

State Responses to Budget Crises in 2004: Texas

Ian Hill

February 2004

Background

Governor Rick Perry, sworn in to replace George W. Bush in December 2000 and elected to a four-year term in November 2002, presented a budget to the state legislature in January 2003 that contained nothing but zeros. Facing the largest revenue drop in state history--\$7.4 billion--the Governor presented this budget as a symbolic gesture to emphasize that this would be a year of "re-examining the core responsibilities of government and state spending." The official estimate of the shortfall facing Texas for the 2004/2005 biennium was \$9.9 billion, or 15.5 percent of the Comptroller's projected \$64 billion in General Revenue spending for the period, a figure that did not include any adjustment for growth in public school enrollment. (However, the Center for Public Policy Priorities, an Austin-based not-for-profit think tank, placed the shortfall at \$15.6 billion, or 22.4 percent of a projected \$69.7 billion in GR spending, which recognizes both current services cost increases in health and education budgets, and adjusts for population and inflation growth.) "In tough budgetary times, every dollar spent by government...must be scrutinized to determine whether it justifies consideration as a priority. That is why this budget contains no numbers," he said in his budget letter to the 78th legislature.¹

In the same letter, the Governor reiterated his commitment to not raise taxes as a means of addressing the state budget crisis. This despite the fact that Texas is one of the nine remaining states that does not have a broad-based personal income tax, and has a business franchise tax that is "easily evaded by corporations by restructuring into limited partnerships."² Instead, the state imposes one of the highest sales taxes in the nation, thus making Texas' tax structure "extremely regressive,"³ as well as

relatively high local property taxes. Cutting spending, therefore, was the primary strategy entertained by the Governor and the Republican-dominated state legislature.

Texas is a large state in terms of both geography and population, with many low-income people, high levels of uninsurance, a substantial number of foreign-born residents, and a traditionally minimalist approach to government that has resulted in low spending on health and social welfare programs relative to other states. Given that, Texas already ranked 43rd in the nation in per capita health, hospital, and public welfare spending in 2000 and 41st in state aid per K-12 pupil in 2001-2002, the prospect of further cuts did not bode well for these two largest components of the state's budget.

The State Budget Situation and Policy Response

During the late winter/early spring of 2003, policymakers worked to balance the biennial 2004/2005 budget. (The 2002/2003 biennial budget was set in 2001, with supplemental cuts and spending for 2003 authorized by the 78th legislature.) As was the case in states across the nation, decreased revenue collections played a large part in fueling the deficit in Texas. In 2002, sales tax revenue was down 1.0 percent from the prior year; in 2003, it dropped another 1.6 percent.

Early on in the process, there were some efforts to address the revenue side of the budget problem. The House Ways and Means Committee reviewed a proposal to eliminate virtually all tax exemptions from the tax code (including sales tax exemptions for consumers on such things as groceries, prescriptions, and electricity, and business exemptions on products

used in manufacturing), as well as proposals to raise the state's sales tax rate. The State Comptroller proposed to increase the state's tax on cigarettes from \$0.41 to \$1.41 to raise \$1.5 billion over two years. And in perhaps the most serious effort, lawmakers worked hard on bills that would have closed the loophole in the state's franchise tax that permits corporations to escape paying the tax by reorganizing as partnerships and creating subsidiaries in other states. Some 4,000 companies, including such major firms as Cox Texas Newspapers, LP, Dell Computer Corporation, and SBC Communications, Inc., have used this loophole in the last four years, leading to drops in revenues to the state of approximately \$200 million per year. Ultimately, each of these proposals failed, as lawmakers held fast to the principle of addressing the deficit through spending cuts, not tax increases.

The firmness of this stance can be attributed, as least in part, to the effect of term limits and a large crop of new Republican state legislators taking control in the House and Senate. Many of the incoming lawmakers looked to the previous biennium, a period that witnessed dramatic growth in enrollment and state spending on such programs as Medicaid and the State Children's Health Insurance Program (SCHIP), and expressed the belief that Texas had gone too far with its social services and needed to restore programs to a more appropriate, conservative level of generosity.⁴ In response, the legislature returned to its traditional, more conservative stance, embracing reduced spending, "a philosophy more protective of taxpayers who pay for services than of Texans who receive them."⁵

To address the deficit, Texas adopted an array of cost-cutting and cost-avoidance measures. For example, a seven percent across-the-board cut in state agency spending was called for by the Governor to make up the \$1.8 billion 2003 deficit by August 31, 2003. For 2004-2005, the largest part of the state budget, K-12 education, saw an all-funds increase of \$893 million (three percent more than in 2002-03), but a General Revenue *reduction* of \$1.1 billion (four percent less than in 2002-03), mostly because of postponed payments to school districts. K-12 cuts include the Texas Education Agency having to lay off 125 of its 860 full-time employees; and

school teachers, counselors, and librarians having their health insurance stipends reduced from \$1,000 to \$500 per year (saving \$700 million over the biennium). In other parts of the budget, the Texas Department of Criminal Justice saw its budget cut by \$300 million, including the elimination of about 1,000 full-time positions; approximately \$55 million was trimmed from three higher education research fund budgets; five agencies were eliminated—the Aircraft Pooling Board, the Wildlife Damage Management Service, the Council on Environmental Technology, the Criminal Justice Policy Council, and the Telecommunications Infrastructure Fund Board—for a combined savings of \$21.5 million; twelve-and-one-half percent of the \$82 million budget for Tuition Equalization Grants was cut, reducing funds that would be available to help students attend private colleges; and the Healthy Families child abuse protection program lost its funding (saving \$2.8 million), along with several other child abuse/neglect prevention programs. The only areas of the budget that got more General Revenue were regulatory agencies (up three percent from 2002-03) and business and economic development (up 46 percent).

Many incoming lawmakers looked at the previous biennium, a period that witnessed dramatic growth in Medicaid and SCHIP, and expressed the belief that Texas had gone too far with its social services.

Lawmakers also reduced state spending through reorganization of state agencies. Of particular note was the sweeping reorganization of health and human services agencies designed to trim \$110 million from the state budget. Under the new law, a dozen agencies will be dismantled and streamlined into five: The Health and Human Services Commission, the Department of State Health Services; the Department of Aging and Disability Services; the Department of Family and Protective Services; and the Department of Assistive and Rehabilitative Services. Part of the reorganization would also entail the state contracting with a private firm to serve as a

“single point of entry” call and application center for all health and human services programs.

Other strategies for addressing the deficit included dipping into reserves and putting off certain payments to future fiscal years. For example, Texas took \$1.3 billion from its surplus “rainy day” fund to cover a large portion of the shortfall. The state also got out from under \$1.3 billion in spending by deferring payments to school districts and other program from August 2005 (the last month of the current biennium) to September 2005 (the first month of the next biennium), and by lowering Medicaid caseload projections to help balance the budget.

However, some of the most striking cuts to state programs were made in Medicaid and SCHIP, as described below.

Medicaid and SCHIP

With an uninsurance rate approaching one-quarter of the nonelderly population, Texas has traditionally relied on public hospitals and county health systems to meet the needs of the medically indigent, rather than on expansion of public coverage. The state departed from this practice in the late 1990s and early '00s by aggressively implementing SCHIP and, subsequently, passing rules to make it easier for eligible children to enroll in Medicaid. Even in the face of the economic downturn and tightening state budgets, the 2002/2003 biennium saw Texas hold the Medicaid and SCHIP programs virtually harmless. In mid-2002, the Medicaid program changed from an accrual- to a cost-based accounting system, permitting a one-time deferral of roughly \$225 million. And a proposal to begin imposing copayments for prescription drugs on some adult Medicaid recipients was stopped by a court order late that year. For SCHIP, child and family health advocates successfully lobbied the state legislature throughout the summer of 2002 to persuade lawmakers to spare the program from cuts.

As mentioned above, the biggest policy change during the period, in fact, supported a significant expansion of the Medicaid program. In June 2001, SB 43 was signed into law calling for a dramatic simplification of Medicaid

enrollment procedures for children bringing them in line with the already simplified rules for SCHIP. Specifically, the law directed Medicaid to adopt a simpler application form; drop the requirement for a face-to-face interview with local social services staff when filing a Medicaid application; reduce asset documentation requirements; adopt six-month continuous eligibility for children (with a provisions to extend to 12 months in the future); and drop the requirement for face-to-face interview at eligibility redetermination (on the condition that the child is up to date with his/her immunizations and well-child visits).⁶ In all, these simplifications were expected to cost the program \$123 million during the 02/03 biennium in the form of increased child enrollment.

In total, Medicaid and SCHIP cuts are expected to...result in approximately 18,000 adults losing Medicaid coverage and 167,000 children losing SCHIP coverage.

Addressing the growing deficit for the 04/05 biennium followed a dramatically different course, however. Both Medicaid and SCHIP experienced significant cutbacks. Still, the cuts would have been worse, had the state not received \$1.3 billion in federal relief resulting from the Jobs and Growth Tax Relief Reconciliation Act of 2003, \$574 million of which was targeted at the Medicaid program through an increase in the federal matching rate. Many “worst case” scenarios and proposed budgets were floated in the legislature in the early months of 2003. These included such proposals as reducing Medicaid provider reimbursement by 33 percent and entirely eliminating the SCHIP program. Later versions of the proposed bills scaled back these cuts to a degree; for example, the House Appropriations committee put forth that the SCHIP program’s upper income threshold be reduced from 200 percent to 150 percent of poverty.

In April 2003, the Perryman Group (a Texas-based economic forecasting firm) released a study (co-sponsored by the Texas Medical, and Hospital, Associations) declaring that Texas

would lose more money than it would save if the proposed cuts were made (in the form of lost federal revenue, increased uncompensated care, increased private insurance premiums, and lost state and local tax revenue). Perhaps influenced by this, lawmakers (and the Governor) finally settled on a budget that contained the following cuts in Medicaid:

- Reducing upper income eligibility limits for pregnant women from 185 percent to 158 percent of poverty (for a savings of \$43.9 million);
- Eliminating the Medically Needy “spend-down” program for adults with dependent children (for a savings of \$45.8 million);
- Eliminating coverage of many optional services for adults, including mental health counseling, podiatric, chiropractic, eyeglasses, and hearing aids (saving \$43.4 million).

Other Medicaid cuts to which individual cost savings estimates were not attached included postponing until FY 2006 the extension of continuous coverage for children from the current six months to 12 months); adopting more stringent verification of declared assets for children; imposing cost sharing at the maximum amount permitted by federal law; and implementing a preferred drug list and prior authorization requirements. Legislative budget decisions also reduced provider reimbursement for hospitals and physicians by 2.5 percent, nursing homes by 1.7 percent, and community care providers by 1.1 percent. Provider reimbursement reductions for both Medicaid and SCHIP (discussed below) will reduce state budget spending approximately \$294.2 million in the 2004/2005 biennium.

SCHIP cuts included the following:

- Changing the income test from a “net” to a “gross” basis, effectively eliminating deductions from income and reducing the program’s upper income limit from 240 percent to 200 percent of poverty;
- Adding an assets test to the eligibility determination process for children in families with incomes over 150 percent of poverty;

- Adding a 90-day waiting period before coverage becomes effective for new enrollees;
- Reducing continuous eligibility from 12 months to six months;
- Eliminating coverage of several benefits, including dental, vision, eyeglasses, hearing aids, chiropractic, home health, and hospice; and reducing coverage of mental health and substance abuse treatment services;
- Reducing provider reimbursement by five percent; and
- Raising premiums and copayments for enrollees of all income levels.

In total, Medicaid and SCHIP cuts are expected to reduce state General Revenue spending by \$835.2 million (\$206.7 million of which result from SCHIP eligibility and benefit cuts), and result in approximately 18,000 adults losing Medicaid coverage and 167,000 children losing SCHIP coverage. Furthermore, state officials estimate that eligibility changes made to children’s coverage under Medicaid will reduce future growth in that program by 332,000 children from 2003 to 2005. Before these cuts were instituted, Medicaid enrollment stood at 2.5 million persons (1.6 million of whom were children under age 19), while SCHIP enrollment was 507,000 children.⁷

The Future

Like many states, Texas is expecting its budget picture to improve modestly in the coming year, as the economy recovers and revenues increase. However, strategies that deferred payment obligations from the current, to the next, biennium will exert pressure on spending flexibility in the next cycle, and state and local health care costs are likely to increase as a result of cuts to both Medicaid and SCHIP. Still, remarkably, most legislators are on the record that they believe the 2004/2005 budget process was a “success,” pointing out that cuts could have been much worse, and philosophically believing that they have restored reason to a health and human service system that “got out of hand” during a time of economic strength.

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. A combined volume of both the overview and state reports can be found on www.kff.org.

Ian Hill is a senior research associate with the Urban Institute's Health Policy Center, where he directs qualitative evaluation projects focused on children's health insurance, Medicaid, maternal and child health, and children with special health care needs. The views expressed are those of the author and should not be attributed to the Urban Institute, its trustees or its funders.

Endnotes

¹ <http://www.governor.state.tx.us/divisions/bpp/budget/letter>.

² Study by Governing Magazine and Pew Center on the states, <http://www.statesman.com/hp/content/coxnet/texas/legislature/0203/0204brfs.html>.

³ Ibid

⁴ Telephone conversation with Jason Cooke, Texas Medicaid/SCHIP Director, September 2003.

⁵ Susswein, Gary. Austin American-Statesman. April 18, 2003.

⁶ The original bill also called for elimination of the assets test for children; this was not passed, but families were permitted to self-declare their assets information.

⁷ Many of the specific budget numbers cited throughout this report, and in particular those pertaining to Medicaid and SCHIP, were provided by the Center for Public Policy Priorities in Austin, Texas. The author is indebted to both Anne Dunkelberg and Eva De Luna for their comments, feedback, and input on this paper.