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# Bulletin

March 1, 2010

## Governor's 2011 Budget: The Worst is Yet to Come

The good news in the Governor's proposed fiscal 2011 state budget is that most accounts are funded at 2010 levels despite the expectation of major cuts in spending. The bad news is that these cuts have been delayed to fiscal 2012.

The Governor's budget for fiscal 2011 totals \$31.7 billion, an increase of \$1.27 billion or 4.2 percent over the original \$30.45 billion appropriated for fiscal 2010. It is striking that the \$31.7 billion proposed for 2011 is virtually the same total as the 2009 budget approved by the Legislature before the recession – yet the 2011 budget is based on forecasted tax revenues of \$19.05 billion, \$2.35 billion less than the \$21.4 billion originally forecast for 2009 (Figure 1).

In order to support this level of spending, the Governor uses approximately \$2.1 billion in one-time funds. While this allows for fewer cuts in 2011, it opens up a huge budgetary hole for 2012 when there will be virtually no reserves to count on and with no possibility that the economic recovery will produce sufficient revenues to close the 2012 structural gap.

### Spending

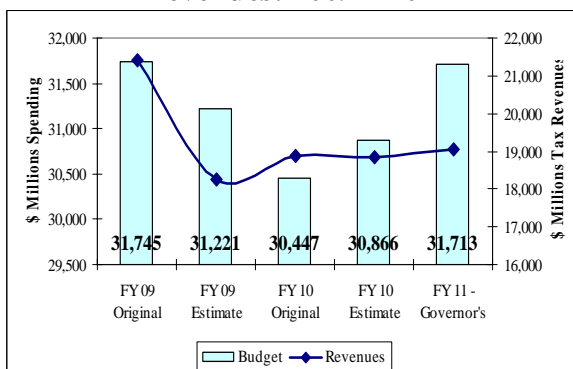
Two major programs, Medicaid and health insurance for state employees and retirees, account for \$1.14 billion in proposed spending increases. The vast majority of other programs are funded at their 2010 levels, with some programs, mostly in human services, seeing cuts totaling slightly more than \$200 million.

Despite \$265 million in cost savings, Medicaid would still increase by \$909 million or nearly 10 percent from the original 2010 budget. Absent these changes, which include rate cuts and freezes, administrative efficiencies, and reductions in services such as the adult dental program and increased co-pays for generic drugs, Medicaid would have grown close to 13 percent. However, due to an expected Medicaid deficiency of \$300 million in fiscal 2010, the actual increase in Medicaid spending over the current year would be approximately \$600 million or 6.5 percent.

Spending on health care for state employees and retirees by the Group Insurance Commission (GIC) would increase by \$235 million or 16 percent over the original fiscal 2010 budget, a combination of higher premiums and an increase in the number of enrollees. Premiums are anticipated to rise between 8 and 9 percent.

Enrollment in the GIC increased by approximately 20,000 in fiscal 2010 with another 7,800 scheduled to join at the beginning of fiscal 2011 – 1,370 from the Mass Turnpike Authority,

**Figure 1 – State Spending and Tax Revenues: 2009 – 2011**



1,585 from the MBTA,<sup>1</sup> 600 from county sheriffs, 200 from the National Guard, and 4,000 from municipalities, bringing total enrollment to approximately 198,000.

Facing a \$35 million shortfall in fiscal 2010, the GIC raised co-pays and deductibles for employees and retirees that will save approximately \$17 million in 2010 and \$40 million annually. The administration agreed to pay for approximately \$20 million of these increased costs in 2011 in exchange for a concession by the unions to accept a 1 percent wage increase in fiscal 2011, postponing a scheduled 3 percent increase until fiscal 2012 and saving the state roughly \$70 million in the 2011 budget.

Commonwealth Care, the program of subsidized health insurance coverage created by the state's health reform law, would be funded at \$838 million in 2011, an increase of \$115 million over the original 2010 budget based on increased enrollment of 20,000.

The budget proposes \$75 million for the Commonwealth Care Bridge Program, which provides health insurance to legal immigrants who have resided in the United States for fewer than five years. The \$75 million would support the 26,000 who are currently enrolled and extend coverage to others. The Bridge Program was created with a \$40 million appropriation in fiscal 2010 to cover the partial year costs for legal immigrants who lost coverage through the traditional Commonwealth Care program.

The Governor's budget includes an increase of \$65 million for state pensions under the third and final year of the current funding schedule that was put in place prior to the stock market collapse. Given the large jump in the unfunded liability, which must be reflected in the new funding schedule, the state will face a major increase in pension costs in 2012, adding to the already large structural deficit.

Aside from these few major accounts, the vast majority of the Governor's budget is funded at 2010 levels, including early education, higher

education, Chapter 70 education aid, and other local aid. The administration also maintains near 2010 funding levels for Transitional Aid to Families with Dependent Children (TAFDC), Department of Correction facilities, and elder home care services.

According to the Foundation's estimates, the Governor's 2011 budget includes approximately \$220 million in cuts, mainly in human services programs. Among these are \$35.4 million for inpatient facilities and community based mental health services, \$26.6 million in services to children and families, and \$11.4 to operate the six Department of Developmental Services facilities for the intellectually disabled. The Governor's budget says there are \$310 million in "line item reductions," but this total presumably includes program cuts which are required because of level funding.

## Revenues

The 2011 budget is based on a consensus tax forecast of \$19.05 billion, a \$590 million or 3.2 percent increase over the latest \$18.46 billion benchmark for fiscal 2010. The \$590 million includes an additional \$150 million from a full year of sales tax collections at the increased rate of 6.25 percent. (Only 10 months will be collected in fiscal 2010.) As such, real revenue growth would be just 2.4 percent over fiscal 2010. Since tax collections have exceeded revised benchmarks for the past four months, it appears that the state has hit bottom and that the 2011 revenue target is realistic.

While the Governor does not propose any broad-based tax increases, the budget counts on \$235 million in additional revenues by:

- Extending the sales tax to candy and soda (\$51.7 million), cigars and smokeless tobacco (\$15 million), and aircraft (\$4.2 million);
- Expanding the bottle bill (\$20 million);
- Capping the film tax credit at \$50 million (\$75 million);
- Limiting the life sciences tax credit to \$20 million (\$5 million);

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<sup>1</sup> Another 9,000 MBTA employees and retirees are scheduled to join the GIC pending the outcome of litigation.

- Granting enhanced collection authority to the Department of Revenue (\$31 million);
- Increasing departmental revenues (\$33 million).

The major concern in the Governor’s budget is the heavy reliance on one-time funds – \$2.1 billion or 75 percent of the 2011 structural shortfall, including \$1.4 billion of federal stimulus dollars, \$175 million from the state’s stabilization fund, a \$160 million federal Medicare reimbursement, and \$300 million from debt restructuring (Table 1). Relying on this one-time money would artificially prop up the 2011 budget at a level that cannot be sustained in fiscal 2012.

Of the \$1.4 billion in federal stimulus aid, roughly \$800 million represents the third installment of the federal stimulus bill, including \$690 million of FMAP funds and \$100 million of state fiscal stabilization funds that must be used by 2011. The Governor is counting on a six-month extension of FMAP for the final two quarters of fiscal 2011 that would bring another \$600 million of federal aid. Although President Obama included the extension in his fiscal 2011 budget and the proposal has strong Congressional support, there is still some risk that the funds may not be available.

**Table 1 - One-Time Funds in Governor’s 2011 Budget**  
(\$ Millions)

Federal Stimulus Aid (ARRA)	
State Fiscal Stabilization Funds	96
FMAP	690
FMAP II (Not Yet Appropriated)	608
Transitional Assistance for Needy Families	23
<b>Subtotal</b>	<b>1,417</b>
Other One-Time Funds	
Medicare Reimbursement	160
Debt Restructuring	300
State Stabilization Fund	175
State Land/Trust Funds	54
Transfers from Quasi-Public Agencies	29
<b>Subtotal</b>	<b>718</b>
<b>Total</b>	<b>2,135</b>

While federal stimulus aid must be spent in the 2011 budget, it is not responsible to use other

one-time funds to support spending that cannot be sustained in 2012. A more prudent policy would be to use only the \$1.4 billion of federal aid in fiscal 2011, reduce spending by \$700 million, and earmark the other \$700 million of one-time monies to the stabilization fund.

The Governor’s proposal to withdraw \$175 million from the stabilization fund would bring the balance well below \$500 million and could trigger a downgrade of the state’s credit rating while leaving the state vulnerable to a real fiscal emergency.

Instead, by not withdrawing the \$175 million and by directing to the stabilization fund both the anticipated \$160 million Medicare reimbursement and the proceeds of the \$300 million “saved” from a debt restructuring, the balance at the end of fiscal 2011 would be more than \$1 billion (Table 2). This would reduce the budget cuts required in fiscal 2012 while also helping the state address the budget emergency that would arise if voters approve the November ballot question to cut the sales tax from 6.25 to 3 percent, which would reduce revenues by \$1.2 billion in the second half of fiscal 2011.

**Table 2 – State Stabilization Fund Balance**  
(\$ Millions)

	Governor’s Budget	MTF Alternative
Current Balance	608	608
FY 11 Budget	-175	0
Medicare Reimbursement		160
Debt Restructuring		300
State Land / Trust Funds		54
Interest	4	10
<b>Projected FY 11 Year End Balance</b>	<b>437</b>	<b>1,132</b>

The administration estimates that the Social Security Administration owes Massachusetts \$160 million in reimbursement payments for recipients of Social Security Disability Insurance who were paid through the state Medicaid program rather than through Medicare over the course of 35 years. Though discussions are ongoing, the amount and timing of any federal payment are uncertain. Any windfall should be directed to the rainy day fund and not included in the 2011 operating budget.

Faced with a jump of over \$150 million in long term debt payments in fiscal 2011 and then an equivalent decline in 2012, the Governor proposes to restructure \$300 million of debt at lower interest rates in order to “smooth” the payment schedule (Table 3). Since the refinancing would add minimal costs to the state, the concept of restructuring the debt may be a valuable mechanism to enhance the state’s financial flexibility, provided the savings are used to build up reserves.

**Table 3 – Debt Service Costs**  
(\$ Millions)

Debt Service	2010	2011	2012
General Obligation Bonds	1,690	1,865	1,714
Federal Highway GANS	196	196	196
Special Obligation Revenue Bonds	76	93	93
<b>Subtotal</b>	<b>1,963</b>	<b>2,155</b>	<b>2,003</b>
Restructuring		-300	25
<b>Total</b>	<b>1,963</b>	<b>1,855</b>	<b>2,028</b>

Office of the Comptroller, Information Statement Supplement, February 8, 2010

### Fiscal 2012

The Governor’s reliance on more than \$2 billion of one-time funds in 2011 will require major budget cuts in 2012. It is commonly assumed that the economic recovery will bring an end to the state’s fiscal problems. However, as Table 4 shows, even with tax revenues growing at 5 percent, the state will face a structural deficit of \$2.5 billion in 2012 with virtually no federal or state reserves remaining to close the gap.

The gap is produced by a combination of the one-time funds and a “maintenance budget” of \$1.4 billion, which reflects continued increases in Medicaid, the Group Insurance Commission, foundation level funding for Chapter 70, and a 3 percent jump in union wages in fiscal 2012. Because of the much greater pension finding requirement, the gap could easily turn out to be larger.

**Table 4 – Fiscal 2012 Structural Deficit**  
(\$ Millions)

	Governor's Budget	MTF Alternative
One-Time Funds in 2011 Budget	-2,100	-1,400
Maintenance Budget	-1,400	-1,400
5% Revenue Growth	1,000	1,000
Stabilization Fund	0	600
<b>Total</b>	<b>-2,500</b>	<b>-1,200</b>

The Foundation’s alternative – to rely on no more than \$1.4 billion of one-time monies in 2011 and build up the rainy day fund – would cut the 2012 structural deficit in half. Not only would there be less of an initial hole in 2012, but \$600 million could be drawn from the replenished state reserves and still leave a balance of more than \$500 million for emergencies.

### Ballot Questions

The fiscal 2012 challenges would become much greater if voters approve two initiatives on the November ballot which would reduce annual tax revenues by approximately \$2.5 billion. One ballot question would cut the state’s sales tax rate from 6.25 to 3 percent with a \$2.4 billion annual revenue impact. The second question would eliminate the recently imposed sales tax on alcohol, which raises about \$100 million annually.

**Table 5 – Impact of Two Ballot Questions**  
(\$ Millions)

	Governor's Budget	Alternative
Fiscal 2012 Structural Deficit	-2,500	-1,200
Revenue Loss from Ballot Questions	-2,500	-2,500
<b>Total</b>	<b>-5,000</b>	<b>-3,700</b>

Since both initiatives take effect January 1, 2011, the state would confront a \$1.2 billion shortfall in sales tax revenues over the last six months of fiscal 2011. In fiscal 2012 there would be a \$5 billion structural deficit based on the Governor’s spending plan for 2011, with virtually no reserves to help close this gap (Table 5).

In sum, the state will continue to confront serious fiscal problems at least through fiscal 2012, and probably longer.

<b>Budget Summary</b>	<b>FY09</b>	<b>FY09</b>	<b>FY10</b>	<b>FY10</b>	<b>FY11</b>
(\$ Millions)	<b>GAA</b>	<b>Estimated</b>	<b>GAA</b>	<b>Estimated</b>	<b>Governor</b>
<b>Health Care</b>	<b>10,329.4</b>	<b>10,236.1</b>	<b>10,333.1</b>	<b>10,670.8</b>	<b>11,389.5</b>
MassHealth	9,151.7	9,200.4	9,321.9	9,635.9	10,230.8
Connector	914.4	784.8	763.0	763.0	913.0
Other Health Care	263.4	250.9	248.2	271.9	245.7
<b>Local Government Support</b>	<b>6,026.3</b>	<b>5,827.2</b>	<b>5,504.3</b>	<b>5,488.0</b>	<b>5,496.2</b>
Chapter 70 Education Aid	3,954.3	3,953.1	4,037.8	4,037.8	4,048.6
Other K-12 Education Aid	611.6	570.2	447.8	434.4	436.6
Unrestricted Local Aid	1,346.7	1,218.7	964.8	964.9	964.7
Other Local Aid	113.6	85.2	53.8	50.8	46.4
<b>Other Education</b>	<b>1,680.8</b>	<b>1,653.4</b>	<b>1,604.9</b>	<b>1,587.1</b>	<b>1,587.6</b>
Early Education	590.1	567.3	537.3	520.8	520.8
Higher Education	1,090.7	1,086.0	1,067.6	1,066.3	1,066.7
<b>Human Services</b>	<b>5,141.6</b>	<b>5,048.8</b>	<b>4,812.1</b>	<b>4,794.6</b>	<b>4,754.3</b>
Developmental Services	1,358.2	1,349.5	1,339.7	1,328.9	1,321.4
Family Services	1,030.4	1,014.0	937.4	924.9	903.7
Cash Assistance	780.0	774.0	769.7	763.7	776.6
Mental Health	705.4	673.9	644.1	634.0	621.7
Public Health	591.1	577.4	504.6	496.9	491.3
Housing Support	274.7	266.5	248.3	287.3	271.3
Senior Support	296.1	288.3	261.1	254.0	251.0
Veteran Services	105.6	105.1	107.3	105.0	117.2
<b>Public Safety</b>	<b>2,453.4</b>	<b>2,451.0</b>	<b>2,134.3</b>	<b>2,340.0</b>	<b>2,267.1</b>
Corrections <sup>1</sup>	1,047.2	1,060.1	881.5	1,093.8	1,012.6
Judiciary	824.6	818.9	752.5	755.9	746.1
Police	280.7	279.5	259.1	254.9	275.6
District Attorneys	107.2	104.1	92.6	92.6	92.6
Attorney General	43.6	43.1	39.3	39.5	39.2
Other Public Safety	150.1	145.4	109.2	103.2	100.9
<b>Transportation</b>	<b>195.5</b>	<b>297.1</b>	<b>220.1</b>	<b>206.3</b>	<b>225.4</b>
MassDOT/ Other	10.1	9.0	11.2	9.5	202.8
Highways	61.0	166.8	93.0	86.1	
Regional Transit	57.9	57.9	59.2	59.2	15.0
Registry	66.6	63.4	56.6	51.5	7.6
<b>Economic Development</b>	<b>433.8</b>	<b>366.7</b>	<b>325.5</b>	<b>302.8</b>	<b>293.7</b>
Business and Labor	187.3	137.5	111.8	101.6	95.7
Environment and Energy	246.6	229.2	213.6	201.2	198.0
<b>Employee Benefits</b>	<b>2,792.5</b>	<b>2,665.8</b>	<b>2,825.9</b>	<b>2,825.1</b>	<b>3,126.3</b>
GIC/Retiree Health Care	1,327.5	1,351.4	1,449.3	1,448.4	1,684.5
Pensions	1,465.0	1,314.4	1,376.6	1,376.6	1,441.8
<b>Capital Support</b>	<b>2,099.1</b>	<b>2,096.6</b>	<b>2,198.1</b>	<b>2,173.9</b>	<b>2,065.6</b>
Debt Service	1,880.7	1,880.7	1,903.8	1,879.6	1,773.0
Contract Assistance <sup>2</sup>	218.4	215.9	294.2	294.2	292.6
<b>Other/General Government</b>	<b>593.4</b>	<b>578.4</b>	<b>488.6</b>	<b>477.5</b>	<b>507.3</b>
<b>Sub-Total</b>	<b>31,745.8</b>	<b>31,221.0</b>	<b>30,446.6</b>	<b>30,866.1</b>	<b>31,713.0</b>
<b>Pre Budget Transfers</b>	<b>1,469.0</b>	<b>1,469.0</b>	<b>1,550.2</b>	<b>1,518.1</b>	<b>1,582.1</b>
School Building Assistance	702.0	702.0	623.1	591.0	655.0
MBTA	767.0	767.0	927.1	927.1	927.1
<b>TOTAL</b>	<b>33,214.8</b>	<b>32,690.0</b>	<b>31,996.8</b>	<b>32,384.2</b>	<b>33,295.1</b>

<sup>1</sup> Includes DOC, county corrections and sheriffs.

<sup>2</sup> Includes \$100m for Turnpike in FY10 and FY11