

February 28, 2007

To the People of Massachusetts:

You elected Lieutenant Governor Tim Murray and me with a clear mandate to strengthen our economy, our communities and our state government – so that each better serves you, your families and the places where you work.

This first budget is a blueprint for reaching those goals. Taken together with initiatives that we have already proposed through our Municipal Partnership legislation, the Commonwealth Corps bill, and our Cabinet-level reorganization – as well as plans coming soon for education and transportation reform – we are building a true foundation for lasting change.

Our budget for Fiscal Year 2008 is balanced and responsible. We've reduced spending growth to match available revenues. We have invested appropriately in our people and our economy because we believe that without well-prepared people and strong companies, large and small, we cannot secure our long-term future. Our budget also takes important steps towards ending years of financial gimmicks and shell games.

Our budget responds to many of the concerns that the Lieutenant Governor and I have heard from communities across Massachusetts over the last two years. For example, our budget:

- Supports initiatives to expedite business permitting, to market Massachusetts as a great place to work and live, and to encourage small business growth;
- Funds direct property tax relief for more homeowners;
- Adds more police officers to community patrols on neighborhood streets;
- Expands learning time in schools and full-day kindergarten, and provides summer job opportunities for young people;
- Provides more school aid to cities and towns;
- Funds implementation of the state's affordable health care reforms; and
- Concentrates funding in a coordinated effort to eliminate homelessness in Massachusetts once and for all.

Developing this budget has been a challenge. As we began to work, we realized that instead of the \$1 billion surplus we had been told to expect, we faced a \$1.3 billion deficit. The deficit results mainly from a combination of low revenue growth, dramatic

increases in health care costs, and new recurring spending commitments carried over from last year.

We also discovered budget gimmicks that we felt had to be addressed. The most notable example is the practice of borrowing money through the capital budget to pay the salaries, benefits and pension contributions for a large number of state employees. Since those employees are funded using capital bond proceeds instead of the operating budget, it costs the Commonwealth 60 cents extra on every dollar to pay the payroll costs alone. Our budget starts to correct that, by moving 158 employees of the Executive Office of Transportation back on to the regular payroll. It's a start. More to come.

We believe that we should not close the deficit gap by cutting local aid. Shortchanging our cities and towns has put significant pressure on local property taxes, and that has to end. In fact, we have held local aid steady and increased state aid to schools by more than \$200 million. By doing this, by enacting the proposals in our Municipal Partnership bill, and by implementing the direct tax credit proposed in our budget, pressure to increase local property taxes will be relieved and property taxes for thousands of homeowners will actually start to decline.

Another challenge we face is a looming change in the accounting rules that requires all states to record the future expense of retiree health care as a current liability. We will redeploy a fund we have from the proceeds of the tobacco litigation back in the 1990s to offset our retiree health care liability. The bottom line is that we will be able to show over time a \$7 billion plan to address that future liability. This will not only lessen the burden on future generations but also show our seriousness in addressing long-term challenges, which Wall Street will appreciate.

Each cabinet secretary, working with his or her team, has identified efficiencies and outright cuts, and proposed to focus spending on the areas where we could get the most impact with the smartest spending. This work will continue even after the budget is filed, as we enlist the business community and others with strong management experience to help career and newly appointed staff to reinvent each agency from the bottom up, instead of just layering new initiatives on top of old. Each agency will re-examine its mission, and propose the very best and most cost-effective way to deliver those services, whether to individuals or to companies. We will reward good ideas, too: the person or team from an agency who comes up with lasting savings and efficiencies will receive a portion of the savings.

Our budget also proposes to close a series of tax "loopholes" for Massachusetts corporations. These are real loopholes discovered by extreme tax planners that exploit the tax code to extract benefits the legislature never intended to confer. One loophole permits multi-state corporations to funnel in-state earnings to out-of-state subsidiaries to avoid Massachusetts taxes. Another allows businesses to charge themselves rent and then lower their tax obligation by deducting those rental costs on their tax returns. Yet another loophole allows businesses to identify their corporate structure differently on their federal, Massachusetts and other state tax returns, selecting the definitions that

produce the lowest tax for each return. The combined effect of these loopholes is an uneven playing field for business and hundreds of millions of dollars of lost revenue that could be used to improve our business climate. Closing these loopholes will not hurt our competitiveness or place an onerous tax burden on business. Many of the states competing with Massachusetts for businesses have taken similar steps to close corporate tax loopholes.

Some businesses will object to these proposed “loophole” closings. But these proposals are not “anti-business.” None of the reforms target benefits that the legislature intended. On the contrary, these reforms are a first step toward achieving equity and fairness in a tax system known to be cumbersome and unfair.

We must work hard to dramatically improve the business climate here in Massachusetts, and I am committed to do so. Businesses are the economic driver of our state. Ultimately, our tax policy must encourage business growth and innovation and strengthen our global competitiveness. Growing our local economy must be job one. But it is also clear that *companies* need and want better schools, more teachers (especially in math and science), decent roads, bridges and mass transit, and affordable housing every bit as much as *individuals* do. This is a competitive issue. The only way we get there is through shared responsibility for public investment. Closing these loopholes, in our view, is a step closer to sharing that responsibility.

Of course, closing loopholes is hardly enough. We need a strategy for economic growth and for the next phase of education reform, pre-K through higher education. We also need significant simplification of both the corporate and individual tax code. The State Treasurer has delivered substantial savings and additional income by improving the state’s debt and cash management activities.

We intend to take these initiatives up methodically through the year, working closely with interested parties and individuals toward the best solutions for all of us. The point is that our budget is part of a broader plan to rebuild Massachusetts, and set her on a course for lasting improvement. This budget lays the foundation for the Commonwealth’s long-term fiscal and economic health. It is a chapter in the story, not the whole story.

Some needs are addressed outside this budget. For example, MassDevelopment, a quasi-independent agency, has agreed to fund \$5 million targeted to small business lending. The Massachusetts Housing Partnership has committed to support an additional \$10 million of affordable housing financing through the SoftSecond program and MassHousing will support \$40 million for the Affordable Housing Trust Fund. These are two highly successful programs that have put homeownership within the reach of low and moderate income families. In Fiscal Year 2008, the state will also commit to spend at least \$85 million from its capital budget for repairs to public housing. We will also use bond and tax credit resources to help address the significant backlog of repairs and upgrades necessary to make our stock of affordable housing available to meet the need.

Then again, some needs are not fully addressed in this budget. For example, the condition of our state parks, forests and beaches is in sore need of improvement. Although we have held funding to modest growth this year, we have begun the process of refocusing our parks agency on its core mission, delivering resources to the front lines of maintenance and operations, and laying the groundwork for future investment.

Similarly, while our public universities and colleges receive a modest funding increase in this budget, greater flexibility to allocate resources, and incentives to achieve savings through shared services and purchasing, more significant investment will come as part of the package of education reform legislation we will propose later this year.

In constructing this budget, we are thankful for the many suggestions we received from people all over the Commonwealth. Among them was a call for a clearer, more transparent budget and budget process. To that end, this budget eliminates dozens of earmarks, collapses hundreds of line items into fewer project categories to enable agencies the flexibility to manage, and significantly limits the use of outside sections for non-budgetary purposes.

We have also provided an easy-to-understand version of the Fiscal Year 2008 budget online at www.mass.gov/budget, which features more explanation about specific programs and services. It's interactive. You are welcome to give us your feedback there, too.

In addition, the Lieutenant Governor and I, along with members of the Cabinet, will visit communities across the Commonwealth and hold public meetings to talk with you about our Fiscal Year 2008 budget and the choices we have made to move Massachusetts forward. Come and participate. Tell us what you think and what your ideas are to rebuild our future. Stay engaged. It's your government.

Also, talk also with your elected leaders – state representatives, senators, mayors, city councilors and selectmen – so that they know what's on your mind. That's the kind of substantive civic dialogue that will lead to a meaningful budget and to a more open and responsive government on Beacon Hill.

Deval L. Patrick