



Bulletin

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MTF

House Budget 2006: Admirable Restraint

The fiscal 2006 budget recently adopted by the House takes a straightforward and constructive approach to the Commonwealth's finances for the coming year, with limited spending growth—only 2.8 percent over 2005—and a conscious focus on budget-making rather than unrelated policy initiatives.

The result is a legislative spending plan that is in many ways similar to Governor Romney's "House 1" budget submission. While total recommended spending is almost \$500 million higher than the Governor's, the lion's share of the additional dollars is needed to fund Medicaid. The Governor's budget held down Medicaid appropriations by funding less than a full year of 2006 costs and shifting payment of approximately \$450 million into fiscal 2007, a questionable approach that was rejected by the House.

Under new leadership and facing enormous pent-up demand to restore the severe cuts of recent years, the House in floor debate added only \$152 million, or 0.6 percent, of net state costs¹ to the extremely tight budget proposed by Ways and Means, a remarkable show of restraint under the circumstances. Although the House budget deliberations left unanswered the question of how the added spending is to be financed, there is no question that it can be afforded at the likely level of 2006 revenues. The House and Senate budget

leaders have agreed to a 2006 tax revenue forecast that is roughly \$250 million lower than the forecast used in the Governor's budget. The Governor's budget forecast is essentially identical to MTF's most recent forecast.

As expected, the House budget made no provision for the Governor's premature proposal to cut the income tax rate from the current 5.3 percent to 5.0 percent, a change that would reduce tax revenues by \$575 million when fully phased-in in fiscal 2007. While the budget also excluded the administration's January recommendation to increase business taxes by \$170 million (the third major increase sponsored by the Governor in as many years), it is expected that the House will consider a separate bill that will include elements of the Governor's original and substitute proposals. However, even a scaled-down business tax increase—such as that espoused by the Governor after his original plan was filed—would be economically unwise and fiscally unnecessary. It makes no sense to add further to the already high costs of doing business in the state while job growth continues to sputter, especially considering the overly conservative revenue forecast adopted by the Legislature.

In addition to rejecting the administration's proposed change in Medicaid accounting, House members also deserve credit for adding to the Ways and Means budget \$86 million of support for uncompensated hospital care. Unfortunately, the Medicaid appropriation recommended by Ways and Means—which already depended on a substantial slowing in the rate of Medicaid cost

¹ This figure takes into account changes in federal reimbursements and assessed revenues as a result of floor amendments.

growth—was simultaneously cut by \$91 million, raising even further questions about the adequacy of the House funding level. In other floor action, legislators took a step backward by decreasing the share of health premiums paid by state employees—\$15 million was added on the floor to cover the six-month impact of this change in fiscal 2006.

As the Senate prepares to consider its version of the 2006 budget, we would urge both branches to reassess the revenue forecast that they agreed to in early March. Since then, the inadequacy of that estimate has become even more clear. In formal recognition of the improved revenue picture, the administration raised its forecast of fiscal 2005 revenue growth from 1.7 percent to 4.4 percent, practically identical to MTF’s forecast.² The 2006 tax total assumed in the House budget represents an increase of only 2.4 percent from this revised 2005 forecast, compared to the 4.1 percent increase of the House 1 tax forecast.

While the higher 2005 forecast—and positive revenue news in April—buttress the case for revisiting the 2006 legislative tax forecast, it will be important for the Senate to hold total proposed

Table 1
Proposed 2006 Spending
(\$, Millions)

	Governor Amended	House
Spending from budgeted funds:		
Proposed		
Direct appropriations	\$23,272	\$23,683
Uncompensated care transfer	<u>86</u>	<u>172</u>
Total proposed in budget	\$23,358	\$23,855
Previously authorized		
Pension transfer	1,275	1,275
RMV fees for transp. projects	52	52
Other	<u>22</u>	<u>22</u>
Total spending from budgeted funds	\$24,707	\$25,204
Spending for budgetary purposes from non-budgeted funds:		
Proposed in budget	376	354
Previously authorized	<u>14</u>	<u>14</u>
Total proposed spending	\$25,097	\$25,572
Difference from est. 2005 spending	204	680
Percent difference	0.8	2.8

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.

spending in its 2006 budget plan to no more than the amount approved by the House. Even with the higher revenue forecast, the House budget counts on drawing almost \$400 million from reserves, a substantial amount considering that the economy is in recovery. Senate leaders have said they also plan to finance from reserves the first-year costs of their health care proposal. Depending too heavily on one-time resources in 2006 will only make the task of balancing the budget more difficult in 2007.

² Since the submission of its proposed budget, the administration has raised its forecast of 2006 revenue growth by another \$164 million, to an increase of 5.1 percent over its revised 2005 forecast. In the Foundation’s view, while 5.1 percent growth in 2006 is potentially attainable, it is overly aggressive for the purpose of budget planning, especially given the uncertainty about capital gains receipts that apparently drove much of the surge in April tax receipts. For that reason, we have used the House 1 forecast of 2006 revenues—which is practically identical to MTF’s forecast—for the budgetary projections in this *Bulletin*.

The Continuing State Fiscal Squeeze

The announcement that April tax receipts exceeded the recently revised revenue benchmark by more than \$300 million has fueled renewed—but still premature—calls to cut the income tax. While 2005 revenues could exceed the original forecast by over \$1 billion if collections do not slip over the next two months, at the beginning of fiscal 2005 authorized spending exceeded ongoing revenues by more than \$800 million, according to administration figures. After filling this large hole, a modest surplus of about \$200 million would remain.

Based on the tax forecast in the Governor's budget (which is consistent with recent revenue performance) and on 2006 spending at the levels authorized by the House, the Foundation projects that in 2006 the state's finances would again be in structural balance, albeit by a tiny margin.

Unfortunately, the underlying dynamic of the so-called "growth gap"—the mismatch between the rate of revenue growth that the economy and tax base can sustain over the longer term and largely unavoidable cost growth in health care, debt service, Chapter 70 local aid, pensions, and other major programs—will reemerge in 2007, reopening a structural gap of \$400 million or more.

In some ways, these projections of the state's finances in 2006 and 2007 are a best case scenario:

- The assumed rates of tax revenue growth are predicated on maintaining current levels of capital gains receipts, a premise that was proved painfully wrong in fiscal 2002.
- Growth in Medicaid spending is assumed to be held to the extremely ambitious, if not improbable, target of 3.1 percent in 2006 (as assumed in the House budget) and to six percent in 2007.
- No provision is made for the likely loss of up to \$600 million of federal health care safety net payments over the next several years under the new federal Medicaid waiver.
- The unknown, but likely large, costs of expanded health care coverage are absent from these calculations, as are the costs of economic stimulus proposals which will have to be funded from tax revenues in fiscal 2007.
- Finally, the estimates include no significant restorations of the \$3 billion of spending cuts during the fiscal crisis.

Given this difficult picture, a major cut in the income tax—with a revenue impact of \$225 million in 2006 and another \$350 million in 2007—could only make a difficult fiscal situation much worse. If enacted, the proposed tax cut would roughly double the amount of red ink in 2007, an estimated total of almost \$800 million, throwing the state's finances into turmoil and necessitating further major cuts or revenue increases to produce a balanced budget.

Medicaid and Uncompensated Care

In its budget the House elected to forego the Medicaid accounting shift proposed in House 1 and provided for a full year of program costs. The administration's plan to shift spending on bills for 2006 services paid after June 30 to the fiscal 2007 budget would have produced a one-time budget "savings" of approximately \$450 million.

The House also rejected the administration's proposal to save \$43.5 million by deferring nursing home rate increases to 2007, added \$7 million for higher reimbursement rates for pediatric hospitals that serve patients requiring more intensive care, restored Medicaid eligibility to 3,000 elderly and disabled legal immigrants, and doubled grants for community outreach to enroll eligible residents to \$500,000.

Despite these changes, the House's \$7.25 billion Medicaid budget is only \$306 million, or 4.4 percent, above the administration's proposal, and an incredibly tight \$217 million, or 3.1 percent, above the administration's projections of spending in 2005. The costs of the House's additions were offset by lower enrollment forecasts (despite the intensified outreach effort) and savings from shifting funds into a new home care program that can serve members more cost effectively than nursing homes. The House also deleted a \$19 million Ways and Means proposal to restore Medicaid reimbursements for hospital care in excess of 20 days.

Holding Medicaid spending growth to the very modest rates assumed in the budget would be an extraordinary achievement in an environment where overall health care costs are still increasing at double-digit rates. With no provisions in the budget for narrowing the gap between provider costs and Medicaid reimbursement rates, providers will face ever stronger incentives to shift costs to private payers, driving the costs of employer-provided health insurance even higher.

The House did take a positive step to shore up hospital finances by largely reversing the \$92 million cut in state contributions to the uncompensated care pool proposed in House 1

and retained by the House Ways and Means Committee. The cut would have further undermined the finances of hospitals and other providers that are already strained by below-cost Medicaid rates. Even with the \$86 million addition, which brings the total state contribution to the pool to \$206 million, hospitals estimate that they are facing a projected gap between uncompensated care costs and pool payments of \$236 million in 2006.

Employee Health Benefits

The House budget retreated from increasing the share of health insurance premiums paid by state employees, an important cost-saving measure adopted in the 2004 budget. 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. The House Ways and Means budget rejected the Governor's recommendation but proposed a compromise: continuing the current rate structure by eliminating the sunset provision for the 20 percent rate for higher paid employees. However, an amendment adopted by the full House extends the current arrangement only until December 31, 2005. After that date, the 20 percent rate would revert to 15 percent, and the 25 percent rate for new hires would drop to 20 percent. The amendment would add \$15 million to benefit costs in 2006 compared to the Ways and Means proposal, and at least twice that amount in 2007 and beyond when the lower rates are in effect for the entire year. Compared to the Governor's proposal, the House budget would add \$75 million in costs in 2006 and roughly \$90 million in 2007.