MTF
Massachusetts
Taxpayers Foundation

333 Washington Street | Suite 853 | Boston, MA 02108 | 617.720.1000
www.masstaxpayers.com

MTF Preview of the House Ways and Means Budget

The House Ways and Means (HWM) committee will release its FY 2022 budget proposal the week of April 12th and much has changed in the ten weeks since the release of Governor Baker's spending plan. The combination of action at the federal level, changing assumptions on the state's Medicaid program and the public health and economic response to COVID-19 all have altered the fiscal landscape for budget writers. This bulletin summarizes these key changes and highlights five areas to watch in the upcoming HWM budget.

The Changing Budget Picture

Governor Baker submitted his FY 2022 budget (H1) on January 27th. His budget, finalized before any clarity on the next round of the federal COVID-19 response was available, relied on assumed savings in the state's Medicaid program (MassHealth) and a $1.6 billion draw from the Stabilization Fund to support $45.9 billion in spending. Since the release of that budget, three critical developments have fundamentally changed some of the assumptions upon which the Governor's budget is based:

1. The Biden Administration released new policies related to health and disaster reimbursements to states;
2. Congress passed the $1.9 trillion American Rescue Plan (ARP), which includes a number of programs that will impact Massachusetts;
3. State revenues have continued to perform above expectations, as the recovery from COVID-19 continues.

Each of these changing elements has both resource and spending implications for the FY 2022 budget that will need to be accounted for by both the House and Senate budgets. The section below summarizes these aspects of the changing fiscal picture. Analysis on how these changes might be reflected in the HWM budget is provided in the final section of the bulletin.

Biden Administration Policy Changes

At almost the same time the Administration's state budget was released, the Biden Administration adjusted COVID-19 policies related to Medicaid coverage and reimbursement and Federal Emergency Management Agency (FEMA) disaster response.

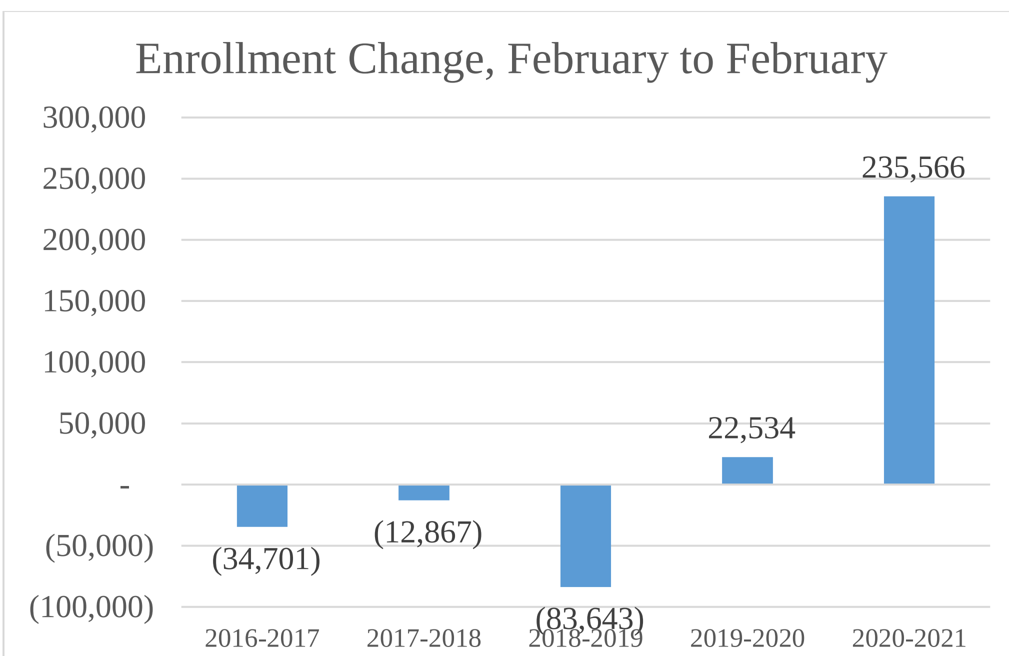
Extension of Enhanced Medicaid Reimbursement

Since the start of the pandemic, the federal government has committed to increased Medicaid reimbursements for the duration of the declared Public Health Emergency (PHE). Health and Human Services Administration notifies states as additional quarters of additional reimbursement are approved. In Massachusetts, each additional quarter of enhanced Medicaid payments provides approximately $250 million in new revenue.

On January 22nd, the Biden Administration informed governors that the PHE would likely continue for at least the remainder of 2021, thereby guaranteeing enhanced Medicaid reimbursements for the first six months of FY 2022. This announcement came after the Governor's budget was finalized, and therefore, H1 assumed no additional Medicaid revenue in FY 2022.

The extension of the PHE will provide the FY 2022 budget with significant new revenue, but it will also increase costs related to enrollment. In order to receive enhanced Medicaid reimbursements, states must suspend standard Medicaid eligibility assessments and maintain enrollment for members enrolled at the start of the pandemic or who have since become eligible. This requirement has contributed to MassHealth enrollment growth of more than 200,000 members over the last year.

Chart 1. MassHealth Enrollment Change by Year



The Governor's budget assumed that, with an end of the PHE expected in spring of 2021, MassHealth numbers would decline by more than 200,000 members by December of 2021. This assumption is no longer valid in light of the PHE extension; rather, further enrollment growth is likely.

Therefore, the HWM budget will be able to rely upon additional Medicaid revenue, but must also account for MassHealth enrollment that continues to grow for at least the first half of FY 2022.

Federal Share of Emergency Costs

Also in January, the Biden Administration committed to 100 percent federal reimbursement of FEMA eligible disaster costs, retroactive to the start of the pandemic. Previously, the federal government committed to a 75 percent share of eligible costs. In FY 2020, Massachusetts expected $350 million in federal FEMA reimbursements, with an additional $50 million in both FY 2021 and FY 2022. The announcement of full federal reimbursement, retroactive to FY 2020, means an additional $150 million in federal reimbursements to be received over the next two fiscal years.

American Rescue Plan (ARP)

MTF's summary of the American Rescue Plan makes apparent the seismic impact the bill will have on Massachusetts residents and state finances. Governor Baker's FY 2022 budget did not rely on any additional resources from future federal action, but we now know that the state will receive $4.5 billion in flexible Coronavirus State Fiscal Recovery Funds (CSFRF), as well as billions in targeted assistance for programs closely linked to budget line-items. These funds are intended for use over the next several years (expenditure timelines vary by program). In addition to CSFRF resources, funding for Massachusetts includes:

- $1.8 billion to support K-12 schools;
- $1 billion for the MBTA and Regional Transit Authorities
- $510 million for early childcare;
- $450 million for emergency rental and foreclosure assistance;
- $174.4 million through a new Coronavirus Capital Projects Fund; and
- $150 million to support the state's public health workforce.

The list above is not exhaustive – for example, it does not include $3.4 billion in direct support for local government in Massachusetts – but it does provide an indication of the direct and indirect impacts the ARP will have on the state budget over the next several years. Unlike federal funds provided in the CARES Act that were primarily distributed by the executive branch, CSFRF funds are likely subject to legislative appropriation. Thus House and Senate will need to determine how the ARP will fit into the FY 2022 budget. New federal resources could impact not just budget spending, but also decisions on the use of other reserves and the advisability of revenue and savings proposals.

State Revenues

The level of revenues expected in FY 2022 is largely based on FY 2021 collection trends, and FY 2021 revenue collection trends have exceeded expectations in most revenue categories. Both tax and non-tax revenue trends indicate stronger than expected economic activity, which will have implications for next year's budget.

Estimating FY 2021 tax revenues in the midst of an unprecedented public and economic crisis has required constant adjusting, but in spite of several upward revisions, FY 2021 tax revenue expectations have consistently surpassed expectations. In the three months since the release of H1, tax revenues have outperformed state benchmarks by $1.4 billion.

Table 1. FY 2016 – FY 2021 Tax Collections through March

	Collections Through March	Total	Share
FY 2021	$22,588	$29,090	77.6%
FY 2020	$21,064	$29,620	71.1%
FY 2019	$20,187	$29,740	67.9%
FY 2018	$19,393	$27,787	69.8%
FY 2017	$18,130	$25,662	70.6%
FY 2016	$17,828	$25,425	70.1%
$ in millions			

Through the first nine months of this fiscal year, and with two of the largest revenue months still to come, 77.6 percent of the full-year benchmark has been collected, a far higher percentage of yearly collections than in any of the previous five years. The FY 2021 full-year benchmark projects revenues to fall short of collections in both FY 2020 and FY 2019. However collections through March are $1.5 billion ahead of the FY 2020 pace and more than $2 billion ahead of FY 2019 collections for the same period.

Notable non-tax revenues are also performing well. Through February, lottery revenues are outpacing FY 2020 collections by 8 percent ($56.6 million) and if this trend continues, will exceed H1 estimates by between $60 and $80 million. In addition, the Commonwealth's most recent financial disclosure estimates that other non-tax revenues will surpass earlier estimates by more than $100 million.

The pandemic's trajectory and the speed and strength of the Commonwealth's economic recovery will determine whether or not the relatively strong revenue trends continue. Should final FY 2021 revenue collections maintain the current pace, it will require a reassessment of FY 2022 revenues as well.

FY 2022 HWM Budget – 5 Questions to Watch

The changing fiscal circumstances summarized above outline just a few of the challenges House Ways and Means will need to address in its FY 2022 budget. Key areas to watch in the HWM budget include:

Will the HWM budget include significant American Rescue Plan resources?

The ARP will profoundly impact the next several state budgets and the HWM budget will be the first spending plan put out after the passage of the $1.9 trillion package. A threshold question is to what extent to will the HWM budget expend ARP resources?

The quick timeline between the final passage of the federal bill and the release of the HWM budget makes it difficult to include significant ARP resources in a thoughtful way. Less than a month has passed since President Biden signed the ARP and critical guidance governing how funds can be used is not yet known. This guidance is necessary to define the state approach for dozens of programs, but will be particularly important in determining how flexible the state's $4.5 billion in CSFRF funding will be for use in the budget.

The ARP does make clear that states are allowed to use CSFRF funds to replace revenue loss attributed to COVID-19, but the method for determining revenue loss has not been established. The bill specifies that revenue loss will be calculated relative to revenues collected in the last full year prior to the pandemic (FY 2019 for Massachusetts), but Treasury guidance is necessary to know how the calculation will be made. Reasonable interpretations of the language could severely limit revenue replacement opportunities or make almost the entire award available to support general budget spending or rebuild the Stabilization Fund, highlighting the need for further clarification.

Table 2. Possible ARP Revenue Replacement Scenarios

	FY 2019 Tax Revenue	FY 2020 Tax revenue w/o pandemic	FY 2021 Tax revenue w/o pandemic	FY 2022 tax revenue w/o pandemic	Total shortfall
Current Estimates	$29,740.1	$29,633.3	$29,891.0	$30,120.0	
Revenue growth at CPI average	$29,740.1	$30,483.6	$31,245.7	$32,026.8	
Low-end shortfall (current estimate v. 2019)		-$106.8	$0.0	$0.0	***-$106.8***
High-end shortfall (Revenue w/o pandemic v. current projections)		-$850.3	-$1,354.7	-$1,906.8	***-$4,111.8***

Table 2. illustrates the potential range of different approaches to calculating revenue replacement. If revenue replacement is limited to actual declines in tax revenue compared to FY 2019, it could mean that less than $150 million of Massachusetts' allocation can be used for that purpose. However, if revenue replacement is based on what tax collections would likely have been absent the pandemic (using the three year CPI average), more than $4 billion of CSFRF will be available to balance the budget over the next several years.

The approach on revenue replacement is illustrative of how important federal guidance will be in ensuring that the state uses ARP resources appropriately, but it is by no means the only example.

The ARP creates new funding programs for public health workforce, childcare stabilization and infrastructure spending that all require further information on how the funding can be used and what it will mean for Massachusetts. Inclusion of ARP funds in the budget without federal guidance is a very risky and could result in the loss of hundreds of millions to the state if spending runs afoul of federal rules.

Maximizing the benefit of ARP resources in a thoughtful and sustainable way will take time and coordination between the legislature and administration and is another reason that HWM is unlikely to incorporate material ARP resources into its FY22 budget. The funds that will flow into Massachusetts through the ARP are unprecedented and could enable transformative investments in a number of policy areas. However, these funds are also temporary and, if not spent as part of a forward-looking plan, will create a fiscal crisis for the state when they are gone.

There are ways in which the HWM budget may reflect elements of the ARP. For example, additional funding for the Childcare Development Block Grant may fit into the HWM spending plan because it builds on a federal program that is usually part of the annual budget. HWM should also provide flexibility in the use of one-time resources, like the Stabilization Fund. Depending on federal guidance, ARP funds could offset or eliminate the need for a reserve draw in FY 2022 and the budget should allow for this possibility. However, in general, the lack of federal clarification on how major funding programs will be overseen and the need for a smart, multi-year approach to temporary federal funds, caution against including significant ARP revenues in the FY 2022 budget at this point and for holding these resources aside until more information is available and a strategy is developed.

How will the extension of the Public Health Emergency affect the HWM MassHealth budget?

The HWM budget will have the benefit of six months of enhanced Medicaid revenue that was not included in the Governor's budget, but it must also account for a higher level of MassHealth enrollment because of the continued prohibition on eligibility redeterminations and the possibility of increased utilization.

MTF estimates that the net impact of higher revenue and higher spending will be approximately $100 million in additional resources for the HWM budget.

Table 3. MassHealth Enrollment & Spending Assumptions in FY 2022

	H1	Updated	Change
Projected 12/21 enrollment	1,750,000	2,100,000	350,000
FY 2022 gross spend	$17,822	$19,270	$1,448
Associated revenue	$10,090	$11,104	$1,014
Enhanced Medicaid revenue	$0	$546	$546
		Net change in MH	-$112

The increased enrollment projection – now likely to remain at or above 2 million members through the end of the year – could increase budget costs by more than $1.4 billion. Much of the new enrollment is among members with a higher federal reimbursement share under the Affordable Care Act, which would offset cost increases by about $1 billion, before accounting for enhanced reimbursements due to the Public Health Emergency. Massachusetts received $546 million in these enhanced reimbursements during the first six months of the pandemic. Assuming MassHealth spending maintains a similar pace during the first 6 months of FY 2022, it means that Medicaid revenue will exceed additional costs by approximately $100 million.

Will HWM adopt the Administration's approach on the Student Opportunity Act?

H1 increased K-12 formula (Chapter 70) funding by $197.7 million to fully fund one-seventh of the Student Opportunity Act. Implementation of the bill was delayed by one year as a result of the budget uncertainty brought about by COVID-19 in FY 2020. The Governor's budget fully reflects all formula changes and expands the count of low-income students, as called for in the bill. The cost of these changes is about $170 million less than it would have been in FY 2020 due to a 30,579 drop in K-12 enrollment.

Some advocates are pushing for the House and Senate to go further than the Governor on Chapter 70 to make up for the delay in implementation and adjust enrollment assumptions. Accelerating the SOA implementation timeline by one year (covering one-sixth of full implementation) would be relatively straightforward and cost $20 - $40 million more than H1. Implementing two years of SOA rates at once would be significantly more expensive – likely more than $100 million higher than the Governor's proposal.

Adjusting enrollment is difficult to do in a rational way that does not create major problems in the future. Many students not included in the October 2020 headcount (which is used for the following year's education funding formula) will likely return to public school in the fall, but how many students will return and how many will not is unknowable right now. Allowing districts to use higher enrollment figures from a previous year will not consistently increase headcount accuracy and will create a problematic precedent for future years. Finally, districts have access to more than $2.4 billion in federal Elementary and Secondary School Emergency Relief (ESSER) funding provided by the ARP and previous legislation – ten times the likely increase in state aid in FY 2022. These funds can be put to a variety of uses over the next several years and will help districts offset the impact of enrollment increase in FY 2022.

It is very likely that the HWM budget will meet the SOA implementation approach put forward in H1. If HWM chooses to go further than the Administration it will likely either speed up the implementation timeframe, to account for last year's delay, or to adjust enrollment. Focusing on the timeline is a more sensible approach.

Will the HWM budget include the same revenue assumptions as the Governor's budget?

It is highly unlikely that the HWM budget will adjust the underlying tax revenue estimate put forward in the Consensus Revenue Agreement and used in H1. An upgrade to FY 2022 tax revenues may ultimately be warranted, but any such adjustment should be delayed until income tax payments, now due in May, are known.

The Administration's budget also proposed close to $300 million in new revenue proposals for FY 2022, many of which have been included in previous Administration budgets.

Table 4. Revenue Initiatives in H1

Item	FY 2022 revenue	Previously proposed by Admin?	House included ?
Drug price penalty	$70	Yes	No
Charitable delay	$64	Yes	Yes
Sports gaming	$35	Yes	No
Cashless lottery	$30	Yes	No
Opioid gross receipts	$5	Yes	No
Hospital assessment	$75	No	NA
Total	$279		

$ in millions

Based on past experience and the altered fiscal context, it is unlikely that the House adopts several of these previously proposed revenue initiatives related to pharmaceuticals and cashless lottery. While the House has passed sports gaming legislation, to date they have not included revenues related to sports gaming in the budget prior to the passage of the bill. The House did delay the implementation of the state's charitable tax deduction in last year's budget and a further delay is likely.

The Governor's budget included a new proposal to increase hospital assessments and dedicates $75 million from the increase to the General Fund in FY 2022. HWM may be reluctant to advance this proposal while awaiting additional clarity on the mechanics of how this assessment increase will work as well as more information on its interaction with the state's 1115 Medicaid waiver, which expires next June.

If HWM does not adopt several of the Governor's FY 2022 revenue proposals, they will have to identify alternate resources or savings to make up the difference. Extension of enhanced Medicaid reimbursements could be used as on offset for some amount of foregone revenue.

How will the HWM budget reflect pandemic response efforts?

The legislature's FY 2021 budgets were notable for their inclusion of more than $300 million in new spending to address the public health crisis and economic recovery. The ongoing need in these areas remains high, but unlike FY 2021, we now know that billions in federal aid are available to help.

Table 5. COVID-19 Investments in the FY 2021 Budget

	New spending in FY 2021 GAA	New Spending in H1	ARP
Early education	$127.5	$50.4	$510M for MA
COVID K-12 funding	$53.1	$0.0	$1.8B for MA
Emergency rental asssistance	$50.2	$13.0	$350M for MA
COVID small business recovery	$46.4	$0.0	PPP, EIDL, Restaurant Recovery
Food security	$15.5	$0.0	Pandemic EBT, WIC expansion, SNAP
COVID Public Health supports	$13.0	$10.0	$100-$175M for MA
Total	***$305.6***	***$73.4***	

The Administration's FY 2022 budget largely eliminated COVID-19 related spending included in FY 2021, due to the ability to use remaining federal funds for similar uses. Since that time, the passage of the ARP augments the federal resources that can be brought to bear to address COVID-19 related needs for education, housing, small business relief and a variety of issues.

Rental assistance and K-12 stand out as two areas where federal funds could offset new state investment. Between the ARP and federal legislation passed in December, close to $800 million is now available to help prevent eviction and stabilize housing for low-income renters. In K-12, more than $2 billion in ESSER funding remains available for school districts to bring students back to school safely, assess and address learning loss and meet other funding needs.

The passage of the ARP does not eliminate the need for the FY 2022 budget to dedicate funds to COVID-19 related needs. For example, much of the ARP's childcare support is subject to legislative appropriation and so will be included either in the FY 2022 budget or a subsequent spending bill. The overlap between state spending on local public health needs and food security is less clear, and so the continuation of increased state spending is likely.

Bottom Line

Events that occurred since the Governor filed H1 create a materially different budget picture for the House and Senate. The passage of the American Rescue Plan, new COVID-19 policies announced by the Biden Administration and relatively strong state revenue provide HWM with different considerations and a markedly different context for developing its FY22 spending plan.

The challenges that face budget-makers in FY 2022 are certainly preferable to the fiscal challenges of a year ago, when the likelihood of catastrophic revenue loss and the potential of major budget cuts loomed, but no less monumental. The House and the Senate will need to chart a fiscal course that uses significant, but temporary, federal funds in a manner that fosters a public health and economic recovery without creating a fiscal cliff down the road. Next week's budget will provide insight into the House's chosen path.