

DIRECTOR'S UPDATE



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Economic Analysis of Current Issues

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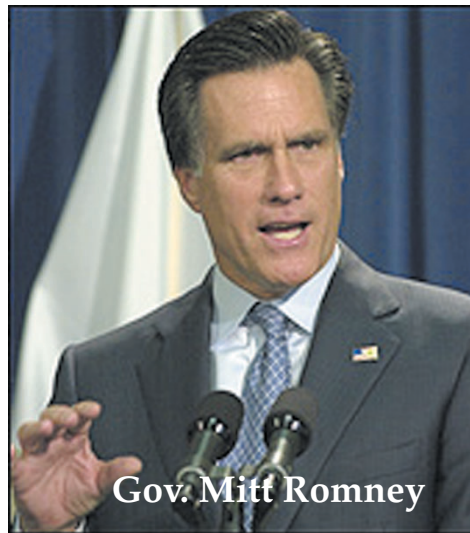
Grading the Governor: It's the principles of the thing

With the fiscal 2004 budget debate drawing to a close, it is instructive to ask how well Governor Romney performed in crafting the 2004 state budget.

Principles of Government Budgeting

To answer, let's consider five principles of good budgeting:

1. *Neutrality:* The government should tax and spend in such a way as to distort private choices as little as possible and thus to exert the smallest negative effect on the state economy: Tax all consumption rather than only some consumption; tax saving once but only once; don't tax or spend in a manner that discourages work; etc.
2. *Equity:* Tax and spend in a way generally seen to be fair: Don't tax the poor more than the rich. Create programs that offer temporary relief to the most disadvantaged.
3. *Efficiency:* Get the greatest possible value, in terms of services delivered, from the tax revenue collected; i.e., keep the cost of government low.
4. *Responsibility:* Balance the budget. Don't create deficits that would burden future generations or surpluses that would burden the present one.
5. *Limiting Government:* Achieve the correct balance between the needs of the public sector and those of the private sector. Give government a large enough, but only a large enough, share of the economic pie, to do its job.



Concerning Principle #5, there are a number of reasons to believe that the voters want state government to take a smaller share of the economic pie:

- The near passage last year of a ballot measure that would have abolished the state income tax.
- A 2000 ballot measure, approved by an overwhelming majority of voters and since negated by the legislature, that re-

duced the income tax to 5.0% and instituted a charitable tax credit.

- The election (or succession) of three previous governors who promised and delivered lower taxes.
- Governor Romney's own election in 2002 on the basis of an anti-tax campaign.
- The refusal of many communities, over the past few weeks, to override Proposition 2 1/2.
- Polls showing that residents consider high taxes to be one of the state's biggest problems.

Governor Romney's First Budget: Our Scorecard

How, then, did Governor Romney perform according to these criteria, given that it is the will of the voters to reduce the size of state government? Our answer: Considering what he was up against, he did a pretty good job. But since we're in the education business, we like to give out grades. So let's tally up his grade according to our five principles:

Neutrality

The governor promised to hold the line on new taxes and did succeed in avoiding any major tax hikes against the onslaught of advertising and lobbying conducted by the hospitals and the teachers' union. His closing of corporate loopholes was probably a step toward tax neutrality (even if, in closing these loopholes, he discouraged investment by some of the affected corporations). And he gets credit for

vetoing the highly non-neutral prescription drug tax. On the other hand, some of his fee increases are tax increases in disguise. We give the governor an A- for this part of his grade.

Equity

Despite the howls of pain from the public employee unions, human services providers and the hospitals, this budget was more than fair to the poor. Or at least as fair as it could have been, given the other principles at stake. The budget increases Medicaid spending another 10.5%. No doubt it would be possible to frame a much fairer budget, should there be some

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practical way to shift some of this growth to other programs. But Medicaid is a national problem, whose solution awaits a national effort. The governor gets an A.

Efficiency

On taking office, the governor set out to close what he determined to be a \$2.8 billion fiscal 2004 budget gap and assigned himself the task of closing this gap by effecting some \$2.2 billion in "savings." Appendix A details his savings measures and shows where he did and did not succeed in implementing these measures. The bottom line is that he managed to achieve \$1.4 billion of his hoped-for savings, surely an impressive result, given the legislature that he was up against. Let's give the governor B+.

Responsibility

The new budget does not, by our reading, use any reserves and has a fair chance of ending up in balance by the end of the year. Among his \$200 million in vetoes were items that he deleted principally to make sure that spending did not exceed revenues. Another A for the governor.

Limiting Government

Total (on-budget plus off-budget) state spending in fiscal 2004 will be about \$23 billion, about the same as fiscal 2003. According to his most vocal critics, this represents a substantial *contraction* in government. The argument from those who would howl in pain (see above) is that, because the cost of government is going up, the amount of "real," inflation-adjusted government will decline over the fiscal year just started.

Because, this argument continues, government revenues have not been growing as they did during the good-time 1990s, government has not been able to keep pace with inflation. Which, of course, is why we need further tax increases.

It is from such thinking that the idea of a "structural deficit" gains currency. Someone, usually an advocate for higher taxes, estimates what he thinks the state has to spend in order to maintain services, given expected revenues and expected increases in the unit costs of providing government services. The difference – presto! – is the structural deficit. This time around we heard endlessly about a \$3 billion structural deficit, a number that was accepted as unquestioningly as a Nobel scientist's calculation of the speed of light (it's a minor detail that the governor's estimate came in at \$2.8 billion).

The flaw in this whole line of reasoning is that it erroneously treats government like the hapless and helpless consumer who walks into the grocery store with a smaller paycheck only to find that the price of bananas and everything else has gone up. Unlike the consumer, who can't get a better price by bargaining with the 18-year-old at the cash register, government has a lot of control over what it pays for things. If government has the capacity to get what it buys at a lower

price, then it doesn't have to shrink the services it delivers even if the amount of money it brings in temporarily levels off or even falls.

Where can government deliver more at lower cost? The list is almost endless. Because education reform hasn't produced results in terms of learning, the state government could presumably get the same disappointing results by spending less on this item. So the state could reduce the \$3.6 billion it spends annually on this item.

Then there is the prevailing wage law and the practice by some localities of entering into project labor agreements for school construction. The state could save millions of dollars in construction costs by repealing the former and discouraging the latter.

Shall we go on? Well, there's the Pacheco (anti-privatization) Bill, police details and the Quinn Bill, all aching to be eliminated. There's the fat MBTA budget, never brought under control, despite much hoopla over the "reform" enacted a few years ago. There's the idea of rethinking and restructuring contracts with teachers, firefighters and police to see how we could get more teaching and fire and police protection for less. You get the idea.

Returning to the governor, we can't fault him for having a legislature that makes such reforms a daunting challenge, but we can fault him for making one crucial mistake, which was buying into the structural deficit concept from the get-go.

By giving himself the job of closing some arbitrarily chosen and unnecessarily inflated budget gap, the governor set himself up for criticism that his proposed savings measures were "unrealistic"

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and "overoptimistic." Better that he had just announced the amount of revenue that he was prepared to raise for this year's budget, offered some suggestions for cost savings, and let the legislature and local officials figure out how to wring more in services from a fixed budget. For making this mistake, we give him a C for his progress in limiting government.

The final grade: a B+. Not a bad grade point average for the freshman year. And when the battle over the 2005 budget starts this fall, the governor can take a number of steps, some suggested above, to raise his grade next year. One further suggestion: start planning now for the senior-year project, which will be to balance the budget without the \$1.2 billion in tax increases enacted by the legislature in 2002.

Appendix

Governor's 2004 Budget Saving Measures: Proposed and Actual

Reform and Restructuring – Line Items	Proposed \$mill	Actual \$ mill
I. Health and Human Services (A+B+C)	424.5	235.5
<i>A. Health Care Reforms (1+2+3+4+5)</i>	175.5	155.5
1. Premium and Co-Pays (a+b+c)	18.5	8.5
a. Assessing premiums on low-income individuals not required for federal reimbursement	6	6
b. MassHealth co-pays of up to \$3.00 for services over \$50.00	2.5	2.5
c. Assessing premiums and co-pays on Children's Medical Security Program (CMSP)	10	-
2. Drug Utilization and Case Management (a+b+c)	87	87
a. Expanding the drug list for generic options	66	66
b. Prior authorization for MassHealth members with 7 or more prescriptions/month	10	10
c. Better case management	11	11
3. Tightening Eligibility Procedures (a+b+c+d)	27	17
a. Verifying that non-senior MassHealth members have no employer health coverage	10	10
b. Improved managing of the disability determination process	10	-
c. Implementing the asset test for MassHealth members	5	5
d. Requiring eligible population to apply for Medicare	2	2
4. Adjusting Rates and Provider Impacts – Rate Reduction	22	22
5. Long-Term Care Reforms – Better Case Management	21	21
<i>B. Administrative Consolidation and Restructuring (1+2+3)</i>	90	10
1. Closing one-fifth of the Regional Health Centers in Massachusetts		
2. Consolidating administrative functions of the DMA and DHCFP into the Executive Office for Health and Human Services		
3. Consolidating functions such as IT, HR, legal services etc. into the Executive Office*		
<i>C. Maximizing Federal Revenue (1+2)</i>	159	70
1. Assessing user fee on insurance companies and HMO's	89	-
2. Federal revenue maximizing through restructuring	70	70
II. Higher Education (A+B)	150	-
<i>A. Administrative Consolidation and Restructuring</i>	100	-
<i>B. Restructuring Tuition, Fees and Financial Aid</i>	50	-
III. Judiciary (A+B)	84	41
<i>A. Administrative Consolidation and Restructuring</i>	43	-
<i>B. Incentives for Collecting Fee Revenue</i>	41	41
IV. Asset Management (A+B)	370	145
<i>A. Mass. Turnpike Debt Restructuring and Refinancing</i>	190	-
<i>B. Transfer of Surplus Land to Pension Fund</i>	180	145
V. Tax Loopholes and Administrative Changes (A+B+C)	166	166
<i>A. Loophole Closing</i>	128	128
<i>B. Changing Interest Rate from 4% to 2% Above Market</i>	28	28
<i>C. Changing Valuation of Used Vehicles for Sales Tax</i>	10	10
VI. Management Reforms (A+B+C)	368	312
<i>A. Changing State Employees Health Premiums To 25%</i>	80	62
<i>B. Eliminating Refund for Mandatory Medicare Part B</i>	25	-
<i>C. Workforce and Other Reforms – Consolidation of MDC and DEM and Debt Restructuring</i>	263	250
VII. Revenue Restructuring (A+B+C+D)	610	522
<i>A. Transfers and Other Changes (1+2+3+4)</i>	246	233
1. Using 100% of the tobacco settlement money instead of the current 50%	106	106
2. \$0.05 bottle deposit to include non-carbonated drinks and \$0.15 deposit for wine and liquor bottles	13	-
3. Funding the Affordable Housing Trust from the capital budget	23	23
4. Other	104	104
<i>B. Registry of Deeds Fee Restructuring</i>	230	230
<i>C. Casino Mitigation</i>	75	-
<i>D. Fee Rationalization</i>	59	59
Total Savings	2,173	1,422

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Appendix

Explanatory Notes

In conjunction with his 2004 budget recommendations, Governor Romney proposed \$2.173 billion in budget savings, of which \$1.422 billion were approved in the June 2003 report of the House and Senate Conference Committee. The preceding table itemizes the reforms proposed by the governor, together with the dollar value associated with each proposal made by the governor and with each proposal actually approved by the Conference Committee. The following offers explanations of the proposals made by the governor and then approved or not approved in the Conference Committee's report.

Health and Human Services

Under Health Care Reforms, the governor proposed and was able to get health insurance premiums on low-income individuals, for an expected saving of \$6 million. He expects to save another \$2.5 million by charging co-payments as high as \$3.00 for services over \$50.00. He requested, but did not get, another \$10 million in saving from co-payments and premiums in the Children's Medical Security Program (CMSP).

Other items falling under Health Care Reforms are Drug Utilization and Case Management, Tightening Eligibility Procedures, Adjusting Rates and Provider Impacts and Long-Term Care reforms. The governor was able to implement all but one of these reforms and to achieve most of his hoped-for saving.

Under the headings of Administrative Consolidation and Restructuring and of Maximizing Federal Revenue the governor achieved \$80 million of \$249 million in hoped-for saving.

All together the governor proposed \$424.5 million in savings measures under Health and Human Services and succeeded in getting \$235.5 million from the Conference Committee.

Higher Education

The governor attempted to restructure state higher education system by eliminating certain offices and consolidating various campuses and functions. Under this new regional structure, the Commonwealth would have realized \$100 million in savings. The Committee rejected this proposal. The Committee likewise rejected \$50 million in proposed saving through tuition and financial aid restructuring.

Judiciary

The governor hoped to save \$43 million in administrative saving and \$41 million in incentives for collecting fees. The Committee accepted the second but not the first proposal.

Asset Management

The governor attempted but failed to achieve \$190 million in savings through debt restructuring and consolidation of the Massachusetts Turnpike with the Highway Department. Although the Committee did not approve the transfer of surplus land to the pension fund, it did approve the transfer of the Hynes Convention Center and Boston Common Parking Garage. This move saves \$145 million that the state would have to pay into the pension fund this year.

Tax Loophole Closing and Administrative Changes

The Romney administration expects to save \$128 million through various measures – proposed by the governor and accepted by the Committee – to close tax loopholes for corporate income. Further, the governor's budget proposes changing the interest rates on pending tax return refunds and abatements, from 4% above market rate to 2% above market rate, and changing the way the sales tax is assessed on used vehicles. Both these proposals were endorsed by the Conference budget and are expected to garner an additional \$38 million in savings to the state.

Management Reforms

The governor proposed increasing state employee contributions for health insurance to 25%, for an expected saving of \$80 million. The proposal, as finally approved, will save \$62 million. Another proposal put forth by the administration but not approved by the Committee would have saved \$25 million by eliminating refunds for Mandatory Medicare Part B. The Committee approved other reforms, such as consolidation of the Department of Environmental Management (DEM) and debt restructuring, for a \$250 million saving.

Revenue Restructuring

The governor proposed \$610 million in saving, of which he was able to obtain \$522 million in saving, under the heading of Revenue Restructuring. He got approval to use 100%, rather than 50%, of tobacco settlement money and to fund the Affordable Housing Trust from the capital budget. He did not get approval of proposals to extend the bottle deposit to non-carbonated drinks and to require a deposit for wine and liquor bottles. The Registry of Deeds will raise fees by \$230 million. Another \$59 million in other fees will be spread out across the offices of Environmental Affairs, Public Safety, Economic Affairs, and Transportation.



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