Massachusetts Taxpayers Foundation

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# MTF Bulletin

*January 26, 2022*

## Governor Baker's FY 2023 Budget

Governor Baker has introduced his eighth and final budget recommendation. As in previous years, he has put forward a fiscally responsible plan that continues to build reserves and follow through on ongoing funding commitments in areas like K-12. This year's proposal also puts forward several tax reduction initiatives designed to reduce costs of living and improve competitiveness. This Bulletin analyzes the Governor's budget highlighting notable revenue, spending, and policy proposals in the $48.2 billion plan.

### Budget Overview

The Governor's budget recommends $48.2 billion in line-item spending, along with $7.1 billion in off-budget transfers, for total spending of $55.3 billion, an increase of $895.4 million over the FY 2022 budget signed into law last July.

*Figure 1. Spending and Revenue in Brief*

**Spending**

| | FY 2022 GAA | FY 2022 Current | FY 2023 Gov | $ Diff. v. GAA |
|---|---|---|---|---|
| Line Item Spending | $47,613.8 | $49,414.0 | $48,231.4 | $617.6 |
| Medical Asst. Trust | $471.4 | $751.5 | $575.9 | $104.5 |
| Pre-budget Transfers | $5,755.5 | $5,787.2 | $6,258.8 | $503.3 |
| Other off-budget | $600.0 | $600.0 | $270.0 | -$330.0 |
| **Total Spend** | **$54,440.7** | **$56,552.6** | **$55,336.1** | **$895.4** |

**Revenue**

| | FY 2022 GAA | FY 2022 Current | FY 2023 Gov | $ Diff. v. GAA |
|---|---|---|---|---|
| Total Tax Revenue | $34,540.4 | $36,001.0 | $36,299.0 | $1,758.6 |
| *Consensus Tax Revenues* | *$34,350.0* | *$35,951.0* | *$36,915.0* | *$2,565.0* |
| *Tax settlements* | *$50.0* | *$50.0* | *$50.0* | *$0.0* |
| *Total rev initiatives* | *$140.4* | *$0.0* | *-$666.0* | *-$806.4* |
| Federal | $14,117.8 | $15,379.5 | $12,393.2 | -$1,724.6 |
| Departmental & Transfers | $7,234.8 | $7,141.7 | $7,404.6 | $169.8 |
| Stabilization Fund Transfer | -$1,170.8 | -$1,261.0 | -$749.1 | $421.7 |
| **Total Revenue** | **$54,722.2** | **$57,261.2** | **$55,347.7** | **$625.5** |

The primary revenue source used to balance the budget is $36.3 billion in projected tax revenue, a figure consistent with the consensus agreement reached with House and Senate budget leaders earlier in the month and then adjusted for tax changes proposed by the Administration. Governor Baker also relies on $12.4 billion in reimbursements from the federal government, primarily related to the state's Medicaid program, and $7.4 billion in lottery and other department revenues and transfers. The Administration estimates that the state's Stabilization Fund will grow by a further $749.1 million in the next fiscal to end the year with a balance of $6.63 billion.

*Governor Baker's Budget – Five Things to Know*

Among the many elements in Governor Baker's budget, several proposals and assumptions stand out as being particularly notable. Each of these items will play a significant role in the budget process in the months ahead.

1. The Governor's budget assumes approximately $700 million in tax reductions he proposed in separate legislation. These changes are designed to reduce the cost of living and improve Massachusetts' competitiveness;
2. This budget does not include any federal Fiscal Recovery Funds or anticipated budget surplus spending;
3. The budget includes a major reduction in both MassHealth spend and associated federal revenue due to the expected end of the federal Public Health Emergency, which will allow MassHealth to re-determine member eligibility, but also mean the end of $1 billion in enhanced federal reimbursements;
4. The FY 2023 budget contains a revised hospital assessment that will help support more than $1 billion in new off-budget spending related to the state's Medicaid Waiver reauthorization; and
5. The cost of implementing the Student Opportunity Act rises dramatically in the second year, which is reflected in Governor Baker's proposed $485.2 million increase for Chapter 70. This increase would be even greater if inflation growth was not capped at 4.5 percent by statute.

## FY 2023 Budget Revenues

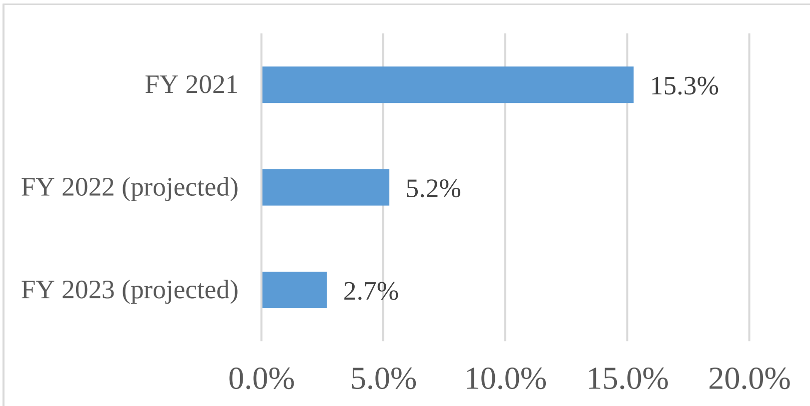
Governor Baker's budget relies on $56.1 billion in revenue, comprised of hundreds of individual sources. To assess the Governor's revenue approach, this bulletin drills down on four broad revenue topics:

- Tax revenue assumptions and new tax proposals;
- Non-tax revenue initiatives;
- Notable non-tax revenue assumptions;
- Examination of ongoing versus one-time revenue initiatives

*Tax Revenue in Governor Baker's Budget*

The revenue foundation for the Administration's budget is the $36.9 billion consensus estimate that will be used for each iteration of the FY 2023 budget proposal.  This estimate assumes that baseline tax growth will slow markedly in FY 2023 after two exceptionally strong years.

*Tax Revenue Growth – FY 2021 to FY 2023*




Governor Baker's budget reflects a number of notable tax changes, the majority proposed in companion legislation that will decrease expected tax collections by more than $665 million in FY 2023.

*Figure 3. Tax Revenue Adjustments in FY 2023*

| | FY 2023 Gov |
|---|---|
| **Total Tax Revenue** | **$36,299.0** |
| Consensus tax revenue | *$36,915.0* |
| Tax settlements | *$50.0* |
| Tax Revenue Proposals | |
| *Dependent tax credits* | *-$167.0* |
| *Rent deduction* | *-$77.0* |
| *Senior circuit breaker* | *-$60.0* |
| *Estate tax* | *-$231.0* |
| *Short-term capital* | *-$117.0* |
| *No-tax status* | *-$41.0* |
| *Research tax credit* | *-$15.0* |
| *Federal income conformity* | *$42.0* |

In separate legislation, Governor Baker introduces six major proposals that lower tax-related housing costs, provide relief for low-income residents and those caring for dependents, and reduce incentives for taxpayers to relocate.[1] In addition, the Governor's budget includes several outside sections making more targeted adjustments to the tax code.

The Governor's tax provisions include:

- ***Childcare and dependent tax credits*** (-$167 million) – the Governor's proposal doubles the maximum allowable tax credits for child and dependent care costs, as well as the dependent tax credit available to families without eligible care expenses. The expansion builds on work in the FY 2022 budget which converted these tax provisions from taxable income deductions into refundable credits, thereby enhancing the benefit for many families. The amount of the credit is based on eligible costs and number of children or dependents in a household. This change would be retroactive to January 1st.
- ***Rent deduction*** (-$77 million) – the Administration proposes increasing the maximum rent deduction from $3,000 to $5,000. Renters can take a deduction on 50 percent of rent costs up to the maximum. This change would be retroactive to January 1st.
- ***Senior Circuit Breaker*** (-$60 million) – the Senior Breaker provides a refundable tax credit of up to $1,170 in TY 2021 to income-eligible seniors whose property taxes and water and sewer expenses exceed 10 percent of their income. Governor Baker proposes doubling the maximum credit to approximately $2,340.[2] The change would be retroactive to January 1st.
- ***No-tax threshold*** (-$41 million) – Governor Baker proposes increasing the income level at which earners must pay state income taxes. The Baker proposal would match the current federal thresholds for no-tax status. This change would be retroactive to January 1st.

*Proposed Adjustment to No-Tax Status Threshold*

| | Current MA Threshold | Proposed Threshold |
|---|---|---|
| Single | $8,000.0 | $12,400.0 |
| Head of Household | $14,400.0 | $18,650.0 |
| Joint filer | $16,400.0 | $24,800.0 |

- ***Estate tax*** (-$231 million) – Massachusetts is an outlier among the states on its estate tax. One of only 12 states with an estate tax, it has (along with Oregon) the lowest threshold for taxation (an estate of $1 million or more) and applies the tax to the entire value of estates that exceed the $1 million threshold, creating a significant cliff effect. Governor Baker proposes addressing both of these problems by increasing the threshold for the tax to $2 million and only applying the tax to the amount of the estate that exceeds the threshold. The Governor's budget assumes the full annualized value of this tax change in FY 2023, but the actual first-year impact is likely to be much less than $231 million. This change would be effective on July 1st.

[1] In addition to the tax change bill, Governor Baker has also filed legislation, which has no assumed revenue impact, designed to modernize statutory provisions related to tax administration.

[2] The maximum credit is adjusted for inflation each year and so the maximum credit in TY 2022 will be higher than $2,340

- ***Short-term capital gains*** (-$117 million) – Short-term capital gains are currently taxed at 12 percent, in contrast to the 5 percent rate for other forms of income. The Administration proposes bringing the short-term rate in line with other income tax rates. This change would be retroactive to January 1st.
- ***Research tax credit*** (-$15 million) – The Governor's budget clarifies industries eligible for the state's Research Tax Credit, addressing ambiguity in the current statute.
- ***Personal income conformity*** (+42 million) – The Massachusetts personal income tax code currently conforms to the 2005 version of the Internal Revenue Code (IRC). The Administration proposes tying our code to the IRC in effect for 2022. This change would represent "static" conformity, meaning that the state tax code would remain tied to 2022 and would not automatically adjust to federal changes barring state legislative action. The Administration's proposal would also decouple the Massachusetts income tax code from the current IRC with respect to the federal business income deduction. This change would be retroactive to January 1st.

The Administration proposes several other tax changes not expected to affect the bottom line. For the fifth consecutive year, the Administration proposes requiring credit and debit card processors to remit sales tax revenue on a daily basis, starting in FY 2026. Credit card companies, financial institutions and retailers strongly oppose this change as costly, cumbersome and out of line with practice in every other state. In addition, Governor Baker includes two sections related to determining whether or not the purchase of a software license is considered tangible personal property.

In total, Governor Baker's tax proposals have an annualized budget impact of between $650 and $700 million and represent the most sweeping set of tax proposals during his Administration.

*Non-tax revenue initiatives*

The Administration's budget proposes or assumes $65 million in budgeted revenue related to non-tax revenue proposals:

- ***Taxes on sports wagering*** (+$35 million) - This is the fourth consecutive budget assuming revenue from the legalization of sports wagering, which the Administration proposed at the start of the legislative session. The House passed legislation to legalize sports gaming in July of last year, but the Senate has yet to take up the issue.
- ***Cashless lottery*** (+$30 million) – For the third consecutive budget, the Administration proposes legalizing debit card purchase of lottery and scratch tickets. To date, the legislature has not adopted this change.

In addition to new non-tax revenue proposals, several of the budget's non-tax revenue assumptions are worth explaining:

- ***Enhanced MassHealth reimbursements*** (-$1 billion) – Since the start of the pandemic, the federal government has increased its share of eligible Medicaid costs by 6.2 percentage points. In Massachusetts, this means that 56.2 percent of most MassHealth costs are reimbursed by the federal government. While this supplement may seem small, it increases state revenues by about $250 million per quarter. While the Biden Administration recently extended this enhanced rate through the end of FY 2022, the Administration assumes that enhanced reimbursements will not be available in FY 2023 resulting in approximately $1 billion less in federal reimbursements compared to the current year. In the Health Care section of the Bulletin, we will look at the implications of this assumption on MassHealth spending.

- ***Lottery*** (+$29.1 million v. FY 2022) – Based on the strong performance of lottery revenues over FY 2021 and FY 2022, he Administration assumes that net profits will be $1.186 billion in FY 2023, compared to $1.1569 billion in FY 2022. Based on actual collection trends, both of these estimates may be conservative.
- ***Gaming*** (level with FY 2022) – Gaming revenues estimates also appear relatively conservative. Not including revenue associated with legalized sports gaming, the Administration assumes gaming excises will be flat in FY 2023, with $181.3 million going to support the budget. Through November, collections from gaming have grown by more than 25 percent over FY 2021.
- ***Marijuana licensing fees*** (-$631K v. FY 2022) – The Administration assumes that marijuana licensing revenue will decline slightly in FY 2023 to $30.7 million. Licensing revenue in the current year has far surpassed the budget estimate of $17.5 million and is on pace to generate $31.3 million.

*Ongoing v. One-time revenues*

None of the revenue proposals included in the Governor's budget are one-time in nature, meaning that the revenue gains or revenue losses can be budgeted on in future years. Surging tax collections make one-time revenue solutions unnecessary and unwise in the current fiscal climate, however, the Baker Administration also deserves credit for consistently limiting and ultimately eliminating one-time resources as means to balance the budget. The House and Senate should follow this budget's lead in keeping temporary fixes out of the budget.

## Major Spending Areas

The Governor's budget increases line-item spending by $617.6 billion (1.4 percent) over the FY 2022 budget. However, this limited spending growth is misleading as it is driven by a $1.1 billion reduction in MassHealth spending related to member redeterminations. Excluding MassHealth, spending in the rest of the budget grows by 6.2 percent. While there are several reasons for this strong level of spending growth, implementation of the Student Opportunity Act and inflationary pressures likely play a significant role.

According to federal data, inflation for state and local government purchases over the last year is 5.9 percent, significantly more than the ten year average of 2.1 percent and more than the next highest rate of 4.5 percent during that time. Not all state spending accounts are sensitive to inflation and different types of spending experience different inflationary pressures, but rising costs could have a major impact on the state budget in FY 2023.

*MassHealth*

MassHealth is by far the single largest category of spending totaling $18.2 billion (37.6 percent) of Governor Baker's FY 2023 budget. While MassHealth costs are significant, the Administration is budgeting MassHealth costs falling by $1.1 billion (5.9 percent) from the FY 2022 budget. Net of federal revenues, MassHealth costs will grow by $461.5 million (5.9 percent).

*MassHealth Spending and Federal Reimbursement*

| | FY 2021 Final | FY 2022 GAA | FY 2022 Current | FY 2023 Gov | $ v. GAA |
|---|---|---|---|---|---|
| Federal Reimbursement Share | $11,069.7 | $11,573.0 | $12,223.5 | $9,972.0 | -$1,601.0 |
| *% of Total Spending* | *60.1%* | *60.0%* | *61.2%* | *54.9%* | |
| State Share | $7,345.9 | $7,726.7 | $7,759.4 | $8,188.2 | $461.5 |
| **Total MassHealth Spending** | **$18,415.6** | **$19,299.7** | **$19,982.9** | **$18,160.2** | **-$1,139.5** |

*$ in millions*

The expected expiration of the federal Public Health Emergency (PHE) is the reason for both the decline in MassHealth spending and the larger reduction in federal reimbursements. At the conclusion of the PHE, MassHealth can recommence determining the continued eligibility of MassHealth clients, a process that has been suspended for the last two years per federal requirements. Largely due to the suspension of MassHealth eligibility checks, the program's enrollment has grown sharply, climbing from 1.75 million members prior to the pandemic to 2.16 members at the end of 2021. The Administration expects this enrollment number to decline significantly next year. At the same time, this budget reflects the loss of approximately $1 billion in enhanced federal revenue.

The Governor's budget also proposes major revisions to the hospital assessment used to support the state's Health Safety Net and to reinvest in the health care system through various payments authorized through the state's Medicaid waiver. The current assessment of approximately $422.5 million expires in October and, without further legislative action, would revert to $165 million in fees dedicated to the Health Safety Net Trust Fund. The Governor's budget proposes an increase of the assessment to $880 million, which will then be used for off-budget Medicaid payments eligible for federal reimbursement. Under the new plan, assessment revenue would be distributed as follows:

- $532 million will go to a new Hospital Investment and Performance Trust Fund (HIPTF), which will also receive federal reimbursements related to spending made through the new fund;
- $131 million will go to a newly created Population Health Investment Trust Fund;
- $62.5 million will go to the Safety Net Provider Trust Fund;
- $10 million will go to the Non-Acute Care Hospital Reimbursement Trust Fund;
- The remaining amount will support the state's existing Health Safety Net Trust Fund;
- The increased assessment will sunset after five years.

The HIPTF will spend an average of $1.2 billion annually for the next five years, with federal revenue augmenting hospital assessments. Payments fall into four categories:

- Health equity incentive payments;
- Clinical quality incentive payments;
- Additional rate payments for MassHealth acute hospital services, which will average $550 million annually; and
- Targeted payments to certain acute hospitals of at least $60 million per year.

The Population Health Investment Trust Fund will spend an average of $290 million annually for the next five years:

- The payments will go to qualifying providers or care organizations and will be used to support primary care and complex care management, to address health-related social needs, and other system reform activities; and
- The fund will be supported by a combination of hospital assessments and federal revenue.

The Governor's budget includes 24 sections to effectuate this proposal, which requires both state legislative and federal CMS approval. Under the plan, the assessment mechanism for hospitals is also altered. Currently, hospitals pay based on a flat assessment rate applied to their commercial patient charges. Under the new proposal, hospitals are organized into five groups, with each group paying a specified rate. Providers with the smallest share of commercially insured payments would pay a higher rate and the rate would decline for hospitals that are more reliant on non-publicly insured patients.

All of the sections related to the new assessment are made contingent upon necessary federal approval of the state's Medicaid waiver application.

Other healthcare-related proposals:

- *Behavioral health payor surcharge and trust fund* (sections 21 and 59)– The Administration proposes increasing assessments on health insurance payors by $33.7 million annually, with the funds to be deposited into a new Behavioral Health Access and Crisis Intervention Trust Fund. Assessment amounts will be based on the existing insurance surcharge used to support the health safety net. The new fund will support:
    - The creation and operation of a Behavioral Health Access Line to connect people with behavioral health services; and
    - Enhancements to the state's behavioral health delivery system, with a focus on ensuring the availability of around the clock crisis intervention services.
- *Substance use trust fund* (section 18) – The budget revises the existing off-budget substance use trust fund related to a provision of the state's Medicaid waiver, in order to increase authorized spending levels consistent with expected levels of revenue dedicated to the fund.
- *Expanded MassHealth rebates* (section 48) – For the third consecutive year, the Administration proposes expanding the MassHealth supplemental drug rebate program to include some medical devices and other medications outside of the existing program. There is no specific revenue estimate for this proposal.

- *Medicare Savings Expansion* (section 49) – The budget expands eligibility for Medicare Savings Program from 165 percent of the federal poverty level to 200 percent of the federal poverty level.

*Chapter 70 & Unrestricted Local Aid*

Governor Baker proposes $5.99 billion in direct aid to school districts (Chapter 70 aid) and $1.2 billion in unrestricted aid to cities and towns (UGGA).

*Chapter 70 and Unrestricted Local Aid in FY 2023*

| Program | FY 2020 | FY 2021 | FY 2022 | FY 2023 Gov |
|---|---|---|---|---|
| **C70** | **$5,175.99** | **$5,283.65** | **$5,503.27** | **$5,988.52** |
| *$ Increase* | *$268.42* | *$107.66* | *$219.62* | *$485.25* |
| *% Increase* | *5.5%* | *2.1%* | *4.2%* | *9.2%* |
| **UGGA** | **$1,128.62** | **$1,128.62** | **$1,168.12** | **$1,199.66** |
| *$ Increase* | *$29.67* | *$0.00* | *$39.50* | *$31.54* |
| *% Increase* | *2.7%* | *0.0%* | *3.5%* | *2.8%* |

The Governor's budget increases Chapter 70 aid by a record $485.3 million. This new investment appears to fully fund second year implementation of the Student Opportunity Act and ensure that each district reaches its foundation budget. The Student Opportunity Act (SOA) increases a number of cost factors used to determine each district's Foundation Budget. These increases will necessitate billions in additional state and local education spending over the next several years. Detailed information on the rates used to determine Chapter 70 aid are not included in the Governor's budget, but the increase is consistent with a phase-in of another 1/6 of the Foundation Budget changes required by the SOA to fully implement the law by FY 2027.[3]

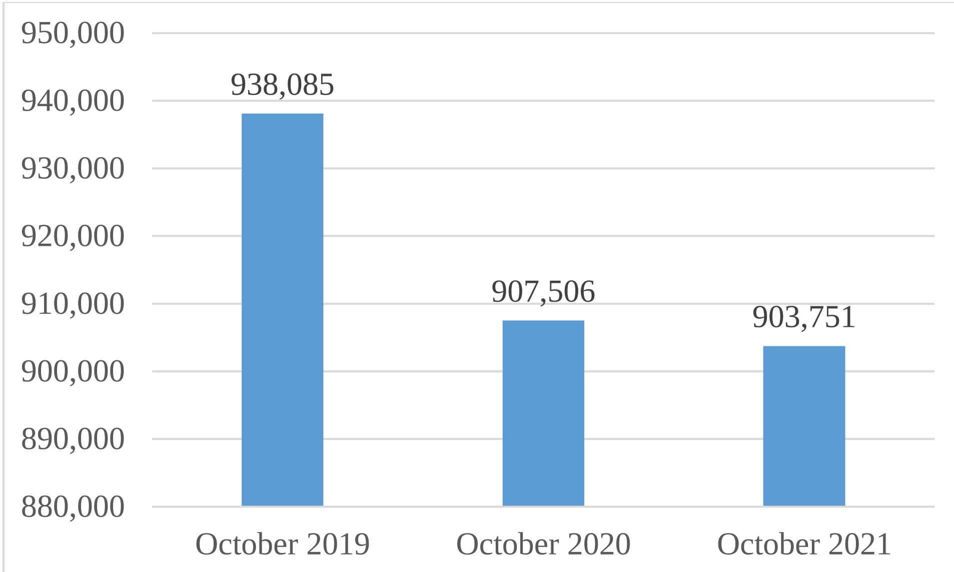
Each year the Foundation Budget is adjusted for inflation. Under state law, the inflation rate is the lesser of a calculation of state and local government inflation and 4.5 percent. This year, state and local government inflation is 5.9 percent, but it does not appear that the Baker Administration waives the 4.5 percent cap. This means that the cost of implementing the SOA would be greater if actual inflation data were used.[4]

Chapter 70 spending increases are partially offset by reduced costs due to enrollment loss. Between October of 2019 and 2020, K-12 enrollment declined by 30,579 students. At the time of last year's budget, the prevailing assumption was that the enrollment numbers would rebound as the pandemic eased. In expectation of this, lawmakers included a separate $40 million Chapter 70 enrollment reserve in the final FY22 budget. The expected spike has still not occurred, and statewide foundation enrollment declined a further 3,756 students from 2020 to 2021, mitigating Chapter 70 cost growth.

[3] Detailed Chapter 70 formula information, including rates, is published by the Department of Elementary and Secondary Education.

[4] Employee health care cost assumptions in Chapter 70 are adjusted by a separate inflation calculation.

*K-12 Enrollment, 2019-2021*




Consistent with a campaign promise made when first elected, Governor Baker increases unrestricted local aid to cities and towns by the expected rate of tax revenue growth in the coming year. In FY 2023 this means an increase of $31.5 million (2.7 percent) in unrestricted local aid.

The connection between expected tax revenue growth and local aid increases has added consistency and predictability to local aid increases in recent years, addressing what had been two chronic problems. However in FY 2021 and likely in FY 2022, actual tax revenue growth has far outpaced initial expectations, meaning that none of the state's tax revenue windfall has yet increased local aid appropriations. One possible alternative approach would be to base FY 2023 UGGA on expected tax revenue growth compared to the FY 2022 estimate used for the budget signed into law last July. This adjustment would increase next year's local aid increase to $85.3 million.

*Other K-12 Spending*

The Administration recommends $735.1 million for other major programs that reimburse school districts for costs related to special education, transportation, and charter school attendance. This is an increase of $110.3 million (17.7 percent) over the FY 2021 budget.

*K-12 Reimbursement Programs in FY 2023*

| Program | FY 2021 | FY 2022 GAA | FY 2022 Current | FY 2022 Reimb. % | FY 2023 Gov |
|---|---|---|---|---|---|
| SPED Circuit Breaker | $337.0 | $373.3 | $393.7 | 75% | $414.6 |
| Charter School Reimbursement | $116.8 | $154.6 | $154.6 | 87% | $219.4 |
| Regional School Transportation | $82.2 | $82.2 | $82.2 | 95% | $77.8 |
| Non-Resident Pupil Transportation | $0.3 | $0.3 | $0.3 | 6% | $0.3 |
| Homeless Student Transportation | $13.4 | $14.4 | $14.4 | 70% | $23.0 |
| **Total** | **$549.7** | **$624.8** | **$645.2** | | **$735.1** |

*Numbers in Millions*

The increases for special education and charter school reimbursements are related to provisions of the SOA. That bill expanded eligible costs for special education to include out-of-district transportation, to be phased-in over four years, and put the state on a schedule to fully fund charter school reimbursements over three years. The Governor's budget adheres to the SOA timeline for both of these commitments.

The Governor's appropriation for charter school reimbursement also reflects a policy section included in the bill, which would increase the required charter school tuition related to facilities costs from $893 per-pupil to $1,088 per-pupil (and adjusted for inflation going forward). Historically, tuition related to facilities costs is reimbursed by the state at 100 percent.

*Early Childhood Education*

The Administration's FY 2023 budget provides $820.3 million in funding for early childhood education programs. This amount represents an increase of $1.2 million over the FY 2022 GAA.

*Early Childhood Education Funding in FY 2023*

| Program | FY 2021 | FY 2022 GAA | FY 2022 Current | FY 2023 Gov |
|---|---|---|---|---|
| Income Eligible Subsidies | $383.6 | $298.7 | $292.6 | $368.1 |
| DTA and DCF Childcare | $263.6 | $358.9 | $359.1 | $325.5 |
| Parent Fee Assistance | $0.0 | $9.0 | $9.0 | $0.0 |
| Workforce Supports | $20.2 | $20.0 | $120.9 | $0.0 |
| Head Start | $15.0 | $15.0 | $15.0 | $15.0 |
| Other Early Education | $108.1 | $117.5 | $122.9 | $111.6 |
| **Total** | **$790.4** | **$819.1** | **$919.5** | **$820.3** |

*Numbers in Millions*

Governor Baker's budget increases funding for income-eligible childcare subsidies by $69.4 million, while assuming costs for DTA and DCF related childcare will decrease. The Administration does not maintain separate funding for early childcare workforce supports.

The separation between budget spending and COVID recovery spending makes assessing the childcare budget particularly challenging. Consistent with the data presented in this Bulletin, the figures above do not include $314 million in federal Childcare Stabilization Funds provided through the American Rescue Plan. These funds have provided operational grants to thousands of childcare providers starting in July of 2021. Childcare Stabilization Funds are likely to run out in the coming months, but the Department of Early Education and Care has committed to continuing these grants through at least the end of FY 2022 using a combination of unexpended state funds and other federal sources. The Governor's budget does not include resources to extend these grants in FY 2023, but it possible that the Administration will continue some form of Stabilization Grants through the next round of COVID response legislation.

*Higher Education*

Governor Baker includes $1.25 billion in direct support for public higher education campuses and $197.6 million in indirect costs for scholarships, student assistance and other higher education outlays. In total, the $4.45 billion investment is an increase of $62.1 million over spending in the FY 2022 budget.

*Higher Education Spending in FY 2023*

| Program | FY 2021 | FY 2022 GAA | FY 2022 Current | FY 2023 Gov |
|---|---|---|---|---|
| Community Colleges | $318.8 | $333.3 | $343.5 | $341.3 |
| State Universities | $291.8 | $298.4 | $323.8 | $319.9 |
| UMass | $565.4 | $574.9 | $589.1 | $586.5 |
| Scholarship Programs | $124.8 | $141.3 | $148.5 | $164.5 |
| Other Higher Education | $30.1 | $35.5 | $37.6 | $33.1 |
| **Total** | **$1,330.9** | **$1,383.3** | **$1,442.5** | **$1,445.4** |

*Numbers in Millions*

The Governor's budget increases the state's main scholarship line-item by $25.3 million, just under 20 percent. The line-item language does not make clear if the increase is to be used to support any specific scholarship programs. Increases to public higher education campuses vary by type. State universities receive, on average, increases of just over 6 percent while increases to community colleges and the University of Massachusetts are in the 1 to 2 percent range. It is not clear what is driving these increases, but differences in collective bargaining agreement implementation costs could be one factor.

The recent $4 billion COVID spending bill included several funding programs for higher education campuses, including $25 million for endowment incentive programs at UMass, state universities and community colleges. These funds are all available for the next several fiscal years and augment the funding proposed in the Governor's budget.

*Transportation*

The MBTA, MassDOT and Regional Transit Authorities (RTAs) receive $2.1 billion in the Administration's budget proposal, an increase of $201.9 million (10.8 percent) over the FY 2022 budget. Close to half of this new funding, 89.2 million, comes from a dedicated transfer to the MBTA which is determined by sales tax collections.

*Transportation Spending in FY 2023*[5]

| | FY 2021 | FY 2022 GAA | FY 2022 Current | FY 2023 Gov |
|---|---|---|---|---|
| Transfer to MTTF | $381.0 | $403.0 | $415.8 | $455.9 |
| Transfer to MBTA | $127.0 | $127.1 | $127.1 | $187.0 |
| Transfer to RTAs | $94.0 | $94.0 | $94.0 | $94.0 |
| MBTA Sales Tax Transfer | $1,261.4 | $1,235.9 | $1,266.0 | $1,325.1 |
| Other Transportation | $11.0 | $11.3 | $11.3 | $11.6 |
| **Total** | **$1,863.4** | **$1,860.1** | **$1,902.9** | **$2,062.0** |

*Numbers in millions*

Aside from the MBTA transfer, Governor Baker increases funding for other transportation accounts by $112.7 million over FY 2022, including a $60 million increase in direct support of the MBTA. As MTF has recently written, the MBTA is confronting significant operating and capital budget challenges. The state's annual transfer to the Massachusetts Transportation Trust Fund (MTTF) grows by $60 million, which is partially related to increasing capacity to manage additional federal infrastructure spending.

The Governor's budget puts forward fewer transportation related policy sections than in his FY 2022 proposal. The budget does include two sections related to regional transit authorities. One section (section 64) revises statutory language governing RTA contract assistance to require that funding be distributed according to a formula that is based upon established metrics. The proposal would eliminate language that allows the state to enter into contracts with RTAs for 50 percent of net operating costs, but does not reference any formula or performance metrics. The second section requires $90 million of the FY 2023 RTA appropriation to be distributed based on a metric-driven formula, with the remaining $3.5 million to go out as performance grants.

The Administration does not reintroduce a number of transportation-related sections proposed in their FY 2022 budget that were never enacted. These sections, which relate to TNC data collection, MBTA project delivery standards and transit oriented development, could be part of a future transportation bond bill.

*Other spending of note*

Below is a brief description of notable funding items and areas in the Governor's proposal

- ***New spending initiatives*** – Governor Baker spends $43.2 million to fund 16 new line-items and initiatives.
  - The recently created Police Officer Standards and Training commission, established in 2020 legislation, receives $5 million to operate the new agency, while a further $800,000 funds four Commissions created in the same bill:
    - The Commission on the Status of African Americans;
    - The Commission on the Status of Latinos and Latinas;

[5] The figures in this table do not include $1.03 billion in direct assistance to the MBTA and RTAs through the American Rescue Plan, or funding from earlier federal COVID response legislation.

        - The Commission on the States of Persons with Disabilities; and
        - The Commission on the Social Status of Black Mean and Black Boys.
    - The Governor sets aside more than $20 million to cover the cost of 2022 cycle elections;
    - The Massachusetts Life Sciences Center (MLSC) receives a $10 million appropriation. Historically, the MLSC has received its funding if there is a sufficient end of year budget surplus; and
    - The Governor creates a new $1 million line-item to fund human trafficking prevention grants to local law enforcement and other organizations.
- ***Housing*** – the Governor's budget increase funding by $135.1 million over the FY 2022 budget.
    - Residential Assistance for Families in Transition (RAFT) funding increases by $58 million over the FY 2022 budget, to a total funding level of $80 million. The RAFT program expanded significantly at the start of the pandemic and the Administration is maintaining the program as it works in conjunction with other state and ARPA supported housing and eviction diversion programs;
    - HomeBASE, which also provides housing stabilization funds to help families leave or avoid family shelter, would increase by $30.9 million, to $56.9 million; and
    - Individual homeless shelter rate funding is increasing by $25.4 million, to $83.3 million. These funds go to non-profit homeless shelters that provide shelter and services for homeless individuals
- ***Workforce*** – the Administration funds 27 separate workforce and career readiness items at $122.7 million, a reduction of $17.9 million from the FY 2022 budget amounts for these same items. The Governor's funding is in addition to more than $170 million in workforce investments included in the recent ARPA bill.
    - Early college and dual enrollment funding increases significantly to $18.3 million, from $11 million in the FY 2022 budget. Early college programs have improved college attendance and success rates for participating students; and
    - Adult basic education spending remains at $50 million in the Governor's plan, essentially the same level as in FY 2022. Since FY 2019, adult education grants have grown by close to 60 percent.
- ***Energy and environment*** – the Governor's budget increases funding for energy and environment spending by $14 million, to $337.2 million. If the Governor's funding for these items is maintained in the final budget, it will represent total spending growth of more than 30 percent since the FY 2019 budget.
    - The Office of the Secretary of Energy and Environmental Affairs grows by more than one-third in the Governor's budget, to $18.2 million.
    - Funding for the Office of Climate Adaptation and Preparedness increases by $1.5 million to $3.7 million.
    - The budget for the Department of Energy Resources, which is funded through assessments on energy utilities, grows by 14.9 percent to $5.1 million.

- ***Non-discretionary spending*** – the Governor's budget includes $5.3 billion for debt service, health care costs for current and retired public employees and the transfer to the state's retiree benefit trust fund.
    - Debt service costs grow by just over 2 percent to $2.8 billion; and
    - Health care costs for public employees and retirees will grow by just over 5 percent to $1.9 billion.
- ***Commonly underfunded accounts*** – consistent with previous proposals, the Baker Administration fully funds historically underfunded accounts, such as the houses of correction and emergency family shelters to account for cost growth. In years past, these accounts would often be underfunded, creating structural deficits approaching $200 million.
    - Public counsel services funding increases by $49.2 million in the Governor's plan. This increase is likely related to four policy sections that increase rates for CPCS attorneys.

## Stabilization Fund

Governor Baker's budget assumes the state will enter FY 2023 with a Stabilization Fund balance of $5.9 billion and that a further $749.1 million deposit is made in FY 2023 for a projected end of FY 2023 balance of $6.6 billion.

*FY 2022 and FY 2023 Stabilization Fund Estimates*

| **FY 2022 Starting Balance** | **$4,626.0** |
|---|---|
| *Planned Deposits* | $1,260.8 |
| **FY 2022 Ending Balance** | **$5,886.8** |
| *FY 2023 Capital Gains Deposits* | $681.0 |
| *FY 2023 Other Deposits* | $68.4 |
| *FY 2023 Withdrawal* | $0.0 |
| **Assumed End of Year Balance** | **$6,636.2** |

*$ in Millions*

The Governor's short-term capital gains rate change reduces the FY 2023 Stabilization Fund deposits by $105.3 million, as the revenue associated with change is assumed to come from above-benchmark capital gains revenue.

## Policy Sections

Governor Baker's budget includes 89 policy sections, of which 28 have been previously proposed in some form by the Administration.

Policy sections related to revenue, health care, education and transportation have been highlighted earlier in the Bulletin. Other notable policy sections include:

- ***Cybersecurity & Resiliency Fund*** (section 9) – This section creates a new fund which will support the state's Modern Workplace Program, which promotes technology resilience for state entities, and to purchase secure technology devices. The fund will receive up to $20 million annually in otherwise unexpended funds.
- ***District Attorney and Sheriff Salary Increases*** (sections 11 & 30) – These sections increase salaries for District Attorneys and Sheriffs to $195,000.
- ***Retired State Police Appointments*** (section 14) – This section would allow the State Police Colonel to appoint honorably retired officers as special state police officers enabling them to perform detail work and other duties. These special officers will be appointed to one year terms and subject to limits on retiree earnings.
- ***Sick leave buyback*** (sections 24, 79-81 ) – These sections, which have been filed in several Administration budgets, would cap unused sick time for state employees at 1,000 hours.
- ***National Guard compensation*** (section 29) – This section increases the compensation due to National Guard Members, in the event of death or disability in the line of duty, from $100,000 to $200,000.
- ***Bow hunting changes*** (section 60 & 61) – These sections would legalize bow hunting on Sundays and reduce the prohibition on hunting near a dwelling from 500 to 250 feet.
- ***Probation and parole supervision fees*** (sections 70 & 71) – These sections eliminate monthly "supervision" fees charged to persons on probation and parole. Probation fees range from $45 to $60 per month.
- ***Supplemental pension transfer*** (section 82) – This section mirrors a provision in the FY 2022 budget by transferring $250 million from any FY 2023 budget surplus to the state's pension investment fund.

## Bottom Line

Governor Baker's proposal kicks off a FY 2023 budget development process that occurs in unique fiscal times. FY 2021, and FY 2022 to date, have seen tax collections far in excess of expectations which creates opportunity, but also significant challenges for making fiscally prudent and sustainable spending decisions. This task is made more complicated by the $2.3 billion in federal Fiscal Recovery Funds that lawmakers must still appropriate on top of the $4 billion spending plan passed earlier this session.

Governor Baker's final budget is consistent with the fiscal approach he has adhered to for the entirety of this tenure. The balance of the state's Stabilization Fund has grown each year during that time, while the budget has supported major new investments in priorities shared with the Legislature, including K-12 education, housing services and substance use prevention and he has done this without relying on new broad-based taxes. Governor Baker's FY 2023 budget also provides more than $650 million in targeted tax reductions to help those most in need and position the state for future growth.

The fiscal FY 2023 picture is not without challenges, however, and the Governor's proposal illustrates several that confront budget-makers:

- Maintaining core budget spending against inflationary pressures, while prioritizing investments that complement, not compete with, COVID recovery spending; and
- Addressing the loss of more than $1 billion in enhanced federal Medicaid reimbursements, while attempting to reassess program eligibility for thousands of MassHealth member; and
- Living up to the state's Student Opportunity Act commitments.

In the coming weeks, MTF will dive more deeply into the Governor's proposal, including a closer look at his tax change package, an examination of hospital and insurer assessments and an analysis of the interaction between the FY 2023 budget and the next round of COVID response legislation.