

medicaid
and the uninsured

State Case Study:

**Medicaid and the 2003-05 Budget Crisis—
A Look At How Texas Responded**

Prepared by

Ian Hill
The Urban Institute

August 2005

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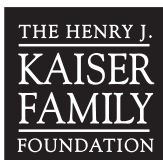
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Preface and Acknowledgments

This report is part of a Kaiser Commission on Medicaid and the Uninsured project that examined how eight states from around the nation responded to their budget crises during the 2003-05 time period, with a special focus on Medicaid and the State Children's Health Insurance Program. The state case studies review budget decisions made by state policymakers in Alabama, California, Colorado, Massachusetts, Michigan, New York, Texas, and Washington. An Overview that summarizes these eight states' experiences was published in *Health Affairs* as a web exclusive in August 2005.

This study would not have been possible without the many state officials and representatives of provider and consumer groups in the study state who gave so freely of their time and insights. We also wish to thank Erin Barringer who did a terrific job doing background research. Finally, we thank Barbara Lyons, Molly O'Malley, David Rousseau and Robin Rudowitz of the Kaiser Commission on Medicaid and the Uninsured for their help throughout the project.

Medicaid and the 2003-05 Budget Crisis: A Look at How Texas Responded

Abstract

Children were among the hardest hit in Texas's 2003-05 budget woes. Texas faced a large structural deficit in fiscal 2004/2005 biennium, but policymakers did not pass any tax measures to address the shortfall. Instead, they adopted a wide array of cost-cutting and cost-avoidance measures affecting all state agencies, K-12 education, criminal justice, health, and social services. Over \$1 billion was siphoned from the state's rainy day fund to help, and a similar amount of spending for schools was deferred to the next fiscal biennium. Medicaid and SCHIP were very hard hit, with significant cuts to eligibility, benefits, and provider reimbursement, though some of these cuts were restored in 2004.

The State of Texas is large 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 (including Medicaid) relative to other states. In 2003, Texas ranked 50th in per capita state taxes.¹ Over the years, the state had consistently ranked near the bottom in the nation in per capita health, hospital, and public welfare spending, as well as in state aid per K-12 pupil.

Texas uses a biennial budgeting process, a fact that must be considered when analyzing how the state responds to economic swings. By debating and adopting a budget only once every two years, policymakers may be less well positioned to identify a growing economic crisis and reflect it in a given budget cycle. By the same token, actions taken by policymakers to address a downturn remain in effect for two full years (unless they are reversed by special legislation), and thus the impacts of those actions are felt by public programs and recipients even if an economy improves during the cycle. In short, the biennial process gives Texas officials less flexibility to respond to worsening, or improving, economic conditions.

An example of this effect can be seen in Texas's fiscal 2002/2003 budget (which was considered during 2001 and became effective in September of that year). Even with growing signs of an economic downturn, primarily evidenced by declining revenue collections, Texas officials could not put the brakes on a major expansion of Medicaid. By June 2001, there was momentum behind SB 43, which was signed into law calling for a dramatic simplification of Medicaid enrollment procedures for children bringing them into line with the already simplified rules for State Children's Health Insurance Program (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 provision 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).² In all, these simplifications were expected to cost the program \$123 million during the 2002/2003 biennium in the form of increased child enrollment, and came at a time when budget problems were beginning to loom on the horizon.

However, come 2003, Texas policymakers reversed course in a big way when formulating the fiscal 2004/2005 budget, seemingly making up for lost time with a series of severe cuts to both Medicaid and SCHIP, cuts that have accounted for a drop in enrollment of 171,000 children. Once again, by late 2004, the state was in the midst of its biennial budget, and the effects of cuts made over a year prior were still being felt. Yet steps to reverse the policies were, practically speaking, impossible until the next budget could be formulated in 2005, despite signs that the economy was now improving.

Key Budget Debates and Decisions in Fiscal 2004 and 2005

During the early months of 2003, policymakers worked to balance the biennial 2004/2005 budget. In January, Governor Rick Perry presented a budget to the state legislature that zeroed out all state spending. It was a symbolic gesture on the part of the governor, made to emphasize his message that this needed to be a year of “reexamining the core responsibilities of government and state spending,” since Texas was facing the largest revenue drop in its history--\$7.4 billion.³ The official estimate of the shortfall facing Texas for the 2004/2005 biennium was \$9.9 billion, or 15.5 percent of the state 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.⁴ “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,” the governor said in his budget letter to the 78th legislature.⁵

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.”⁶ Instead, the state imposes one of the highest sales taxes in the nation, thus making Texas’s tax structure “extremely regressive,”⁷ 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.

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, 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. Perhaps the most serious effort involved 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.⁸ 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 2002/2003 biennium, a period that witnessed dramatic growth in enrollment and state spending on such programs as Medicaid and SCHIP, and expressed the belief that Texas had gone too far with its social services and needed to restore programs to a more conservative level of generosity.⁹ In response, the legislature returned to its traditional stance, embracing reduced spending, "a philosophy more protective of taxpayers who pay for services than of Texans who receive them."¹⁰

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 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 eliminated¹¹ for a combined savings of \$21.5 million; 12.5 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).

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 law, a dozen agencies were dismantled and streamlined into five.

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 programs 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 growth projections to help balance the budget, on paper. However, some of the most striking cuts to state programs were made in Medicaid and SCHIP, as described below.

Medicaid and SCHIP Budget Actions

2002/2003 biennium. 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 2000s by aggressively implementing SCHIP and, as mentioned above, passing rules to make it easier for eligible children to enroll in Medicaid. While formulating the 2002/2003 budget in 2001, signs of the coming economic downturn were not compelling enough to persuade legislators to tighten Medicaid or SCHIP. By mid-2002, with budget conditions more clearly worsening, Medicaid changed from an accrual- to a cost-based accounting system, permitting a one-time deferral of roughly \$225 million. But 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.

2004/2005 biennium. Addressing the now-large deficit for the 04/05 biennium, Texas followed a dramatically different course, however, as 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 fiscal 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) were projected to reduce state budget spending approximately \$294 million in the 2004/2005 biennium.

SCHIP cuts were also sweeping and 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 were expected to reduce state general revenue spending by \$835 million over the 2004/2005 biennium, and result in approximately 18,000 adults losing Medicaid coverage and 167,000 children losing SCHIP coverage. Furthermore, over the same period, state officials estimated that eligibility changes made to children’s coverage under Medicaid would reduce future growth in that program by 332,000 children.

In actuality, the impact of the above cuts has been arguably worse. By December 2004, 171,000 children had lost health coverage, with total SCHIP enrollment dropping from 507,000 to 336,000—a decrease of over 30 percent. Meanwhile, the rate of growth for children on Medicaid had slowed to less than one percent.¹² The plunge in SCHIP enrollment is even more notable given that, for most of the period following implementation, the new asset test had not been implemented.¹³ Furthermore, the governor enacted a moratorium on disenrolling children for nonpayment of premiums, a moratorium that was still in place at the time of this writing. Thus, the lion’s share of the decrease can be attributed to the impact of changing SCHIP period

of continuous eligibility from 12 to six months. In other words, by making families renew coverage twice as often, enrollment dropped by over 30 percent. While certainly a portion of these children lost eligibility for legitimate causes (*e.g.*, as a result of increases in family income), and some whose family income dropped were shifted to Medicaid, advocates fear that a large proportion lost coverage for logistical reasons (*i.e.*, their parents did not complete the renewal process), or as a result of confusion surrounding SCHIP cuts and misunderstandings about whether or not their children were still eligible.¹⁴

Mid-2004/2005 Biennium Budget Adjustments

Despite being in the middle of its fiscal 2004/2005 biennial budget, Texas policymakers were active during calendar year 2004 considering, and enacting, a number of mid-cycle changes. These activities were largely spurred by an improved revenue picture—total sales tax collections through June 2004 were up nearly 8 percent compared to the same point in 2003—coupled with the announcement by the state comptroller in April 2004 that there were over \$469 million of unspent funds available from the prior year’s receipt of enhanced federal match, and urging the restoration of the health and human services budget.¹⁵ In response, the Health and Human Services Commission (HHSC) laid out a proposal over the summer that included money both for covering shortfalls in program funding and for reversing a few program cuts that were made the prior year. In August, the governor and Legislative Budget Board approved the HHSC proposal to spend \$561 million, which:

- Restored to 185 percent of FPL the upper income eligibility level for pregnant women under Medicaid (which had been lowered to 158 percent in 2003), at a cost of \$20.2 million;
- Restored \$20 million to Medicaid Graduate Medical Education funding to bolster the financial viability of the state’s safety net hospitals;

- Maintained provider rate cuts at the 2003 level which would have doubled if not for the allocation of \$53.2 million;
- Increased funding for Medicaid community care services for aged and disabled persons by \$141.5 million; and
- Allocated \$300.5 million to cover roughly half of the projected shortfall in funding for Medicaid and SCHIP, which resulted from overly conservative projections of caseload and spending growth by the legislature when formulating the fiscal 2004/2005 Medicaid and SCHIP budgets.

Even with this additional funding, however, Medicaid and SCHIP are expected to have a \$280 million shortfall.

Other activities during the year included unresolved debates over strategies for overhauling the state's system for funding K-12 education through property taxes.

Conclusions and Outlook for the Biennium 2006/2007 Budget

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. In anticipation of this, and despite a five percent improvement in total tax collections, the Legislative Budget Board and governor's budget office issued instructions to Texas state agencies and public universities to ask for five percent less in general revenue for the next (2006/2007) biennial budget than they are currently receiving. This would translate into a reduction of almost \$3 billion across the board.¹⁶ Still, most legislators are on the record that they believe the 2004/2005 budget process was a success and that they dealt with the state's budget challenges in a way that "meets the basic needs of Texans," 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.¹⁷

Endnotes

¹ Center for Public Policy Priorities. “Truth and Consequences—The State Budget for 2004/2005 and its Impact on Texans.” Austin, Texas. July 2004.

² The original bill also called for elimination of the assets test for children; this did not pass, but families were permitted to self-declare their asset information.

³ 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.

⁴ 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 general revenue spending, which recognizes both current services cost increases in health and education budgets, and adjusts for population and inflation growth.

⁵ www.governor.state.tx.us/divisions/bpp/budget/letter.

⁶ Study by Governing Magazine and Pew Center on the states, <http://www.statesman.com/hp/content/coxnet/texas/legislature/0203/0204brfs.html>.

⁷ Ibid.

⁸ Some 4,000 companies, including such major firms as Cox Texas Newspapers, 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.

⁹ Telephone conversation with Jason Cooke, Texas Medicaid/SCHIP Director, September 2003.

¹⁰ Austin American Statesman. Gary Susswein. “House Puts its Focus on Austerity: Budget that eschews tax hikes may squeeze Texans on the margins.” April 18, 2003. www.statesman.com/hp/content/coxnet/texas/legislature/0403/0419statebud.html

¹¹ 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.

¹² Star-Telegram.com. Mitch Mitchell, “At Least Partial Remedy Sought For CHIP Cuts.” January 25, 2005. www.dfw.com/mid/dfw/news/legislature/10728313.htm

¹³ The asset test was not added to the SCHIP application process until August 2004.

¹⁴ Center for Public Policy Priorities. “Texas Children’s Medicaid and CHIP Enrollment: The Facts.” Austin, Texas. October 2004.

¹⁵ Center for Public Policy Priorities. “469.3 Million Available now to Repair some Health and Human Services Budget Cuts.” Austin, Texas. April 2004.

¹⁶ Center on Public Policy Priorities. “State Proposes Slashing Spending by Another 5 Percent.” Austin, Texas. June 2004.

¹⁷ Center on Public Policy Priorities. “Truth and Consequences—The State Budget for 2004/2005 and its Impact on Texans.” Austin, Texas. July 2004.

Appendix A

List of Study Respondents

Texas

Jason Cooke, Texas Health and Human Services Commission
Eva De Luna Castro, Center for Public Policy Priorities
Anne Dunkelberg, Center for Public Policy Priorities
Joanne Molian, Texas Health and Human Services Commission

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