Massachusetts Taxpayers Foundation

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Bulletin

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MTF

Analysis of Governor Baker's FY 2018 Budget

The Governor's FY 2018 budget proposal (House 1) has been released and proposes $45.2 billion in spending. This Bulletin provides an overview of the major spending, revenue and policy components included therein.

Budget overview

The Governor's budget proposes $45.2 billion in total spending, an increase of $1.57 billion (3.59%) over FY 2017. This spending growth does not account for $200 million in assumed budget savings built into the FY 2017 budget. If those savings are included, spending growth would be 4.06 percent. Of the total spending, $40.9 billion is distributed across 672 different programmatic line items, while $4.3 billion is spent on pre-budget transfers and other off-budget spending.

Figure 1. House 1 Spending & Revenue Summary

	House 1 Spending			
	FY 2017 Current	FY 2018 H1	$ Difference	% Difference
Line item spending	$39,617.3	$40,909.0	$1,291.7	3.26%
Pre-budget transfers	$4,026.6	$4,300.6	$274.0	6.80%
Total spending	$43,643.9	$45,209.6	$1,565.7	3.59%
	House 1 Revenue			
	FY 2017 Current	FY 2018 H1	$ Difference	% Difference
Consensus Tax Revenues	$26,056	$27,072	$1,016	3.90%
Tax settlements	$125	$100	-$25	-20.00%
Less cap gains transfer	$0	-$52	-$52	N/A
Revenue initiatives				
Employer assessment	$0	$300	$300	N/A
Ongoing tax	$0	$62	$62	
One time	$245	$125	-$120	-48.88%
Federal				
MassHealth related	$8,537	$9,068	$532	6.23%
Other	$2,504	$2,369	-$136	-5.41%
Departmental & transfers				
Lottery	$1,105.5	$1,083.0	-$23	-2.04%
MassHealth rebates	$728.0	$770.5	$43	5.84%
Other	$4,350.20	$4,345.10	-$5	-0.12%
Total	$43,650.1	$45,243.1	$1,593.0	3.65%

Federal Medicaid reimbursements continue to make up the lion's share of non-tax revenues and are estimated to grow by $532 million (6.2%) in FY 2017.

The chart below summarizes the top level spending and revenue highlights of House 1:

Figure 2. Major Spending and Revenue in House 1

Budget in a Box			
Spending		*Revenue*	
Total spending	$45.2 billion	Consensus tax revenue	27.072 billion
Increase	$1.57 billion	*Increase*	$1.016 bilion
Spending growth	3.59%	*Revenue growth*	3.90%
MassHealth	$16.26 billion	Increases to the Rainy Day Fund	
Increase	$794.50	*Cap gains*	$51.5 million
Chapter 70	$4.719 billion	*Other*	$46.9 million
Increase	$91.4 million	Budget gap closed	$832 million
Other Non-discretionary	$7.4 billion	One-time solutions	$95 million (net)
Increase	$298.7 million	New ongoing revenues	
Discretionary spending	$13.3 billion	*New taxes*	$62 million
Increase	$436.67 million	*New assessments*	$300 million
Total spending items	672	*Other*	$50 million
New	24	Tax settlements	$100 million
Increased	322	OPEB Savings	$129 million
Decreased/eliminated	203		

There are several noteworthy attributes of House 1, among them are the continued reduction in the use of one-time revenues to balance the budget and a new approach to replenishing the Stabilization Fund, both of which will mitigate the likelihood of a midyear budget gap and improve the state's fiscal outlook. This budget reduces one-time solutions from $276 million in the Governor's budget to $95 million (net). House 1 also changes the law governing automatic transfers to the Stabilization Fund resulting in a $51.5 million up-front deposit to the fund and a better process for dedicating higher than expected revenues to the fund over the course of the year.

Also notable, but not surprising, is that MassHealth continues to be the biggest spending area of the budget – $16.26 billion (39.7% of all line item spending) in House 1. The negative impact of spending growth in MassHealth and other non-discretionary items on the rest of the budget is equally apparent and grows starker each fiscal year. Just $436.7M (27.8%) of the new spending in House 1 goes to discretionary spending programs like non-Chapter 70 education, environment and human services.

Big picture spending in House 1 may follow a familiar script, but the Administration took a new approach to revenue. House 1 proposes $362 million in new assessments and increased tax revenue, introducing new sustainable revenue sources. Similar to the Administration's FY 2017 budget in which the Governor proposed a $250 million increased assessment on acute care hospitals, this spending plan proposes a new $13 million assessment on non-acute care hospitals.

Major spending areas

MassHealth

The $16.26 billion of MassHealth spending in the Governor's budget accounts for 50.6 percent ($794.5 million) of all new spending proposed. As shown in figure 3, MassHealth costs – primarily driven by higher than expected increases – have grown at a faster rate than expected in FY 2017 creating a strain on the operating budget. In FY 2018, MassHealth costs are projected to increase just over 5 percent.

Figure 3. MassHealth Spending and Revenue, FY 2017 & FY 2018

	FY 2017 GAA	FY 2017 Current	FY 2018 H1	*Increase over FY 2017 Current*
MassHealth Spending	$15,340,353,833	$15,467,961,789	$16,262,491,317	*$794,529,528*
Federal Reimbursement	$8,608,311,176	$8,536,552,385	$9,068,119,986	*$531,567,601*
Net Cost	$6,732,042,657	$6,931,409,404	$7,194,371,331	*$262,961,927*
Reimbursement as share of spending	56.12%	55.19%	55.76%	

It is not clear from the language in House 1 what savings assumptions from rate payment or benefit changes are imbedded in the spending plan. House 1 includes a proposal to create caps on cost growth for different types of providers, but again, it's not clear if this proposal is expected to have a material impact on MassHealth in FY 2018.

House 1 does include a new assessment on employers which, while not dedicated to MassHealth, was prompted by recent enrollment growth in the program. The assessment is expected to generate $300 million in FY 2018 and will apply to employers with 11 or more full-time employees who do not either cover 80 percent of the full time equivalent employees or provide a health insurance subsidy of at least $4,590.

Since the implementation of the Affordable Care Act that expanded eligibility for MassHealth, the transition of workers from employer coverage to MassHealth has been a major factor in MassHealth enrollment growth. The assessment is intended to ensure that employers whose employees may be opting to enroll in MassHealth are picking up some of the costs. Unlike the Massachusetts health care reform law, the ACA contains no prohibition on individuals who are offered employer-sponsored coverage from choosing to enroll in the state's Medicaid program.

The idea of assessing employers for failing to offer adequate insurance to full-time employees is not new. In fact assessing employers who failed to meet insurance coverage criteria with a "Fair Share Contribution" was a cornerstone of the Massachusetts health reform. However, there are several notable differences. Under the Massachusetts reforms, an employer satisfied the requirement with an offer of coverage and was not penalized if an employee declined the offer. The original fair share contribution was much smaller in scope (it generated approximately $20 million per year as opposed to $300 million), with a lower assessment amount and a much lower threshold for avoiding assessment. The Fair Share Contribution was repealed in 2013 as part of ACA implementation because the federal law included a larger employer assessment and MA did not want to impose an additional penalty. The assessment in the ACA, like the House 1 proposal, envisioned a $2,000 per employee fee for employers that did not meet coverage criteria, but the ACA assessment has never been implemented and the coverage criteria were less strict than the House 1 proposal.

Other notable MassHealth and health care reform elements in House 1 include:

- A continued financial contribution from the Commonwealth Connector to the General Fund to help balance the budget. The contribution is capped at $110 million, the same amount as in FY 2017; and
- Language allowing $17 million from a Community Health Center trust fund, that was created last year, to be expended for infrastructure improvement and capacity grants to healthcare providers. In prior years, these grants have been made from the MassHealth budget.

Other health care policy provisions included in House 1 can be found later in this bulletin.

Local Aid

House 1 includes $131.3 million in new Chapter 70 education aid and Unrestricted General Government Aid (UGGA) for cities and towns.

Figure 4. Chapter 70 and UGGA Funding, FY 2014 – FY 2018

	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
C70	**$4,299,935,166**	**$4,399,910,261**	**$4,511,882,199**	**$4,628,013,618**	**$4,719,407,242**
$ Increase	$126,273,172	$99,975,095	$111,971,938	$116,131,419	$91,393,624
% Increase	3.03%	2.33%	2.54%	2.57%	1.97%
UGGA	**$920,230,293**	**$945,702,568**	**$979,797,001**	**$1,021,928,272**	**$1,061,783,475**
$ Increase	$21,250,000	$25,472,275	$34,094,433	$42,131,271	$39,855,203
% Increase	2.36%	2.77%	3.61%	4.30%	3.90%

The UGGA increase of 3.9 percent matches assumed Consensus Revenue tax growth. This is the second straight year that the Governor has made good on his campaign promise to align the two.

The $91.4 million increase to Chapter 70 reflects several policy choices, including:

- Increasing Foundation Budget rates for "employee benefits and fixed charges" by between 2 and 10 percent depending on grade and type of school;
- Ensuring that all school districts receive at last $20 per pupil in new state aid;
- Allowing districts that are judged to have too high a local share of school funding to reduce their contributions;
- Providing sufficient state aid to ensure that all districts meet their base "Foundation Budget."

Finally, House 1 adopts the process for identifying low-income students (who receive higher funding allocations) first proposed in the Governor's FY 2017 budget. The final FY 2017 budget included a hybrid system for identifying low-income students due to concerns that some districts would be negatively impacted by the Administration's plan.

House 1 level funds all of the major educational reimbursement accounts, including those for special education and charter school costs. Unlike the Governor's FY 2017 budget, House 1 does not propose any changes to the formula for reimbursing district schools for charter school costs.

Figure 5. Education Reimbursement Accounts, FY 2017 & FY 2018

Program	FY 2017 Funding	FY 2017 Reimbursement Level	FY 2018 House 1	FY 2018 Estimated Reimbursement Level
SPED Circuit Breaker	$277,281,180	74.0%	$277,281,180	70.48%
Charter School Reimbursement	$80,500,000	58.5%	$80,500,000	50.87%
Regional School Transportation	$61,021,000	72.0%	$61,021,000	69.90%
Homeless Student Transportation	$8,350,000	32.0%	$8,350,000	29.36%
Non-Resident Pupil Transport	$250,000	7.8%	$250,000	7.80%

Early Education and Higher Education

House 1 essentially level funds early education spending at $568 million. This level is unlikely to reduce the state's waiting list (approximately 25,000) for subsidized childcare, but does include $7 million to support rate increases for center-based child care centers.

In higher education, House 1 proposes one percent funding increases for the University of Massachusetts and state universities and slightly larger increases (between 1.5 – 2.5%) for community colleges due to collective bargaining costs. House 1 also includes a proposal to study tuition retention for state universities and community colleges. Tuition retention, which exists at UMass, allows a campus to keep all student tuition received.

Figure 6. Early Education & Higher Education, FY 2017 & FY 2018

	FY 2017 Current	FY 2018 House 1	$ Difference	% Difference
Early Education	$567,552,842	$568,030,468	$477,626	0.08%
University of Massachusetts	$508,292,447	$513,375,371	$5,082,924	1.00%
State Universities	$247,990,809	$250,268,692	$2,277,883	0.92%
Community Colleges	$268,836,440	$273,963,784	$5,127,344	1.91%

Transportation

House 1 frees up $60 million for other budgetary purposes by reducing the MBTA transfer from $187 million to $127 million while also committing $60 million in capital funds to the MBTA. While this approach should result in the same amount of total resources available to the MBTA, it reduces the state's recent operating support for the MBTA by 33 percent and places that money at the discretion of the Administration.

The reduction to the MBTA transfer is partially offset by $29.4 million additional sales tax revenue that will be dedicated to the MBTA if the Governor's sales tax proposals are adopted (as a result, the sales tax transfer in House 1 is $15 million higher than the amount assumed in the recent Consensus Revenue agreement).

Figure 7. Transportation, FY 2017 & FY 2018

	FY 2016 GAA	FY 2016 Actual	FY 2017 GAA	FY 2017 Current	FY 2018 H1
MassDOT transfer	365,025,340	316,468,038	329,085,302	359,085,302	344,311,545
MBTA transfer	187,000,000	171,416,667	187,000,000	187,000,000	127,000,000
Regional Transit transfer	82,000,000	82,000,000	82,000,000	82,000,000	80,000,000
Merit Rating Board	9,553,119	9,553,119	9,695,430	9,695,430	9,695,430
MBTA sales tax	985,200,000	986,200,000	997,700,000	992,200,000	1,021,600,000
Total	1,628,778,459	1,565,637,824	1,605,480,732	1,629,980,732	1,582,606,975

Other non-discretionary spending

Group Insurance Commission costs increase just $24.9 (1.5%) million in House 1 and this increase is offset by contributions from municipalities covered through the GIC. GIC net costs are partially held steady by recently adopted benefit and plan design changes, but about $40 million in FY 2018 savings is related to a proposal (section 29 of House 1) to cap GIC provider payments at 160 percent of the Medicare rate. Rate caps are a new strategy to control GIC cost growth that could result in higher provider rates for non-GIC insurers.

Debt service and state retiree health benefit cost growth is minimal in House 1. In total, spending in these two areas increases just $22.6 million over FY 2017 – less than one percent.

Figure 8. Other Non-discretionary programs, FY 2017 & FY 2018

	FY 2017 Current	FY 2018 House 1	$ Difference	% Difference
Debt Service	$2,636,176,173	$2,658,287,940	$22,111,767	0.84%
Retiree health care	$440,000,000	$440,569,153	$569,153	0.13%
Group Insurance Commission	$1,637,028,930	$1,661,961,313	$24,932,383	1.52%

Commonly underfunded programs

In recent years, chronic underfunding of indigent legal defense (CPCS), family homelessness prevention and county sheriffs have contributed to midyear funding gaps. To avoid a similar problem in FY 2018, it is important that these accounts are appropriately funded at the start of the fiscal year.

House 1 appears to provide sufficient funds for CPCS and the sheriffs, but is relying on a sizable reduction in demand for family homelessness prevention programs. Caseload for these homelessness prevention programs has declined in the last two years, with the current caseload approaching its lowest level since FY 2011.

Figure 9. Underfunded accounts, FY 2017 & FY 2018

	FY 2017 GAA	FY 2017 Projected	FY 2018 H1
Indigent legal defense	$172,754,716	$220,032,217	$227,453,599
Family homelessness	$187,477,612	$215,617,177	$195,776,242
Sheriffs	$555,142,023	$583,189,305	$610,953,043

Closing the budget gap

State budget-makers face an $832 million structural deficit in FY 2018. The Governor's budget closes that gap as follows:

Figure 10. FY 2018 budget gap

Estimated Gap	$832
Employer assessment	$300
Tobacco settlement/OPEB	$129
Sales tax timing (one time)	$95
New ongoing tax revenue	$62
Capital gains	$52
Reduced transportation transfers	$48
GIC rate caps	$40
TAFDC eligibility/caseload	$43
Increased DOT revenues	$20
Other cuts	$43
Total solutions	$832

The Baker Administration uses a number of measures to close the budget gap including a number of spending, revenue and policy provisions. Below are brief descriptions of some of these strategies that generate $50 million or more in revenue or savings.

Employer assessment - $300M

As mentioned earlier, House 1 relies on $300 million in new ongoing revenues from a $2,000 per employee assessment for certain employers that do not meet health care coverage criteria. It is not known how many companies are expected to be impacted by the assessment.

Tobacco settlement retiree health contribution - $129 million

A portion of the approximately $250 million each year that the state receives as part of a settlement with tobacco companies is dedicated to the state's retiree benefit trust fund under state law (10 percent beginning in FY 2013 with a 10 percent increase each year until 2022.) However, since the first year of implementation, the state has dedicated unspent debt service appropriations to cover the transfer to the retiree benefit trust in lieu of tobacco revenues. Since FY 2016, the budget has frozen the amount of the trust fund deposit at a lower level than the contribution called for by the original law. In FY 2018, 60 percent ($154.2 million) in settlement revenues should go toward retiree health benefits. House 1 freezes the contribution at 10 percent ($25.7 million) and makes the contribution from assumed debt service reversions, thereby freeing up $129 million in budget resources.

Sales tax timing - $95 million
House 1 includes a provision (section 34) that would speed up sales tax revenue collections for the state by requiring credit card companies to remit sales tax on a daily basis. This change has the impact of moving revenue that would otherwise be collected in the first month of FY 2019 to the last month of FY 2018. This change will increase total budget revenues by $125 million, but $30 million of that amount goes directly to the MBTA and School Building Authority sales tax transfers. This is the only one time solution in House 1.

New ongoing tax revenues - $62 million
House 1increases ongoing tax revenue by $62 million by making temporary accommodations like Airbnb subject to the hotel excise tax ($12 million) more aggressively enforcing sales tax collection ($30 million); and modernizing notification of income tax for some workers to improve compliance ($20M).

Capital gains/Stabilization Fund - $51.5 million
House 1 proposes a positive change for how the state deposits money into the Stabilization Fund that results in an additional $51.5 million in tax revenue being available for the budget.

Currently, capital gains revenues above a threshold amount are dedicated to reserves (the FY 2018 revenue agreement assumes $103 million in above threshold revenue). In practice, the current system has two shortcomings. First, capital gains revenues that have been far different from initial projections has caused budget problems. Second, the deposit isn't made until the end of the fiscal year and it has proven tempting for budget-makers to suspend the deposit from ever occurring if budget challenges arise.

The House 1 proposes a two-prong approach. Half of expected above-threshold capital gains revenue would be transferred to the Stabilization Fund at the start of the fiscal year – and that amount would not change regardless of actual collections. In addition, 50 percent of tax revenue above the consensus benchmark would be dedicated to the Stabilization Fund at the end of the year. Instituting a pre-budget transfer to the Stabilization Fund is a practice for which MTF has strongly advocated. Combining that with an end-of-the-year deposit that can be tracked against benchmark after each month instills fiscal discipline, makes the practice more transparent and increases the likelihood that the deposits will be made.

The House 1 proposal frees up $51.5 million in expected capital gains revenue above threshold for the operating budget, while depositing the other $51.5 into the Stabilization Fund. Without this change, state law requires $103 million to be held aside from the budget (though no deposit to the Stabilization Fund would be made until the end of the year).

Policy Changes

The Governor's FY 2018 budget takes a more proactive approach to policy including 83 policy sections, compared to 44 in FY 2016 and 43 in FY 2017. Below is a description of major policy proposals included in House 1 that have not already been mentioned:

Health care cost transparency (section 11)
Requires the Center for Health Information and Analysis (CHIA) to publish health care rates paid by MassHealth and private insurers to health care providers.

Non-acute hospital assessment (sections 19, 42 – 45, 79 – 80, 85)
Extends the acute hospital assessment included in last year's budget to non-acute hospitals to ensure compliance with federal regulation. The new assessment (approximately $13 million) will be dedicated to a trust fund and used to make Medicaid payments to non-acute hospitals.

MBTA retirement fund (section 23)
Allows the state's Pension Reserves Investment Management Board to manage the MBTA pension fund.

Veteran tax credit (sections 30, 35, 78)
Creates a two year, $2,000 tax credit for businesses that hire qualified veterans. This credit is estimated to cost $1 million annually.

Health care cost growth caps (sections 50 – 54)
Creates a tiered system of capping annual growth of payment rates charged by providers. Growth rates that exceed the relevant caps are subject to disapproval by the Division of Insurance

Consolidated net surplus (section 60)
Directs up to $10 million of any FY 2017 budget surplus to the Mass. Life Science Investment Fund and up to $10 million to support the Community Preservation Act.

Conclusion

Governor Baker's FY 2018 budget proposal is directionally sound. It reduces the state's structural deficit for the third year in a row by replacing several one-time solutions with new ongoing revenue sources while replenishing the Stabilization Fund through a novel approach. On the spending side, House 1 offers a familiar blueprint, with large increases to MassHealth leaving room for targeted investments in areas like local aid and changes to the operation of Bridgewater State Hospital, but little else for other discretionary spending.

House 1 is most noteworthy for the number of major policy proposals it contains. From the employer assessment, to tax modernization, to attempts to cap health care costs in both the public and private arena, there is little doubt that each of these proposals will be closely watched and fiercely debated over the next six months.

Massachusetts Taxpayers Foundation - Fiscal 2018 Budget Summary

		FY 14 Final	FY 15 Final	FY 16 Final	FY 17 GAA	FY 17 Projected	FY 18 H1
Health Care		**13,015**	**14,519**	**15,647**	**16,263**	**16,391**	**17,196**
MassHealth	MAS	12,121	13,583	14,741	15,340	15,468	16,262
Trust Funds [1]	MAT	661	701	651	658	658	642
Other Health Care	OTH	232	235	255	264	265	292
Local Government Support		**5,919**	**6,023**	**6,211**	**6,347**	**6,351**	**6,488**
Chapter 70 Education Aid	CHA	4,303	4,402	4,514	4,628	4,628	4,719
Other K-12 Education Aid	OED	602	585	623	603	613	614
Unrestricted Local Aid	ULA	948	973	1,007	1,049	1,049	1,089
Other Local Aid	OLA	67	63	67	67	61	66
Other Education		**1,612**	**1,710**	**1,760**	**1,732**	**1,734**	**1,741**
Early Education	EEC	524	544	566	569	568	568
Higher Education	HED	1,088	1,167	1,194	1,164	1,166	1,173
Human Services		**5,404**	**5,665**	**5,916**	**5,952**	**6,015**	**6,335**
Developmental Services	DEV	1,553	1,715	1,847	1,891	1,903	1,979
Family Services	FAM	977	1,077	1,156	1,166	1,195	1,219
Cash Assistance	CAS	794	716	714	678	680	635
Mental Health	DMH	708	719	740	761	761	773
Public Health	DPH	560	601	553	593	586	603
Housing Support	HOU	420	422	471	429	457	448
Senior Support	ELD	253	271	283	285	284	530
Veteran Services	VET	140	143	152	149	150	149
Public Safety		**2,523**	**2,632**	**2,709**	**2,635**	**2,734**	**2,812**
Corrections	COR	591	607	612	610	640	672
Sheriffs	SHF	542	582	606	555	583	611
Judiciary	JUD	828	863	889	860	907	926
Police	POL	310	308	323	342	335	344
District Attorneys	DAS	103	108	115	117	119	121
Attorney General	AGO	43	44	45	47	47	49
Other Public Protection	OPP	106	120	119	105	103	90
Transportation		**624**	**803**	**637**	**608**	**638**	**561**
MassDOT	TRP	272	471	359	329	359	344
Regional Transit	RTA	68	40	82	82	82	80
Registry	RMV	9	9	10	10	10	10
MBTA Discretioary Assistance	MTA	275	283	187	187	187	127
Economic Development		**396**	**318**	**394**	**364**	**349**	**364**
Business and Labor	BUS	176	91	152	134	128	137
Environment and Energy	ENV	220	227	242	230	221	227
Employee Benefits		**1,815**	**2,104**	**2,151**	**2,175**	**2,175**	**2,202**
GIC[2]	GIC	1,395	1,683	1,726	1,735	1,735	1,761
State Retiree Benefits (OPEB)	RET	420	420	425	440	440	441
Capital Support		**2,423**	**2,498**	**2,518**	**2,636**	**2,636**	**2,658**
Debt Service	DBT	2,118	2,219	2,240	2,370	2,370	2,416
Contract Assistance	DCA	304	279	278	266	266	243
Other/General Government	**GGO**	**707**	**617**	**502**	**536**	**594**	**551**
Off budget spending		**3,179**	**3,559**	**3,825**	**4,060**	**4,033**	**4,301**
Pensions	PEN	1,630	1,793	2,001	2,198	2,198	2,394
MA School Building Authority	SBA	729	772	815	835	813	862
MBTA	MTAF	799	971	986	998	992	1,022
Workforce Training	WFT	21	24	23	23	23	23
Other off budget	OOB	0	0	0	6	6	0
Total on-budget spending		**34,437**	**36,888**	**38,444**	**39,249**	**39,617**	**40,909**
Total (Including Pre-Budget Transfers)		**37,616**	**40,447**	**42,269**	**43,309**	**43,650**	**45,210**

[1] Includes the Medical Assistance Trust Fund and the Delivery System Transformation Initiatives Trust Fund

[2] Includes health care costs for municipalities and authorities that reimburse the state