FY 2007 Total</b>	<b>\$786,517,061</b>
<b>FY 2007 Ongoing</b>	<b>\$762,317,061</b>
<b>FY 2008 Gov.</b>	<b>\$744,978,295</b>
<b>Increase (decrease)</b>	<b>(\$17,338,766)</b>
<b>Percentage Change</b>	<b>-2.3%</b>

The Governor proposes to hold spending for each tier of the state court system at FY 2007 levels. With respect to the trial court system, the Governor proposes to eliminate

individual line items for each court, replacing them with a single line item for the trial court system.

The most significant cuts in the Governor's judiciary proposal impact spending for court-appointed attorneys and court costs for indigent clients. The account for the Committee for Public Counsel Services absorbs two other line items in the Governor's proposal and funding is cut by \$4.6 million or 17.5 percent. Funding for indigent court costs is reduced by \$3.1 million or 26.7 percent.

Additionally, spending on private counsel fees is reduced by \$617,000 or 0.5 percent. While \$24 million in one-time FY 2007 spending paid for FY 2006 fee increases for private attorneys, an amount to cover these increases was not included in the FY 2007 budget. Therefore, it is estimated that there may be an FY 2007 shortfall of between \$10 and \$13 million for private counsel fees.

## PUBLIC TRANSIT

The Governor's budget provides \$52 million in contract assistance to the Commonwealth's regional transit authorities (RTA), while the sales tax formula yields \$756 million in funding for the Massachusetts Bay Transit Authority (MBTA).

<b>FY 2007 Total</b>	<b>\$785,737,200</b>
<b>FY 2007 Ongoing</b>	<b>\$785,737,200</b>
<b>FY 2008 Gov.</b>	<b>\$808,254,572</b>
<b>Increase (decrease)</b>	<b>\$22,517,372</b>
<b>Percentage Change</b>	<b>2.9%</b>

Funding for MBTA is considered off-budget because 20 percent of all sales tax revenue is allocated to MBTA pre-budget. Because sales tax revenues are projected to grow by 3

percent between FY 2007 and FY 2008, state funding for the MBTA will grow by the same amount, or \$22 million.

Regional transit authorities' funding is appropriated through the budget process and the Governor proposes to increase RTA funding by about \$517,000 or 1.0 percent. Since FY 2001, contract assistance to RTAs has increased by only 4.8 percent, or \$2.4 million after adjusting for inflation.

## GROUP INSURANCE

The budget for the Group Insurance Commission (GIC) appears to increase by \$126.9 million, or 12 percent, under the Governor's proposal. For technical reasons (discussed below) this is an overstatement of the actual increase in spending.

<b>FY 2007 Total</b>	<b>\$1,056,581,827</b>
<b>FY 2007 Ongoing</b>	<b>\$1,056,581,827</b>
<b>FY 2008 Gov.</b>	<b>\$1,183,509,840</b>

<b>Increase (decrease)</b>	<b>\$126,928,013</b>
<b>Percentage Change</b>	<b>12.0%</b>

NOTE: The FY 2008 total includes \$380 million that the Governor has proposed be shifted from the General Fund to an off-budget account, the State Retiree Benefits Trust Fund. This fund was established (in an outside section of the Governor's budget) to meet liabilities of the state retirement system for health care and other non-pension benefits for retired state employees. As this \$380 was drawn from an appropriated line item within GIC in prior years, we add it back to the FY 2008 total.

To provide an apples-to-apples comparison of FY 2007 and FY 2008 spending, we need to account for three technical issues. The following table summarizes these issues. Once we account for these three technical issues, the growth in GIC spending is \$37 million, or 3 percent.

- Accounting adjustment: The FY 2007 total includes approximately 11.5 months of spending, creating a one-time

saving of about \$50 million. In order to make an apples-to-apples comparison, this amount should be added to the FY 2007 total. The reason that this amount is not included in the FY 2007 total is that the definition of the "payable period" was changed. In just one year, FY 2007, this creates a savings: medical bills received by the GIC in FY 2008 for services provided in FY 2007 will be paid out of the 2008 budget, rather than the FY 2007 budget. Until FY 2007, the GIC would have had a window of two months (June 30 through August 31) to pay bills for prior year services with prior year appropriations. Therefore, bills received early in FY 2007 for FY 2006 costs were paid with FY 2006 appropriations, but the FY 2007 appropriations will not be used to pay similar bills in FY 2008. This created a one-time savings in FY 2007.

	<b>GIC Funding</b>		<b>Change</b>
	<b>(Millions of Dollars)</b>		
	<b>FY 2007 Ongoing</b>	<b>FY 2008 House 1</b>	
Appropriated Amount	1,066	803	
Shift to State Retiree Benefits Trust Fund		380	
<b>Subtotal</b>	<b>1,066</b>	<b>1,183</b>	<b>117</b>
Adjusting for One-Time Saving	50		
Chapter 16 Cuts	-10		
Expected Reversions	-10		
Adding Springfield		-50	
<b>Grand Total</b>	<b>1,096</b>	<b>1,133</b>	<b>37</b>

- Ch. 16 Cuts: Because actual spending in FY 2007 will likely be lower than projected, Governor Patrick reduced

GIC spending by \$10 million in Chapter 16 of the Acts of 2007 (Section 9).

- **Expected Reversions:** In addition to the \$10 million reduction in Chapter 16, another \$10 million is expected to be unspent and to revert to the General Fund at the end of the year. Thus combining the Chapter 16 reduction with this expected reversion, FY 2007 spending is projected to be \$20 million below the original appropriation level. In implementing 9(c) cuts, Governor Romney reported that GIC spending in FY 2007 was expected to be \$30 million less than the amount appropriated. If Governor Romney's 9(c) reversion estimate proves accurate, FY 2007 spending would be an additional \$10 million below the budgeted number.
- **Adding Springfield:** In FY 2008, employees of Springfield will get their health insurance through the GIC, which will be reimbursed by the city of Springfield. Bringing this spending into the GIC accounts for \$50 million of the new spending we see in the GIC line item. It will, however, be offset by new revenue.

#### State Retiree Benefit Trust

In response to a change in accounting rules, House 1 establishes a new fund to begin to set aside money for future retiree health care costs. In 2004, the Governmental Accounting Standards Board (GASB) issued Statement 45, which mandates that governments begin to measure their unfunded obligations for retiree health care benefits and consider options for financing them. While GASB 45 does not require contributions to a savings account, the disclosure requirement creates an incentive for governments to do so. A growing obligation in a government's balance sheet, with no plan to begin funding it, is damaging to its credit quality.

In his budget proposal, the Governor establishes the State Retiree Benefits Trust Fund to address the need to begin paying for the cost of retiree health care benefits. The FY 2008 funding for this new trust fund, approximately \$421 million, would come from a one-time revenue source: the Health Care Security Trust Fund. This transfer has no positive or negative effect on the bottom line of this year's budget.

While this is a use of one-time revenue it is also a commitment to fund a future obligation that has never before been funded. By creating a trust fund, the Commonwealth both lowers the accounting entries for unfunded obligations and also helps defray the cost of such obligations through investment returns. In future years, funding will come from increasing shares of the tobacco settlement funds, which means that revenue will not be available for other uses.

## **REVENUE**

On January 16, 2007, the Secretary of Administration and Finance and the Chairpersons of the House and Senate Ways and Means Committees announced the official tax revenue estimate for FY 2008. They project that tax revenue will total \$19.300 billion in FY 2007; this is an increase of \$168 million over the projection provided by the Secretary of Administration and Finance on October 24, 2006 (of \$19.132 billion). They project that baseline tax revenue will grow by 3 percent to reach \$19.879 billion in FY 2008.

This is a lower rate of growth than the Commonwealth has experienced in recent years. A major reason for this low growth estimate is the administration's projection that capital gains taxes will decline from a projected \$1.875 billion in FY 2007 to

\$1.459 billion in FY 2008, a drop of \$416 million. One of the major reasons for the budget gap projected in FY 2008 is that previous year's budgets have depended on rapidly rising capital gains tax receipts. Because the markets move in cycles, capital gains tax receipts are notoriously unstable: in good years they can increase rapidly, when the market falls they can decline.

House 1 includes three major sets of policy changes that relate to revenue: new debt issuance strategies ("Bond-Ahead"); reforms of the corporate tax laws; and the use of reserves.

### ***Enhanced Cash Management ("Bond-Ahead")***

The Treasurer has proposed and House 1 adopts the idea of "bonding-ahead." Historically capital expenditures have been financed by first drawing the funds out of the General Fund and then reimbursing that fund with proceeds from subsequent bond issuance. The problem with this strategy is that by spending from the General Fund before issuing bonds, interest earnings on the balance of the General Fund are reduced and, if such spending creates a temporary deficit, the state has to borrow and pay interest costs. The advantage of the historical strategy, however, was that it avoided the problem of the state selling bonds before spending money and then having to start paying interest on those bonds before the money was really needed. Right now, however, the short-term interest rates the state can receive on its bond proceeds are higher than the long-term rates that the state has to pay bond holders. In this situation "Bond-Ahead" can save the state money.

The Federal government regulates how tax exempt bonds are issued and when the spending has to occur. But if certain

conditions are met, states are able to issue bonds up to 18 months before expenditures. Because the state has built the capacity to track expenditures in the manner that the federal government requires, it should be able to utilize these "Bond-Ahead" strategies to achieve significant savings and also generate revenue by taking advantage of favorable short term interest rates. The total savings and new revenue from this initiative is estimated to be approximately \$50 million.

### ***Reform of Tax Laws***

Along with the budget, the Governor filed legislation to reduce corporate tax avoidance and to reduce payments of the state Earned Income Tax Credit to non-residents. These changes are expected to generate \$295 million a year in revenue. A proposal to extend the property tax circuit breaker to non-seniors with low incomes and high property tax bills will cost \$5 million in tax revenues in FY 2008; therefore, the Governor's tax proposals yield a net increase of \$290 million in tax revenue.

The tax legislation accompanying the budget closes tax loopholes in several ways.

- implementing combined reporting so that companies cannot shift income between subsidiaries to reduce their taxes (see <http://www.massbudget.org/CombinedReportingFeb07.pdf> for a more complete explanation of combined reporting) (\$136 million);
- conforming to federal rules so that companies cannot avoid taxes by being classified as partnerships in one state and corporations in another state (\$99 million);
- requiring that businesses owned by insurance companies pay the same taxes as other businesses (\$14 million);

- prohibiting corporate taxpayers from placing real estate in a subsidiary entity and selling that entity rather than the real estate itself to avoid the real estate transfer tax (\$12 million);
- ensuring that internet sites that sell hotel rooms remit the sales tax on the full cost of the rooms they sell (rather than on the wholesale price they pay to the hotels) (\$5.6 million);
- reducing the ability of businesses to lease equipment from their own subsidiaries to avoid paying the full sales tax up front (\$28 million); and,
- changing the Commonwealth's Earned Income Tax Credit so that non-residents of Massachusetts only receive a state EITC benefit proportional to the share of their income that is earned in Massachusetts (\$2 million).

### ***Use of Reserve Funds***

House 1 uses \$125 million in reserve funds to balance the budget. This includes a transfer of \$50 million from the Health Care Security Trust Fund to the General Fund and also a transfer of \$75 million from the Stabilization Fund. The transfer from the Stabilization Fund is less than the amount of interest expected to be earned in the fund in FY 2008. As a result, the balance in the Stabilization Fund should grow regardless of the transfer.

## BUDGET TRANSPARENCY

This budget makes significant progress on transparency and provides information that makes it much easier for an ordinary reader to understand the meaning of the funding recommendations made in the budget document. The budget materials provided on-line include several new features that make the budget a more accessible and informative document, including the following.

- a “Budget Navigation Guide” that provides information about how to understand the budget, where to find information about both spending and revenue, and links to additional background information;
- tables that provide extensive information on current and prior spending levels by line item so that the reader can see where spending is increasing, where it is falling, and how current appropriations compare to historic trends;
- a spreadsheet that includes all of the appropriations by line item and can be easily downloaded; and,
- mission statements and organizational charts to explain the goals, responsibilities, and structure of each state department (to find this you have to click on “Department Information” when you get to the page with the budget of a given department).

While the progress on transparency is impressive for an administration that has been in office for less than 60 days, there are several areas where additional progress could still be made. A more complete discussion of budget transparency can be found in *Creating a Transparent Budget for Massachusetts*, available at this link: [http://www.massbudget.org/Creating\\_a\\_Transparent\\_Budget.pdf](http://www.massbudget.org/Creating_a_Transparent_Budget.pdf) In addition to all of the new information provided in this year’s

budget, ideally a transparent budget would include several other features, such as the following.

- a clear and complete balance sheet that separately identifies ongoing and temporary spending and ongoing and temporary revenue and allows the reader to determine easily not only whether the budget is balanced, but also whether it is structurally balanced;
- short descriptions of each program funded that includes a clear statement of goals and objectives; and,
- information about caseload assumptions and other data that would allow the reader to determine when spending changes are due to caseload or cost changes rather than the result of decisions to expand or cut a program or service.

## BALANCE

The balance sheet on the next page seeks to identify all revenues relied on and expenditures made in the Governor’s FY 2008 budget proposal. The largest difference between this balance sheet and the spending and revenue numbers historically and presently found in the state budget is the treatment of transfers. The state budget obscures total spending and revenue because transfers into and out of the General Fund are added together into a net revenue number called Consolidated Transfers. For example, in House One, the Consolidated Transfers line is reported as \$702 million in revenue. However, this number includes \$935 million in lottery revenues as well as other positive revenues. The lower number results from the subtraction of transfers out of the General Fund. In effect these transfers out of the General Fund are spending, but in the budget each year they are shown as negative revenues.

In this Budget Monitor the MBPC treats all money received by the state as revenue. Likewise, all money paid out of those revenues is treated as spending. Therefore, the MBPC's total revenue and spending numbers are larger than those found in the budget.

The major transfers into the General Fund are lottery and tobacco settlement fund proceeds. House One also provides for \$125 million in one-time transfers into the General Fund.

Transfers out of the general fund, included in the chart under other spending, are primarily for various health care programs. The MBPC also includes in other spending revenues that are committed by law to the school building assistance fund, the Massachusetts Bay Transit Authority, and the state pension system. While these items are not appropriated in line items, they are a component of total state spending.

Spending for Group Insurance for state employees and retirees has historically been funded through appropriations. Beginning in FY 2008, Group Insurance costs for retirees will be funded through a transfer from the General Fund rather than through a line-item appropriation. Therefore, Group Insurance appears twice in the chart, once as an appropriation for employee benefits and once as a transfer for retiree benefits.

This chart shows a slightly larger positive balance than the official documents. Since the difference is about one tenth of one percent, it could be explained by a number of factors, including rounding.

<b>Budget Balance</b> (in Millions of Dollars)	
<b>Category</b>	<b>FY08 Gov.</b>
<b>Tax Revenue Total</b>	<b>20,169.0</b>
Tax revenue	19,879.0
Tax law changes <sup>1</sup>	290.0
<b>Departmental Revenues Total</b>	<b>2,399.8</b>
Departmental revenues	2,399.8
<b>Transfers into the General Fund Total</b>	<b>1,889.0</b>
Lottery revenues	1,011.0
Tobacco settlement revenues	219.0
Other transfers into the General Fund	659.0
<b>Federal Grants &amp; Reimbursements Total</b>	<b>6,245.2</b>
Federal grants and reimbursements	6,245.2
<b>One-time Revenues</b>	<b>125.0</b>
Transfer from the Stabilization Fund	75.0
Transfer from the Health Care Security Trust	50.0
<b>Ongoing Revenue Grand Total</b>	<b>30,828.0</b>
<i>Appropriated spending</i>	
Local Aid - Lottery	935.0
Local Aid - Additional Assistance & PILOT	410.1
Local Education Aid (Chapter 70)	3,705.5
K-12 Education (non-Chapter 70)	552.5
Higher Education	1,038.0
Early Education and Care	509.9
Income Support Programs	601.8
Health Care Programs	8,346.8
Public Health	547.0
Mental Health	664.0
Mental Retardation	1,215.8
Social Services	790.3
Elder Affairs	227.0
Other Health & Human Services	599.4
Environmental Affairs	218.5
Housing & Community Development	124.9
Economic Development	147.1
Public Safety & Corrections	1,466.5
Judiciary	745.0
District Attorneys	93.5
Attorney General	40.4
Libraries	31.4
Transportation	165.5
Group Insurance	803.0
Other Administrative	786.9
Debt Service	1,947.2
<i>Other spending</i>	
Health Care Programs	907.8
Group Insurance	380.5
Pensions	1,398.6
School Building Assistance	634.7
MBTA	756.0
<b>Ongoing Expenditures Total</b>	<b>30,790.6</b>
<b>Balance</b>	<b>37.4</b>
<small>1. Tax law changes are estimated to net \$290 million in new revenue with \$295 million in revenue generated by loophole closings and \$5 million in revenue lost in FY 2008 by extending the property tax circuit breaker to the non-elderly. The extension of the property tax circuit-breaker is projected to cost up to \$80 million in revenues in later fiscal years.</small>	

## Budget by Program Area

(in Millions of Dollars)

Program	FY07 Total Ongoing	Gov. FY 08	Gov. FY 08 vs. FY 07	
Local Aid - Lottery	920.0	935.0	15.0	1.6%
Local Aid - Additional Assistance & PILOT	407.6	410.1	2.5	0.6%
Local Education Aid (Chapter 70)	3,505.5	3,705.5	200.0	5.7%
K-12 Education (non-Chapter 70)	538.7	552.5	13.7	2.5%
Higher Education	1,031.5	1,038.0	6.4	0.6%
Early Education and Care	510.3	509.9	(0.4)	-0.1%
Income Support Programs	608.3	601.8	(6.4)	-1.1%
Health Care Programs <sup>1</sup>	8,005.5	8,346.8	341.3	<sup>2</sup>
Public Health	512.5	547.0	34.5	6.7%
Mental Health	646.5	664.0	17.5	2.7%
Mental Retardation	1,175.9	1,215.8	39.9	3.4%
Social Services	769.9	790.3	20.4	2.6%
Elder Affairs	223.1	227.0	4.0	1.8%
Other Health & Human Services <sup>3</sup>	607.2	599.4	(7.8)	-1.3%
Environmental Affairs	215.0	218.5	3.5	1.6%
Housing & Community Development	124.8	124.9	0.1	0.1%
Economic Development	168.7	147.1	(21.7)	-12.8%
Public Safety & Corrections	1,432.6	1,466.5	33.9	2.4%
Judiciary	762.3	745.0	(17.3)	-2.3%
District Attorneys	92.2	93.5	1.3	1.4%
Attorney General	38.6	40.4	1.8	4.7%
Libraries	31.7	31.4	(0.3)	-0.8%
Transportation	159.1	165.5	6.4	4.0%
Group Insurance	1,056.6	803.0	(253.6)	<sup>4</sup>
Other Administrative	784.9	786.9	2.0	0.3%
Debt Service	1,952.4	1,947.2	(5.2)	-0.3%
<i>Sub-total appropriated spending</i>	<i>26,281.5</i>	<i>26,713.0</i>	<i>431.5</i>	<i>1.6%</i>
Health Care Programs	925.2	907.8	(17.4)	<sup>2</sup>
Group Insurance	0.0	380.5	380.5	<sup>4</sup>
Pensions	1,335.2	1,398.6	63.4	4.8%
School Building Assistance	557.0	634.7	77.7	13.9%
MBTA	734.0	756.0	22.0	3.0%
<i>Sub-total other spending <sup>5</sup></i>	<i>3,551.4</i>	<i>4,077.6</i>	<i>526.2</i>	<i>14.8%</i>
<b>Total</b>	<b>29,832.9</b>	<b>30,790.6</b>	<b>957.7</b>	<b>3.2%</b>

1. In FY 2008, spending for nursing home rate adjustments that had been off-budget in prior fiscal years was brought on-budget as a line-item appropriation. In order to provide an accurate comparison between FY 2007 and FY 2008, the FY 2007 total for health care spending includes \$288.5 million for nursing home rate adjustments. In actuality that \$288.5 million was not line-item appropriated spending in FY 2007.

2. Total health care spending is a combination of appropriations in the budget and off-budget transfers into various health care trust funds. To accurately understand the overall change in health care spending from one year to the next, we combine appropriated and transfer spending in each year. In total, House One would increase health care spending from \$8.93 billion in FY 2007 to \$9.25 billion in FY 2008, an increase of 3.6%.

3. Other health and human services spending includes \$28 million in FY 2007 and \$12 million in FY 2008 to fund wage increases for the state's lowest-wage human services workers. Ultimately, these funds will be distributed across the state's human services agencies including the departments of Mental Health, Mental Retardation, Social Services, and Youth Services.

4. Unlike prior years, insurance costs for retired employees will be funded through an off-budget transfer beginning in FY 2008. To accurately examine changes in Group Insurance spending from FY 2007 to FY 2008 it is necessary to combine appropriated and transfer Group Insurance spending in FY 2008. Once combined, spending on Group Insurance in FY 2008 is \$1.183 billion, or a 12.0% increase over FY 2007. This 12% increase is still not entirely accurate because of a variety of accounting changes taking place with Group Insurance. Please refer to the Group Insurance section of this report for more information.

5. Some programs and activities of the Commonwealth are funded through transfers from the General Fund or legislatively-mandated allocations of revenue rather than as line-item appropriations. These are in fact spending and are treated as such in our spending totals.