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Bulletin

May 15, 2003

MTF

House 2004 Budget: Some Reforms, But Structural Gap Remains

Despite a series of difficult decisions that affect virtually every state program and service, the House's recently adopted budget for fiscal 2004 -- like the Governor's -- does not fully address the underlying structural problem in the Commonwealth's finances. While both budgets represent tremendous progress in dealing with the fiscal crisis, the somber reality is that the expected $2.5 to $3 billion gap between revenues and spending in 2004 cannot realistically be resolved in a single year. Clearly, the state needs a comprehensive, multiyear financial strategy in order to fully address the problem.

Table 1
Fiscal 2004 Proposed Spending
($, Millions)

	Fiscal 2004	
	Governor	House
Direct appropriations	$22,858	$22,579
Other authorized spending:		
Off-budget Medicaid	0	337
Retained tuition/fees	231	0
Uncompensated care/ hospital rate relief	30	118
Other	79	79
Total	$23,199	$23,113
Increase over Fiscal 2003*		
Amount	$374	$288
Percent	1.6	1.3

* Based on MTF estimate of 2003 spending assuming $120 million of reversions (unspent agency appropriations) at end of fiscal year.

Although the reforms approved by the House are not as sweeping as those recommended by the Governor, taken as a whole the House plan reflects a serious effort at reform, with lawmakers embracing many of the Governor's reorganization proposals. However, given the real world constraints on the pace at which restructuring can be implemented -- and the limited amount of administrative savings that remain to be realized after almost $2 billion of spending cuts over the last two years – the reforms authorized in the House budget, like those proposed by the Governor, will have only a modest impact on the immediate fiscal crisis, though the savings will build over the longer term.

At the broadest level, the similarities between the House's 2004 spending plan and the Governor's "House 1" budget submission far outweigh the differences. Like the Governor, the House uses a conservative estimate of revenues that assumes essentially no growth in the state's tax base in the coming year, with no new taxes[1] and a heavy reliance on fee increases. After accounting for differing treatment of off-budget expenditures and the addition of approximately $113 million[2] in floor debate, the House's spending total is practically identical to the Governor's (see Table 1). To hold the spending increase over 2003 to roughly 1.5 percent during a period of rapid growth in health care and other costs, the House -- like the Governor -- proposes major appropriation reductions that will require services to be curtailed and state and local workforces to be reduced by thousands. Although well intentioned, the early retirement incentive plan adopted by lawmakers will not generate savings in addition to those already built into the House spending levels, and will in many departments make the necessary workforce reductions more difficult to manage.

At the same time, the House budget cuts aid to cities and towns by an almost identical amount as the Governor, bringing the total amount of local aid reductions since the fiscal crisis began to more than $750 million. The recommended cuts will exacerbate the financial squeeze on local budgets, leading to property tax hikes, layoffs, or service reductions in most, if not all, municipalities.

In another, unwelcome similarity between the House and the Governor, 2004 spending exceeds ongoing revenues in both budgets by several hundred million dollars. In the House budget, the operating imbalance is approximately $335 million after taking into account the use of one-time resources and a 2004 shortfall in the children's and seniors' fund.[3] This figure may well understate the operating gap since the lawmakers' spending plan also depends on almost $200 million of difficult-to-achieve Medicaid savings in excess of those proposed by the administration. In the Governor's budget, spending exceeds on-going revenues by almost $320 million, largely because of the budget's reliance on one-time Turnpike reserves and a controversial proposal to transfer state-owned land to the employee pension system in lieu of a significant portion of the required annual appropriation. On top of this operating imbalance, the administration has withdrawn its proposal to generate $75 million of new revenues in 2004 from casino gambling "blocking payments" and acknowledged that its plan to impose $90 million of new health insurance assessments was based on faulty analysis.

Revenues

The House budget, like House 1, is built on the $14.68 billion consensus revenue forecast for 2004, which provides for growth in baseline taxes of slightly more than one percent over the administration's forecast for 2003, a real decline after adjusting for inflation. Given the continued job losses in the state and a cloudy overall economic outlook, this estimate -- just $30 million higher than 2003 -- remains appropriately conservative.

[1] Apart from approximately $160 million of additional taxes, primarily from "corporate loophole closing," that is counted in both budgets.

[2] Including $28 million of transfers to the uncompensated care pool for hospital rate relief and $4 million of additional off-budget Medicaid expenditures.

[3] In addition to the operating shortfall due to 2004 operations, almost $100 million of additional deficits accumulated in the children's and seniors' fund in prior years goes unaddressed in the House budget.

Lawmakers are counting on $155 million of new tax revenues, largely by "closing corporate tax loopholes," from legislation proposed by the Governor and adopted by the Legislature in March. In addition to making controversial retroactive changes to the treatment of real estate investment trusts that are likely to be litigated by the affected taxpayers, the legislation goes well beyond mere "loophole closing," granting the Commissioner of Revenue unprecedented discretion and imposing a new -- and many believe almost impossible to meet -- burden of proof on taxpayers. In contrast, the House's decision to extend the investment tax credit for another five years is clearly an important step in shoring up the state's competitive position.

Like the Governor, the House relies heavily on new fee revenues in fiscal 2004. The already adopted increases that are counted in both budgets include $260 million from Registries of Deeds fees and $60 million from petroleum product delivery fees. The House also counts on $59 million of additional fee increases proposed by the Governor, as well as $31 million of court fee increases in lieu of the Governor's plan to collect existing probation fees more aggressively. The House did not adopt the Governor's proposal to move $131 million of tuition revenues off budget and increase tuition and fees retained by the campuses by an additional $100 million.

Health Care

In the massive Medicaid program the House budget takes an even broader approach than the Governor to containing rampant cost growth. Lawmakers have adopted almost all of the Governor's Medicaid savings initiatives and have proposed $171 million of additional savings in 2004, largely by establishing a new system of managed care for the disabled, the program's most expensive non-institutional population. However, the administration has questioned the ability to realize much of the cost reductions that the House has attributed to the plan.

While this initiative -- as well as administration proposals to manage eligibility and the utilization of services that have been embraced by the House -- may help rein in at least some of the enormous growth in Medicaid costs, other savings proposals in both budgets will only aggravate the crisis in the state's health care system.

A variety of measures -- including cuts in reimbursement rates for providers whose costs already far exceed the state's payments for service, higher co-pays, and enrollment restrictions -- will place an even greater burden on an overstressed system. And although tightening eligibility standards is almost certainly unavoidable on fiscal grounds, a significant portion of those denied access to Medicaid services will turn to the already overburdened free care system for their care.

Senior pharmacy In a fiscally questionable move, the House has retained the increasingly unaffordable senior pharmacy program, which the Governor recommended eliminating unless federal support for the program becomes available.

In order to sustain the program with a 30 percent lower appropriation in 2004, the House proposes changes -- including higher deductibles and co-pays -- that are likely to make the program even less financially viable in the future, and relies on one-time revenues from a complex and problematic scheme that diverts funds from proposed state contributions to the free care pool in order to temporarily generate additional federal Medicaid reimbursements.

At a broader level, there is a serious question whether this program can be afforded at all, given the current fiscal climate. However, it is clear that the proposed financing source for the program only undercuts the otherwise positive House initiative to address the large and growing deficit in the uncompensated care pool. Although hardly perfect, the plan for the uncompensated care pool recommended by House Ways and Means was generally recognized as a step forward in dealing with the pool's shaky finances.

Local Aid

The House -- like the Governor -- attempts to preserve the key financing principle of the education reform law: ensuring that all districts spend at the law's "foundation" standard of adequate school expenditures. Unfortunately, the deep cuts in overall levels of local aid in both budgets undermine this effort, all but guaranteeing significant layoffs and service reductions in the cities as well as the suburbs.

Like the administration, the House recommends total aid of just under $5.1 billion in 2004, an almost 5 percent reduction from the 2003 level and a 10 percent drop from 2002 (see Table 2). While the House recommends approximately $200 million less in Chapter 70 school aid than the Governor -- a reduction that primarily affects better off communities -- that difference is largely made up in other categories of local assistance. Although there are substantial variations in how much aid different communities get under the two budgets, those differences are fundamentally about how the pain of the almost equal amount of overall cuts is spread around.

Reorganizations and Reforms

Though not nearly as far-reaching as envisioned by the Governor, the restructurings in the House budget reflect a serious effort to improve the operations of state government on behalf of taxpayers. Most notable are the areas where the House has effectively adopted the Governor's recommendations in full, including:

- Grouping the 15 health and human services

Table 2
Fiscal 02-04 Local Aid
($, Millions)

	Fiscal 2002	Fiscal 2003	Fiscal 2004 Governor	Fiscal 2004 House
Chapter 70 school aid	$3,213	$3,259	$3,319	$3,118
General revenue sharing	1,271	1,120	885	1,049
Other school aid	883	763	690	695
Other non-school aid	252	177	186	206
Total	$5,620	$5,320	$5,080	$5,069

Note: Charter/choice aid of $12.7 million that the Governor includes in 2004 Chapter 70 aid is shown in "other school aid." For purposes of comparison, "general revenue sharing" includes lottery aid, additional assistance, payments in lieu of taxes and proposed mitigation aid.

departments into four clusters to improve collaboration among the agencies;

- Containing Medicaid cost growth;
- Establishing new executive offices for education, economic development and commonwealth development;
- Eliminating the Metropolitan District Commission and incorporating its functions into other state agencies with similar missions; and
- Consolidating the minor budgetary funds (with the notable exception of the children's and seniors' fund).

Although the House budget does not close some courts, as proposed by the Governor, it does redistribute workloads and establishes a more rational basis for allocating budget dollars and personnel. The House also authorizes limited transferability of appropriations among the individual courts -- subject to the approval of the ways and means committees -- a modest step toward the more balanced use of court resources.

The House is to be commended for bringing the share of health premiums borne by state workers more in line with the private sector -- in a scaled-back version of a gubernatorial initiative that addresses a long-time priority of the Foundation. Under the House plan, the percentage of premiums paid by current state workers will increase from 15 percent to 20 percent and, for workers hired after January 1, 2004, to 25 percent. The House action would save roughly $30 million in 2004, less than half the amount that would be saved under the Governor's proposal.

In another positive step, the House loosens the unreasonable restrictions on contracting out the delivery of state services that is imposed by the so-called Pacheco law. Under the House plan, the most onerous hurdle to competitive delivery of state services -- the "most cost efficient" standard -- would be suspended for two years. However, in a step backward from the initial Ways and Means proposal, floor amendments excluded the MBTA from this provision and watered down a second initiative that would have completely lifted the Pacheco law's strictures for the Executive Office of Transportation and Construction and the University of Massachusetts, substituting two much smaller agencies, the Division of Capital Asset Management and the Bureau of State Office Buildings.

Reflecting a consensus among educational experts, the House budget rejects the Governor's proposal to dismantle the University of Massachusetts system. Regrettably, the highly politicized focus on the University of Massachusetts has drawn attention away from potentially constructive proposals to rationalize the state and community college system.

Capital

Legislative Bond Cap Included in the House budget is a well-intentioned but misguided proposal to limit borrowing for capital projects to $800 million per year for the next five years. The administration is currently operating under a self-imposed $1.2 billion annual bond cap. The proposed legislative cap would exacerbate the Commonwealth's persistent capital funding crunch while doing little to resolve the fiscal crisis or reduce the state's heavy debt burden.

- Foregoing $2 billion in capital spending over the five-year period would only add to the backlog of approved but unfunded capital projects that currently totals nearly $10 billion. Over $2.6 billion in bond financing was approved by the Legislature and Governor in 2002 alone. Important capital priorities ranging from roads and bridges to housing and higher education have been sacrificed while the state built the Central Artery; furthermore, for the next decade up to half of the state's federal highway aid will be used to repay Grant Anticipation Notes issued to help finance the Artery.

- Because bond payments are typically spread out over 20 years, slashing capital spending by $400 million per year would yield debt service savings of only roughly $15 million in fiscal 2004 and $45 million in 2005, a small dent in the overall budget shortfall.

- Growth in debt service over the last decade has been steady but far below the budget-busting, double-digit rates experienced in the late 1980s, and, at about seven percent of the operating budget, debt payments are manageable.

- While Massachusetts has among the highest levels of outstanding debt in the nation, the lower cap will not produce a significant improvement in the state's ranking.

Turnpike Interstate Maintenance The House has rejected the Governor's proposal to use $191 million of Turnpike Authority reserves as a one-time funding source to help balance the state's budget. The Commonwealth would have provided $133 million in contract assistance to pay the Turnpike's debt service, to be reimbursed by Turnpike toll revenues, and merged administrative and maintenance functions of the authority with the Highway Department.

Instead, the House included in its budget an unusual proposal to transfer responsibility for the maintenance and policing of several interstate highways in central and western Massachusetts from the Highway Department to the Turnpike Authority. The Turnpike Authority expects to be able to absorb some of the cost without state reimbursements or increased tolls; other roads would require payments from the Commonwealth. An apples-to-apples comparison of the highway department and Turnpike costs is needed to determine if this approach will actually save the state any money.