



Bulletin

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MTF

2004 Legislative Budget: Constructive Effort, But Major Challenges Remain

The Legislature is to be commended for its timely and constructive action on the 2004 state budget, and for its efforts to develop a financing plan for the new year that -- like Governor Romney's budget -- goes a long way toward closing the roughly \$2.5 billion structural deficit in fiscal 2004. The \$23.1 billion legislative spending proposal also reorganizes human service agencies along the lines recommended by the Governor, reconfigures the state's environmental and economic development programs in meaningful ways, and takes several steps to reform long-standing spending abuses and

inefficiencies, including the costly, scandal-ridden "Quinn bill" program of incentive pay for local police.

The Legislature also deserves recognition for taking the lead in extending the investment tax credit for another five years, a key step in bolstering the state's economic competitiveness. The conference committee that hashed out the differences between the House and Senate versions of the 2004 budget wisely rejected provisions that would have required corporations doing business in Massachusetts to disclose confidential tax

Table 1
Total State Spending
(\$, Millions)

	2003 Estimated	Fiscal 2004			
		Governor	House	Senate	Conference
Line item total*	\$22,450	\$22,859	\$22,579	\$22,528	\$22,335
"Off-budget" spending	519	412	612	865	806
Assumed reversions**	-120	--	--	--	--
Total	\$22,849	\$23,271	\$23,191	\$23,393	\$23,141
Change from 2003					
Amount	--	422	342	544	292
Percent	--	1.8	1.5	2.4	1.3

* House line item total includes \$832 million of proposed off-budget pension appropriations. Senate line item total excludes \$145 million of pension appropriation requirements met by transfer of convention center to the pension fund. Conference total includes \$687 million of pension appropriations moved off budget in 2004 budget but excludes \$145 million of pension appropriation requirements met by transfer of convention center to the pension fund. All totals exclude one cent of regular and motor vehicle sales taxes (an estimated \$684 million in 2003 and 2004) dedicated to the MBTA.

**Unspent agency appropriations at end of fiscal year.

information, as well as a long list of other provisos unrelated to the state's finances, including proposals to ban smoking in the workplace statewide, limit the kinds of foods that can be advertised on public school buses, and restrict the size of signs on the Turnpike. Lawmakers also took a major step forward in increasing budget transparency by eliminating scores of so-called "minor" budgetary funds and adopting a more meaningful definition of budgetary balance. Unfortunately, these initiatives were undercut by a substantial increase in the amount of spending counted "off-budget."

The legislative budget also includes positive and much needed reforms of the state's uncompensated care fund -- the pool of dollars intended to cover the costs of free health care provided to the poor. These measures should mean better use of pool resources and greater accountability for pool spending. Many of the provisions clearly try to refocus the pool on its core purpose -- reimbursing hospitals and community health centers for services provided to low-income uninsured residents.

Using the pool's resources to restore Medicaid coverage to 35,000 low-income unemployed stretches that purpose, but can be justified by the lower demands on the pool that should result. However, this approach is a short-term remedy at best, particularly since the pool's funding for fiscal 2004 will rely on one-time federal funds and non-recurring state resources to meet a significant portion of its anticipated obligations.

These facts highlight the urgent need to devise an equitable and sustainable approach to covering otherwise uncompensated health care costs in future fiscal years. Language directing development of a "new program" by this October sets a worthy goal but is unlikely to produce a consensus where one has failed to materialize in the past.

Closing the 2004 Gap

Like the Governor, lawmakers have relied on a combination of additional revenue and spending cuts to close most of the 2004 budget shortfall, with non-recurring financing sources providing a stopgap solution to a remaining structural deficit of at least \$400 million. According to the administration's preliminary analysis, the budget is out of balance by a further \$200 million as a result of a too high estimate of non-tax revenues,¹ and the Governor plans to use his veto power to reduce appropriations by that amount.

Revenues With increases in the broad-based income and sales taxes off the table and projections of anemic tax revenue growth in 2004 -- only \$30 million, or less than 0.5 percent -- the state's leaders have depended heavily on new and higher fees to generate additional dollars. Several of the fee hikes (in particular, the increases in Registries of Deeds fees) strain to the breaking point the concept of a cost-based "fee for service." Other fee increases that fall heavily on poorer individuals, including new probation fees and higher co-payments for Medicaid clients, are likely to prove difficult to collect.

Despite the lack of appetite for tax increases, the 2004 budget approved by the Legislature relies on \$175 million of higher taxes, primarily from "corporate loophole closing" measures originally recommended by the Governor.

Spending The legislative budget recommends \$23.14 billion in total spending, an estimated \$292 million more than 2003, a 1.3 percent annual rate of growth that is the third lowest in the last 25 years. The bottom

¹ Including \$80 million of estimated revenues from Registry of Deeds fee increases. The administration originally projected the fee increases would generate \$230 million in 2004 -- the amount counted in the legislative budget -- but revised that figure down to \$150 million after the Governor's budget was filed.

line is slightly less than the Governor's initial proposal.

The increase in 2004 spending is almost entirely attributable to cost pressures on the state's health care budget. Despite more than \$300 million of cuts to Medicaid in 2003 and another \$500 million of cuts in 2004, this huge program is still expected to grow by more than \$600 million, or 10.5 percent, in the coming year (see Table 2).

The other major area of growth is debt service, a largely unavoidable annual cost that will increase \$120 million or 8.1 percent. After accounting for these increases, 2004 spending for all other state programs will decline by \$462 million or three percent (including a \$145 million reduction in pension appropriations that will be offset by the transfer of assets to the state pension fund).

A comparison of the 2004 budget with spending in fiscal 2001, before the fiscal crisis began, presents an even starker picture of the impact of Medicaid cost growth -- and where the burden of spending cuts has fallen. As shown in Table 2, state Medicaid expenditures are up \$1.9 billion or 40 percent since 2001, while spending on all other programs (excluding debt service) has fallen more than \$1 billion or almost seven percent, producing an overall budget increase of \$1 billion, or roughly five percent, from 2001 to 2004.

This comparison actually understates the spending cuts in 2004 and prior years, since

Table 2
Medicaid, Debt Service and Other Spending Growth
(\$, Millions)

	Actual 2001	Actual 2002	Est. 2003	Conf. 2004	Total Change 01-04
Medicaid	\$4,777	\$5,416	\$6,056	\$6,690	
Dollar change	--	639	641	634	1,913
Percent change	--	13.4	11.8	10.5	40.1
Debt service	1,432	1,396	1,476	1,597	
Dollar change	--	-36	80	120	165
Percent change	--	-2.5	5.7	8.1	11.5
All Other	15,897	15,966	15,316	14,854	
Dollar change	--	68	-650	-462	-1,044
Percent change	--	0.4	-4.1	-3.0	-6.6
Total Budget	22,106	22,777	22,849	23,141	
Dollar change	--	671	71	292	1,035
Percent change	--	3.0	0.3	1.3	4.7

reductions in many individual programs are obscured by the overall budget figures. According to the Foundation's analysis, spending cuts in specific programs total over \$3 billion since the fiscal crisis began, including \$1.9 billion from 2001 through 2003 and more than \$1.3 billion in the 2004 budget.

One-Time Revenues Like the Governor's proposal, the Legislature's budget fails to close fully the state's structural deficit because of its use of one-time revenues to pay for ongoing operating costs. While lawmakers in the end rejected the Senate's proposal to draw \$175 million from the state's rainy day fund to cover 2004 costs, their budget relies on a variety of other one-time resources including:

- An extraordinary transfer of the Hynes Convention Center and Boston Common Garage to the state pension fund in order to meet \$145 million of the Commonwealth's pension funding obligation in 2004;

- \$70 million of prior surplus revenues that had been set aside to finance bonus payments to highly qualified individuals entering teaching; and
- Ten percent, or \$55 million, of the state fiscal assistance recently authorized by Congress, used to augment the finances of the uncompensated care pool.

The reliance on one-time revenues in combination with underfunding and restorations of some previous cuts will make the job of balancing the 2005 budget -- already expected to be difficult -- even more challenging.

Despite the collective efforts to contain health care costs, the Medicaid program is underfunded, perhaps by as much as \$200 million, because of what the Foundation believes are overly optimistic estimates of the savings from proposed cost containment measures and the potential for delays in obtaining necessary federal approvals.

In addition, the state's snow and ice removal account is underfunded by at least \$30 million as well, and the Governor will undoubtedly identify other accounts where the proposed appropriations are insufficient. At the same time, the administration estimates that fixed costs will rise \$1.5 billion in 2005, while the prospects for even moderate revenue growth remain uncertain at best. Taken in combination, these factors point to a budget gap approaching \$1.5-\$2 billion in fiscal 2005.

Vetoes

The administration's budget experts are reviewing the massive, 715-section legislative budget with an eye toward potential vetoes, line item reductions, and amendments. The Governor has announced that he will reduce appropriations by \$200 million to bring the spending total closer in

line with available revenues, and has also indicated that he will veto elements of the court and highway reforms. There are several other provisions of the budget that deserve to be vetoed on policy grounds.

Health Care - Pharmacy Assessment The resurrected tax on prescriptions should clearly be vetoed. The \$36 million annual assessment is levied against prescriptions paid out-of-pocket or through private insurance, but is used to meet the state's obligation for costs associated with its Medicaid program. This is a clear shifting of a public responsibility onto a narrow segment of the private sector -- through a tax which benefits least those who already pay the most for their health care and which is implemented in a way that tends to hide the true costs of the state's Medicaid program.

Health Care - Bulk Pharmacy Purchasing The bulk pharmacy purchasing plan, however well-intentioned, should be vetoed. The specific language appears to be hastily constructed, opening up the possibility of seriously disrupting the established and effective approaches already in use at state agencies and destabilizing the private sector health plans that currently provide health benefits to state employees and retirees. Not only are the savings from this proposal unlikely to be realized, but it flies in the face of the Commonwealth's efforts to recruit biotechnology companies to Massachusetts.

Capital - Borrowing Cap The Governor should also veto the budget provision that limits borrowing for capital projects to \$1.1 billion annually. The administration currently operates under a self-imposed \$1.2 billion bond cap. Even though it is more generous than the \$800 million limit proposed by the House, the \$1.1 billion cap would exacerbate the long backlog of capital projects currently awaiting financing -- to which the budget adds \$70 million for

affordable housing -- while doing very little to reduce the Commonwealth's debt burden or debt service costs.

Welfare - Work Requirement The budget extends a 20-hour-per-week work requirement to welfare recipients with children between ages two and six, as proposed by the Governor and House, and allows these parents to meet their work requirement through education and training programs.

The Governor should *not* veto either of these provisions, which in no way undercut the key elements of welfare reform -- the work requirement and the time limit. The Foundation's 2001 report, "*Off Welfare... On to Independence*," recommended that the work requirement be applied to the two-to-six group, provided that education and training be allowed to satisfy all 20 hours. Massachusetts stands out as the state with the most restrictive definition of work by not counting any education and training activities, even though they are allowed by federal law and would help more welfare recipients attain the kind of employment that leads to long-term self-sufficiency.

Reforms

The combination of reform and restructuring provisions contained in the conference budget represents the most significant changes in many years to the way state government operates. While most of the attention in the reform debate has focused on the Legislature's defeat of the Governor's Article 87 reorganization bills, many of the reforms are included in the budget.

- The Commonwealth's myriad human services agencies are grouped into five clusters to improve interagency coordination and consolidate administrative functions. Just as importantly, the budget initiates the long

process of reforming the troubled system for purchasing services from private providers.

- The independent departments of Economic Development, Consumer Affairs and Business Regulation, and Labor and Workforce Development are combined into a cabinet-level Executive Office of Economic Development, providing a single, high-level focal point for economic development and better coordination of the state's many business-related programs. Unfortunately, the closely related functions of unemployment insurance and job training have been split into separate departments.
- A Commonwealth Development Coordinating Council is created to improve collaboration among transportation, environmental, housing, economic development, and planning agencies, and to develop a long-overdue statewide transportation plan.
- The Metropolitan District Commission and the Department of Environmental Management are merged into a single statewide parks agency, allowing for a more equitable allocation of funds and modest cost savings.
- Rejecting the Governor's proposal to merge functions of the Turnpike into the Highway Department, the budget transfers responsibility for operating and maintaining certain interstate highways in central and western Massachusetts to the Turnpike Authority, and creates a commission to make recommendations on the complicated issues of reorganizing the state's transportation agencies. The Governor has indicated that he will veto the interstate maintenance provisions, which would have produced modest savings for state taxpayers.

On other reform issues, the Legislature took smaller, but still positive steps.

- The budget increases the share of health insurance premiums paid by state employees from 15 percent to 25 percent for new hires, and to 20 percent for current employees who make \$35,000 or more, though the latter provision expires after two years. With hiring severely limited for at least the next two years by budget cuts and layoffs, the conference compromise will produce far smaller savings than moving to 25 percent for all employees as recommended by the Governor and the Foundation.
- The conference committee adopted the Senate's approach to reforming the costly "Quinn bill" program, replacing percentage salary premiums for police officers who obtain college degrees with fixed annual bonuses, and codifying new Board of Education standards for the quality of degree programs. The fixed bonuses of \$6,000 to \$8,500 will slow the rapid growth in Quinn bill costs but are still too generous to produce substantial savings. Though the Governor did not include changes to the Quinn bill in his reform proposals, it would be disappointing and inconsistent if he decided to veto these modest but long-overdue reforms.

In two critical areas, the provisions adopted by the conference committee fall far short of earlier reform proposals.

- The budget fails to make the substantive reforms to court management proposed by the Governor and the Senate. Their proposals would have collapsed the more than 160 current line items for individual courts, allowing court administrators to allocate funds based on workloads, and also would have strengthened court

management by creating a professional court administrator position.

Instead, the budget follows the House approach of redistributing workloads among courts but retaining line items and allowing court administrators only limited ability to transfer funds between line items. The Governor, who proposed merging the Boston Municipal Court into the statewide district court system, has indicated that he will veto the expansion of the BMC included in the budget.

- The budget also missed a major opportunity to save taxpayer dollars and improve the quality of state services by reforming the "Pacheco law," the Commonwealth's unique statute that makes it nearly impossible to employ competitive contracting to provide state services. The conference committee backed away from the House's modest proposals to lift the law's standard for comparing costs that stacks the deck in favor of state employees, and to suspend the entire law for two small state agencies, both for a two-year trial period. The budget's new standard for evaluating savings will do little to level the playing field for competitive proposals.

BUDGET SUMMARY
Fiscal 2001-2004

(millions)	Actual 2001	Actual 2002	Estimated 2003 (3)	2004			
				Governor	House	Senate	Conference
Investment in Children	\$6,014.3	\$6,270.7	\$6,141.0	\$6,102.4	\$5,805.9	\$5,893.7	\$5,750.7
Education Local Aid	3,830.1	4,096.6	4,021.5	4,009.0	3,813.4	3,842.8	3,769.4
Higher Education	1,109.1	1,037.1	969.1	935.8	823.0	867.8	815.8
Services to Children	573.6	631.8	656.6	684.7	694.4	689.8	678.2
Youth Services	118.3	122.5	124.8	126.0	123.0	125.7	122.9
Child Care Services	383.2	382.7	368.9	346.8	352.1	367.6	364.4
Criminal Justice and Law Enforcement	\$1,708.6	\$1,752.6	\$1,758.4	\$1,743.1	\$1,760.0	\$1,737.1	\$1,748.2
Corrections	799.3	824.6	824.1	831.5	829.0	829.5	830.5
Judiciary	588.7	580.0	583.5	562.1	588.9	569.1	583.4
Police	205.3	230.8	239.6	238.3	232.8	228.8	224.5
DAs	81.4	81.4	78.5	78.3	75.8	76.3	76.3
Attorney General	33.8	35.7	32.7	32.8	33.5	33.5	33.5
Local Government	\$1,541.0	\$1,523.1	\$1,297.4	\$1,071.2	\$1,255.2	\$1,244.5	\$1,240.5
Assistance to the Poor	\$5,817.0	\$6,494.9	\$7,152.4	\$7,603.5	\$7,567.6	\$7,782.6	\$7,771.3
Medicaid	4,777.0	5,415.6	6,056.3	6,583.2	6,530.1	6,682.2	6,690.3
Cash Assistance	646.1	682.6	706.8	732.3	691.5	709.2	696.6
Housing Assistance	158.4	142.6	109.7	101.3	94.7	103.2	96.8
Elderly	235.6	254.1	279.5	186.6	251.3	288.0	287.6
Assistance to the Sick and Disabled	\$2,053.8	\$2,076.3	\$1,992.2	\$1,984.2	\$1,974.2	\$2,028.1	\$1,988.5
Mental Retardation	916.1	966.1	987.7	1,019.7	1,010.1	1,024.1	1,010.9
Mental Health	602.3	607.6	602.5	585.9	591.6	595.2	591.3
Public Health	535.3	502.6	401.9	378.6	372.4	408.8	386.3
Transportation	\$260.4	\$215.2	\$219.8	\$178.6	\$179.2	\$181.7	\$180.1
MBTA	41.2	49.3	47.8	47.8	47.8	47.8	47.8
MDHighways	155.4	98.8	106.7	64.7	66.0	67.5	66.9
Registry	63.8	67.1	65.4	66.2	65.4	66.4	65.4
Economic Development	\$403.5	\$373.7	\$293.2	\$297.6	\$278.8	\$292.2	\$276.8
Business and Labor	158.4	142.3	110.0	117.7	93.3	111.9	99.7
Environment	245.1	231.5	183.2	179.9	185.5	180.3	177.1
Central Costs	\$3,127.0	\$2,923.5	\$3,075.7	\$3,047.8	\$3,269.5	\$3,140.4	\$3,131.5
Employee Benefits (1)	1,695.3	1,527.4	1,599.2	1,454.5	1,672.9	1,543.8	1,534.9
Debt Service	1,431.8	1,396.2	1,476.4	1,593.3	1,596.6	1,596.6	1,596.6
Other	\$1,180.5	\$1,147.2	\$1,038.6	\$1,242.3	\$1,100.7	\$1,092.5	\$1,053.1
General Government	688.4	685.3	623.0	705.0	671.3	638.5	630.4
Residual	492.1	461.9	415.6	537.2	429.4	453.9	422.7
Total Budget	\$22,106.1	\$22,777.3	\$22,968.7	\$23,270.6	\$23,191.3	\$23,392.9	\$23,140.8
Adjusted for MBTA (2)	\$22,760.7	\$23,441.6	\$23,652.7	\$23,954.6	\$23,875.3	\$24,076.9	\$23,824.8

1. Does not include workers' compensation and unemployment insurance which are budgeted in agency accounts.
2. In 2001, expenditures (and supporting sales tax revenues) for operating and debt service assistance to the MBTA moved off-budget.
3. Including 2003 general appropriation act, chapter 300 of 2002, and Governor's Oct., Dec. and Jan. administrative cuts, chapters 4, 6 and 12 of 2002, and estimated Medicaid deficiencies, but not adjusted for expected reversions.