

Budget Development

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Introduction

Included in this section are descriptions and summaries of the annual state budget development process in Massachusetts. To better illustrate the state's budget objectives, we include summaries of the state's organization, fund structure, budget development processes and, finally, the particular factors and challenges affecting next year's budget (FY 2014). Graphs and tables have been provided to help illustrate many of the trends and factors affecting the state budget. Also included within this document is a user guide and glossary to assist in navigating this budget document. We encourage budget readers to visit our online website at www.mass.gov/budget.

Serving as a blueprint for the activities and obligations of the year, the state budget reflects the Commonwealth's collective judgment about state government's role in our society, obligations to serve its people and strategic investments to secure its future prosperity. Each program or line-item represents a critical service, program or responsibility that the state will perform or provide to families and individuals throughout the course of the year.

The Patrick-Murray Administration's FY 2014 budget is a balanced, responsible budget. It reflects the continuing financial challenges confronting Massachusetts, along with most other states in union, which is continuing to recovery from the unprecedented impact of the 2008-09 economic recession. Despite continued improvement in revenue growth in FY 2014, the state's revenue is not keeping pace with the rate of growth for costs in core services such as health care, safety net programs, education, public safety and transportation without difficult cuts. The Administration's budget once again reflects difficult choices and fundamentally changes the way we do business across an array of government programs, services and operations. This budget relies on a responsible amount of one-time resources and a modest amount of new revenue, which will assist in preserving crucial state services while maintaining our nationally-recognized fiscal standing.

In addition, the FY 2014 budget invests strategically in a number of areas of state government: funding for public education to help close the achievement gap, controlling growth in health care costs in order to preserve our nation-leading access to affordable health insurance, job creation and addressing youth and urban violence. The Patrick-Murray Administration is committed to protecting these investments and making difficult choices today that will allow us to uphold our responsibilities to future generations and position us for growth in the future.

The following sections describe the particular challenges facing the state in developing the FY 2014 budget and highlights the measures proposed to bring fundamental change and innovation to the way the state does business.

Massachusetts Government Structure

The government of the Commonwealth is divided into three branches: the Executive branch, the bicameral Legislature consisting of the House of Representatives and the Senate and the Judiciary.

Executive Branch

Chief Elected Positions

Governor

The Governor is the chief executive officer of the Commonwealth.

Lieutenant Governor

The Lieutenant Governor is elected along with the Governor. The two work closely together to address important day to day administrative functions of the Commonwealth.

Executive Council

Also referred to as the "Governor's Council," this body consists of eight members who are elected to two-year terms in even-numbered years. The Executive Council is responsible for the confirmation of certain gubernatorial appointments, particularly judges, and must approve all warrants (other than for debt service) prepared by the Comptroller for payment by the State Treasurer.

Appointed Positions

Governor's Cabinet

The Governor's Cabinet is comprised of eight gubernatorial appointees who assist the Governor in administration and policy making. Each cabinet secretary serves as the chief executive of their respective executive office.

The eight Cabinet Secretariats are:

- Executive Office for Administration and Finance;
- Executive Office of Health and Human Services;
- Executive Office of Public Safety and Security;
- Executive Office of Housing and Economic Development;
- Executive Office of Labor and Workforce Development;
- Executive Office of Education; and
- Executive Office of Energy and Environmental Affairs.
- Massachusetts Department of Transportation

Secretary of Administration and Finance

The Secretary of Administration and Finance is the Governor's chief fiscal officer. The activities of the Executive Office for Administration and Finance fall within six broad categories:

- Administrative and fiscal supervision, primarily the implementation of the Commonwealth's annual budget and monitoring of all agency expenditures during the fiscal year in accordance with published long-term fiscal policies;
- State tax law enforcement and collection of tax revenues through the Department of Revenue for remittance to the State Treasurer;

- Human resource management, the administration of the state personnel system, civil service system and employee benefit programs and negotiation of collective bargaining agreements with certain members of the Commonwealth's public employee unions;
- Capital facilities management, coordination and oversight of the construction, management and leasing of all state facilities;
- State 5-year capital plan development and implementation, including state debt affordability policies; and
- General government administration, including operational services and information technology services.

Of note, the Secretary of Administration and Finance serves as Chairperson of the Commonwealth Health Insurance Connector Authority, co-chairs the Massachusetts Life Sciences Center and serves as a member of numerous other state boards and commissions.

Secretary of Education

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

Secretary of Energy and Environmental Affairs

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

Secretary of Health and Human Services

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

Secretary of Housing and Economic Development

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

Secretary of Labor and Workforce Development

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

Secretary of Public Safety and Security

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

Secretary of Transportation

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

State Comptroller

The State Comptroller is responsible for administering and ensuring lawful and reasoned accounting policies and practices. Among the Comptroller's responsibilities are the publication of official financial reports, the management of the state accounting system and the oversight of fiscal management functions within all state agencies and departments. The Comptroller is appointed by the Governor for a term coterminous with the Governor's and may be removed by the Governor only for just cause.

The annual financial reports of the Commonwealth, single audit reports and any rules and regulations published by the Comptroller must be reviewed by an advisory board. This board is chaired by the Secretary of Administration and Finance and includes the State Treasurer, the Attorney General, the State Auditor, the Chief Administrative Justice of the Trial Court and two persons with relevant experience appointed by the Governor for three-year terms. The Commonwealth's audited annual reports include financial statements on both the statutory basis of accounting (the Statutory Basis Financial Report, or SBFR) and the General Accepted Accounting Principles (GAAP) basis (the Comprehensive Annual Financial Report, or CAFR).

Elected Constitutional Officers

Treasurer and Receiver-General

More commonly referred to as the State Treasurer, this individual has four primary statutory responsibilities:

- Collection of all state revenues, with the exception of agency-held funds;
- Management of both short-term and long-term investments of Commonwealth funds (excluding state employee and teacher pension funds), including all cash receipts;
- Disbursement of Commonwealth monies and oversight of reconciliation of the state's accounts; and
- Issuance of almost all debt obligations of the Commonwealth, including notes, commercial paper and long-term bonds.

In addition to these responsibilities, the State Treasurer serves as Chairperson of the Massachusetts Lottery Commission, the State Board of Retirement, the Pension Reserves Investment Management Board, the Massachusetts Water Pollution Abatement Trust and the Massachusetts School Building Authority. The State Treasurer also serves as a member of numerous other state boards and commissions, including the Municipal Finance Oversight Board.

Secretary of the Commonwealth

The Secretary of the Commonwealth, commonly referred to as the Secretary of State, is responsible for collection and storage of public records and archives, securities regulation, state elections, administration of state lobbying laws and custody of the seal of the Commonwealth.

Attorney General

The Attorney General is the chief lawyer and law enforcement officer of the Commonwealth of Massachusetts. The Attorney General represents the Commonwealth in all legal proceedings in both the state and federal courts, including defending the Commonwealth in actions in which a state law or

executive action is challenged. The office also brings actions to enforce environmental and consumer protection statutes, among others, and represents the Commonwealth in public utility and automobile rate-setting procedures. The Attorney General works in conjunction with the general counsels of the various state agencies and executive departments to coordinate and monitor all pending litigation.

State Auditor

The State Auditor provides independent and objective evaluations of the Commonwealth's financial and operational activities. The State Auditor is charged with improving the efficiency of state government by auditing the administration and expenditure of public funds and reporting the findings to the public. The State Auditor reviews the activities and operations of approximately 750 state entities and verifies contract compliance of private vendors doing business with the Commonwealth.

District Attorneys

The eleven elected Massachusetts District Attorneys and their combined staff of 1,500 employees, including 700 prosecutors and 250 victim-witness advocates are responsible for prosecuting approximately 300,000 cases annually.

State Sheriffs

The fourteen elected Massachusetts State Sheriffs have various county-based responsibilities, including law enforcement, the care and custody of inmates and detainees, judicial services, transportation of prisoners, recidivism, officer training and inmate re-entry programming.

Legislative Branch

The Legislature (officially called the General Court) is the bicameral legislative body of the Commonwealth, consisting of a 40 member Senate and a 160-member House of Representatives. Members of the Senate and the House are elected to two-year terms in even-numbered years. Each General Court meets for a two-year period. January of 2011 marked the start of the 187th General Court, which runs through January of 2013. The joint rules of the House and Senate require all formal business to be concluded by the end of July in even-numbered years and by the third Wednesday in November in odd-numbered years. The two legislative branches work concurrently on pending laws brought before them.

Lawmaking begins in the House or Senate Clerk's office where petitions, accompanied by bills, resolves, etc., are filed and recorded in a docket book. The clerks number the bills and assign them to appropriate joint committees. There are over 20 of these committees, each responsible for studying the bills which pertain to a specific area (i.e., taxation, education, health care, insurance, etc.), and each committee is composed of senators and representatives.

The standing committees schedule public hearings for the individual bills, which afford residents, legislators and lobbyists the opportunity to express their views. Committee members meet at a later time in executive session to review the public testimony and discuss the merits of each bill before making their recommendations to the full membership of the House or Senate. The committee then issues its report, recommending that a bill "*ought to pass*", "*ought not to pass*" or "*as changed*" and the report is submitted to the Clerk's office.

All legislation proposing an increase in taxes or a new tax must originate within the House of Representatives. Once a tax bill is originated by the House and forwarded to the Senate for consideration, the Senate may amend it. All bills are presented to the Governor for approval or veto. The Legislature may override the Governor's veto of any bill by a two-thirds vote of each house. The Governor also has the power to return a bill to the chamber of the Legislature in which it was originated

with a recommendation that certain amendments be made; such a bill is then brought before the Legislature and is subject to amendment or re-enactment, at which point the Governor has no further right to return the bill a second time with a recommendation to amend, but may still veto the bill.

Judicial Branch

The judicial branch of state government is composed of the Supreme Judicial Court, the Appeals Court and the Trial Court. The Supreme Judicial Court has original jurisdiction over certain cases and hears appeals from both the Appeals Court, which is an intermediate appellate court, and in some cases, directly from the Trial Court. The Supreme Judicial Court is authorized to render advisory opinions on certain questions of law to the Governor, the Legislature and the Governor's Council. Judges of the Supreme Judicial Court, the Appeals Court and the Trial Court are appointed by the Governor, with the advice and consent of the Governor's Council, to serve until the mandatory retirement age of 70 years.

Independent Authorities and Agencies

The Legislature has established a number of independent authorities and quasi-public agencies within the Commonwealth, the budgets of which are not included in the Commonwealth's annual budget. These include the Commonwealth Connector Authority, Massachusetts Bay Transportation Authority (MBTA), Massachusetts School Building Authority (MSBA), individual Regional Transit Authorities and other entities. Budgetary information can be requested directly from these agencies.

Local Government

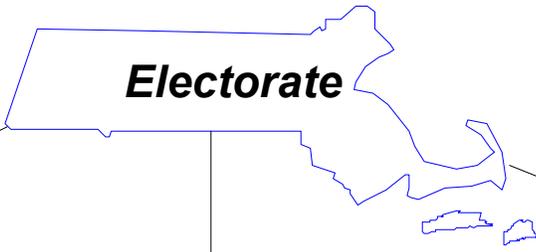
All territory in the Commonwealth lies within one of the 351 incorporated cities and towns that exercise the functions of local government, which include public safety, fire protection and public construction. Cities and towns or established regional school districts provide elementary and secondary education. In addition to schools, various local and regional districts administer water, wastewater and certain other governmental functions. Cities are governed by one of many nuanced variations of the mayor-and-council or manager-and-council form. Most towns place executive power in a board of three or five selectmen elected to one or three-year terms and retain legislative powers in the voters themselves, who assemble in periodic open or representative town meetings.

Municipal revenues consist of taxes on real and personal property, distributions from the Commonwealth under a variety of programs and formulas, local receipts (including motor vehicle excise taxes, local option taxes, fines, licenses and permits, charges for utility and other services and investment income) and appropriations from other available funds (including general and dedicated reserve funds). Because property tax levies are limited by Proposition 2½, an initiative petition approved by the voters in 1980, local governments have become increasingly reliant on distribution of revenues from the Commonwealth to support local programs and services (commonly known as "local aid"). The amount of local aid received varies significantly among municipalities.

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

Organizational Chart

The following organization chart identifies the present structure of state government and its constituent agencies.



Electorate



State Agencies

<p><u>Administration and Finance</u></p> <p>Executive Office for Administration and Finance Appellant Tax Board Bureau of the State House Civil Service Commission Department of Revenue Development Disabilities Council Division of Administrative Law Appeals Division of Capital Asset Management And Maintenance George Fingold Library Group Insurance Commission Health Policy Commission Human Resource Division Information Technology Division Massachusetts Office on Disability Teachers' Retirement System Operational Service Division Public Employee Retirement Administration Commission</p>	<p><u>Health and Human Services</u></p> <p>Executive Office of Health and Human Services Department of Children and Families Department of Developmental Services Department of Elder Affairs Department of Mental Health Department of Public Health Department of Transitional Assistance Department of Veterans' Services Department of Youth Services Massachusetts Commission for the Blind Massachusetts Commission for the Deaf And Hard of Hearing Massachusetts Rehabilitation Commission Office for Refugees and Immigrants Soldiers' Home, Holyoke Soldiers' Home, Massachusetts</p>	<p><u>Labor and Workforce Development</u></p> <p>Executive Office of Labor and Workforce Development Department of Career Services Department of Labor Standards Department of Workforce Development Division of Industrial Accidents Division of Labor Relations</p> <p><u>Public Safety</u></p> <p>Executive Office Public Safety and Security Department of Criminal Justice Information Services Department of Workforce Development Department of Corrections Department of Fire Services Department of Public Safety Massachusetts Emergency Management Agency Military Division of Massachusetts National Guard Municipal Police Training Committee Office of the Chief Medical Examiner Parole Board Sex Offender Registry</p>
<p><u>Education</u></p> <p>Executive Office of Education Department of Early Education Care Department of Elementary and Secondary Education Department of Higher Education State Universities Community College University of Massachusetts System</p>	<p><u>Housing and Economic Development</u></p> <p>Executive Office of Housing and Economic Development Department of Business Development Department of Housing & Community Development Department of Telecommunications and Cable Division of Banks Division of Insurance Division of Professional Licensure Division of Standards Massachusetts Marketing Partnership Office of Consumer Affairs & Business Regulations</p>	<p><u>Board of Library Commissioners</u></p>
<p><u>Energy and Environmental Affairs</u></p> <p>Executive Office of Energy and Environmental Affairs Department of Agricultural Source Department of Conservation and Recreation Department of Environmental Protection Department of Fish and Game Department of Public Utilities Division of Energy Resources State Reclamation Board</p>		<p><u>Commission Against Discrimination</u></p> <p><u>Center for Health Information and Analysis</u></p> <p><u>Health Care Security Trust</u></p> <p><u>Transportation and Public Works</u></p> <p>Department of Transportation</p>

Overview of the Operating Budget Process

The annual budget is a declaration of the Commonwealth's priorities, given available resources, and a statement on how to allocate the resources to best accomplish essential government services. Following the unprecedented fiscal challenges resulting from the 2008-09 downturn, revenues have not recovered to levels prior to FY 2008. In addition, the state continues to face historic levels of demand for public services is greater, particularly for those residents who rely most on state-operated safety net programs. The state's economy continues to recover, but the FY 2014 continues to be challenged to fund the level of services and programs provided during FY 2013.

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

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

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

The Constitution and Budget Related Laws

The *fiscal year* is a commonly used term to describe annual budgeting period. State fiscal years start in one calendar year and end in the next. For example, fiscal year 2014 extends from July 1, 2013 to June 30, 2014. In a typical year, state agencies have the authority to spend funding provided for a fiscal year over a 14-month period, after accounting for the two month "accounts payable" period through August during which final payments for costs incurred before June 30 are reconciled and made.

The budget planning process for any fiscal year begins before the end of the previous fiscal year. For example, planning for the FY 2014 budget began no later than July 2012. State agencies develop their budget plans for the following fiscal year with the consideration on "out-years" as well, projecting the costs of current state employees, programs and services over the next two years.

The Massachusetts State Constitution and General Laws outline and govern the budgeting process. The Massachusetts Constitution requires the Governor to present a budget to the Legislature within 3 weeks of the beginning of the new session in January. This year that occurs on January 23, 2013. State finance law (Chapter 29 of the Massachusetts General Laws) requires the Legislature and the Governor to approve a balanced budget for each fiscal year. In other words, the Commonwealth cannot spend more than it receives in revenue during any single year. Further, during the fiscal year, the Governor may approve no supplementary appropriation bills that would result in an unbalanced budget.

Funds for the Commonwealth's programs and services must be appropriated by the Legislature each fiscal year. The final budget is a law known as the General Appropriations Act (GAA). The GAA specifies how agencies and departments may spend their appropriations and allocates exact dollar amounts authorized for a specific period and purpose. The budget also lists major revenue assumptions and reflects the most up-to-date projections for the total amount of resources that can be budgeted against from tax collections, reimbursements to the state from the federal government, and other revenues (fees, penalties) that are collected by state agencies.

Developing Next Year's Operating Budget: FY 2014 General Appropriations Act

FY 2014 Planning

Department Planning & Secretariat Review
(July-September 2012)

Department and agency staff review their policies and programs, develop spending plans for FY 2013 and 2014 and submit budget requests to their respective Cabinet secretary for review.

The Cabinet Secretaries evaluate the requests and develop a secretariat-wide budget. Secretariats were assigned a spending cap by the Executive Office for Administration and Finance (A&F) based on projections at the time of available FY 2014 revenues.

Formal Budget Request
(October-December 2012)

Secretariats and agencies submit spending plans to A&F. Independents, constitutional officers and the judiciary also submit spending plans.

The consensus revenue number is announced. The executive and legislative branches jointly agree and commit to a single tax revenue projection for the next fiscal year. Both the Governor's budget and the Legislature's budget will be based off this number.

A&F, under the direction of the Governor's Office, prepares the Governor's budget recommendations. For this year's budget, each secretariat held hearings across the state to solicit input on programs and services under their jurisdiction from the general public. This input was considered by agencies and A&F in the development of their spending plans.

Governor's Budget
(January 23, 2013)

The formal budget begins as a bill that the Governor submits to the Legislature. According to the Constitution of the Commonwealth of Massachusetts, the Governor must propose a budget for the next fiscal year within 3 weeks after the Legislature convenes, which this year translates into the 4th Wednesday of January.

In odd years, the Governor's budget is called House 1 (H.1) and in even years it is called House 2 (H.2).

Accordingly, the FY 2014 budget will be filed on January 23, 2013. More detailed information regarding the specific budget development process for FY 2014 can be found later in the Budget Development section.

House Budget
(February-April 2013)

The House Ways and Means Committee reviews the Governor's budget and then develops its own budget recommendation. Individual members of the House of Representatives submit budget amendments which are then debated on the House floor. Once debated, amended and voted on by the full House, it becomes the final House budget bill and moves to the Senate.

Senate Budget (February-May 2013)	The Senate Ways and Means Committee reviews both the Governor's and House budgets and develops its own recommendation. Individual senators submit budget amendments which are then debated on the Senate floor. Once debated, amended and voted on, it becomes the final Senate's budget.
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Conference Committee Budget (June 2013)	House and Senate leadership assign members to a "conference committee" to negotiate the differences between the House and Senate bills. The conference committee report can only be approved or rejected, no additional amendments can be made.
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Veto (June 2013)	Once approved by both chambers of the Legislature, the Governor has ten days to review it. The Governor may approve or veto the entire budget, or may veto or reduce particular line items or sections, but may not add anything. If the Governor does not act within ten days, the conference committee bill becomes law.
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Overrides (June 2013)	The House and Senate may vote to override the Governor's vetoes. Overrides require a two-thirds roll-call vote in each chamber.
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Final Budget (June - July 2013)	Once the Governor signs the bill with his recommended vetoes, it becomes the budget for the fiscal year. The final budget is also known as the General Appropriations Act (GAA) or "Chapter (# to be determined) of the Acts of 2014."
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The new fiscal year 2014 begins on July 1, 2013.

Developing Supplemental Budgets

While the GAA is the primary budget law, it is customary for supplemental budgets to be passed within a fiscal year, typically where unanticipated funding needs have been identified for critical items or additional budget legislation is required to implement a funding requirement. A supplemental budget authorizes additional spending above GAA levels. A supplemental budget is similar to the GAA but is generally smaller in size and often contains technical or "corrective" language in addition to increasing funding. It addresses unforeseen growth and/or decline in state revenues and/or additional expenses and/or savings. The supplemental budget process is the same as the GAA budget process; supplemental budgets are bills filed by the Governor with the Clerk of the House of Representatives, debated and passed by both the House and Senate, negotiated in a Conference Committee and signed by the Governor in order to become law.

The timeline for supplemental budget legislation is usually shorter since supplemental budgets often provide funding for unforeseen situations that need timely resolution. For example, supplemental budget funding may be necessary from year to year to ensure that the Commonwealth can pay for unanticipated additional costs for snow and ice removal. In this case, at the time the GAA became law

specific assumptions for the winter's costs for snow and ice removal were in place. As the winter progresses and the state's Department of Transportation begin to manage snow and ice removal, total projected costs may change and additional funding may be necessary.



Spending Plan and Budget Proposal Development

Spending Plan and Budget Proposal Development

The Executive Office for Administration and Finance (A&F) is the state agency responsible for preparing the Governor's budget recommendations and for oversight of the annual budget enacted by the Legislature, known commonly as the General Appropriations Act or the GAA. Under state law, every state agency is required to annually prepare a budget for review and evaluation by the Secretary for A&F. The spending plan typically includes staff, expenditure and revenue estimates for the current fiscal year (FY 13) as well as the agency's anticipated staffing additions or deletions, expenses and receipts for the next fiscal year (FY 14) based on the assumption that they will maintain the same level of services and programs from one year to the next.

In July of each year, after the GAA is signed into law by the Governor, agencies present spending plans to A&F to identify in extensive detail how funds appropriated for the current fiscal year will be spent. These spending plans reflect each agency's plans to operate their programs and services for the current fiscal year. Agencies are also requested to reflect any changes that may be necessary to their operating budgets, whether savings or increased costs, that will result from projects and investments made through the five-year capital plan.

For FY 2013 most state agencies were funded with modest increases above FY 2012 levels. This required that many state agencies continue to find ways to account for increased costs within their budget, particularly for such items as collectively-bargained wage increases, mileage increase and inflation in fuel and leasing costs. Agencies submitted their FY 2013 plans to A&F for review in August 2012. Spending plans were approved in September 2012 after A&F budget analysts carefully reviewed all spending and revenue projections. These approved plans then served as the base for then developing the FY 2014 budget.

FY 2014 Budget Development

In developing budget recommendations for FY 2014, agencies incorporated projected costs for the programs and services they operate, such as anticipated changes in staffing, caseload growth or increases in fixed costs such as fuel and energy costs. Agencies also take into account changes in laws, regulations and policies that will impact programs and services for the next year. Based on revenue projections and other changes that A&F projected for available budgetary resources, agencies were asked to focus on developing spending plans for FY 2014 with an emphasis on controlling or preventing growth in spending over the projected FY 2013 spending levels.

Two new legislative changes of note for FY 2014 were the federal Affordable Care Act and Massachusetts' 2012 Health Care Reform Law (Chapter 224 of the Acts of 2012). Agencies were required to include within their FY 2014 budget projections how each of these laws would affect their spending and revenues in the upcoming budget year.

On December 4, 2012 Governor Patrick announced budgetary spending reductions and other fiscal measures necessary to address a \$540 M budget shortfall in FY 2013. (This is described in greater detail in a later section). This introduced another challenge to the FY 2014 budget development process since state agencies were required to adjust their approved spending plans for the current and corresponding budgets for FY 2014 based on these announced reductions.

After reviewing reported agency cost in FY 2014 and consulting A&F's long-term financial modeling of sustainable growth levels, A&F established spending parameters that would be necessary in FY 2014 to balance the state's budget. Agencies were required to submit proposals that would ensure that total

spending fell below FY 2014 reported costs. These plans were submitted to A&F and serve as the base for the Governor's FY 2014 budget recommendations.

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

On December 12, 2012 the annual Consensus Revenue hearing was held by the administration, the Senate and the House. The three branches received testimony from the Department of Revenue and other economists regarding the amount of tax revenue that could be expected for FY 2013 and 2014. The expert testimony forecast revenues continuing to grow and a recovering economy. At the same time, the economists also warned of slowing growth in the national economy, most notably as a result of the "fiscal cliff" resulting from triggered budget cuts and tax increases at the federal level. .

For the third straight year, A&F established an Inter-Secretariat Budget Team (ISBT) to identify and develop additional cost-saving proposals. The ISBT team members were selected from across the secretariats and were charged with developing innovative ideas that would help to mitigate budgetary reductions and improve how government works. This team worked with A&F throughout the FY 2014 budget process and will continue their work after the submission of the FY 2014 budget to ensure timely implementation of the approved solutions.

Fiscal Year 2014 Post-Budget Release Process

In preparation for the start of FY 2014 (July of 2013), A&F will continue to work with agencies to develop implementation plans well ahead of the beginning of the fiscal year. As part of the budget development process most agencies have successfully identified areas already where reductions to programs and services will be necessary or where they may capitalize on efficiencies. However, due to the complexity of some recommended programmatic changes, in some cases agencies have not yet been able to determine exactly how they will restructure programs to live within recommended funding levels. The implementation planning process led by A&F helps to best ensure that all necessary steps are completed by the beginning of FY 2014 to ensure that agencies will be able to operate at expected funding levels.

Specific and General Financial Policies

Overview of State Finance

The state's finance laws are outlined in **Chapter 29** of the Massachusetts General Laws. (In August of 2012 the Governor signed legislation that constituted a significant re-write of Chapter 29 –Chapter 165 of the Acts of 2012- although most items related to the budget development process were left unchanged.) They require that the Governor file a balanced budget, that the House and Senate each produce a balanced budget and that the final general appropriation act (GAA) is in balance accordingly. Any supplemental budget bill that may accompany or follow a budget cannot impair the overall fiscal balance. Typically, surplus resources at the end of any given fiscal year will be deposited into the Commonwealth's Stabilization Fund, also known as the Rainy Day Fund. Any further use of the Fund's resources must be explicitly authorized in legislation.

Prior to the Governor's submission of the budget, the Secretary of Administration and Finance and the House and Senate Committees on Ways and Means are required to reach agreement on a "consensus tax revenue forecast" from which to build their spending projections. The consensus revenue process for FY 2014 is discussed in more detail later in this section. In addition to tax revenues, non-tax revenues are forecast within the Governor's budget and factor into the total amount of resources that are available to the state to support its costs in FY 2014.

Budget Administration

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

If a revenue shortfall is identified, the Governor is required by section 9C of Chapter 29 to reduce agency appropriations or recommend a transfer from other funds. On December 4, 2012 the Governor, noting the requirements of section 9C, announced spending reductions and other necessary measures in order to ensure that FY 2013 budget remained in balance. This resulted after a \$540 M budgetary shortfall was recognized, largely due to underperformance in state tax collections.

In other years, if additional revenues are available, the Governor may recommend a supplemental budget. At the end of the fiscal year, the Comptroller determines the statutory balance of the budgeted funds and transfers any excess funds to the Stabilization Fund.

General Fiscal Policies of the Commonwealth

The following principles and policies were used to guide the development of the FY 2013 budget:

Financial Reporting

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

- State agencies utilize the accounting and payroll systems to ensure adequate audit controls are in place for the purpose of reporting on the receipt and expenditure of tax dollars and other revenues.
- The presentation of the annual Statutory Basis Financial Report, Comprehensive Annual Financial Report and official bond statements will continue to adhere to full disclosure.
- Websites will continue to be published to present the annual budget in an interactive format.
- Since November 2011, the public has been able to visit the state's transparency website, "Open Checkbook", which is regularly updated with state payroll and expenditure data

Revenue

- In preparation of the annual budget, a consensus revenue estimate for taxes must be agreed to by the executive and legislative branches and will serve as the basis for building the budget.
- All revenue received by departments will be deposited with the Treasurer and recorded in the accounting system, ensuring the timely and transparent receipt of all state funding sources.

Cash Flow

- The Cash Management Division of the State Treasurer's Office utilizes close to a thousand operating accounts to track cash collections and disbursements for the Commonwealth. The Division relies primarily upon electronic receipt and disbursement systems. The State Treasurer, in conjunction with Comptroller and the Executive Office for Administration and Finance, monitors cash to maximize the Commonwealth's return on investment and minimize the use of borrowing.
- The State Treasurer, in conjunction with the Executive Office for Administration and Finance, is required to submit quarterly cash flow projections for the current fiscal year to the House and Senate Committees on Ways and Means on or before the last day of August, November, February and May. The projections must include estimated sources and uses of cash, together with the assumptions from which such estimates were derived and identification of any cash flow gaps. The State Treasurer's office, in conjunction with the Executive Office for Administration and Finance, is also required to develop quarterly and annual cash management plans to address any gap identified by the cash flow projections and variance reports. Legislation approved by the Governor on July 27, 2012 provides for monthly rather than quarterly distributions of local aid, beginning in fiscal 2014.
- The State Treasurer's office oversees the issuance of short-term debt to meet cash flow needs, including the issuance of commercial paper.

Expenditures

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

- MMARS also tracks receivables, payables, fixed assets and other process management.
- The Comptroller will annually review policies governing transactions in MMARS.

Expenditure Controls

- The amount of all obligations under purchase orders, contracts and other commitments for the expenditures of moneys are required to be recorded as encumbrances. Once encumbered, these amounts are not available to support additional spending commitments.
- As a result of these encumbrances, agencies can use MMARS to determine at any given time the amount of their appropriations available for future commitments.
- The bulk of state appropriations must be “subsidiarized” in the central accounting system with total funding budgeted and allocated for spending categories such as payroll, travel, operational expenses, leases and information technology services.
- Executive branch agencies are restricted from transferring funds between spending categories without first gaining the approval of the Executive Office for Administration and Finance.
- Total cash allotments, or the amount of total appropriations available for actual expenditure at any given time, are subject to a published schedule by the Secretary of Administration and Finance. A&F staff will consult state cash flow projections and agency expenditure activity before approving any increased allotments beyond the published schedule.

Internal Controls

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

Reserves

- The Commonwealth will aggressively seek to replenish the Commonwealth Stabilization Fund when able to do so.
- Capital gains tax revenues that exceed \$1.023 B will be deposited into the Fund to better calibrate spending with reliable revenue streams and to build a cushion against future economic and fiscal uncertainty. In fiscal year 2014 total capital gains receipts are projected to total \$1.06 B, an estimated \$37 M will be deposited in the Fund under this policy.
- Any one-time tax or other revenues collected as a result of a judgment or settlement of outstanding tax litigation that exceeds \$10 M will be segregated and deposited into the Stabilization Fund, ensuring that this non-recurring revenue source is not relied on for general budget needs. Thus far in FY 2013 (through December 2012), the Attorney General and Commissioner of Revenue have certified \$120 M for transfer to the Stabilization Fund on account of settlements and judgments.

Debt Affordability

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

Capital Budget

- Bond-funded capital spending will be limited by an annual administrative bond cap. The cap will be established based on debt affordability, and annual growth in that cap will not exceed \$125 million between FY 2012 and FY 2015.
- A five-year capital investment plan will be developed and update annually, and will focus on affordability, targeted investments in projects that maintain our existing infrastructure and/or promote economic growth, and transparency.

Pensions

- The Commonwealth will continue to follow a pension funding schedule to address our unfunded liability and to pursue reforms that will reduce costs over the long term.
- In addition, 5% of any capital gains in excess of the statutory threshold (see above) will be used to fund the Commonwealth's unfunded pension liability.

Other Post-Employment Benefits

- To address the Commonwealth's retiree health care funding liability, reforms have been adopted that will annually allocate a portion of the state's tobacco master settlement revenue to the State Retiree Benefits Trust Fund (SRBTF), the trust from which we pay for retirees' health costs. This portion of the tobacco settlement will increase incrementally each year until 2022, when it will be fully dedicated to SRBTF. In addition, included in Pension Reform legislation adopted in FY 2012, a new Commission was established to study and propose recommendations to further address the state's unfunded liability.
- In addition, 5% of any capital gains in excess of the statutory threshold (see above) will be used to fund the Commonwealth's OPEB liability.

Strategic Fiscal and Budgetary Policies

In developing the FY 2014 budget, special attention was paid in the following areas:

- Cost-containment in the state's various health care programs, including the costs for current and retired state employees and health coverage for low-income and unemployed residents in the Commonwealth.
- Preservation of programs to ensure residents can lead safe and healthy lives and find long-term employment in a competitive global economy:
 - Addressing youth and urban violence through investments in our youth and communities
 - Closing the achievement gap and protecting education funding as a cornerstone of long-term economic growth and opportunity.
 - Increasing job creation through investments that enhance Massachusetts' ability to compete for the jobs and businesses of tomorrow, such as green technology and the life sciences, while ensuring a more competitive environment for the state's private employers in more traditional sectors.
 - Ensuring the state's most vulnerable populations, particularly the disabled and those who have served our country, can continue to receive assistance and life-changing services from the state where needed.

- Adopt government reforms that promote efficiency and sustainability of services and ensure state dollars are stretched further in challenging fiscal times.
 - Implementing technology improvements to support innovative service delivery to improve services for the public at lower costs to taxpayers.
 - Pursuing shared service models across state government more aggressively for the most-effective administration and operation of state agencies and programs.
 - Improving state purchasing and procurement processes to leverage state buying power and drive further cost savings.
- Identify additional recurring revenues to support worthwhile programs while recognizing the state cannot afford to maintain all programs and services that have been operated in the past.
- Reduce the use of temporary or one-time resources to balance the budget.
- Utilize long-term financial model to set annual and multi-year budget targets with respect to expected revenues, sustainable spending levels and appropriate annual use of non-recurring resources in developing a balanced budget.

Performance Management, Accountability and Transparency

- The FY 2012 budget established the Office of Commonwealth Performance, Accountability and Transparency (CPAT) to execute nation-leading strategies for improving performance and transparency, maximizing federal grants, reducing fraud, waste and abuse and informing our financial planning by using the latest economic and caseload forecasting tools.
- Since it was inaugurated in July 2011, CPAT has had some notable successes in driving reform and innovation across state government:
 - Performance Management - establishing a collaborative relationship with the Collins Center at UMASS Boston to develop strategies and dashboards for the Governor's four strategic priorities; initiating discussions with Secretariats to develop strategic plans and publish them by January 2013; and rolling out a comprehensive training program on performance management for staff across state government.
 - Enhanced Coordination and Federal Grants - leveraging experience in coordinating ARRA funds to secure and maximize federal dollars and ensure compliance with federal requirements; engaging Cabinet Secretaries to develop better cross-government coordination of grant applications and rewards; utilizing the outcome measurement regime required to comply with the federal Recovery Act for all grants secured in state government; and commencing procurement of unified grants management technology that will enable coordination to be achieved.
 - Transparency Website - launching the State's Open Checkbook website in December, which details state spending, including payrolls and pensions.
 - Program Integrity - making permanent the Lt. Governor's task force on fraud, waste and abuse, and coordinating efforts throughout government, including with other executive officers such as the Auditor and Attorney General.
 - Economic Forecasting & Analysis - appointing its Advisory Board and conducting its first meeting; developing its forecasting approach and methodology; began working with high impact service areas, such as MassHealth (Medicaid), to better model caseloads; and linking historical data into a 5-year economic model.

Overview of Budget Funds

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

Budgeted Funds are the primary operating funds of the Commonwealth. They account for all budgeted governmental transactions. Typically, the level of expenditures made annually from these fund sources is “subject to appropriation”, meaning that no payments can be made from these funds until they are explicitly authorized in the state budget. The main budgeted funds include the General Fund the Commonwealth Stabilization Fund, the Massachusetts Tourism Fund, and the Commonwealth Transportation Fund, which are identified by the Comptroller as the operating funds of the Commonwealth. .

Non-Budgeted Special Revenue Funds are established by law to account for specific revenue sources that have been segregated from the budgeted funds to support specific governmental activities such as federal grants, funds related to the tobacco settlement and the operations of the state lottery. Typically, these funds are available annually to one or more agencies for dedicated purposes, but do not require annual legislative approval for the use of the funding. Most funds are subject to annual reporting rules and all funds are subject to state accounting and audit practices.

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

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

Expendable Trust Funds account for trusts whose principal and investment income may be expended for a designated short-term purpose. They typically are created administratively for a brief period to allow a state agency to collect one-time revenue and spend this funding for a dedicated purpose. For example, the Department of Public Health receives funding from private organizations from time to time to conduct research and studies on specific issues and must collect and segregate funding dedicated for this purpose from all other funding sources.

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

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

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

Individual Budgeted Funds

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

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

most other governmental taxes. It also receives federal reimbursement generated by the Commonwealth's Medicaid expenditures.

The *Commonwealth Transportation Fund* accounts for road and highway use revenues, including the gas tax, registry fees and 0.385% of the sales tax. The fund is used to pay debt service associated with highway maintenance and construction projects and provides funding for the operation of the independent Massachusetts Department of Transportation (MassDOT). Established as part of the historic transportation reforms implemented in FY 2010, this fund replaced the former *Highway Fund* as the principal source of transportation related revenues and expenditures for the Commonwealth.

The *Massachusetts Tourism Fund*, authorized in section 35J of Chapter 10 of the General Laws, is funded with 35 % of the State's annual revenues received from the hotel occupancy tax authorized in section 3 of Chapter 64G. In FY 2013, Tourism Fund revenues are estimated to total \$44.9 M. The Fund's use is prescribed in Chapter 10, which includes a formula that assigns various funding levels for tourism promotion programs and activities including the Massachusetts Office of Travel and Tourism, regional tourism promotion agencies, the Massachusetts Office of International Trade and Investment, the Cultural Facilities Fund and the Massachusetts Convention Center Authority. While funding for the purposes prescribed in the section are being made in this budget, the specific requirements of the fund have been suspended through an outside section in the Governor's FY 2014 proposal.

The *Marine Recreational Fisheries Development Fund* accounts for all recreational saltwater fishing permit fees collected by the director of the division of marine fisheries. Fees collected in this fund shall be used for the development and administration of the recreational saltwater fishing permit program, to support science and conservation programs designed to improve recreational saltwater fishing and other recreational saltwater fishing improvement programs.

The *Commonwealth Stabilization Fund* is a reserve to enhance the Commonwealth's fiscal stability. A later section describes the Stabilization Fund in more detail.

Administrative Control Funds account for the revenues generated by certain administrative functions of government, for which the Legislature has required that separate funds be established. These funds include:

- *Temporary Holding Fund* –The fund accounts for cumulative tax revenues during the fiscal year in excess of permissible tax revenues as defined in Section 6A of Chapter 62F of the General Laws. The fund balance is transferred annually to the Stabilization Fund only to the extent that stabilization funds are used to fund expenditures of the Commonwealth. Overall, any remaining balance is transferred to the General Fund.
- *Intragovernmental Service Fund* – Accounts for the charges of any state agency for services provided by another state agency, for example, charges levied by the Human Resources Division for workers' compensation costs.

The *Inland Fisheries and Game Fund* accounts for revenues from license and permit fees for inland fishing, hunting, trapping and sporting licenses and revenue-producing stamps or the sales of land, rights and properties, gifts, interest and federal grant reimbursements. These revenues are used for developing, maintaining and operating the Division of Fisheries and Wildlife within the Department of Fish and Game. Annual spending from this fund is subject to annual appropriation by the Legislature, and any unexpended funds remain in the Fund for future use for related purposes.

The *Community College Fund*, established in Chapter 194 of the Acts of 2012 (An Act Establishing Expanded Gaming in the Commonwealth), will collect 17 percent of any one-time gaming licensing funding paid to the Massachusetts Gaming Commission by Category 1 or Category 2 licensees. In FY 2014, this amount is calculated to total \$29.8 M.

The *Manufacturing Fund*, established in Chapter 194 of the Acts of 2012 (An Act Establishing Expanded Gaming in the Commonwealth), will collect 13 percent of any one-time gaming licensing funding paid to the Massachusetts Gaming Commission by Category 1 or Category 2 licensees. In FY 2014, this amount is calculated to total \$22.75 M.

The *Local Aid Stabilization Fund*, established in Chapter 194 of the Acts of 2012 (An Act Establishing Expanded Gaming in the Commonwealth), will collect 5 percent of any one-time gaming licensing funding paid to the Massachusetts Gaming Commission by Category 1 or Category 2 licensees. In FY 2014, this amount is calculated to total \$8.75 M.

The *Local Capital Projects Fund*, established in Chapter 194 of the Acts of 2012 (An Act Establishing Expanded Gaming in the Commonwealth), will collect 11 percent of any one-time gaming licensing funding paid to the Massachusetts Gaming Commission by Category 1 or Category 2 licensees. In FY 2014, this amount is calculated to total \$19.25 M.

The *Public Infrastructure Fund*, established in the Governor's House 1 budget proposal, and effective on July 1, 2014 (the beginning of fiscal year 2015), will be credited with all the proceeds generated from the 4.5 percent state sales tax to fund public works to support transportation, the school building fund, and other infrastructure. The dedicated penny for the School Building Authority and MBTA will be preserved and given priority, with the second tranche of funds being dedicated to the Commonwealth Transportation Fund to fully support investments identified in MassDOT's recently releasing financing plan "*The Way Forward: A 21st Century Transportation Plan*", with any remaining amount dedicated for other new or ongoing non-transportation public infrastructure projects.

Long-Term Forecasting

The Patrick-Murray Administration is the first Administration in Massachusetts to establish a long-term planning policy to ensure that the state budget is consistent with the principle of fiscal sustainability. The FY 2014 budget achieves fiscal sustainability based on an evaluation of structural balance as defined by the Commonwealth's Long-Term Fiscal Policy Framework, which is posted on www.mass.gov/anf. Structural balance is achieved when budgetary spending is based on sustainable levels of revenue and does not include excess spending that would result in a structural deficit. When the economy is operating under capacity, the policy benchmark to evaluate structural balance compares the cyclical shortfall in tax revenue to the use of one-time resources included in the budget to offset this shortfall. When the economy is operating over capacity, the policy benchmark compares the cyclical surplus in tax revenue to the deposit of excess resources into the Stabilization Fund.

The Governor's proposed FY 2014 budget is in structural balance because the proposed use of \$393 M in one-time resources is significantly lower than the estimated \$1.313 B cyclical shortfall. The \$393 M in one-time resources is based on the \$555 M figure identified in the budget development write-up, net of \$162 M in projected stabilization fund deposits. The estimated cyclical deficit of \$1.313 B is based on the long-term revenue forecast that was developed in concert with the consensus tax revenue process as described below.

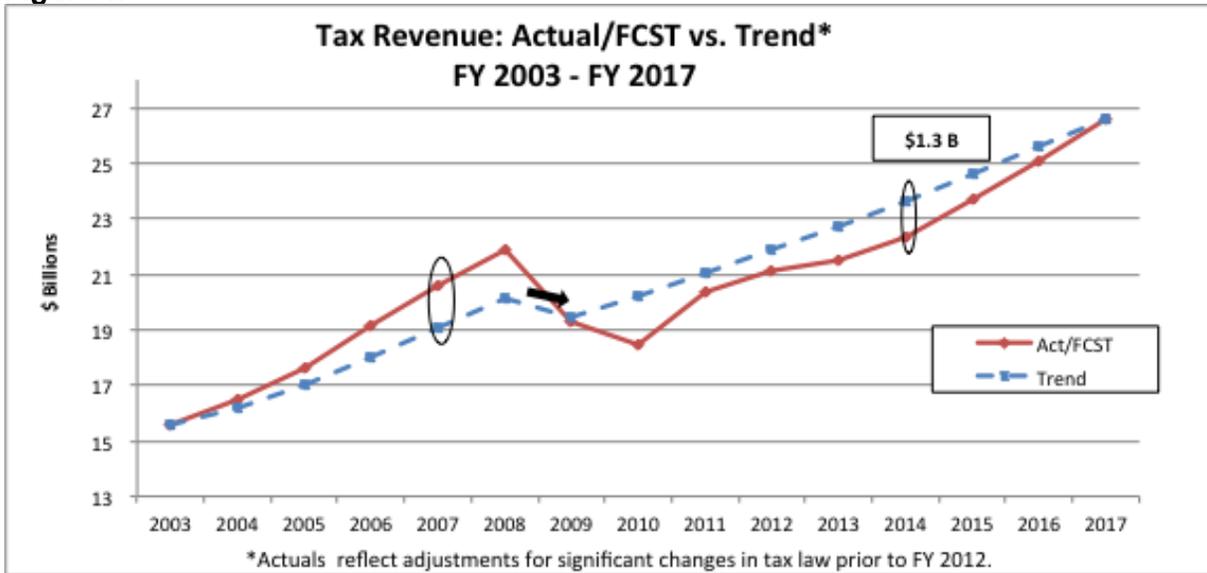
Note that these forecasts do not include the impact on revenue and spending of the Governor's revenue proposal. This revenue proposal would eventually increase the long-term tax revenue forecast by over \$1.9B annually to fund new investments in transportation, education, and innovation, with a portion of the new revenue generated in FY 2014 used to support current budgetary spending. In future years, the entire amount of new revenue would be applied towards new investments as the fully annualized impact of the revenue proposal is realized and the projected economic recovery provides additional resources to support existing programs. As a result, while the proposed changes to tax policy would have a significant impact on the different components of the structural balance analysis in the future, the evaluation based on the forecast developed earlier this year still provides a reasonable basis to evaluate the benchmark.

Measuring Structural Balance

The policy benchmark for structural balance is based on a framework for long-term tax revenue forecasting, developed by the Executive Office of Administration and Finance (A&F) and the state's Office of Tax Policy Analysis, using revenue projections provided by outside economists. The revenue forecast is also used to evaluate other policy benchmarks, described in the Long-Term Fiscal Policy Framework, based on best practices recommended by the Government Finance Officers Association (GFOA).

The FY 2014 budget achieves structural balance based on an estimated \$1.313 B cyclical shortfall and the use of \$393M in one-time resources, net of deposits into the stabilization fund. The cyclical shortfall represents the difference between the FY 2014 consensus tax revenue estimate of \$22.334 B and A&F's estimate of \$23.647 B in tax revenue that the Commonwealth would generate if the economy were at full capacity or "on trend." The difference between actual/forecasted tax revenue and trend tax revenue is depicted in Figure 1. The development of these estimates is described in more detail in the "Long-Term Revenue Forecast Methodology" section that follows.

Figure 1.



The use of \$393 M in one-time resources provides a significant margin of safety in comparison to the cyclical shortfall. Further, the Governor’s proposed budget will maintain \$1.035 B in stabilization fund balances at the end of FY 2014. The Commonwealth currently has the third highest stabilization fund balance in the country. The projected stabilization fund balance for year-end FY 2014 will ensure that there are sufficient resources to support the balance of the economic recovery and to provide protection in the event of another economic slowdown. For further discussion of the Stabilization Fund balance, see the Budget Challenges section.

Long-Term Revenue Forecast Methodology

The long-term tax revenue forecast used to estimate the cyclical shortfall is developed in three steps. The foundation for the analysis is the 10-year tax revenue forecast developed by outside economists for the FY 2013 - FY 2022 time period. Second, these forecasts include an estimate of the long-run “steady-state” tax revenue growth rate, which reflects the level of tax revenue growth that may be expected in the future when the economy is at full capacity. The third step is to develop an imputed revenue-trend line, which is based on the FY 2022 tax revenue estimate for each forecast, discounted for the steady-state rate of revenue growth.

A summary of the external forecasts, the Administration’s estimates for long-term tax revenue growth, key assumptions and calculations are included in Table 1 below. These results show strong revenue growth of 6.0% annually during a projected economic recovery between FY 2014 and FY 2017, a steady state growth estimate of 4.0% applied to the period between FY 2018 and FY 2022, and a resulting growth rate of 4.7% during the full forecast period. The cyclical shortfall reflects the difference between the FY 2014 consensus tax revenue estimate of \$22.334 B and \$23.647 B, which is the FY 2014 estimate associated with the revenue trend-line calculated using the formula described above and noted in Table 1.

Table 1.

Commonwealth of Massachusetts					
Long-Term Tax Revenue Forecast Summary*					
FY 2013 - FY 2022 (\$ Ms)					
Tax Revenue Assumptions	(1)				
FY13 Consensus Tax Revenue		\$21,496			
FY14 Consensus Tax Revenue		\$22,334			
		External Forecasts			
		Low	Median	High	A & F Estimate
Key Data Points					
FY17 Tax Revenue Forecast		\$25,232	\$27,305	\$27,851	\$26,600
FY22 Tax Revenue Forecast		\$29,448	\$33,128	\$33,745	\$32,363
Compounded Annual Growth Rates (CAGR)	(2)				
FY13-FY22		3.6%	4.9%	5.1%	4.7%
FY14-FY17 (Recovery)		4.2%	6.9%	7.6%	6.0%
Long-Run Steady-State		2.9%	4.0%	4.3%	4.0%
Calculation of Estimated Cyclical Shortfall					
A) FY14 Trend	(3)	\$23,341	\$24,158	\$24,076	\$23,647
B) FY14 Consensus Tax Revenue		\$22,334	\$22,334	\$22,334	\$22,334
C) FY14 Estimated Cyclical Shortfall (A-B)		-\$1,007	-\$1,824	-\$1,742	-\$1,313
MEMO: FY 2013 Cyclical Shortfall					-\$1,242

* Forecasts were received in December 2012 and were subsequently adjusted for consensus revenue estimates.

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

(2) Includes assumed inflation for FY15-FY22 of 2.0%

(3) $FY14\ Trend\ Tax\ Revenue = (FY22\ Tax\ Revenue\ Forecast)/(1+4.0\%)^8$

Role in the Long-Term Planning Framework

The long-term tax revenue forecast also plays a central role in developing other policy benchmarks that are included in the Commonwealth’s Long-Term Fiscal Policy Framework. The projections for long-term growth in tax revenue and the Massachusetts economy are used to formulate policy benchmarks for the sustainable rate of growth in total spending and health care spending in the budget. The projected rate of growth for Massachusetts gross state product, which is inherent in the tax revenue forecast, is used to evaluate projected changes in the level of long-term liabilities as a percentage of the state economy over time.

In addition, M.G.L. Chapter 224, the Health Care Cost Containment law, requires the Secretary of A & F and the House and Senate Ways & Means Committees to develop an estimate of long-term growth in Massachusetts potential gross state product, to be used by the Health Policy Commission to set the state’s health care cost growth benchmark. Potential gross state product, a measure of the output of the Commonwealth’s economy excluding fluctuations due to the business cycle, is also an estimate of the long-term trend in gross state product.

The alignment of these policy benchmarks and the best practices for long-term planning prescribed by GFOA and GASB are described in more detail in the complete Long-Term Fiscal Policy Framework, which will be updated based on the FY 2014 budget proposal and posted on www.mass.gov/anf.

Long-Term Planning and Annual Budget Development

Beginning in FY 2012, the A & F budget staff has consulted the Long-Term Fiscal Policy Framework cited above to establish parameters for agency and program cost growth based on projected annual revenues over medium- and long-term periods. These parameters were used to inform decision-making related to allowable hiring and related program expenditures, as well as served to help A & F develop funding targets for FY 2014 to ensure that state spending ultimately could be sustained by available resources.

FY 2013 Update

In July 2012, the Governor signed into law the FY 2013 General Appropriations Act (GAA) – Chapter 139 of the Acts of 2012. The FY 2013 budget authorized spending of \$32.509 B (or \$34.060 B when including the \$1.552 B annual pension contribution), a 4.9 percent increase from FY 2012 actual expenditures of \$30.976 B.

FY 2012 Year-End Supplemental Funding for FY 2013

Similar to most fiscal years, total FY 2013 spending was increased upon the adoption of “year-end” FY 2012 supplemental budget legislation, which authorized \$117 M in FY 2012 budgetary appropriations (known as Prior Appropriations Continued or “PACs”) to continue to be expended into FY 2013. The year-end FY 2012 supplemental bill (Chapter 239 of the Acts of 2012) also provided additional supplemental appropriations for FY 2013 in the amount of \$176.3 M. These changes brought total FY 2013 spending to \$32.802 B.

FY 2013 Original One-Time Resources

When the Governor signed the FY 2013 budget into law the, Executive Office for Administration and Finance (A&F) projected a total of \$616 M in non-recurring or “one-time” resources needed to maintain a balanced budget this year.

FY 2013 One-Time Resources \$s in millions	
	FY 2013 Original
Budgetary Resources:	
Stabilization Resources:	350
Delay FAS 109 Deduction:	46
Suspend Statutory Carry-Forward:	110
Unclaimed Check Fund (non-recurring):	10
Non-Budgetary Resources:	
Group Insurance Trust Funds:	45
Quasi Public Contributions:	11
Commonwealth Care Reserves:	44
TOTAL ONE TIME RESOURCES	616

The largest one-time resource was \$350 M of Stabilization Fund (also known as rainy day fund) resources. In addition, an estimated \$110 M was estimated in one-time resources by suspending the requirement that one-half of 1 percent of tax revenues be held in reserve and “carried-forward” from FY 2013 to FY 2014. Other one-time resources were \$46 M in delaying the FAS 109 tax deduction and \$110 M in utilizing non-budgetary resources, largely in health care related trust funds and from shifting costs to quasi-public authorities for programs in-line with their missions.

FY 2013 December Revenue Revision

Through November, total year-to-date state tax revenues had been performing at \$235 M below benchmark. The factors that were most cited by economic forecasters as contributing to the

underperformance in revenues were the continued uncertainty surrounding the so called “fiscal cliff” (potential federal tax increases and spending cuts) and the global economic slowdown, particularly within the European markets. On December 4, 2012 the Secretary of Administration and Finance informed the Governor that total FY 2013 tax revenues were projected to be \$515 M less than the original GAA assumption of \$22.011 B, or \$21.496 B. In addition, the Secretary noted that, of the taxes collected through November, \$25 M had already been used for dedicated purposes, making them unavailable to support general budgetary spending and therefore increasing the total budgetary shortfall to \$540 M.

FY 2013 Fiscal Action Plan

Fiscal Action Plan (\$s in millions)	
Change in Estimated FY 2013 Tax Receipts:	(515)
Year-To-Date Dedicated One-Time Tax Settlements:	(25)
Projected Budgetary Shortfall:	(540)
Solutions:	
Increase Rainy Day Fund Withdrawal:	200
Executive Branch Reductions (net)*:	157
Increased Medicaid and Federal Revenue:	98
Non-Executive Branch Reductions (1%):	25
Reduced Sales Tax Transfer to School Building Authority:	20
Local Aid Reduction (1%):	9
Health Care and Debt Service Savings:	20
Other Fund Surpluses:	11
sub-total:	540
Remaining Gap:	-
*Total Recurring Executive Branch reductions are \$225 M; after accounting for reduced federal revenue resulting from the spending reductions, the net budgetary savings is \$157 M.	

On December 4, 2012 the Governor announced a fiscal action plan to close the forecast \$540 M shortfall. The plan was implemented consistent with the Administration’s published long-term fiscal policy which requires that no more than 50 percent of any mid-year budget shortfall should be solved using one-time budget resources. The plan called for increasing the rainy day fund draws from \$350 M to \$550 M this year. Executive Branch reductions totaled \$157 M net (\$225 M gross), of which \$10 M was one-time in nature through spending delays or payment shifts. In addition, the Governor proposed 1 percent reductions across the Executive and Non-Executive branches and unrestricted general governmental aid to cities and towns, estimated to provide budgetary savings of \$34 M. The plan also called for using \$98 M in additional federal revenues, \$49 M of which could only be collected on a one-time basis. Other solutions included: \$20 M less in tax transfers to the School Building Authority, resulting from lower forecasted sales tax revenues; \$20 M of projected savings in debt service costs and health care savings based on updated spending projections; and, \$11 M in one-time resources from non-budgetary resources. The one-time solutions announced by the Governor totaled \$270 M. While the Governor’s plan required reduced spending (by an estimated 1 percent statewide) the Governor noted that these actions were not on scale with those required during the 2008-09 economic downturn when in FY 2009 alone budgeted tax revenues dropped over \$3 B, from \$21.402 B to \$18.260 B.

In order to implement the non-executive branch and local aid reductions and the increased rainy day fund withdrawal, the Governor filed legislation on December 4. The Governor also filed supplemental budget legislation calling for increased funding in a limited number of key areas to address time-sensitive deficiencies, such as family homeless funding and public counsel costs.

As a result of the proposed Fiscal Action Plan, A&F updated its projected one-time resources needed to balance the FY 2013 budget to a total of \$919 M. In addition to the \$270 M in increased one-time sources outlined above, A&F also estimates that \$36 M of FY 2012 PACs carried into FY 2013 are used to supporting ongoing costs and has updated the value of the suspension of the statutory carry-forward to reflect the revised FY 2013 tax revenue estimate.

Revised FY 2013 One-Time Resources	
\$s in millions	
	FY 2013 Revised
Budgetary Resources:	
FY12 Resources Used to Support Ongoing FY13 Costs:	36
Stabilization Resources:	550
Delay FAS 109 Deduction:	46
Suspend Statutory Carry-Forward:	107
Unclaimed Check Fund (non-recurring):	10
Federal Revenues (9C Announcement):	49
One-Time Reductions:	10
Non-Budgetary Resources:	
Trust Sweeps or Cost Shifts:	11
Group Insurance Trust Funds:	45
Quasi Public Contributions:	11
Commonwealth Care Reserves:	44
TOTAL ONE TIME RESOURCES	919

Revised FY 2013 Estimated Spending

The table outlines the changes to the FY 2013 spending since the Governor signed the budget into law, including PACs, supplemental funding, 9C reductions (implemented and proposed), and net A&F contingencies (combination of surpluses and deficiencies recognized in A&F's budget assumptions). All FY 2013 estimated spending amounts used in this document and the Governor's FY 2014 budget proposal reflect these assumptions.

FY 2013 Estimated Spending \$s in millions	
FY 2012 Spending	30,976
FY 2013 GAA	32,509
<i>FY 2012 Prior Appropriations Continued (PACs) into FY 2013</i>	117
<i>Supplemental Budget - Chapter 239 of 2012</i>	176
<i>December 4 Fiscal Action Plan Reductions</i>	(259)
<i>Net ANF Contingency Expenditures</i>	25
FY 2013 Estimated Spending	32,568
FY 2013 GAA - % Change from FY 2012 Spending	4.9%
FY 2013 Estimated Spending - % Change from FY 2012	5.1%

Fiscal Year 2014 Budget Development

Critical Factors for the FY 2014 Budget Development

When developing the annual operating budget, there are three factors that must be considered:

- Loss of any one-time resources utilized in the preceding year's budget;
- Growth in costs to operate state programs and services from the previous year; and,
- Annual change in available budgetary revenues, including tax collections and other non-tax sources.

Since the state budget must be balanced each year, the year-to-year impact of these factors – and how they affect available budgetary resources – will play a critical role in determining how challenging it will be for developing a balanced budget for any given year.

One-Time Resources

As noted in the preceding section, the state budget in FY 2013 relies on an estimated \$919 M in one-time resources, after accounting for the December 4 fiscal action plan, to remain in balance. This amount is above one-time resources used in FY 2012, but still within the sustainable level of one-time resources as documented by A&F's released long-term fiscal policy framework. The policy, however, stresses the importance to limit the reliance on one-time sources, particularly as the economy recovers. Given the limited availability and appropriateness of one-time sources, therefore, the FY 2014 budget was developed from the starting point that it was necessary to ensure that FY2014 one-time sources were less than the level budgeted in FY 2013. A more detailed section follows addressing the state's Stabilization Fund (also referred to as the rainy day fund).

Cost Growth and Major Budget Increases

Since state tax revenues experienced an historic drop in FY 2009 (falling over \$3 B in one year) the state has had to control state spending through reductions, reforms and other savings initiatives across almost every area of state government. This has been in the face of growth in program caseloads to historic highs among state-operated safety net programs, such as MassHealth (Medicaid), Supplemental Nutrition Assistance Program (formerly known as Food Stamps) and family homelessness. Enrollment and utilization growth in these and other related programs has required the state to shift resources away from other areas in order to preserve the state's safety net for those populations most impacted by the economic downturn.

In FY 2014, for most areas in state government only a modest level of cost growth can be sustained within existing budgetary resources. However, there are a limited number of areas where cost growth is likely and must be accounted for in preparing the FY 2014 budget proposal. This list of items includes state health care spending on subsidized care for low-income residents and on employee and retiree health care costs; human services/safety net spending; K-12 aid to cities and towns (Chapter 70); debt service; and annual state pension contributions. Over the past several fiscal years these cost drivers have constituted the majority of year-on-year increases that have had to be accounted for in developing the annual operating budget. Other areas in the state budget typically experience modest cost increases from year to year, mostly related to negotiated wage increases, leasing, the cost of fuel or related factors that are sensitive to annual cost inflation.

Annual Change in Budgetary Resources

The third critical factor in developing next year's budget is the amount of budgetary resources that will be available to support operating expenses next year. As discussed in further detail below, tax revenues make up the largest component of state budgetary resources, representing 63 percent of the total estimated FY 2013 budgetary revenues. Tax revenues also typically represent the greatest

contributor to new state revenues in any given year. Other important resources include non-tax revenues such as federal reimbursements and departmental revenues. Historically, these revenues have increased consistently with related programmatic expenditures. Similarly, other budgetary transfers from non-budgeted sources have been relatively flat from year-to-year.

FY 2014 Tax Revenues

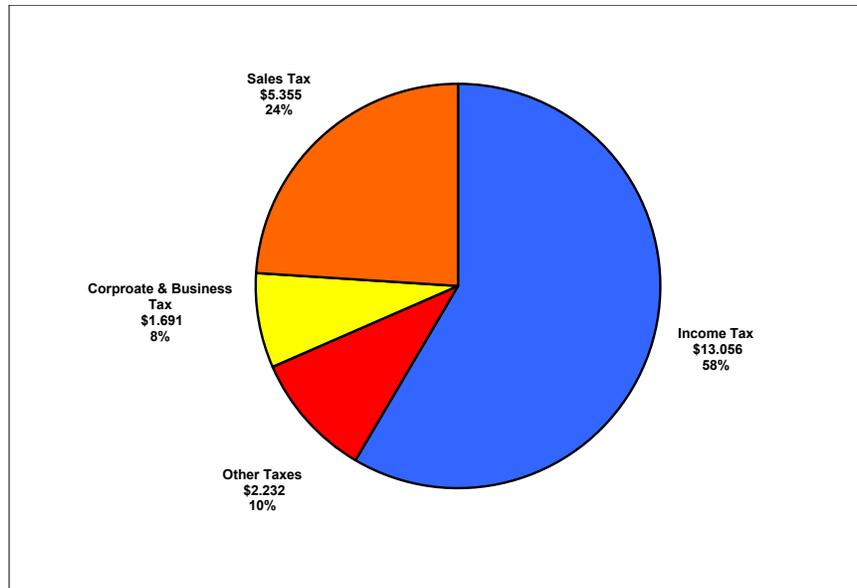
As discussed in greater detail below, tax revenues in FY 2014 are projected to increase over FY 2013 levels, as the state economy continues to recover from the recession. Tax revenues in FY 2014, however, will still be substantially below what they would have been in FY 2014 without the economic recession. The FY 2014 consensus tax projection totals \$22.334 B.

FY 2014 Tax Consensus Figures	
(\$s in millions)	
Original FY13 Tax Consensus Figure*:	22,011
Revised FY13 Tax Projection (Dec. 4, 2012):	21,496
FY13 Revised vs. Original:	(515)
FY14 Tax Consensus Figure:	22,334
FY14 Consensus vs. FY13 Revised Estimate	838
<i>*Includes \$46 M for one-time tax increase associated with the delay of FAS 109 corporate tax deduction.</i>	

FY 2014 Tax Revenue Consensus Forecast

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

FY 2014 Consensus Tax Revenue Estimate of \$22.334
(in \$ Billions)



General Information Regarding Consensus Revenue

The consensus revenue process is required under M.G.L. c.29, s.5B, and states that on or before January 15 the Secretary for Administration and Finance shall meet with the House and Senate Committees on Ways and Means and shall jointly develop a consensus tax revenue forecast for the budget for the next fiscal year, which shall be agreed to by the Secretary and the House and Senate. The law requires that the consensus revenue estimate be placed before the General Court in the form of a joint House and Senate Resolution for full consideration.

On December 11, 2012, the Secretary for Administration and Finance and the House and Senate Committees on Ways and Means held a public hearing in Boston and heard testimony from the Massachusetts Department of Revenue (DOR), the Massachusetts Taxpayers Foundation, Beacon Hill Institute and economists from the University of Massachusetts and Northeastern University. The three branches subsequently agreed upon a FY 2014 tax revenue estimate of \$22.334 B, consistent with testimony presented at the hearing. This estimate also assumes that the state will collect \$1.06 B in capital gains-related revenues in FY 2014, \$37 M of which will be deposited into the Stabilization Fund under the state law that caps the amount of this volatile revenue source that can annually be included in the operating budget.

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

For FY 2014, these transfers are estimated to total \$3.154 B and will be directed to the following funds in the following amounts:

- School Modernization and Reconstruction Trust Fund = \$ 703.6 M;
- MBTA State and Local Contribution Fund = \$ 799.6 M;
- Pension Reserves Investment Trust Fund = \$ 1.630 B; and
- Workforce Training Trust Fund = \$21.6 M.

Basis for the FY 2013 Consensus Revenue Forecast

On December 4, 2012, the Executive Office for Administration and Finance reduced the FY 2013 revenue estimate of \$22.011 B (The \$22.011 B estimate reflects the FY 2013 consensus tax estimate of \$21.950 B adjusted for the impact of FY 2013 revenue initiatives and the sales tax holiday) by \$515 M, to \$21.496 B. Based on updated economic forecasts and testimony taken at the consensus revenue estimate hearing held on December 11, 2012, the FY 2013 tax revenue estimate has been kept unchanged at \$21.496 B, and the FY 2014 revenue estimate has been set at \$22.334 B (<http://www.mass.gov/anf/press-releases/fy2013/consensus-on-fy-2014-revenue-forecast-announced.html>). The basis for these revenue estimates is described below.

All three economic forecasters used by the Commonwealth in developing its revenue forecasts (Economy.com, Global Insight, and the New England Economic Partnership) assume that the Massachusetts economic growth will remain slow in FY 2013 but improve in FY 2014, though the uncertainty is still very high mostly due to U.S. fiscal policy challenges and the Eurozone's recession and sovereign debt/banking crisis.

The FY 2013 and FY 2014 tax revenue estimates are based on the following economic assumptions, as presented at the December 11, 2012 consensus estimate hearing:

- The growth of the national economy is expected to remain slow in FY 2013 but improve in FY 2014. Uncertainties related to the global economic slowdown (particularly in the Eurozone economies) and U.S. fiscal policies continue to be sources of risk to economic growth. Real

GDP growth for the full FY 2013 is projected to be 1.9% compared to growth of 2.0% in FY 2012 and 2.2% in FY 2011. In FY 2014, real GDP growth is projected to range from 2.3% to 3.0%;

- Massachusetts employment levels are expected to growth by 0.8% to 1.2% over the remainder of FY 2013, and by 0.9% to 1.2% for FY 2013 as a whole. For FY 2014, Massachusetts employment is expected to increase by 1.0% to 1.3%;
- Massachusetts personal income (excluding capital gains) is expected to grow by 3.7% to 3.8% over the remainder of FY 2013 and 3.9% for FY 2013 as a whole. For FY 2014, Massachusetts personal income is projected to grow by 4.3% to 6.0%;
- Massachusetts wages and salaries are projected to increase by 4.1% to 4.7% for the remainder of FY 2013 and 4.2% to 4.7% for the year as a whole. For FY 2014, the growth in Massachusetts wages and salaries is projected to range from 4.2% to 6.8%;
- Massachusetts retail sales growth is expected to range from 3.6% to 4.4% over the remainder of FY 2013 and 4.0% to 5.2% for the FY as a whole. For FY 2014, Massachusetts retail sales are projected to grow by 2.6% to 4.2%;
- Corporate profits at the national level are expected to increase by 4.4% to 10.0% over the remainder of FY 2013, and by 6.8% to 12.1% for the FY as whole (there are no forecasts for state corporate profits). For FY 2014, growth in corporate profits is projected to range from 2.1% to 4.8%;
- The stock market, as measured by the average of the S&P 500 over the entire year, rose by 8.7% in calendar year 2012 (which largely determines FY 2013 capital gains taxes), and is expected to increase by 3.9%-6.9% in calendar year 2013 (which largely determines fiscal year 2014 capital gains taxes). Massachusetts capital gains realizations are projected to increase by 17.8% in calendar year 2012 and increase by 2.7% in calendar year 2013.

In the first half of FY 2013, tax revenue collections increased by \$204 M, or 2.1% actual and 2.7% baseline (the baseline measure adjusts for tax law and processing changes that affect revenue collections) compared to the same period in FY 2012. Based on the economic assumptions and other factors described above, tax collections for the remainder of FY 2013 are projected to increase by \$177.6 M, or 1.6% actual, and \$234.0 M, or 2.1% baseline, from the same period last year. FY 2014 tax revenues are projected to grow by \$838 M, representing a 3.9% actual increase and a 4.3% baseline increase from the updated FY 2013 forecast. The details of the forecast are set out in the two tables below.

FY13 Tax Revenues -- Year-to-Date Results and Forecast for Remainder of Fiscal Year

Tax Type	FY13 YTD Baseline Growth through 12/12	% Baseline Growth Remainder of FY13	% Baseline Growth Full Year FY13	FY13 Full Year Revenue Estimate	FY13 Estimate Change From FY12 (\$ Millions)	FY13 Revenue Estimate Change from GAA Estimate* (\$ Millions)
Total Income	4.1%	6.0%	5.6%	12,463	552	-257
Withholding	4.1%	2.1%	3.7%	10,036	269	-167
Sales	2.1%	3.2%	2.6%	5,176	117	-134
Corporate/Business**	-1.6%	-16.4%	-10.7%	2,037	-283	-87
Other	-0.1%	-0.1%	-0.1%	1,819	-5	-37
Total	2.7%	2.1%	2.6%	21,496	381	-515
Memo: Capital Gains Taxes	NA	NA	10.6%	1,100	106	0

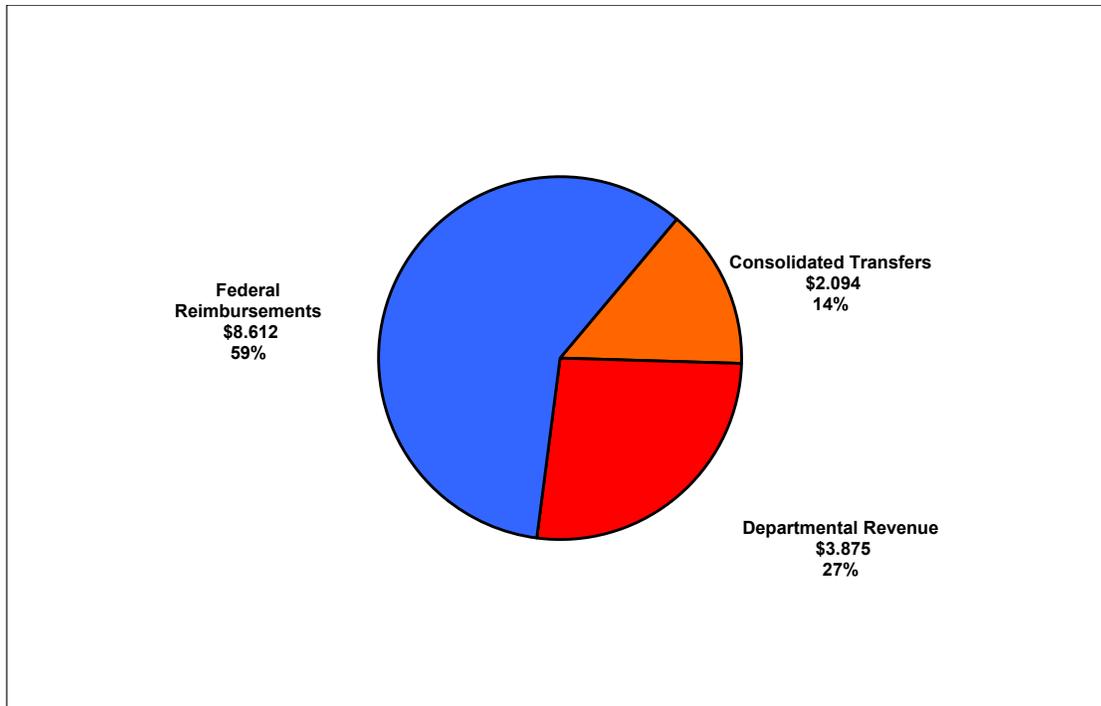
* Includes impacts of revenue initiatives and the Sales Tax Holiday in August 2012

** Includes impact of one-time corporate/business tax payments for FY12 and FY13

FY14 Consensus Tax Revenue Forecast

Tax Type	% Actual Revenue Growth from FY13	% Baseline Revenue Growth from FY13	FY14 Revenue Estimate (\$ Millions)	FY14 Growth from FY13 (\$ Millions)
Total Income	4.8%	5.0%	13,057	593
Withholding	4.7%	4.7%	10,504	468
Sales	3.5%	3.3%	5,355	179
Corporate/Business	2.5%	5.8%	2,087	50
Other	0.9%	1.0%	1,835	16
Total	3.9%	4.3%	22,334	838
Memo: Capital Gains Taxes	-3.6%	-3.6%	1,060	-40

**House 1 Total Non-Tax Revenues: \$14,581 B
(in \$ Billions)**



Federal Revenues

Federal revenues are collected through reimbursements for the federal share of entitlement programs such as Medicaid and through block grants for programs such as Temporary Assistance for Needy Families (TANF) and Child Support Enforcement. The amount of federal reimbursements to be received is determined by state expenditures and federal regulations that govern federal programs. Staff from the A&F work with agencies to project spending levels for these federally-supported programs and the resulting federal reimbursements those expenditures will generate. Federal revenues are projected to increase by \$453.4 M next year, largely reflecting increased Medicaid expenditures, for which the federal government typically reimburses the state \$0.50 for every dollar expended.

Departmental Revenues

Departmental revenues are derived from licenses, tuition, fees for programs and services, reimbursements and assessments for services including, but not limited to, revenues from the Registry of Motor Vehicles, reimbursement of healthcare costs from municipalities participating in the state's Group Insurance Commission (GIC) health care programs, drug rebate money received by the Executive Office of Health and Human Services, interest earnings received on the state's budgeted fund balances and fees collected by the Secretary of State's Office. To the extent possible, the Administration has minimized fee increases. However, MGL Chapter 7:3B provides for an annual review of fees to confirm that they are sufficient to defray the cost of providing the service. As part of this exercise, A&F analyzes historical non-tax revenue receipts and works with agencies to develop budget-year projections for these revenues. During the budget process, agencies are asked to review the fees to ensure they are current and reflect the actual cost of doing business. In FY 2014, total departmental revenues are projected to grow modestly by \$69.6 M before accounting for additional revenue proposals, largely due to increased economic activity and cyclical fee collections.

As mentioned above, the Governor's budget includes two sections that give a detailed overview of projected non-tax revenue for FY 2014. Section 1B details projected FY 2014 non-tax revenue receipts by the department, board, commission or institution that administers and collects the respective revenue source. The online version of the Governor's budget allows the user to further examine each governmental area and view the title and description of each revenue source contributing to that area's

total non-tax revenue. Additionally, the fund statements, which are included in the “Financial Statements” section of the budget document, offer another view of departmental revenues by operating fund.

Consolidated Transfers

Consolidated transfers reflect inflows to the General Fund from non-budgeted funds which include annual tobacco settlement proceeds received as part of the Master Settlement Agreement with tobacco companies, net revenues from the State Lottery Fund, fringe revenue to recoup the cost of various statewide benefits assessed on non-budgeted funds and revenues from the Commonwealth’s Unclaimed Property Division. The Executive Office for Administration and Finance solicits agency feedback and uses historical data to project transfers to and from the budgeted funds for the proposed budget year. Section 1C of this document provides further detail behind this revenue type. In FY 2014, consolidated transfers are projected to decline by \$91.9 M.

FY 2014 Budget Recommendation

FY 2014 Budget Recommendation

Annual Change in Budgetary Resources, FY 2013 vs. FY 2014 (\$s in millions)			
Revenue Category	FY 2013 Estimated	FY 2014 House 1	Annual Change
Projected Base-Line Tax Collections (excluding one-time FAS 109 Delay in FY13):	21,450.0	22,334.0	884.0
Transfer of Capital Gains in Excess of Maximum for Budgetary Purposes to Rainy Day Fund:	(100.0)	(37.0)	63.0
Transfer for Annual Pension Contribution:	(1,552.0)	(1,630.0)	(78.0)
Transfers of Tax Revenue to MBTA, SBA, and Workforce Training Fund:	(1,490.7)	(1,529.0)	(38.3)
Federal Reimbursements:	8,158.4	8,611.8	453.4
Departmental Revenues:	3,348.2	3,417.8	69.6
Consolidated Transfers from Non-Budgeted Sources:	1,749.5	1,657.7	(91.9)
Prior Year Funds Used to Support Current Year Non-Recurring Budgetary Spending:	173.4	28.0	(145.4)
One-Time Sources for Recurring Costs (including Stabilization Fund withdrawal, eliminating Carry-Forward and FAS 109 Delay):	820.1	513.0	(307.1)
Other New Revenues Supporting the Budget:			
Increased Tax Revenue (Includes Motor Fuel Taxes):	-	791.0	791.0
Revenue Anticipation Notes:		400.0	400.0
Gaming Budgetary Revenues:	-	83.0	83.0
Employer Responsibility Health Care Assessment:	-	94.0	94.0
Modernize Bottle Redemption:	-	24.0	24.0
Enhanced Tax Enforcement:	-	27.0	27.0
Amazon Agreement and Expansion of Hotel Tax to Rental Units:	-	29.0	29.0
CHANGE IN BUDGETARY RESOURCES (INCLUSIVE OF RESOURCES FOR THE PENSION CHANGE):			2,257.4
Additional Off-Budget One-Time Resources:	99.0	10.0	(89.0)
TOTAL CHANGE, FY 2013 vs FY2014			2,168.4

The tables provided above and immediately below outline the year-on-year changes in major revenue and spending categories. The following narrative summarizes the contributing factors to the annual changes adopted in the Governor's House 1 budget recommendations. As shown in the table, total budgetary resources in FY 2014 are estimated to increase by \$2.257 B from FY 2013 estimated levels. A corresponding increase in spending is recommended, and the FY 2014 Spending Summary section outlines the major changes adopted within these spending assumptions.

FY2014 Governor's Budget Recommendation

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)			
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change
Judiciary	777,777,825	808,468,103	30,690,277
District Attorneys	101,329,973	103,160,535	1,830,561
Sheriffs	512,994,922	522,315,138	9,320,216
Other Constitutional Offices	192,042,911	188,996,140	(3,046,771)
Lottery Division	89,113,321	90,892,716	1,779,395
Debt Service	2,368,477,959	2,429,552,869	61,074,910
Comptroller	60,942,945	58,543,692	(2,399,253)
Legislature	66,184,475	65,374,164	(810,311)
Administration and Finance	337,271,223	316,745,683	(20,525,540)
Group Insurance Commission	1,298,847,997	1,362,226,112	63,378,115
Energy and Environmental Affairs	203,037,066	224,010,561	20,973,495
Health and Human Services	4,917,578,099	5,120,637,514	203,059,415
MassHealth	10,859,431,334	12,277,879,935	1,418,448,601
Housing and Economic Development	470,602,829	458,695,973	(11,906,856)
Labor and Workforce Development	41,341,324	44,071,217	2,729,893
Higher Education Campuses	857,463,222	930,673,973	73,210,751
Executive Office of Education	1,169,147,840	1,463,022,636	293,874,796
K-12 Aid (Chapter 70)	4,173,783,011	4,397,257,332	223,474,321
Local Aid	916,760,490	956,760,490	40,000,000
Public Safety	969,837,771	1,007,278,097	37,440,326
Health Connector Authority	661,249,148	470,637,393	(190,611,755)
Transfers for Payments to Hospitals and Providers	751,914,223	485,449,470	(266,464,753)
Other Transfers to Non-Budgetary Funds	6,500,000	2,625,000	(3,875,000)
State Retiree Health Care	415,042,237	425,044,755	10,002,518
Life Sciences Innovation Investments	-	25,000,000	25,000,000
Transportation	348,912,182	589,673,153	240,760,971
Total Appropriated Spending	32,567,584,328	34,824,992,653	2,257,408,325
State Pension Contribution	1,552,000,000	1,630,000,000	78,000,000
Total Spending Including Pensions	34,119,584,328	36,454,992,653	2,335,408,325

FY 2014 Budgetary Resources

FY 2014 Tax Consensus Change

As noted in a previous section, the FY 2014 tax consensus figure announced on January 15, 2013 jointly by the Secretary of Administration and Finance and the Chairs of the House and Senate Committees for Ways and Means totaled \$22.334 B. After accounting for \$46 M of the FY 2013 tax projection of \$21.496 B coming from one-time resources generated by the delay of the FAS 109 deduction, the total baseline tax revenue growth before any tax law changes equals \$884 M.

FY 2014 Capital Gains

The estimated FY 2014 tax receipts associated with capital gains totals \$1.060 B, down from the FY 2013 assumption of \$1.1 B. A contributing factor to this decrease is the anticipated shift that may occur in capital gains receipts from FY 2014 to FY 2013 resulting from increased federal taxes on capital gains effective January 1, 2013. This change was adopted under the New Year's Day agreement reached by Congress to avoid most of the tax increase and spending reduction triggers under the so-called fiscal cliff. Given the volatile nature of capital gains receipts, the Governor and the Legislature worked to adopt a reform that restricts the amount of capital gains receipts that can be used for budgetary purposes in any given year. In FY 2013, that ceiling is \$1 B, but grows to \$1.023 B in FY 2014 (reflecting changes adopted in 2012 State Finance Reform legislation). Given that capital gains receipts as a component of the total tax estimate have decreased while the budgetary cap for capital gains increased in FY 2014, the effect increases total budgetary resources in FY 2014 by \$63 M.

FY 2014 Pension Contributions

Typically, state pension costs are not appropriated within other annual state appropriations or “line-items”. Rather they are prescribed in other budget legislation or within the state budget’s “outside sections” that accompany the appropriations. Under a pension funding scheduled adopted in Section 46 of the state’s FY 2012 General Appropriations Act (GAA) –Chapter 68 of the Acts of 2011- the annual state contribution in FY 2014 for existing and future pension costs totals \$1.630 B, an increase of \$78 M from the FY 2013 contribution. While these costs are not appropriated directly in the Governor’s House 1 filing, they must be budgeted for, and the year-on-year increase has the effect of reducing budgetary resources in FY 2014 by \$78 M from FY 2013.

FY 2014 Transfers of Tax Revenue

Under state law, specific amounts of the consensus revenue estimates are dedicated for annual transfers for dedicated purposes: the Massachusetts School Building Authority, the Massachusetts Bay Transportation Authority and the Workforce Training Fund. The first two receive an annual percentage of the state sales tax collections, while the third receives dedicated employer contributions to the Workforce Training Fund for grants to support incumbent worker training in the private sector. In total, the FY 2014 consensus forecast projects these transfers to equal \$1.529 B, an increase of \$38.3 M from the FY 2013 estimate of \$1.490 B. Similar to pensions, this annual increase has the effect of reducing budgetary resources when comparing year-on-year changes.

FY 2014 Non-Tax Revenues

As described in an earlier section, the three major categories of state non-tax revenues are: federal reimbursements, departmental revenues and transfers from non-budgetary sources. Total non-tax revenues are forecast to grow in FY 2014 by \$431 M, from \$13.256 B in FY 2013 to \$13.687 B in FY 2014. The major contributor to this increase is additional projected federal revenues (\$453 M) largely associated with state MassHealth (Medicaid) expenditures. In addition to growth in Medicaid reimbursements resulting from increased Medicaid spending, the state will be eligible to receive an enhanced federal Medicaid matching fund percentage associated with the federal Affordable Care Act (ACA) that becomes effective on January 1, 2014. Department revenues are forecast to increase modestly by \$69 M in FY 2014, or growth of 2 percent. Finally, increases in federal and departmental revenues are offset by a \$91.9 M reduction in budgetary transfers. The decrease is attributable to the projected reduction in state fringe revenue in FY 2014 and one-time transfers from non-budgetary sources in FY 2013 that are budgeted to support one-time costs this year.

Prior Year Funds and Reserves

The FY 2013 budgetary resources currently include an estimated \$173 M in reserves largely funded through prior-year appropriations extended into FY 2013 for one-time purposes. The Governor’s FY 2014 House 1 recommendation does not assume that unspent funds in FY 2013 will be made available in FY 2014, and therefore only projects a limited amount of reserves will be carried forward. The year-on-year impact is \$145 M less in budgetary resources than FY 2013; however, these reductions are typically offset by like reductions in spending.

FY 2014 One-Time Sources

As noted earlier, total estimated FY 2013 one-time resources equal \$919 M, which are listed above as \$820 M of one-time sources for recurring costs and \$99 M of additional off-budget one-time resources (largely from the use of surplus trust resources of the Health Connector and the Group Insurance Commission). These compare to total FY 2014 one-time resources of \$555 M.

FYs 2013 and 2014 One-Time Resources		
\$s in millions		
	FY 2013 Revised	FY2014 House 1*
Budgetary Resources:		
FY12 Resources Used to Support Ongoing FY13 Costs:	36	-
Stabilization Resources:	550	400
Delay FAS 109 Deduction:	46	-
Suspend Statutory Carry-Forward:	107	-
Unclaimed Check Fund (non-recurring):	10	-
Federal Revenues (9C Announcement):	49	-
One-Time Reductions:	10	-
Adjust DSTI Hospital Payments Fund:	-	41
One-Time Gaming Funds Supporting Ongoing Costs:	-	32
Sale of Assets:	-	32
Non-Budgetary Resources:		
Trust Sweeps or Cost Shifts:	11	40
Group Insurance Trust Funds:	45	-
Quasi Public Contributions:	11	-
Commonwealth Care Reserves:	44	-
One-Time Shift of Health Care Costs to Gaming Funds:	-	10
TOTAL ONE TIME RESOURCES	919	555
*For discussion of the use of new proposed FY 2014 tax revenues supporting, please refer to the Long-Term Fiscal Policy section of this document.		

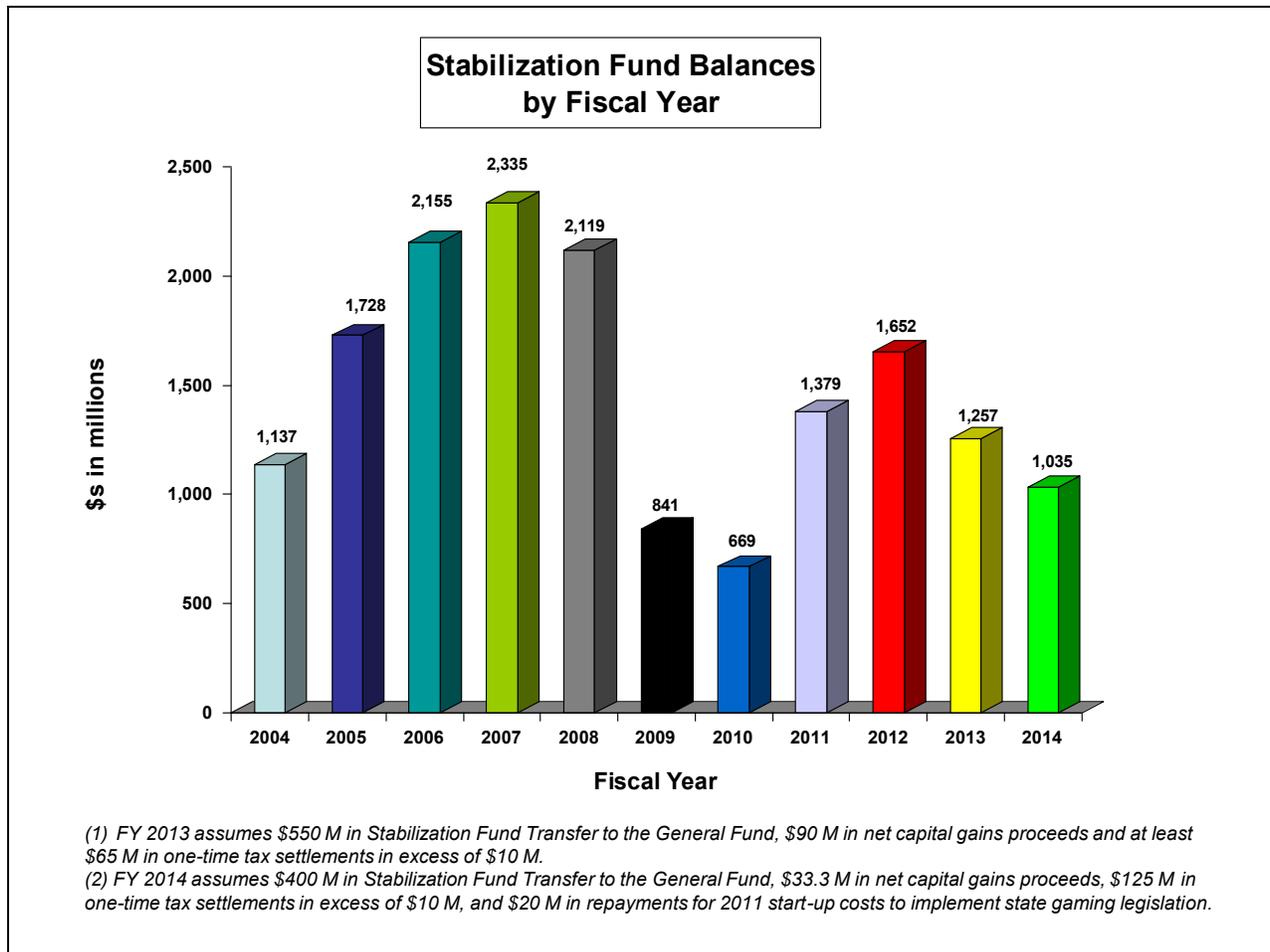
Assumed one-time resources in FY 2014 include:

- \$400 M in Stabilization Fund or “rainy day fund” resources (a discussion of the rainy day fund follows in a later section). The rainy day fund draw is \$150 M less than the current FY 2013 budgeted assumption of \$550 M, and is projected to leave a balance of \$1.035 B in the fund at the close of FY 2014.
- \$41 M (net) in reduced state budgetary resources resulting from the restructuring of state funding for payments to state hospitals for the delivery system transformation initiatives. This shift allows the state to achieve one-time savings by shifting one of two annual payments from FY 2014 to FY 2015 without impacting state hospitals, which operate on a different fiscal year schedule.
- \$32 M from supporting ongoing FY 2014 budgetary costs with one-time gaming licensing revenues in accordance with the gaming law (a further discussion of gaming licensing revenues is provided below). Total budgeted gaming licensing revenues equal \$83 M in FY 2014; however, the bulk of these expenditures are for one-time or short-term projects or purposes.
- \$32 M from the sale of certain state assets and properties. An outside section is included within concurrent budget legislation filed by the Governor authorizing the utilization of the proceeds of specific properties for the FY 2014 budget.
- \$40 M from the transfer of surplus non-budgetary fund resources to the General Fund. An outside section is included within the Governor’s FY 2014 House 1 budget that authorizes the Secretary of Administration and Finance to close or sweep trust funds where he determines that such funds can be appropriately used to support the budget.
- \$10 M (net) from shifting costs in FY 2014 to off-budget funds supported with one-time gaming licensing revenue. An outside section is provided in the Governor’s House 1 recommendation authorizing that up to \$20 M in provider incentive payments under the state’s Health Care Reform Act of 2012 shall be made from the Health Care Payment Reform Fund, which will receive a projected \$40 M from one-time gaming licensing revenue in FY 2014.

In total, the House 1 recommendation for FY 2014 relies on \$364 M less in one-time resources than those budgeted for FY 2013. This amount, \$550 M, is within the sustainable amounts projected within the Executive Office for Administration and Finance’s published long-term fiscal policy framework

published originally in early 2012 and updated this month coinciding with the release of the FY 2014 budget.

Stabilization Fund



The table provided above shows the year-end Stabilization Fund balances over the period FY 2004-14. The projected balances for Fiscal Years 2013 and 2014 are shown. Currently, FY 2013 is assumed to close the year with \$1.257 B in Stabilization Fund proceeds. This assumes a \$550 M budgeted draw to the General Fund, which is partially offset by a net \$90 M deposit of estimated capital gains revenues and at least \$65 M in deposits of one-time tax and other settlements in excess of \$10 M. Please note that the total amount of capital gains revenue restricted from being used for budgetary purposes equals \$100M: 90 percent of this amount is dedicated to the Stabilization Fund, while 5 percent each is allocated to reducing the state's pension and retiree health care liabilities.

In FY 2014, the projected Stabilization Fund balance totals \$1.035 B. This reflects the assumed \$400 M in proposed draws to the General Fund, partially offset by \$33 M in capital gains-receipts deposited into the Fund, an estimated \$125 M in one-time tax and other settlements in excess of \$10 M deposited into the Fund, and the \$20 M repayment from gaming licensing revenues associated with the 2011 Expanded Gaming Act provision that used \$20 M of Stabilization Fund proceeds to fund the start-up costs for gaming oversight activities. The FY 2014 assumption of \$125 M in one-time tax and other settlements in excess of \$10 M, which must be deposited into the Stabilization Fund under a FY 2012

reform, is based on historical collections over the past six years in which the state averaged over \$175 M annually in tax settlements in excess of \$10 M.

The projected year-end balance at the close of FY 2014 will leave Massachusetts one of a handful of states with balances in excess of \$1 B. It also reflects the continued effort of the Governor and Legislature to adopt fiscal policies that responsibly limit the use of volatile or unsustainable resources (such as capital gains receipts or large tax settlements) from general budgetary purposes. The Stabilization Fund has proven to be a critical tool over the past several fiscal years to help mitigate some of the impact of reduced tax collections resulting from the 2008-09 economic recession. It is important to continue policies that support a sufficient fund balance and ensure resources are available for the future as state continues to recover from an unprecedented fiscal collapse.

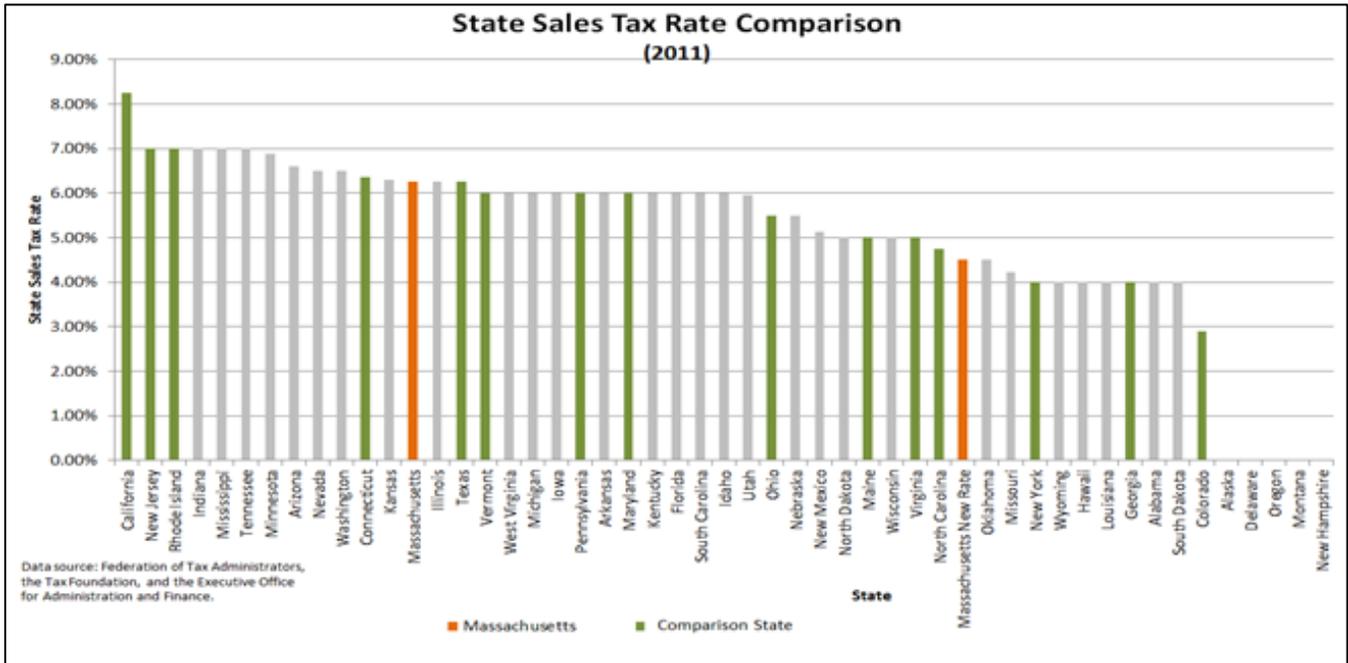
FY 2014 New Tax Revenues

The Patrick-Murray Administration proposes the following reforms to our tax system to raise \$1.9 B on an annual basis:

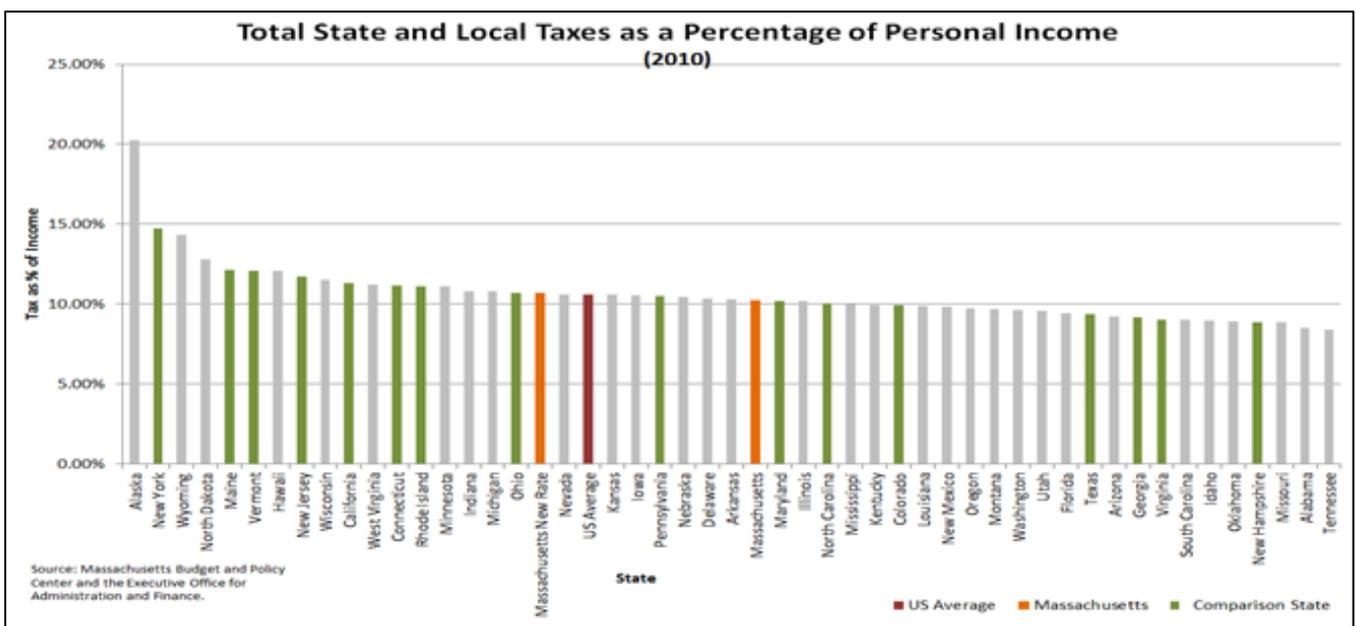
1. Reducing the sales tax from 6.25 percent to 4.5 percent and dedicating all proceeds to a fund for public works to support transportation, the school building fund, and other infrastructure.
2. Increasing the income tax rate by 1 percentage point to 6.25 percent.
3. Doubling the personal exemptions.
4. Eliminating some complicated tax deductions that benefit select taxpayers.

Economic Competitiveness

The chart below compares the Massachusetts sales tax rate, current and proposed, to that of other states. Our proposed rate reduction would bring Massachusetts from nearly the top to close to the bottom of state sales tax rates, a tax that is widely regarded to be the most regressive tax that states impose. In Massachusetts, there are no such locally-imposed sales taxes.



This proposal keeps Massachusetts competitive by ensuring that our total state and local effective tax rate as a percentage of personal income remains in the middle of the pack relative to our neighbor and competitor states, as shown below.



The Patrick-Murray Administration’s tax reform proposal will raise \$1.9 B on an annual basis. In FY 2014, it is expected to increase revenues by \$779 M as a result of the fact that the tax law changes would take effect in the middle of the fiscal year. In addition, the Governor’s proposal calls for indexing the state’s motor fuel tax to inflation, which will generate an additional \$13 M in new budgetary revenues in FY 2014. The total projected new tax revenue in FY 2014 for budgetary purposes equals \$791 M.

FY 2014 Revenue Anticipation Notes

In order to meet our existing and new investments in transportation, education, and innovation that ramp up over time, the Governor is proposing to allocate the new tax revenues among those purposes in the manner shown below. This funding plan assumes that \$400 M of the anticipated new tax revenue in FY 2015 and FY 2016 is borrowed to support investments in FY 2014, when the full-year revenue impact of the tax law changes will not be realized.

Uses of New Tax Revenue by Fiscal Year (\$Ms- Before Inflation)						
	FY14	FY15	FY16	FY17	FY18	FY23
New Revenue	779	1,900	1,900	1,900	1,900	1,900
Investments						
Transportation	231	600	700	755	755	755
Education	912	975	975	1,020	1,020	1,020
Innovation*	36	50	100	125	125	125
Total New Spending	1,179	1,625	1,775	1,900	1,900	1,900
*Includes \$25M for life sciences						
(Issue)/Repay Revenue Note	400	(275)	(125)			
Note: Transportation need before other solutions	650	746	909	856	1,021	1,291

FY 2014 Gaming Licensing Revenues

The Governor’s FY 2014 House 1 recommendation assumes an \$83 M in budgetary revenues associated with the licensing of 3 gaming facilities (2 “Category 1” Licensees and 1 “Category 2” Licensee). Of this amount, just short of \$32 M will be used to support on-going budgetary expenses and has therefore been listed among the \$555 M in projected FY 2014 one-time resources for next year.

Under the current published calendar of the Massachusetts Gaming Commission (MGC) two Category 1 licenses and one Category 2 license will be awarded by June 30, 2014, making them available to support state programs and services in FY14. The minimum Category 1 license fee is \$85 M, and a Category 2 license fee totals at least \$25 M, generating at least \$195 M in gaming licensing revenues in FY 2014. Under the existing laws (Chapter 194 of 2011) the first \$20 M of any gaming licensing must repay the Stabilization Fund for the “start-up costs” for the MGC. This leaves \$175 M in licensing revenues to be distributed via the prescribed allocation under Section 93 of Chapter 194. Of this amount, \$83 M is projected to be available for state budgetary purposes.

Projected FY 2014 Gaming Licensing Receipts and Distributions	
\$s in millions	
Estimated Gaming Licensing Receipts:	195.0
Less \$20 M for Repay Rainy Day Fund:	(20.0)
Budgetary Fund Distributions:	
Tourism Fund (1.5%)	2.7
Local Aid Stabilization Fund (5%)	8.8
Manufacturing Fund (13%)	22.8
Community College Fund (17%)	29.8
Local Capital Projects Fund (11%)	19.3
Non-Budgetary Fund Distributions:	
Health Care Payment Reform Fund (23%)	40.3
Transportation and Infrastructure Development Fund (14.5%)	25.4
Community Mitigation Fund (10%)	17.5
Race Horse Development Fund (5%)	8.8
Total Distributions After Stabilization Fund Repayment:	175.0

The table above outlines the projected FY 2014 licensing revenues and distributions, per Chapter 194. It is important to note that Health Care Payment Reform Fund originally was required to be a budgetary fund (or subject to annual appropriation). However, the Governor has filed subsequent legislation to amend this requirement to clarify that the spending from the fund is not subject to annual appropriation but will be instead under the authority of the Health Policy Commission established in the 2012 Health Care Reform Act (Chapter 224). This proposal is reflected within the Governor's House 1 recommendation.

FY 2014 Employer Responsibility Contribution

The transition of the Massachusetts health care system under ACA provided the Governor with the opportunity to reduce costs for businesses through the elimination of both the Fair Share Contribution and the Medical Security Program. The Fair Share Contribution was established under the Commonwealth's 2006 health care reform law and mandates that employers with 11 or more full-time equivalent employees (FTEs) make a "fair and reasonable" contribution toward the health care costs of their full-time workers, or pay a \$295 per FTE assessment. The ACA includes a similar policy for employers with over 50 employees, effective in 2014, that could result in double-penalties if the two policies were to coexist. The Commonwealth will discontinue the Fair Share Contribution policy, but employers continue to share in the responsibility for health reform in Massachusetts. In order to ensure employers are contributing their share of maintaining quality, affordable health care for all residents, the legislation creates an "employer responsibility contribution" for employers which will, starting in 2014, help finance the cost of subsidized care for low-income state residents. The funding, estimated to total \$94 M in FY 2014, will be directed to the MassHealth and the subsidized plans offered under the Health Connector.

Modernize Bottle Redemption in FY 2014

The Massachusetts Bottle Bill, enacted in 1982, is designed to encourage consumers to return their empty soda and beer containers by means of a redeemable \$0.05 deposit. The \$0.05 refundable deposit is placed on all carbonated sodas, beer and malt beverages. Most bottle deposits are redeemed through two types of sites, redemption centers and large retail stores. When the Bottle Bill

was enacted in 1982, the beverages covered by the law were limited to carbonated soft drinks, mineral water, beer and other malt beverages. Since that time, the beverage market has changed with bottled water, fruit drinks, iced tea and sports drinks now being some of the most popular choices available. However, these non-carbonated beverages are not covered by the Bottle Bill and often end up in landfills or along the side of the road.

By revising the definition of “beverages” in Massachusetts General Law, the Bottle Bill can be brought up to date. Consumers will be required to pay an additional \$0.05 cents on water, flavored waters, iced teas, coffee based drinks and sports drinks. The amounts paid for deposits for expanded beverages will be returned to consumers if they return the empty bottles for recycling. The Governor’s FY 2014 budget assumes that by adopting these changes, the state will collect at least \$24 M in additional revenues next year, allowing for \$4 M in investments in state recycling coordination and redemption efforts.

Enhanced Tax Enforcement

The Department of Revenue (DOR) will generate an estimated \$27 M in additional state tax revenue in FY 2014 through its investments in software and processes that will perform advanced analytics to identify tax collection and audit opportunities involving the sophisticated use of historical data, data mining, and statistical probability. In addition, the Department is launching a new statutory audit process to conduct more meaningful audits of businesses organized in pass-through structures.

FY 2014 Amazon Agreement and Expansion of Hotel Tax to Rental Properties

On December 11, 2012 the Commissioner of DOR announced an agreement with the online retailer, Amazon.com, for it to begin collecting Massachusetts sales tax on purchases by state residents by next November. The Executive Office for Administration and Finance estimates that total resulting increased tax collections, including under the projected sales tax changes outlined above, will equal \$26.2 M, roughly \$4 M of which will be transferred to the Massachusetts School Building Authority.

Currently, properties such as rental vacation homes, corporate executive temporary apartments, time shares, and rented vacation condominiums are not subject to the state or local hotel/motel room occupancy excise. Concurrent with the budget, the Governor filed legislation that would expand the state and local option tax base to include these so-called transient accommodations and eliminate the existing statutory exemption for small bed and breakfast establishments with three bedrooms or less. This expansion of the existing room occupancy excise base could generate more than \$3.8 M annually for the 176 municipalities (50 percent) that have opted to enact the local option room occupancy excise to date, and will benefit municipalities that choose to adopt the local option room occupancy excise in the future. State revenues would increase by an estimated \$2.6 M in FY 2014 as a result of this change.

FY 2014 Spending Summary

FY 2014 Spending Growth

The Governor’s FY 2014 budget is balanced and fiscally responsible. Total state FY 2014 spending is projected to be \$34.825 B (or \$36.455 B after including the annual pension contribution), a 6.93% increase from FY 2013 estimated spending.

State Budgetary Spending FYs 2003-2014 \$s in millions		
FY	Amount	% Growth
2003	21,936	n/a
2004	22,146	0.96%
2005	22,562	1.88%
2006	24,310	7.75%
2007	27,588	13.48%
2008	29,410	6.60%
2009	29,292	-0.40%
2010	29,047	-0.84%
2011	30,636	5.47%
2012	30,976	1.11%
2013	32,568	5.14%
2014	34,825	6.93%

In the fiscal years following the fiscal downturn of 2008-09 (which began in state FY 2009) total state spending growth has averaged 2.90 percent annual growth through FY 2014. This compares to 6.13 percent in average annual growth in the 5 years preceding FY 2009.

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
Judiciary	777,777,825	808,468,103	30,690,277	3.9%
District Attorneys	101,329,973	103,160,535	1,830,561	1.8%
Sheriffs	512,994,922	522,315,138	9,320,216	1.8%
Other Constitutional Offices	192,042,911	188,996,140	(3,046,771)	-1.6%
Lottery Division	89,113,321	90,892,716	1,779,395	2.0%
Debt Service	2,368,477,959	2,429,552,869	61,074,910	2.6%
Comptroller	60,942,945	58,543,692	(2,399,253)	-3.9%
Legislature	66,184,475	65,374,164	(810,311)	-1.2%
Administration and Finance	337,271,223	316,745,683	(20,525,540)	-6.1%
Group Insurance Commission	1,298,847,997	1,362,226,112	63,378,115	4.9%
Energy and Environmental Affairs	203,037,066	224,010,561	20,973,495	10.3%
Health and Human Services	4,917,578,099	5,120,637,514	203,059,415	4.1%
MassHealth	10,859,431,334	12,277,879,935	1,418,448,601	13.1%
Housing and Economic Development	470,602,829	458,695,973	(11,906,856)	-2.5%
Labor and Workforce Development	41,341,324	44,071,217	2,729,893	6.6%
Higher Education Campuses	857,463,222	930,673,973	73,210,751	8.5%
Executive Office of Education	1,169,147,840	1,463,022,636	293,874,796	25.1%
K-12 Aid (Chapter 70)	4,173,783,011	4,397,257,332	223,474,321	5.4%
Local Aid	916,760,490	956,760,490	40,000,000	4.4%
Public Safety	969,837,771	1,007,278,097	37,440,326	3.9%
Health Connector Authority	661,249,148	470,637,393	(190,611,755)	-28.8%
Transfers for Payments to Hospitals and Providers	751,914,223	485,449,470	(266,464,753)	-35.4%
Other Transfers to Non-Budgetary Funds	6,500,000	2,625,000	(3,875,000)	-59.6%
State Retiree Health Care	415,042,237	425,044,755	10,002,518	2.4%
Life Sciences Innovation Investments	-	25,000,000	25,000,000	n/a
Transportation	348,912,182	589,673,153	240,760,971	69.0%
Total Appropriated Spending	32,567,584,328	34,824,992,653	2,257,408,325	6.9%
State Pension Contribution	1,552,000,000	1,630,000,000	78,000,000	5.0%
Total Spending Including Pensions	34,119,584,328	36,454,992,653	2,335,408,325	6.8%

Listed in the table above is a summary of the major spending categories of the state budget with FY 2013 estimated spending and FY 2014 House 1 recommended funding levels, as well as dollar and percent changes year-on-year. Description of major highlights and policy changes is provided below.

Non-Executive Branch Agencies

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
Judiciary	777,777,825	808,468,103	30,690,277	3.9%
District Attorneys	101,329,973	103,160,535	1,830,561	1.8%
Sheriffs	512,994,922	522,315,138	9,320,216	1.8%
Other Constitutional Offices	192,042,911	188,996,140	(3,046,771)	-1.6%
Lottery Division	89,113,321	90,892,716	1,779,395	2.0%
Comptroller	60,942,945	58,543,692	(2,399,253)	-3.9%
Legislature	66,184,475	65,374,164	(810,311)	-1.2%
Total Appropriated Spending	1,800,386,373	1,837,750,489	37,364,116	2.1%

Agencies outside of the Executive branch include: the judicial agencies, such the Supreme Judicial Court, the Trial Courts, and the Committee for Public Counsel Services (CPCS); District Attorneys; State Sheriffs; Constitutional Officers; the Lottery Division; the State Comptroller and the Legislature, comprising of \$1.838 B of the FY 2014 budget recommendations. Some areas of note include –

- Judiciary** –The Governor’s FY 2014 budget recommends a 4 percent increase in funding for most judicial agencies. In addition, the Governor proposes to consolidate virtually all Trial Court appropriations helping the department to more flexibly shift operational resources. Since the economic downturn the Trial Court has seen a marked reduction in its total employee levels as it has needed to shed payroll in order to live at funding levels provided in the annual budget. The Governor filed concurrent legislation a proposal to form a commission, including members from within and outside of state government, to carefully review existing court operations for opportunities for efficiencies and realignment of resources. In addition, the FY 2014 budget funds the costs of CPCS as it completes its transition in FY 2013 to 25/75 percent public/private attorneys. Finally, the Governor’s budget restores aid to the Massachusetts Legal Assistance Corporation in FY 2014 to \$15.5 M.
- Sheriffs** – The Governor’s FY 2014 budget provides 2 percent increases for the main operating funding appropriations for state sheriffs’ offices. The Governor’s FY 2013 funding level assumes that supplemental funding will be provided for a number of sheriffs in FY 2013 to more closely align with sheriff facility costs needed for the full year. In addition, Governor Patrick has charged two of his new Secretaries, Andrea Cabral of the Executive Office of Public Safety and Security (EOPSS) and Glen Shor of the Executive Office for Administration and Finance (EOAF), to work with sheriffs to improve sheriffs’ outdated funding structure, identify savings from sentencing reform, determine ways to best use existing capacity to prevent overbuilding, and measure and improve re-entry outcomes for inmates. Secretary Cabral’s experience as the Suffolk County Sheriff for over ten years will be invaluable to this endeavor. The Secretaries will provide recommendations in July of 2013.
- District Attorneys** – Funding for District Attorneys’ main operational budgets funding is increased in FY 2014 by 2 percent from FY 2013 levels. This funding level sustains the 5% increase received by the DAs in FY 2013 as well as \$500 K that was provided in FY 2013 for retention of assistant district attorneys across the state.

- **Other Constitutional Officers** – With very limited exceptions, the funding for the main operational budgets of the Constitutional offices (Attorney General, Treasurer, Auditor, Secretary of the Commonwealth) has been funded at 2 percent above FY 2013 estimated spending levels. Decreased funding needs are projected for the Secretary of State projected to oversee elections, in comparison to FY 2013 which was a high-spend year given it included the recent presidential election. It is important to note that FY 2013 funding assumptions for the Secretary of State assume that funding for special elections (including US Senate) may be required in FY 2013 and into FY 2014. In addition, the Governor’s budget continues modest investments at the State Attorney General’s Office and the State Auditor’s Office for expanded activities to prevent, detect or prosecute cases of fraud, waste and abuse of state funds and to fund the Auditor’s responsibilities in implementing the 2012 Health Care Reform Act (Chapter 224).
- **Lottery** – The state’s Lottery Commission oversees the state’s various lottery and gaming operations. The Commission generates well over \$900 M in annual state budgetary revenue, of which a large portion is used to support unrestricted local aid distributions to the state’s cities and towns. Funding in fiscal year 2014 for Lottery operations is increased by 2 percent above estimated FY 2013 spending levels.
- **Governor** – Funding for the Governor’s office is increased by 2 percent from FY 2013 estimated spending levels.
- **Legislature** – The funding for the annual operations of the House, Senate and Joint Legislative activities in FY 2014 is increased by 2 percent from to estimated spending levels in FY 2013.

Debt Service

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
Debt Service	2,368,477,959	2,429,552,869	61,074,910	2.6%
Total Appropriated Spending	2,368,477,959	2,429,552,869	61,074,910	2.6%

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

State debt service spending in FY 2014 totals \$2.429 B, an increase of 2.6% from FY 2013 levels of \$2.368 B. Most debt service costs are funded from within the budget of the State Treasurer, who is responsible for the day-to-day oversight of all Commonwealth debt service and debt financing activities. In a limited number of cases, annual debt service payments are from appropriations within A&F. In collaborating with the Administration, the State Treasurer has been able to leverage the Commonwealth’s upgraded financial ratings, attractive borrowing environment and the state’s proactive fiscal management to help reduce annual state debt service costs below originally-budgeted amounts. This occurred again most recently in FY 2013 when \$55 M in debt service savings were identified to help support other budgetary shortfalls.

Executive Branch Agencies

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
Administration and Finance	337,271,223	316,745,683	(20,525,540)	-6.1%
Group Insurance Commission	1,298,847,997	1,362,226,112	63,378,115	4.9%
Energy and Environmental Affairs	203,037,066	224,010,561	20,973,495	10.3%
Health and Human Services	4,917,578,099	5,120,637,514	203,059,415	4.1%
MassHealth	10,859,431,334	12,277,879,935	1,418,448,601	13.1%
Housing and Economic Development	470,602,829	458,695,973	(11,906,856)	-2.5%
Labor and Workforce Development	41,341,324	44,071,217	2,729,893	6.6%
Higher Education Campuses	857,463,222	930,673,973	73,210,751	8.5%
Executive Office of Education	1,169,147,840	1,463,022,636	293,874,796	25.1%
K-12 Aid (Chapter 70)	4,173,783,011	4,397,257,332	223,474,321	5.4%
Local Aid	916,760,490	956,760,490	40,000,000	4.4%
Public Safety	969,837,771	1,007,278,097	37,440,326	3.9%
Health Connector Authority	661,249,148	470,637,393	(190,611,755)	-28.8%
Transfers for Payments to Hospitals and Providers	751,914,223	485,449,470	(266,464,753)	-35.4%
Other Transfers to Non-Budgetary Funds	6,500,000	2,625,000	(3,875,000)	-59.6%
State Retiree Health Care	415,042,237	425,044,755	10,002,518	2.4%
Life Sciences Innovation Investments	-	25,000,000	25,000,000	n/a
Transportation	348,912,182	589,673,153	240,760,971	69.0%
Total Appropriated Spending	28,398,719,996	30,557,689,295	2,158,969,299	7.6%

Direct funding for Executive Branch Agencies for programs and services or funding that falls within each of these government areas totals \$30.557 B in FY 2014, which represents an increase of 7.6% from FY 2013 spending. Highlights of major funding changes in the Executive Branch include:

- **Executive Office of Education (EOE)** – The budget recommendation for the Secretariat for Education (excluding Chapter 70 and aid to Higher Education campuses discussed below) increases by 25.1%, or \$293.9 M above FY 2013 estimated spending.

Providing access to high-quality early education programs is a vital component of addressing the achievement gap. This budget reflects a commitment to early education and care by making significant investments in access to and quality of child care programs for children served by the Department of Children and Families (DCF), the Department of Transitional Assistance (DTA), and for other qualified low income families. The significant new investments will provide:

- \$56.75 M to significantly increase access to high-quality early education programs and provide universal access by eliminating the wait list for qualified children from birth to age five by FY 2017;
- \$60.5 M to enhance the quality of early education programs and the effectiveness of the early educator workforce, including higher education grants for providers of the Department of Early Education and Care (EEC) programs;
- \$6.2 M to strengthen parent, family, and community engagement programs;
- \$5 M to expand comprehensive social and health services; and
- \$2.5 M to increase EEC capacity and develop partnerships to effectively implement initiatives and sustain them over time.

The Patrick-Murray Administration will dedicate \$11 M to support the expansion of locally-designed and implemented initiatives in the Gateway Cities, including:

- \$575 K for Early Literacy and Kindergarten Readiness Programs to establish pilot programs for Kindergarten Literacy Readiness;
- \$3.6 to create Student Support Councils and deploy Student Support Counselors to predominantly low-income schools;

- \$5 M for Enrichment and Acceleration Academies for English Language Learners to operate Summer English Learning Camps;
- \$1 M to create the Education and Industry Councils and Planning for High School Career Academies, to offer high school students, especially those most in need of academic and career support, the opportunity for early career exploration and experiential, job-embedded learning opportunities;
- \$1 M to create a Statewide Education Innovation Fund that will combine annual appropriations from the Commonwealth and supplemental funds from business, nonprofits, and philanthropists to promote innovation in policy, practice, research, professional development, and capacity-building efforts.

Finally, the Governor's proposal includes \$115 M in FY 2014 to make college more affordable and accessible, particularly for lower- and middle-income students by:

- Significantly increasing funding by \$112 M to the MASSGrant program, which provides financial assistance for students demonstrating the greatest need.
- Expanding the Completion Incentive Grant Fund (\$3 M) which allows students enrolled at certain campuses to receive a maximum of \$8,000 over four years for credits earned towards their degree.
- **Executive Office of Health and Human Services (EOHHS)** – The non-health insurance portion of the EOHHS budget totals \$5.1 B in FY 2014. Funding under EOHHS supports a wide range of services, including transitional assistance to families, services to persons with disabilities, care for veterans, public health and disease prevention activities, protection of children at risk of abuse or neglect and care for youthful offenders. Recognizing the importance of maintaining critical safety net programs and services, the Governor's budget preserves funding within EOHHS for programs and services that affect the state's most vulnerable residents. Projected caseload needs for critical safety net programs are fully supported at FY 2013 levels in FY 2014 including substance abuse services, cash and nutritional assistance for low income families, early health screenings for children, suicide prevention services and domestic violence prevention treatment.

The Governor's budget also provides \$10 M in funding for Safe and Successful Youth Initiative grants, which provide assistance to cities for targeted intervention programs with high impact youth and their families providing education, job, trauma and street outreach program services. The Administration is investing \$1.28 M annually to expand the network of Family Access Centers (FACs) statewide, improving family access and ensuring that there is no wrong door for any family in need. Long-term savings may be achieved through shared services, reducing duplication, and evaluating possible co-location for existing service centers. Each FAC operates programs reflecting the culture and needs of its community, but all have a core set of services, including connection to community and state services, educational programs, and peer support. In addition, the Governor's budget funds continued implementation of cost increases associated with the Chapter 257 reforms that require updates to human services contracts with respect to the actual costs of providing services under a variety of programs. Across all EOHHS agencies, the FY 2014 additional costs of implementing Chapter 257 totals \$120 M. These costs reflect rate increases that will be phased in over different parts of year depending on when regulatory changes for each service type are promulgated. Finally, in FY2014, the Governor's budget recommends a funding increase for mental health services of \$22.5 M (3.3%) over the previous year, including a 15% increase in funding for child and adolescent behavioral health services.

- **Executive Office of Public Safety and Security (EOPSS)** –The Governor's FY 2014 budget funds projected cost increases by state agencies that provide an array of public safety services

to the state's residents, including but not limited to highway patrols and policing, corrections and inmate re-entry services. The State Police will graduate roughly 150 new officers from a cadet class that begins in June 2013, and the State Police Crime Lab will expand its Central Massachusetts operations, having now taken over the duties of the Department of Public Health Drug Lab.

- **Massachusetts Department of Transportation (MassDOT)** – In addition to the Patrick-Murray Administration's \$13 B capital investment over 10 years in transportation projects in the Commonwealth, a \$269 M increase is included in the Governor's FY 2014 budget recommendations (\$240 M of which is supported with state budgetary resources, including motor fuel taxes), which begin to fund the transportation needs highlighted in the "The Way Forward: A 21-st Century Transportation Plan". In FY 2014, this investment will:
 - Eliminate the MBTA's structural operating deficit, which has been solved in recent years through the use of one-time, unsustainable funding sources;
 - Provide modest MBTA service enhancements such as expanding evening hours, restoring weekend service in areas that have been cut and improved customer service;
 - Take a significant step forward in discontinuing the decades-old practice of using borrowed funds (bonds) to pay for personnel and other operating costs; and
 - Sustainably fund Regional Transit Authorities (RTAs) by ending the practice of funding the RTA operating budgets in arrears, thereby eliminating the need for the RTAs to take on short-term debt in order to fund annual operating costs which, in turn, increases costs to the taxpayers and customers.
- **Executive Office of Energy and Environmental Affairs (EOEEA)** – FY 2014 funding for EOEEA is approximately 10.3 % above FY 2013 estimated spending. This reflects a \$4 M investment for increased efforts to promote recycling coordination across the state, which is funded through increased revenues generated by expanding the bottle deposits to include bottled water, juices and sports drinks. The Governor also proposes a \$2.5 M increase in permitting and compliance services at the Department of Environmental Protection to reflect the increasing cost of providing critical environmental oversight at the speed of business.
- **Executive Office of Housing and Economic Development (EOHED)** – FY 2014 funding for EOHED is approximately \$12 M less than FY 2013 estimated spending, reflecting a decrease in projected spending on emergency services for homeless families in the Commonwealth. The Governor's budget does propose to use \$20 M in surplus resources in FY 2013 to capitalize a new Housing Stabilization and Preservation Fund, which would become a flexible funding source under the Department of Housing and Community Development (DHCD) to craft affordable housing strategies to the specific needs of DHCD clients in the most efficient and effective way possible. This new trust fund spending will offset the reduction in emergency services spending but will occur within programs focused on permanent housing solutions.
- **Executive Office of Labor and Workforce Development (EOLWD)** – Compared to the FY 2013 estimated spending, funding at EOLWD is increased by 6.6 percent in FY 2014. This corresponds to increased investments proposed by the Governor for the Summer Jobs program, which subsidizes employment opportunities for low-income youth primarily during the summer. The Governor's budget will fund summer jobs opportunities at \$10 M.
- **Executive Office for Administration and Finance (A&F)** – Annual funding levels under A&F can vary greatly from year-to-year since A&F typically houses reserve or other short-term appropriations that are not continued from year-to-year. In FY 2014 \$7.5 M in additional funding is provided to fund a sinking fund to support the first-in-the-nation pay for performance social innovation funding initiatives. This will help support two initiatives that target lowering state costs

while improving outcomes for youth offenders and unaccompanied adults who face chronic homelessness.

School Aid for Public K-12 Education (Chapter 70)

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
K-12 Aid (Chapter 70)	4,173,783,011	4,397,257,332	223,474,321	5.4%
Total Appropriated Spending	4,173,783,011	4,397,257,332	223,474,321	5.4%

Chapter 70 funding is the primary method by which the state finances local K-12 public education. An increase of \$223 M in Chapter 70 funding will bring this vital support for communities to an unprecedented \$4.39 B. This represents a \$677 M (18 percent) increase in Chapter 70 funding from pre-recession levels.

This investment will finalize implementation of the 2007 Chapter 70 reforms while ensuring that all school districts receive increased funding of at least \$25 per pupil. The FY 2014 budget will fully fund all schools at foundation levels, and also begin to factor increased special education and pre-kindergarten costs into the calculation of the foundation budget. This allocation of funds to Chapter 70 will increase equity and access among all school districts and is intended to allow local educational authorities the flexibility to fund initiatives most needed in their communities. By providing flexibility at the local level, the FY 2014 budget allows schools to prioritize funding where it is needed most, whether in special education, MCAS support, literacy programming, or other programs.

Aid to Higher Education Campuses

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
Higher Education Campuses	857,463,222	930,673,973	73,210,751	8.5%
Total Appropriated Spending	857,463,222	930,673,973	73,210,751	8.5%

The FY 2014 budget increases state support to the University of Massachusetts, the state universities, and community colleges. This collaboration between the Administration and the campuses creates a shared sense of responsibility to provide high-quality services to all students while maintaining affordability. This increased funding, a total of \$57.5 M in FY 2014 and reaching \$240 M by FY 2017, will allow the campuses to maintain their delivery of educational and other services without requiring unaffordable increases to tuition and student fees. After including additional increases for collective bargaining costs increases, total campuses funding increases by \$73.2 M in FY 2014 from previous year's levels.

MassHealth (Medicaid) Spending

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
MassHealth	10,859,431,334	12,277,879,935	1,418,448,601	13.1%
Total Appropriated Spending	10,859,431,334	12,277,879,935	1,418,448,601	13.1%

The Massachusetts Medicaid program (MassHealth) provides comprehensive health insurance to approximately 1.38 million low-income Massachusetts children, adults, seniors and people with disabilities. This figure does not include the new MassHealth Expansion populations; with the Expansion population and projected growth in the base population, total MassHealth enrollment will be approximately 1.6 million. Many of these new MassHealth enrollees are not new to subsidized coverage but are currently enrolled in Commonwealth Care or the Medical Security Program.

Overall, MassHealth's FY 2014 funding level of \$12.3 B represents a 13.1 percent increase over FY 2013. Most of this increase, however, is driven by the ACA Expansion populations and coverage preservation under ACA (4.2 percent of increase), operational and hospital investments and dental benefit restoration (0.8 percent of increase), enrollment increases for currently-eligible members of 40,000 member months (2.6 percent of increase) and FY 2013 cash management strategies (2.9 percent of increase). When the annual growth rate is adjusted for these unavoidable costs, the resulting growth rate is 2.5 percent, which is lower than the state's health care cost growth benchmark. In addition, there will be 105,000 members leaving the Health Connector and moving into MassHealth which will result in decreased spending at the Health Connector of \$257 M gross/\$128.5 M net over the 6-month period in FY 2014.

The Commonwealth has made significant investments in MassHealth in recent years and will continue to do so in FY 2014 in order to promote program innovation and lay the ground work for larger savings.

The Administration proposes policies that aim to maintain coverage for current populations who otherwise could be adversely affected by ACA implementation, and that support streamlining current programs to promote alignment, access and administrative simplification in a post-ACA coverage environment at minimal cost to the Commonwealth. These proposals include:

- Considering the use of Modified Adjusted Gross Income (MAGI) instead of gross income to determine eligibility for adults with disabilities, consistent with the methodology used for non-disabled adults. This may protect individuals with disabilities from having more stringent MassHealth income eligibility standards than non-disabled individuals. (\$5.9 M cost; \$3 M revenue);
- Continuing to provide health insurance coverage at full state cost to Aliens with Special Status (AWSS) who are ineligible for largely federally-funded participation in the state Exchange; this is a small number individuals, as most AWSS are newly eligible for federal assistance through the Exchange (\$5.9 M cost; \$0 revenue);
- Extending MassHealth coverage to the end of the month for members transitioning to Health Connector coverage, which begins on the first of the month, in order to prevent gaps in coverage (\$7 M cost; \$3.9 M revenue);
- Maintaining current waiver programs to cover individuals with breast or cervical cancer up to 250 percent of the federal Poverty Level (FPL) and individuals with HIV up to 200 percent FPL (no budget impact in FY 2014); and
- Providing a MassHealth Standard level of benefits for all pregnant women up to 200 percent FPL (\$5.2 M cost; \$4.5 M revenue).

Group Insurance Commission

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
Group Insurance Commission	1,298,847,997	1,362,226,112	63,378,115	4.9%
State Retiree Health Care	415,042,237	425,044,755	10,002,518	2.4%
Total Appropriated Spending	1,713,890,234	1,787,270,867	73,380,633	4.3%

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

In FY 2013, the Group Insurance Commission (GIC) has focused on providing high quality health insurance coverage to its members while containing costs for the Commonwealth. The GIC embarked on a major procurement of its health plans, utilizing innovative strategies to maintain coverage and quality of care while containing costs. To pursue this in a creative and thoughtful manner, the GIC devotes significant internal resources to successfully incentivize health plans to reduce costs over the long term. This includes implementing the principles of payment reform and incorporating changes resulting from national health care reform.

The GIC continues to work closely with its health plans to minimize rate increases. The Commission held rate increases in FY 2013 to 1.4 percent and initiated a procurement that is estimated to save the Commonwealth \$1.29 B through FY 2018. The GIC will accomplish this by reducing the average annual growth in spending from 6 percent to 2 percent in FY 2014, saving over \$65 M and holding growth at or below 2 percent thereafter.

Health Connector Authority

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
Health Connector Authority	661,249,148	470,637,393	(190,611,755)	-28.8%
Total Appropriated Spending	661,249,148	470,637,393	(190,611,755)	-28.8%

The year-on-year reduction in the budgetary contributions to the Health Connector Authority reflects the FY 2014 implementation of the federal Affordable Care Act (ACA).

Under the ACA, the Health Connector will administer the Commonwealth's health insurance Exchange. The Exchange will allow individuals and businesses to shop for health insurance coverage. The State Wrap, beginning January 1, 2014, will supplement federal subsidies available in the Exchange by providing premium assistance to individuals with incomes 133 percent to 300 percent FPL, as well as certain Aliens with Special Status (AWSS) with incomes 0 percent to 300 percent FPL who are ineligible for MassHealth. These combined federal and state subsidies are intended to make subsidized coverage for this population as affordable for them as it is today under Commonwealth Care. An estimated 150,031 members are expected to enroll from Commonwealth Care, MassHealth, MSP, and HSN. The cost of the State Wrap in the second half of FY2014 is estimated at \$118.5 M. The cost of the current Commonwealth Care program in the first half of FY 2014 is \$430 M.

The Centers for Medicare and Medicaid Services (CMS) has indicated that a 50 percent federal match will be available in FY 2014 for premium assistance payments for State Wrap members, with the exclusion of AWSS, making available an additional \$21 M in available revenue. This revenue, combined with the enhanced federal financial participation (FFP) available through the ACA, will enable

the restoration of full adult dental coverage for MassHealth members and for individuals with incomes below 133 percent FPL who are enrolled in the Health Connector with the State Wrap.

The Health Connector was recently one of the first six state exchange programs in the nation to be certified conditionally as a state-based health insurance exchange on the path to operating in compliance with the Affordable Care Act. The Health Connector will kick off its annual Seal of Approval process in early 2013 for coverage that will be available to individuals and small businesses starting January 1, 2014. This year's Seal of Approval is a major milestone for the Health Connector, as it will enhance its products and services to comply with the ACA and better serve small employers and individuals.

Unrestricted General Government Aid

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
Local Aid	916,760,490	956,760,490	40,000,000	4.4%
Total Appropriated Spending	916,760,490	956,760,490	40,000,000	4.4%

Unrestricted General Government Aid (UGGA) and state payments in lieu of taxes (PILOT) aid make up unrestricted local government aid. In FY 2014 UGGA will be funded at \$899 M, the same amount and same distribution provided for in the FY 2013 GAA (Current FY 2013 spending assumptions reflect the 1 percent reduction in local aid this year proposed in the Governor's December 4 Fiscal Action Plan). PILOT aid is level funded in FY 2014 at \$26.3 M.

An additional \$31 M in local aid will be distributed to all municipalities through the new "Annual Formula Local Aid" program. The existing allocation of local aid among the Commonwealth's cities and towns (UGGA) is meant to maintain year-to-year consistency regardless of changes in a municipality's circumstances and is no longer based on a rational funding formula. Annual Formula Local Aid addresses these critical aspects of a rational local aid program:

- Provides a simple and transparent formula using a combined measure of property values and income to calculate each municipality's relative ability to provide essential local services; and
- Will consistently provide equitable distributions into the future, as each year the formula components will be updated and the total distribution of aid will be calculated using the updated components.

Other Budgetary Transfers

FY 2013 Estimated Spending vs. FY 2014 House 1 Recommendation (\$s)				
Spending Category	FY 2013 Estimated Spending	FY 2014 House 1	Annual Change	Percent Change
Transfers for Payments to Hospitals and Providers	751,914,223	485,449,470	(266,464,753)	-35.4%
Other Transfers to Non-Budgetary Funds	6,500,000	2,625,000	(3,875,000)	-59.6%
Life Sciences Innovation Investments	-	25,000,000	25,000,000	n/a
Total Appropriated Spending	758,414,223	513,074,470	(245,339,753)	-32.3%

Other Budgetary transfers include payments to hospitals under the Delivery System Transformation Initiative Fund (DSTI) and the Medical Assistance Trust Fund (MATF). The DSTI program traditionally provides two payments per fiscal year to hospitals, but due to the timing of program requirements, only half of the FY 2014 obligation will be paid in this fiscal year. The first FY 2014 payment totals \$105 M, funded with \$94 M from the General Fund and \$11 M through an Inter-Governmental Transfer (IGT) by

Cambridge Health Alliance. The federal match for this payment is \$52 M. The second DSTI payment will also total \$105 M, with a \$52 M federal match, and will be moved from FY 2014 to FY 2015. This change does not alter the timing of the payment, only the fiscal year in which it occurs. The FY 2014 budgeted transfer for MATF decreases by \$172 M in FY 2014 simply to reflect the elimination of a one-time supplemental funding increase in FY 2013 to a group of hospital payments that had not yet received federal approval by the close of FY 2012.

Lastly, the Governor's FY 2014 budget invests \$25 M in the Massachusetts Life Sciences Center (MLSC), an increase of \$10 M above FY 2013. This funding will enable MLSC to provide research grants and accelerator loans to researchers and early-stage companies, a direct investment in business expansion and job growth in this critical sector. The House 1 proposal represents the first time in five years that the 2008 life sciences initiative will be funded with a dedicated direct appropriation rather than potential year-end surplus.

State Workforce

Chapter 29, Section 6 states that “The operating budget shall indicate the number of positions proposed to be authorized for each state agency or such other public instrumentality for the ensuing fiscal year, the number of positions for each state agency in the current and ensuing fiscal years and such other information as may be held to explain the anticipated results of the proposed expenditures”.

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

Effect of the Budget on Personnel to Date

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

Between the fall of 2008 and January 2013, the state workforce for jobs in the Executive Branch funded with operating dollars has declined by 3,541 jobs. The reduction can be attributed to layoffs, attrition and retirement across all agencies in the Executive Branch. This trend has been mirrored in the Non-Executive Branch. After accounting for an increase of 2,770 positions in January 2010 corresponding to the transition of seven county sheriffs’ offices to state agencies, total non-Executive budgetary jobs have declined by over 2,918 jobs. When considering employees paid in both branches, from all funding sources, the total state FTEs have decreased by close to 6,000 since FY 2008 (please see FTE discussion in the FY 2012 Statutory Basis Financial Report prepared by the State Comptroller’s Office).

The following chart lists the latest snapshot information. It should be noted that roughly 1,270 transportation FTEs were shifted off-budget in the Fall of 2009 while 2,770 sheriff employees were shifted on to the state budget on January 1, 2010. These changes should be accounted for when making historical comparisons.

STANDARD WORKFORCE SUMMARY AND VARIANCE REPORT, PAY PERIOD ENDING: 01/12/13

PAY PERIOD	BUDGET	NON-BUDG	TOTAL	VARIANCES	BUDGET	NON-BUDG	TOTAL
BENCHMARK 1/20/2007				YTD FROM 1/20/2007			
Executive Jobs	38,742	6,138	44,880	Exec Job Var	(3,998)	3,110	(888)
Non-Exec Jobs	30,844	9,658	40,502	Non-Exec Job Var	749	5,436	6,185
<i>Totals</i>	69,586	15,796	85,382	<i>Totals</i>	(3,249)	8,546	5,297
Executive FTE	37,366	5,950	43,316	Exec FTE Var	(3,550)	3,162	(388)
Non-Exec FTE	30,079	8,616	38,695	Non-Exec FTE Var	643	2,504	3,147
<i>Totals</i>	67,445	14,566	82,011	<i>Totals</i>	(2,907)	5,665	2,758
BENCHMARK 10/11/2008				YTD FROM 10/11/2008			
Executive Jobs	39,554	6,268	45,822	Exec Job Var	(4,810)	2,980	(1,830)
Non-Exec Jobs	31,741	9,895	41,636	Non-Exec Job Var	(148)	5,199	5,051
<i>Totals</i>	71,295	16,163	87,458	<i>Totals</i>	(4,958)	8,179	3,221
Executive FTE	38,308	6,119	44,427	Exec FTE Var	(4,492)	2,993	(1,499)
Non-Exec FTE	31,037	8,780	39,818	Non-Exec FTE Var	(315)	2,339	2,024
<i>Totals</i>	69,345	14,899	84,244	<i>Totals</i>	(4,807)	5,333	525
PREVIOUS 12/29/2012				PREVIOUS VS. CURRENT 12/29/2012 1/12/2013			
Executive Jobs	34,864	9,265	44,129	Exec Job Var	(120)	(17)	(137)
Non-Exec Jobs	31,776	14,938	46,714	Non-Exec Job Var	(183)	156	(27)
<i>Totals</i>	66,640	24,203	90,843	<i>Totals</i>	(303)	139	(164)
Executive FTE	33,924	9,129	43,053	Exec FTE Var	(109)	(17)	(126)
Non-Exec FTE	30,884	10,901	41,785	Non-Exec FTE Var	(162)	218	57
<i>Totals</i>	64,808	20,030	84,838	<i>Totals</i>	(270)	201	(69)
CURRENT 1/12/2013				BENCHMARK VS. CURRENT EXEC BUDGETARY JOBS			
Executive Jobs	34,744	9,248	43,992	Benchmark	10/11/2008	39,554	
Non-Exec Jobs	31,593	15,094	46,687	Current	1/12/2013	34,744	
<i>Totals</i>	66,337	24,342	90,679	<i>Actual Variance NOT adjusted</i>		<i>(4,810)</i>	
Executive FTE	33,816	9,112	42,928	<i>Variance adjusted for MassDOT reform</i>		<i>(3,541)</i>	
Non-Exec FTE	30,722	11,120	41,842				
<i>Totals</i>	64,538	20,232	84,770				

Definitions:

- Standard Workforce:** Describes the set of employees who are likely working regularly. It excludes those on unpaid leave and those in contractor, board member and seasonal positions.
- FTE:** "Full-Time Equivalent". Measures the workforce based on the hours each job is scheduled to work (not on hours actually worked per job). For example, two employees each scheduled as half-time (0.5) count as two jobs ("employees"), but only one FTE.
- Jobs:** Actual people ("employees") on the pay period, also known as "head count". It is a measure of workforce counting the actual number of employees filling positions.
- Budgetary:** Positions funded by the operating budget through direct appropriation and retained revenue accounts (i.e., GAA) based on the default account number in HRCMS.
- Non-Budgetary:** Positions funded by sources other than the state's operating budget (federal, trust, grant and capital)
- Executive:** Positions assigned to agencies in the Executive Branch, where the Governor is the Chief Executive Officer.
- Non-Executive:** Positions assigned to agencies not within the Executive Branch. These include Legislative, Judiciary, Independents and the colleges and UMass in Education.

H.1 Employment Levels

In reviewing the funding levels available to them for 2014, agencies must critically evaluate their employee level and determine further reductions are necessary to maintain a balanced budget. The Governor's FY 2014 budget recommendation projects a total of 64,655 budgetary FTEs. This amount includes FTEs from both Executive and Non-Executive departments as well as positions funded from the operating accounts listed within the budget. It should be noted that these figures are subject to change, based on various factors including final FY 2014 funding levels, actual payroll spending experience and budgetary guidance issued by A&F during FY 2014 spending plans (July-August 2013).

FY 2013 and FY 2014 Budgetary FTEs Levels by Government Area			
	Estimated FY 2013	Proposed FY 2014	AnnualCh ange
Executive Branch Secretariats:			
Administration and Finance	2,779	2,809	30
Education	529	565	36
Energy and Environmental Affairs	1,984	1,970	(14)
Housing and Economic Development	701	718	17
Health and Human Services	19,434	19,218	(217)
Transportation	0	0	-
Labor and Workforce Development	275	275	-
Public Safety	8,880	8,962	82
sub-total	34,584	34,517	(66)
Non-Executive Branch:			
Judiciary	7,230	7,230	-
Legislature	945	945	-
Constitutional Officers and Independents	9,555	9,567	12
Campuses	12,395	12,395	-
sub-total	30,125	30,137	12
TOTAL STATE BUDGETED FTEs			
	64,709	64,655	(54)

Workforce Planning Goals

The Executive Office for Administration and Finance (ANF) and the Human Resources Division have worked together to implement clear policies surrounding employees. Each fall, ANF engages each agency in a spending plan process in which each account is evaluated to determine how funds will be spent for the current fiscal year. This requires a detailed description of employees for the current year - including those currently on staff, positions that are open and intended to be filled and new positions for which funding is available. The goals of the employee caps are to:

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

restrictions are simply shifted to higher overtime. Therefore, prudent management of both overtime and staffing levels must be evaluated.

