

# State Responses to Budget Crises in 2004: New Jersey

Randall R. Bovbjerg

February 2004

## Background

New Jersey is a high-income, high-tax state whose budgetary problems have become severe during the last three state fiscal years, 2002 through 2004. Politically, voter registration somewhat favors Democrats over Republicans, but independents constitute a majority. A grass-roots backlash against a Democratic governor's tax increase in 1990 gave Republicans control of both legislative and executive branches for the following decade, and numerous tax cuts ensued. Recessionary revenue shortfalls became apparent early in SFY 2002 and influenced the November 2001 elections (the state votes in "off" years). Democrats won the governorship, an Assembly majority, and a tie in the Senate. Fiscal prudence was a major campaign theme for new governor Jim McGreevey. In 2003's mid-term election, Democrats took full legislative control.

The state significantly expanded health programs in the late 1990s. This was affordable because state revenues rose rapidly despite repeated tax cuts, although borrowing also grew, notably to fill a gap in pension capital in 1997. Compared with other states, New Jersey traditionally covered only a moderate share of the state's uninsured,<sup>1</sup> but beginning in 1997 coverage was rapidly expanded to relatively high income levels for children, their parents, and uninsured adults, funded by a mix of Medicaid, SCHIP, and state-only funding.<sup>2</sup> Medicaid coverage as a percentage of population remained below the national average because of the state's high incomes, but above-average rates of employer-sponsored insurance kept the uninsurance rate below national norms.<sup>3</sup> Health programs have faced budgetary pressure to cut back during SFYS 2002 through 2004, given historically high levels of projected deficits.

## The Budget Problem and Overall Responses

*Budget balancing prior to SFY 2004.* In January 2002, the new McGreevey administration projected large budget deficits both for SFY 2002 and for SFY 2003,<sup>4</sup> largely because revenues had declined from 2001 rather than increasing as expected. The mid-SFY 2002 gap of \$2.8 billion was met largely from \$1.7 billion in one-time shifts, along with cuts in administration and other programs. For SFY 2003, the governor's budget projected the deficit to grow to \$5.3 billion, given pre-existing tax and spending projections, and projected shortfalls widened somewhat during the budget process. The SFY 2003 final budget filled this shortfall by raising revenues, inter-account shifts, and spending cuts.

New revenues of about \$2.9 billion included a boost in corporate taxes of about \$1 billion, securitization of half of future tobacco settlement funds, a 70 cent per pack increase in cigarette taxes, and many increases in fees. Shifts among accounts and spending cuts or reductions in growth accounted for the remaining \$2.4 billion: These included a shift of surplus unemployment insurance funds to the state's Hospital Charity Pool, zero increase in state aid to localities, a cut to higher education, and early retirements in the state workforce. Final state appropriations for SFY 2003 were \$23.4 billion, barely 2 percent above the SFY 2002 initial appropriation.

Major health programs were largely spared from cuts in either budget--traditional Medicaid, state pharmaceutical coverage, and the Hospital Charity Pool (New Jersey is one of a handful of states that help hospitals cope with charitable burdens). Indeed, among the SFY 2003 budget's "major increases and decreases" in appropriations, the largest single increase was \$187.7 million for "Medicaid mandatory growth." Many marginal economies affected Medicaid, such as

constrained increases in provider payment levels. But the only major cuts were focused on the late 1990s expansions in NJ FamilyCare for parents of uninsured children as well as other low-income adults (below). Despite the cuts, Medicaid appropriations were again slated to rise by over 5 percent--much more than the 2 percent rise for total state appropriations.

However, projections had worsened by mid-SFY 2003, suggesting a \$1.3 billion deficit for the remainder of the fiscal year, about 5 percent of appropriations. Lagging revenues were the main cause, including a shortfall in state taxes of about \$500 million, which worsened during the budget process to over \$700 million. The state also failed to win federal approval for some \$392 million in Medicaid maximization assumed in the year's budget. Higher than anticipated supplemental spending also occurred, including \$60 million for court-mandated school aid, \$50 million for post retirement medical costs, and \$47 million for county solid waste debt service. Medicaid over-spending was not a problem; indeed, it had a \$35 million surplus for year's end.

Numerous stratagems helped fill the mid-year gap during SFY 2003, but Medicaid played little role. Many fixes were one-time measures. On the revenue side, the state accelerated some collections: Third-quarter estimated payments for large corporate taxpayers were shifted from September 2003 to June 2003, which put five payments into the FY 2003 budget. The state also tapped remaining funds of \$413 million from its first tobacco securitization and \$166 million from higher than expected revenues under a tax-amnesty initiative. On the spending side, payments totaling \$361 million were postponed from late SFY 2003 into early SFY 2004 (\$296 million for School Aid and \$43 million for colleges and universities). After the changes, SFY 2003 ended in surplus. At least \$100 million of surplus is attributable to state funds, including higher than expected corporate taxes. Federal fiscal relief (below) was used for general budgetary purposes, for example, forestalling additional cuts to Medicaid or charity care.

*The SFY 2004 Budget Process.* In February 2003, the administration projected almost a \$5 billion deficit for SFY 2004, beginning in July.<sup>5</sup> This amounted to 18 percent of projected state appropriations. Spending was estimated to rise some \$3.6 billion to \$27 billion because of Medicaid,

debt payments, employee benefits for current and retired state and local workers, retiree pension-fund contributions, and need to increase state surplus. Revenues were projected to drop \$1.4 billion from SFY 2003, partly because of the acceleration of 2004 collections into the year before. The new budget had to offset losses of \$453 million in SFY 2003 one-time funding sources not available in 2004. Governor McGreevey blamed "national economic downturn, 10 years of [state Republicans'] fiscal irresponsibility, and a federal government that has turned its back on states."<sup>6</sup>

***In New Jersey, rises in taxes and fees, federal fiscal relief and temporizing fiscal stratagems have helped stave off most Medicaid and SCHIP cuts, although the state's recent expansions of coverage for parents and childless adults are being reduced by attrition.***

In response, for SFY 2004 the governor again proposed and the legislature enacted a slow-growth budget. Final state appropriations totaled \$24.0 billion, an increase of about 2.6 percent above SFY 2002 initial appropriations, about double the increase that had been proposed by the governor at the start of the process.<sup>7</sup> Deficit reduction was accomplished by a mix of revenue increases, spending cuts or reduced growth, and various shifts among accounts and other "temporizing measures," as at least one bond rating agency has called them, although the governor's budget termed them "special revenue opportunities."<sup>8</sup> Overall, the legislature made modest changes to the governor's budget proposal, including some cuts in proposed taxes and fees sought by Republicans with an eye to November campaigning on tax issues and some restoration of proposed spending cuts championed by Democrats with a different electoral strategy. Many changes were negotiated in the final days and hours of the process.<sup>9</sup>

New Jersey taxes and fees were also increased for SFY 2004, but by less than for 2003, when corporate taxes alone were hiked by \$1 billion. No increase was proposed or legislated in the "big three" taxes on incomes, sales, and corporations, despite opinion-poll support for a temporary sur-

charge on high earners and some Democratic support in the legislature. However, there were many smaller increases in taxes and fees, totaling nearly \$600 million, notably on hotels and motels, realty transfers, cigarettes, and casino revenues. Anti-tax Senate Republicans won rejection or reduction of some \$200 million in tax increases initially sought by the governor, including a new levy on telephones and part of the proposed realty-transfer fee. To reduce the governor's planned spending cuts, however, the legislature raised cigarette taxes by 55 cents a pack rather than the governor's 40 cents and imposed a new billboard tax. The cigarette increase came on top of last year's 70-cent rise and boosted the per-pack total to \$2.05, highest in the nation.

For SFY 2004, as for the year before, the budget assumed successful new Medicaid maximization to increase receipt of federal funds. A small new nursing-home assessment (about \$18 million) was designed to support a rise in Medicaid payment rates to enhance quality and also draw down additional federal matching dollars, starting at mid-year. Much larger were assumptions of federal authorization to continue intergovernmental transfers involving nursing homes, or other stimulus, along with a new Pharmacy Plus waiver to get federal matching revenues for two preexisting state-only pharmaceutical programs. The governor's budget in February assumed an increase in these federal funds totaling \$630 million. Neither the IGT authority nor the pharmacy waiver was approved during SFY 2003 (which increased the mid-year deficit last year), and neither seems likely for 2004. Federal stimulus did arrive, enacted on May 28th and implemented on June 4th.<sup>10</sup> It supplied both grant funding and a one year's rise in the percentage rate of federal Medicaid match. New Jersey's estimated share is \$561 million--\$143 million in SFY 2003 and \$418 million in fiscal 2004.<sup>11</sup>

Reductions in spending--or in anticipated growth--contributed at least as much to deficit reduction as did rises in revenues. The governor proposed numerous slowdowns or cuts in state programs, including some in health, totaling upwards of \$2 billion in ongoing economies, but many were reduced or eliminated during the legislative budget process. Constituencies from arts groups to health advocates seemed pleased with the aftermath of their lobbying. Notable among

final cuts or deficit reduction were essentially level funding in school and other local aid programs (perhaps \$500 million in deficit reduction below previously projected growth)<sup>12</sup>; about \$226 million from new limits on NJ Saver (property taxpayer relief, cut even more than the governor had proposed); and about \$50 million in reductions to higher education (about half the initial proposal), according to news accounts. Employee health benefits were slightly trimmed for new hires. Moreover, the governor plans to cut direct state operations by about 4 percent, with some 1000 employees expected to depart via attrition. The governor also proposed cuts of \$99 million in state pharmaceutical spending and \$76 million for FamilyCare adult enrollees, both also moderated by the legislature (see below).

One significant economy in state spending did not reduce the deficit. In early calendar 2003, the McGreevey Administration had its first chance to negotiate contracts with unionized state employees, and won agreement that no cost-of-living wage increases would occur in SFY 2004. This slow-down from past trends was anticipated, so it was not counted as deficit reduction--but it did hold down spending growth. No dollar savings estimate is readily available.

Again for fiscal 2004, a number of temporizing stratagems helped fill the budget gap. A second securitization of remaining future tobacco-settlement revenues generated \$1.6 billion of revenues for SFY 2004, which cannot be repeated next year.<sup>13</sup> A large pension contribution was due for SFY 2004 for the first time since former governor Whitman floated bonds to refinance pension obligations in 1997, but the governor and legislature agreed to stretch out the contribution over 5 years, thus postponing about \$600 million from the current year. Fund balance transfers also continued, including \$325 million from Unemployment Insurance to the Hospital Charity Pool, along with \$220 million in shifts from a number of other funds.<sup>14</sup> Aid to public schools and higher education seems also to have "suffered a de facto cut of one-twelfth" by the postponement of a June payment into July.<sup>15</sup>

## Medicaid and SCHIP

For fiscal 2004, traditional Medicaid--as distinct from the recent expansions--was largely protected from the level of cuts felt elsewhere, both in

the governor's budget and in final appropriations. As for the year before, the largest of the 2004 budget's listing of "major increases and decreases" was \$216 million for Medicaid and General Assistance health care growth.<sup>16</sup> The governor and legislature agreed that growth needed to be slowed slightly, but large-scale changes were avoided. The final budget allowed more growth than the governor's budget had contemplated in February. Given the new availability of federal fiscal relief funds via grants and enhanced federal Medicaid match, the governor agreed during budget season to scale back some cuts, and the legislature rejected or reduced several others.

Eligibility cuts were a major gubernatorial proposal, with some 60,000 adults to be dropped from FamilyCare coverage by reducing the income limit to 133 percent of FPL and dropping immigrants, saving \$76 million (a majority in unmatched state support for such enrollees). Eligibility standards for SCHIP-funded children in FamilyCare were not affected, remaining at a high 350 percent of FPL. Enrollment of adults in the program had far outpaced initial authorizations, was frozen in June 2002 and childless adults were moved back into less generous General Assistance coverage. The final SFY 2004 budget rejected outright cuts, but it maintained the freeze on adult enrollment and allowed attrition to continue to reduce enrollment. As of early November 2003, adult enrollment was about 146,000, dropping somewhat more slowly than expected toward the target of 125,000. The legislature made up for the \$76 million in savings proposed by trimming benefits instead, also allowing higher spending than proposed, though still \$45 million less than in 2003.

The main benefit-related proposal was to eliminate dental and chiropractic services for non-pregnant adults; this \$15 million cut was rejected. Also rejected was a proposal to impose a co-payment on non-emergency outpatient hospital services, worth almost \$2 million.

Provider payment changes were also proposed. A freeze on hospital outpatient rates was enacted, saving \$24 million in state appropriations. Physician fees were unchanged; a zero rate increase is the norm for New Jersey fee-for-service Medicaid. The regular fee-for-service inpatient hospital payment update was allowed to proceed unchanged, providing its standard annual in-

crease by the "TEFRA" economic-index. MCO rates were also unaffected, increasing by 8.5 percent, although some FamilyCare coverage was removed from capitation into an ASO-like arrangement, with slight budgetary impact. The governor sought to reduce growth state spending on nursing homes by not "re-basing" the rate-making methodology and by starting mid-year to impose a new assessment on beds to pay for care, drawing down new federal funds to offset state appropriations, together achieving \$34 million in savings. The legislature increased the state savings to \$51 million, but relied entirely on new federal funds to do so (by imposing the new assessment earlier in the year). The state awaits federal approval, hoped to be retroactive.

***Despite spending cuts in much of the budget, again in SFY 2004 changes were small for traditional Medicaid, the hospital charity care pool, and the state's pharmaceutical program.***

Proposed and enacted changes in pharmaceutical spending were substantial for the first time in New Jersey. Both for Medicaid and for the state-only pharmaceutical programs for the elderly and disabled, the governor sought mandatory generic substitution, an increase in the discount below average wholesale price (from AWP minus 10 percent to minus 15), a preferred drug list (only for 6 months of fiscal 2004), prescription drug co-payments, and a voluntary mail order program--totaling \$65 million in state savings, according to Medicaid staff. Mandatory generic substitution and AWP less 12.5 percent were enacted, but the other cuts were reduced or rejected.

The legislature also made small additional changes, adding \$10 million in new spending for federally qualified community health centers in recognition of increased demand by the uninsured, and calling for about \$13 million in new savings not proposed by the governor, through long term care drug recycling, disease management, and a generic rebate program.

An unusual non-Medicaid increase helped Human Services' Division of Youth and Family Services. The governor requested increases to upgrade computer systems to track youth and par-

ents as well as higher state staffing. Still larger increases were enacted, presumably influenced by news accounts of horrible abuse and starvation of children. The total increase, however, was only \$30 million. The state is moving toward better integration of youth and Medicaid services, to improve quality and efficiency; children under medical care should be better monitored. (Similar reforms achieved bigger savings in the state pharmaceutical programs.)

In part the modest legislative changes to the governor's proposals reflect differing philosophies and responsiveness to constituents. In part they also reflect new circumstances, notably the arrival of new federal stimulus after the budget was originally proposed.

## The Future

Budget deficits began running at about 10 percent each year in New Jersey, starting in mid-SFY 2002. One year ago, despite hard times, the state had successfully continued its relatively generous support for health care, even beyond conventional Medicaid. But it seemed then that policymakers had exhausted one-time fixes and the state's unusual political willingness to raise taxes other than income and sales. Accordingly, serious cuts in Medicaid and other health programs were expected to begin in SFY 2004. However, this year's budget looks much the same: Again, New Jersey proved unusually willing to raise fees and taxes, although not the big three on incomes, sales, and corporations. Temporary federal stimulus support also boosted revenues. There were significant cuts in much spending, including in some public health programs. Changes in traditional Medicaid, the hospital charity care pool, and the state's elderly-and-disabled pharmaceutical benefits seem relatively small. Health care advocates appear to have been gratified that cutbacks were much smaller than expected, though one outside observer commented that a number of changes were occurring "below the radar." Overall, growth in health benefits spending continues to outpace growth in revenues.

The Democratic governor's cutbacks and fiscal gymnastics have not made him popular, as shown by low ratings in opinion polls. At the election polls in November, however, counterattacking Republicans suffered unusual off-year setbacks. Republicans lost control of the Senate that they

had shared since 2001, and fell further into minority in the Assembly. Bond raters ratified the SFY 2004 budget deals by holding the state's rating steady in July, although some maintained a rating watch on the state.

SFY 2005 budget pressure also looks to be severe. Many gap-filling mechanisms to date have been temporary, the state's reserves are only 1.5 percent of state appropriations, federal fiscal stimulus is scheduled to expire, and some SFY 2004 expectations may prove unrealistic. Most clearly, the anticipated ongoing federal support for intergovernmental transfers and new pharmaceutical-program matching has yet to be realized. However, four months into SFY 2004, most other revenue sources were growing slightly faster than expected, according to the state's Office of Legislative Services, and support was growing for increasing the state's gasoline tax after the election.<sup>17</sup> Continued growth in Medicaid may still be difficult to sustain. Interviewees were not at liberty to discuss specific potential cuts to Medicaid, but it is acknowledged that "everything is on the table" at this point.

*Funded by the Kaiser Commission on the Future of Medicaid and the Uninsured and the Urban Institute's Assessing the New Federalism project, this study is part of a broader project that examined state responses to the 2004 budget crises in ten states (Alabama, California, Colorado, Florida, Massachusetts, Michigan, New Jersey, New York, Texas, and Washington). An overview paper and other state report reports can be found at [www.urban.org](http://www.urban.org). A combined volume of both the overview and state reports can be found on [www.kff.org](http://www.kff.org).*

*Randall R. Boobjerg is a principal research associate at the Urban Institute. He has almost 30 years of experience of consulting research in public and private insurance, state and local health policy, medical injury, liability, and patient safety; and state regulation. The views expressed are those of the author and should not be attributed to the Urban Institute, its trustees or its funders.*

## Endnotes

<sup>1</sup> Spillman, Brenda C. "Adults without Health Insurance: Do State Policies Matter?" *Health Affairs* 19(4):178-187 (Jul-Aug 2000). Note that this report does not cite to its interviews; for case study methods see overview chapter.

<sup>2</sup> By early 2001, New Jersey offered coverage to children with family incomes up to 350 percent of the poverty level, parents up

to 200 percent, and childless adults up to 100 percent. Randall R. Bovbjerg and Frank C. Ullman, *Recent Changes in Health Policy for Low-Income People in New Jersey* (Washington, DC: Urban Institute/Assessing the New Federalism, State Update No. 21, March 2002)

.<<http://www.urban.org/UploadedPDF/310445.pdf>>, last accessed Jan. 15, 2004.

<sup>3</sup> New Jersey state program covers 8 percent of its population of all ages, versus a national average of 11 percent (average of 2000 and 2001 for NJ). The uninsurance rate is 13 percent, below the national average of 15 percent because ESI is high, at 64 percent versus 58 percent nationally. Kaiser Family Foundation, *State Facts Online, New Jersey: Population Distribution by Insurance Status*, state data 2000-2001, U.S. 2001, accessible from <<http://www.statehealthfacts.kff.org>>, last accessed Jan. 11, 2004.

<sup>4</sup> Randall R. Bovbjerg, "New Jersey," in *The State Fiscal Crisis and Medicaid: Will Health Programs Be Major Budget Targets? Overview and Case Studies*, prepared by John Holahan, Joshua M. Wiener, Randall R. Bovbjerg, Barbara A. Ormond and Stephen Zuckerman, 71-81 (Washington, DC: The Kaiser Commission on Medicaid and the Uninsured, January 2003, pub. no. 4074), accessible from <<http://www.kff.org/medicaid/4074-index.cfm>>, last accessed Jan. 11, 2004.

<sup>5</sup> New Jersey Office of Management and Budget, Department of the Treasury, *NJ State Budget FY 2003 - 2004* (February 4, 2003), component documents accessible from <<http://www.state.nj.us/treasury/omb/publications/04budget/index.shtml>>, last accessed Jan. 15, 2004.

<sup>6</sup> *Governor's Message, State of New Jersey Budget, Fiscal Year 2003 -- 2004*, February 4, 2003, page i <<http://www.state.nj.us/treasury/omb/publications/04budget/pdf/front.pdf>>, last accessed Jan. 15, 2004.

<sup>7</sup> Office of Legislative Services, New Jersey Legislature, *Analysis of the New Jersey Fiscal Year 2003 - 2004 Budget; Final Budget Summary: Appropriation and Language Changes* (July 2003) <<http://www.njleg.state.nj.us/legislativepub/budget/finalchn04.pdf>>, last accessed Jan. 15, 2004. Compare New Jersey Office of Management and Budget, *NJ State Budget FY 2003 - 2004*, above. The increase for SFY 2004 appropriations is 1.6 percent if compared with adjusted fiscal 2003 appropriations, because of mid-2003 supplemental appropriations. Budget Office, "Fiscal 2004 Appropriations" (Powerpoint file) <<http://www.state.nj.us/treasury/omb/publications/04veto/pdf/presentation.pdf>>, last accessed Jan. 15, 2004.

<sup>8</sup> Business Editors, "Fitch Places State of New Jersey GOs & Appropriation Bonds on Rating Watch Negative," *Business Wire*, March 10, 2003 <[http://www.findarticles.com/cf\\_dls/m0EIN/2003\\_March\\_10/98575677/p1/article.jhtml](http://www.findarticles.com/cf_dls/m0EIN/2003_March_10/98575677/p1/article.jhtml)> last accessed Jan. 15, 2004; compare NJ Budget document Summaries of Revenues Expenditures and Fund Balances, February 4, 2003, p. C-4 <<http://www.state.nj.us/treasury/omb/publications/04budget/pdf/revexp.pdf>>, last accessed Jan. 15, 2004.

<sup>9</sup> Information on legislative decisions comes heavily from press accounts, for example, Michael Symons, "Marathon Talks Produce a Deal on State Budget," *Cherry Hill Courier Post*, NJ, July 1, 2003 <<http://www.southjerseynews.com/issues/july/m070103f.htm>>; Michael Jennings, "Stalemate Ends as State Budget OK'd," *Trenton Times*, July 01, 2003

<<http://www.nj.com/search/index.ssf?/base/news-0/1057046795230491.xml?times?nxt>>; "The Budget Is Passed" [Editorial], *Trenton Times*, July 02, 2003

<<http://www.nj.com/search/index.ssf?/base/news-0/1057133101319530.xml?times?nex>>, all last accessed Nov. 7, 2003.

<sup>10</sup> The legislation was the Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law No. 108-27, 117 US Statutes at Large 752, May 28, 2003. Implementation occurred in early June. See letter of U.S. Secretary of the Treasury John W. Snow to state governors, June 4, 2003

<<http://www.ustreas.gov/press/releases/reports/stateletter.pdf>>, last accessed Jan. 15, 2004. Exactly how much FMAP a state gets depends of course upon how much it spends in state and local funds.

<sup>11</sup> In New Jersey, increased federal revenues may be described as cut in state spending rather than a revenue increase, as federal funds are separately budgeted and may supplant other state appropriations.

<sup>12</sup> Combining numerous categories of aid to help localities or their ratepayers shows that fiscal 2004 appropriations rose about 2 percent above adjusted 2003 appropriations, see "Funding for Property Tax Relief," slide no. 5 in Budget Office, "Fiscal 2004 Appropriations," above. The governor's budget projected \$512 million in deficit reduction from reduced growth in school aid alone, NJ Budget Office, *Summaries of Appropriations*, above, page B-5.

<sup>13</sup> The governor's budget proposed to appropriate only \$250 million in SFY 2004; it is unclear from this report's research into which accounts all the money is allocated.

<sup>14</sup> Inter-fund shifts may be able to continue year after year if the fund being tapped for other purposes generates more ongoing revenues than needed for its basic purpose. This has occurred in New Jersey with the tapping of unemployment insurance funds to cover expenses of the hospital charity pool.

<sup>15</sup> *Trenton Times* Editorial, July 2, 2003, above.

<sup>16</sup> NJ Budget Office, *Summaries of Appropriations, SFY 2004*, above, page B-41 <<http://www.state.nj.us/treasury/omb/publications/04budget/pdf/summaries.pdf>>, last accessed Jan. 15, 2004.

<sup>17</sup> OLS Revenue Snapshot, FY 2004 - Through November 2003 <<http://www.njleg.state.nj.us/legislativepub/budget/novsnap04.pdf>>; Michael Symons, "N.J. Gasoline Tax Increase Called Likely; Governor quickly Rejects 15 Cent per Gallon Hike," *Courier-Post* online (Cherry Hill), November 11, 2003 <<http://www.southjerseynews.com/issues/november/m111103e.htm>>, both last accessed Jan. 15, 2004.