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Bulletin

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MTF

2006 Budget Conference Challenge: Reducing Reliance on One-Time Revenues And Outside Sections

With the recent passage of the 2006 Senate budget, the deliberations on state spending for the coming fiscal year have moved to the six-member conference committee that must iron out the differences between the House and Senate budget versions. After both branches vote on the resulting compromise bill, the Governor will have ten days to veto any provisions he deems objectionable.

While the dollar differences between the legislative budgets are marginal in the majority of accounts—with no difference at all in almost half of the roughly 700 line items in the two budgets—higher recommended spending in several areas brings the Senate total to $25.9 billion, $358 million above the House and $1.0 billion above estimated 2005 spending (see Table 1).[1]

Table 1
Proposed Fiscal 2006 Budgets
($, Millions)

	Total Spending	Change from 2005 Amount	Change from 2005 Percent
House	25,572	679	2.8
Senate	25,931	1,037	4.2

Note: Spending totals include "off-budget" spending (primarily for pension and health care costs) and exclude an estimated $712 million of assistance to MBTA and $488 million of school construction funding to be paid from dedicated sales taxes.

The additional spending in the Senate plan—with health care, criminal justice, and education the primary beneficiaries—would certainly provide much-needed relief for these programs, many of which were hard hit by previous spending cuts. Unfortunately, the Senate proposes to pay for the added expenditures almost entirely from one-time revenues, bringing the overall reliance on non-recurring resources in 2006 to a level that would only exacerbate the long-term structural problems in the state budget.

[1] The comparison of the 2006 House and Senate appropriation totals with estimated 2005 spending is complicated by differences in accounting for Medicaid spending in the two budgets. While both budgets recommend a full twelve-month appropriation for 2006 Medicaid costs (unlike the Governor), the amount of Medicaid spending paid from fiscal 2005 revenues would be reduced under the Senate proposal to move to "cash basis budgeting" in 2005, resulting in lower overall spending for the fiscal year. In the calculation of the 2006 change from 2005 spending shown above, we do not adjust 2005 for the Senate's Medicaid accounting proposal, but do exclude $232 million of proposed 2006 appropriations for Medicare "buy-in" costs that were previously financed via a reduction in federal Medicaid reimbursements.

The Senate budget uses more than $650 million of one-time resources to finance 2006 appropriations, almost $300 million more than proposed by the House. To their credit, Senate budget makers have formally recognized that the 2006 consensus tax forecast of the two branches is overly conservative, by mandating that the first $236 million of 2006 tax collections in excess of that forecast be used to repay withdrawals from the stabilization fund. However, even with these added revenues, the Senate budget would still depend on more than $400 million of one-time receipts in 2006, an unacceptably high amount given the continuing economic recovery. By comparison, the House's dependence on non-recurring resources would be less than $150 million assuming the same level of additional revenues.

It is unfortunate that the Senate—and apparently the House as well—assumes $100 million of new 2006 tax revenues from the closing of so-called "corporate tax loopholes." The proposals to be included in this yet-to-be enacted legislation are likely to be drawn from a grab bag of initiatives originally recommended by the Governor. It makes little sense to increase business taxes—the third round of such increases in as many years—at a time when the economy has recovered only a small fraction of the more than 200,000 jobs lost in the recession.

The likely level of 2006 tax revenues will be a critical issue for the conference committee's deliberations, as well as for lawmakers' subsequent consideration of a final supplemental appropriation bill for 2005. Despite the improving revenue picture, it would be a mistake to conclude that the state will generate huge surpluses in 2005 or 2006. And in any event, with the economy in recovery, any budgetary surpluses clearly should go to the stabilization fund, which was seriously depleted during the fiscal crisis.

At the time of its passage, the fiscal 2005 budget was out of balance by $1.1 billion, a gap that was filled by withdrawals from reserves and other one-time resources.[2] Since then, tax collections have outpaced expectations by a substantial margin and are now on track to exceed the forecast on which the 2005 budget was based by as much as $1.2 billion. As a result, fiscal 2005 could now end with a small excess of revenues over spending—but not the billion dollar surplus that some are expecting.

There is no question that the $17.1 billion tax forecast assumed in the 2006 legislative budgets is overly conservative. Tax receipts for 2006 are also likely to exceed MTF's forecast of $17.4 billion, perhaps by as much as $300 million, to a potential total of $17.7 billion. However, both budgets rely on reserves or other one-time resources—almost $400 million in the House and more than $650 million in the Senate. Thus, the possible $600 million of additional tax collections above the $17.1 billion figure would put the House budget in the black by only a small margin, and would not fully fill the gap in the Senate budget.

Like the House, the Senate has wisely rejected the Governor's plan to generate—and spend—roughly $450 million of one-time Medicaid "savings" in 2006 by pushing that amount of costs into 2007. While the Governor's proposal would not affect payments to Medicaid providers, it has unnecessarily diverted the attention and time of the program's administrators to defend an initiative that contributes nothing to the much

[2] The $1.1 billion of one-time resources included a $340 million withdrawal from the stabilization fund, $358 million of revenues carried forward from 2004, and $270 million of nonrecurring federal fiscal relief. Two months into the fiscal year, the administration projected a lower, but still large, deficit of $829 million based on its analysis of likely 2005 revenues and spending.

larger task of finding real savings in that massive program. Unfortunately, the alternative approach proposed by the Senate, which would implement cash-basis Medicaid budgeting in fiscal 2005, is marred by the accompanying plan to use $150 million of unspent Medicaid appropriations in 2005 as a one-time source of financing for ongoing program costs in 2006.

The Senate has fallen substantially short of the House in limiting the use of budgetary riders—so-called "outside sections"—to enact major policy changes that are unrelated to the budget. In a positive reform, the House budget generally excludes such extraneous provisions, as part of a larger effort intended to revitalize the Legislature's committee process. The custom of including unrelated law changes in the budget all too often short-circuits the more deliberative and open consideration of issues provided by the legislative policy committees.[3] The result is enactment—through the single up-or-down vote by which the budget as a whole is adopted—of major changes in state law that would not be approved if they were presented as separate measures.

While the approximately 150 outside sections in the Senate budget are a far cry from the 712 in the 2004 budget and the 435 in the 2005 budget, this total is more than triple the 43 outside sections proposed by the House. Whatever the merits of the non-germane provisions of the Senate budget (and of the House budget as well), in the Foundation's view the conference committee should reject the proposals to allow them to receive fuller consideration as separate bills. The Senate provisions range from establishing a new program to reimburse municipalities for school costs arising from the approval of local housing projects, to a major revision of the state's process for disposing of surplus land, to expanding the scope of state police collective bargaining and arbitration, as well as other less sweeping but still extraneous matters such as authorizing land transfers in several specific communities and establishing a rental car tax in Revere.

It is worth noting one meritorious outside section in the Senate Ways and Means budget that clearly pertained to the appropriation process but did not survive floor debate—a provision authorizing the state's university and colleges to retain for educational purposes 100 percent of the tuition revenues they collect rather than remit them to the General Fund. This long-overdue reform is a key recommendation of the Foundation's 2004 report, *The University of Massachusetts: Removing Barriers to Educational Excellence at the State's Public Research University*, which focused on ways to remove bureaucratic barriers to the university's success. Instead, like the House, the final Senate budget includes language extending the current limited pilot program for retention of out-of-state tuition at the Amherst campus.

Spending

The 2006 Senate budget proposes $25.93 billion of spending, $359 million, or 1.4 percent, more than the House (see Table 2). This total includes $24.0 billion of line item appropriations, $1.35 billion of off-budget spending that the state comptroller categorizes as on-budget expenditures in the Commonwealth's annual financial statement, and $330 million of other spending for budgetary purposes, primarily Medicaid. It does not include $1.2 billion of support for the MBTA and the new School Building

[3] The inappropriate use of outside sections has been long opposed by groups as diverse as Common Cause, the Taxpayers Foundation, and Citizens for Limited Taxation. In recent years, the House's MacQueen Commission, a succession of governors, and lawmakers on both sides of the aisle have all called for a halt to the practice.

Table 2
Proposed 2006 Spending
($, Millions)

	Governor Amended	House	Senate
Spending from budgeted funds:			
Proposed			
Direct appropriations	$23,272	$23,683	$24,007
Uncompensated care transfer	120	206	240
Total proposed in budget	$23,392	$23,889	$24,247
Previously authorized			
Pension transfer	1,275	1,275	1,275
RMV fees for transp. projects	52	52	52
Other	22	22	22
Total spending from budgeted funds	$24,741	$25,238	$25,596
Spending for budgetary purposes from non-budgeted funds:			
Proposed in budget	342	320	320
Previously authorized	14	14	14
Total proposed spending	$25,097	$25,572	$25,931
Difference from est. 2005 spending	204	679	1,037
Percent difference	0.8	2.8	4.2

Note: Spending totals exclude an estimated $712 million of assistance to MBTA and $488 million of school construction funding to be paid from dedicated sales taxes. The comparison with 2005 estimated spending excludes $232 million of proposed 2006 appropriations for Medicare "buy-in" costs which were previously financed via a reduction in federal Medicaid reimbursements.

Authority that is financed from dedicated tax revenues.

Comparing the Senate budget total with both the House budget and with estimated 2005 spending is complicated by the proposed accounting changes in Medicaid. In an apples-to-apples comparison that adjusts for accounting differences and includes proposed expansions, MTF estimates that the Senate Medicaid budget is approximately 6.9 percent above projected 2005 spending, compared to about 5.8 percent for the House budget.

For the rest of state government (that is, excluding Medicaid), the Senate proposes 2006 spending growth of $675 million, or 3.8 percent, compared to $462 million, or 2.6 percent, for the House (see Table 3). While the Senate is more generous than the House in every area (albeit by small amounts in some), in both budgets 60 percent of the additional dollars go to human services and state aid to cities and towns. Health care other than Medicaid—primarily health coverage for state employees and retirees—is the most rapidly growing area of spending, in part because of provisions in both budgets that reduce the share of premiums paid by state workers. The reductions shown in the "other" category of Table 3 are largely the result of extraordinary 2005 expenses that are not expected to recur in 2006, including approximately $60 million of capital costs for parks and recreational facilities and $30 million for snow and ice control.

While the proposed increases in the 2006 legislative budgets would provide much-needed relief for many discretionary areas of spending, they do not come near to restoring the deep cuts of recent years, especially after adjusting for inflation. Overall, House and Senate spending for these programs is roughly $2 billion, or more than 10 percent, below fiscal 2001 in inflation-adjusted dollars (see Table 4). In almost all of these areas, the shortfall from 2001 spending levels remains in the hundreds of millions of dollars. In higher education, one of the programs most severely affected by the cuts, the proposed 2006 spending remains almost 30 percent below 2001 levels, despite the recommended increases. Other significantly affected areas not shown separately in Table 4 include economic and business development (down about 27 percent), environmental programs (down 28 percent), and parks and recreation (down more than 40 percent).

Medicaid

Reconciling their different approaches to budgeting for Medicaid, by far the largest program in the budget, will be one of the conference committee's most important tasks. Both the House and the Senate have rejected the administration's proposed accounting change that would have generated approximately $450 million in one-time "savings" by shifting to fiscal 2007 costs that otherwise would have been paid in 2006 and budgeting for only 11¼ months of Medicaid spending. While both of the legislative budgets improve on the administration's plan by including funding for a full 12 months, they take different approaches to that end.

The House version maintains the recent practice of continuing to pay bills for services rendered during the fiscal year— and charging those payments against the same year's appropriations—in an "accounts payable period" after June 30, the norm in almost every other state program. The Senate, like the administration, proposes to return Medicaid accounting to the so-called cash basis used for much of the 1990s, in which all spending after June 30 is charged to the new fiscal year regardless of when the services were provided. However, the Senate proposal differs from House 1 by implementing the

Table 3
Change in Annual State Spending Excluding Medicaid
($, Millions)

	FY05 Change		FY06 Change			
			House		Senate	
	Amount	Pct.	Amount	Pct.	Amount	Pct.
Human services	$207	4.6	$138	3.0	$210	4.5
Education and other aid	307	6.7	132	2.7	189	3.9
Health other than Medicaid	169	17.0	174	14.9	180	15.5
Debt service and contract assistance	195	11.3	80	4.2	83	4.3
Pensions	530	75.5	57	4.6	58	4.7
Criminal justice	115	6.6	13	0.7	44	2.4
Higher education	44	5.1	11	1.2	32	3.5
Other	-5	-0.4	-142	-11.8	-123	-10.2
Total	1,562	9.6	462	2.6	675	3.8

Table 4
Fiscal 2006 Spending Change from 2001
"Discretionary" Programs
($ Millions, Inflation-Adjusted)

	House Budget		Senate Budget	
	Amount	Percent	Amount	Percent
Human services	-435	-8.3	-362	-6.9
Education and other aid	-682	-11.9	-625	-10.9
Criminal justice	-143	-7.1	-111	-5.5
Higher education	-371	-28.6	-349	-26.9
Other	-499	-31.9	-480	-30.7
Total	-2,129	-13.5	-1,927	-12.2

accounting shift at the end of fiscal 2005 rather than the end of fiscal 2006.

While legitimate arguments can be made for either legislative approach, the Senate unfortunately undercut the rationale for its proposal by using $150 million in 2005 Medicaid savings as a one-time funding source for 2006 appropriations. Under the House budget, approximately $330 million would be spent on 2005 bills—and charged against 2005 appropriations—during the accounts payable period. Under the Senate plan, these costs would be charged to 2006 instead, saving $330 million in the 2005 budget. Together with another $200 million that is expected to remain unspent even without the accounting shift, Medicaid savings in 2005 under the Senate plan would total approximately $530 million, from which the Senate draws $150 million for use in 2006. Any unspent Medicaid appropriations would otherwise go to the stabilization fund.

The Senate Medicaid budget, including off-budget spending of nursing home fees, totals $7.36 billion, $112 million, or 1.5 percent, more than the House. Compared to the House, the Senate adds $23 million to enroll 10,000 more long-term unemployed residents in the MassHealth Essential Program, $19 million to restore coverage for patients who require hospital care for more than 20 days, and $4 million to restore dental and smoking cessation benefits for pregnant women and new mothers.

All three versions of the budget assume that underlying spending growth in Medicaid will continue to slow from the double digit rates experienced from 2000 to 2002, raising questions of whether the budget will be adequate to cover program costs. Excluding the proposed expansions and restorations, the Senate budget is about 6.1 percent above projected 2005 spending on a cash year basis, compared to about 5.6 percent in the administration and House budgets. Reining in Medicaid to such moderate growth rates would be a remarkable achievement. Even after subtracting the $200 million in unspent 2005 funds discussed above, spending in 2005 is expected be more than eight percent above 2004 levels.

Revisions to Medicaid's pharmacy management program proposed by the administration and adopted in both legislative budgets will save an estimated $31 million in 2006. The program, which instituted a prior approval process designed to encourage the utilization of cost-effective drugs, has already shown substantial success in slowing Medicaid spending on pharmaceuticals. The Senate budget, as it has in the past, also includes a dubious proposal to create a pharmacy bulk purchasing program, but wisely does not assume any savings from such a plan since the amount of savings would be questionable at best.

None of the budgets includes funding for the health care expansion proposals now being debated in the Legislature. While the expansion plans rely in part on enrolling many of the estimated 106,000 uninsured residents who are eligible for Medicaid but not enrolled, all three budgets assume that enrollment growth will slow to about 13,000 in 2006 (excluding the Senate's proposal to expand MassHealth Essential enrollment by 10,000), compared to growth outside of Essential of more than 27,000 over the last year.

While both legislative budgets reject the Governor's proposal to shift $43 million in costs to fiscal 2007 by deferring nursing home rate increases, neither addresses the broader problem of below-cost Medicaid reimbursement rates, currently estimated at 80 percent of provider costs for serving Medicaid patients. Inadequate Medicaid payments encourage providers to shift costs to private payers, driving up the cost of employer-provided health insurance and increasing the number of residents who cannot afford insurance. Separate health care legislation introduced by Senate President Travaglini would provide $116 million in fiscal 2006 as the first installment in a three-year plan to boost reimbursement rates to hospitals, doctors and community health centers. The plan relies on state reserves and over time the rate increases would need to be built into the budget.

The Senate budget does go further than the House in shoring up provider finances by increasing the state contribution to the uncompensated care pool to $240 million, compared to $206 million in the House budget and $120 million in House 1. The funding will allow the pool to increase uncompensated care payments to community health centers by 40 percent to $56 million, and to maintain payments to hospitals at the $500 million level budgeted in 2005.

Employee Health Benefits

Like the House, the Senate budget retreats from an important cost-saving measure adopted in the 2004 budget, increasing the share of health insurance premiums paid by state employees. The 2004 reforms increased the employee share from 15 percent to 25 percent for new hires, and to 20 percent for existing employees making $35,000 or more, saving roughly $25 million annually. The 20 percent rate is scheduled to expire and revert to 15 percent at the end of the current fiscal year, while the 25 percent rate would remain in place.

The Governor's 2006 budget included a positive proposal to have all active employees and able-bodied retirees under the age of 65 pay 25 percent, saving an estimated $60 million relative to spending under current law. In contrast, the legislative budgets extend the current arrangement until December 31, 2005, after which the 20 percent rate for higher-paid employees would revert to 15 percent, and the 25 percent rate for new hires would drop to 20 percent. Compared to the Governor's proposal, the legislative budgets add $75 million in costs in 2006 and roughly $90 million in 2007.

BUDGET SUMMARY[1]

($ Millions)	2005 Estimated	2006 Governor Amended	2006 House	2006 Senate	Senate Difference from House	Senate Difference from Governor	Senate Difference from Est. 2005
Investment in Children	**$5,846.1**	**$5,980.2**	**$6,017.4**	**$6,120.5**	**$103.2**	**$140.3**	**$274.4**
Education Local Aid[2]	3,637.7	3,729.6	3,754.6	3,807.4	52.8	77.8	169.6
Higher Education	914.7	922.4	925.6	947.2	21.5	24.8	32.5
Services to Children	712.1	731.1	737.4	744.1	6.8	13.0	32.0
Youth Services	133.1	146.9	139.9	147.2	7.3	0.3	14.1
Child Care Services	448.4	450.2	459.9	474.7	14.8	24.5	26.2
Criminal Justice and Law Enforcement	**$1,834.0**	**$1,857.8**	**$1,847.3**	**$1,877.4**	**$30.1**	**$19.6**	**$43.4**
Corrections	848.6	860.2	855.2	864.6	9.4	4.4	16.0
Judiciary	628.7	629.6	631.2	642.7	11.5	13.1	14.1
Police	241.3	248.7	245.0	248.2	3.2	(0.5)	7.0
DAs	79.3	82.6	80.8	84.8	4.1	2.2	5.5
Attorney General	36.2	36.6	35.1	37.0	1.9	0.4	0.8
Local Government	**$1,350.6**	**$1,354.2**	**$1,370.1**	**$1,374.5**	**$4.4**	**$20.3**	**$23.9**
Assistance to the Poor	**$8,115.7**	**$8,164.3**	**$8,587.2**	**$8,757.6**	**$170.4**	**$593.3**	**$641.9**
Medicaid & Other Health Care	6,995.6	7,060.7	7,452.5	7,598.0	145.6	537.4	602.5
Cash Assistance	710.4	696.9	723.0	725.6	2.6	28.7	15.2
Housing Assistance	108.0	117.0	117.0	122.1	5.1	5.1	14.1
Elderly	301.7	289.7	294.6	311.8	17.2	22.1	10.1
Assistance to the Sick and Disabled	**$2,087.0**	**$2,149.5**	**$2,155.7**	**$2,172.9**	**$17.2**	**$23.4**	**$85.9**
Mental Retardation	1,086.0	1,122.1	1,122.7	1,122.9	0.2	0.7	36.9
Mental Health	598.7	619.9	620.3	626.1	5.8	6.2	27.4
Public Health	402.3	407.5	412.6	423.9	11.3	16.4	21.6
Transportation	**$242.7**	**$227.3**	**$212.6**	**$211.1**	**($1.5)**	**($16.2)**	**($31.5)**
Regional Transit	48.8	49.2	50.2	49.2	(1.0)	0.0	0.4
MDHighways	129.3	112.1	97.2	96.6	(0.6)	(15.5)	(32.8)
Registry	64.5	66.0	65.3	65.4	0.1	(0.6)	0.9
Economic Development	**$399.0**	**$323.7**	**$317.5**	**$338.0**	**$20.4**	**$14.3**	**($61.0)**
Business and Labor	151.2	133.2	134.2	144.1	9.9	10.9	(7.1)
Environment	247.8	190.5	183.3	193.8	10.5	3.3	(53.9)
Central Costs	**$3,760.0**	**$4,035.4**	**$4,111.6**	**$4,112.2**	**$0.7**	**$76.8**	**$352.3**
Employee Benefits[3]	2,082.0	2,255.5	2,331.7	2,332.3	0.7	76.8	250.4
Debt Service	1,678.0	1,779.9	1,779.9	1,779.9	0.0	0.0	101.9
Other	**$1,026.1**	**$1,005.0**	**$953.1**	**$966.5**	**$13.5**	**($38.5)**	**($59.6)**
Total[4]	**$24,661.1**	**$25,097.3**	**$25,572.4**	**$25,930.7**	**$358.4**	**$833.4**	**$1,269.6**
Excl. Medicare Buy-in Costs		**$24,865.5**	**$25,340.6**	**$25,698.9**			**$1,037.8**
Adjusted for MBTA and SBA[5]	$25,762.4	$26,297.7	$26,772.8	$27,131.1			

1. Amounts are adjusted to include certain off-budget authorizations, primarily for health care and pensions.
2. For purposes of comparison, 2001-2004 amounts exclude school building costs which were moved off-budget beginning in fiscal 2005.
3. Does not include workers' compensation and unemployment insurance which are budgeted in agency accounts.
4. The fiscal 2006 totals include $231.8 million of Medicare buy-in costs carried as offset to revenues in 2005 and prior years.
5. In 2001, expenditures (and supporting sales tax revenues) for operating and debt service assistance to the MBTA were moved off-budget; in 2005, state assistance for school building construction was similarly moved off-budget.