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STATE BUDGETS WOULD BE SQUEEZED UNDER BUDGET CONFERENCE AGREEMENT

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The budget reconciliation conference agreement, which passed the Senate in late December and will be considered again in the House as early as the first day of February, would have a significant impact on state budgets. The agreement includes numerous changes to low-income programs in which states share costs with the federal government, such as Medicaid, Child Support Enforcement, and TANF. On the whole, CBO estimates indicate that over the next five years, the loss to states from reductions in federal funding and increased costs as a result of new mandates on states would be \$11 billion. The CBO estimates also indicate that states would receive about \$6 billion in funding increases over the same period from other low-income program provisions in the bill.¹ On balance, states would lose \$5 billion more than they would gain from the bill's low-income provisions.

What Do States Lose?

CBO estimates show that in the TANF program, the legislation would impose more than \$8.4 billion over five years in new unfunded work requirements on states. States also would lose \$1.5 billion in federal funding for Child Support Enforcement programs, \$300 million in federal funding for the foster care program, and \$750 million from the repeal of certain TANF bonuses.² The total "hit" to state budgets from these provisions exceeds \$11 billion over five years.

What Would States Gain?³

¹ This analysis uses CBO cost estimates of the legislation and applies the appropriate federal and state matching rates. The analysis assumes that states will bear the costs and realize the savings of the new Medicaid options in the bill consistent with CBO's projections of state use of the options.

² The \$750 million figure is a *net* estimate that takes into account some funding increases for new TANF-related grants to states to promote marriage.

³ For the purposes of this analysis, we exclude \$626 million in new LIHEAP outlays for fiscal years 2007 to 2009 because Congress can simply reduce the regular appropriation for this program by an equivalent amount. The provision of these LIHEAP funds in the reconciliation conference agreement is likely to be of little significance. We also exclude \$2 billion provided for Katrina health care relief. This is one-time funding to a limited number of states to compensate them for increased health care costs as a result of the hurricane.

The bill provides \$1 billion in new child care funds, although this falls \$11 billion short of the amount that CBO has estimated that states will need to meet the new work requirements established by the legislation and to ensure that federal child care funding provided to states keeps pace with inflation. In addition, the bill would provide an extension of TANF state supplemental grants, at a cost of \$850 million over five years.

The effect of the bill's Medicaid changes on state finances is a complex matter. Some provisions — such as those that reduce the amount paid for prescription drugs in Medicaid or make it harder for people to qualify for Medicaid coverage for long-term care — are expected to reduce both federal and state costs, while other provisions of the bill would reduce federal costs but *increase* state costs, such as provisions that would reduce federal funding for targeted case management services in Medicaid.

On net, CBO estimates that the federal government would save about \$6.9 billion over five years from the Medicaid provisions (not counting the provisions related to temporary hurricane relief), and states would save \$4 billion. To secure much of this \$4 billion in savings, however, states would have to impose pain on their low-income Medicaid beneficiaries by reducing the set of health services that Medicaid covers and/or by raising co-payments and imposing premiums on beneficiaries. States that choose not to reduce benefits or increase cost-sharing on their low-income Medicaid beneficiaries would see significantly lower savings. As noted above, even with this \$4 billion in savings, states will suffer an overall net loss of \$5 billion over the next five years under the low-income provisions of the bill.

What Will the Impact be on Services Provided by States?

Despite the recent improvement in fiscal conditions at the state level, many states would find it difficult to provide state funds to restore these federal cuts. Many states continue to feel the after-effects of the recent fiscal crisis brought on by the recession. During the crisis, states cut back on services, drew down rainy day funds, enacted temporary revenue measures, and used an array of fiscal gimmicks to balance their budgets. Undoing and repairing those actions are likely to require all of the revenue growth that states are currently experiencing.

Even without any change in federal policies toward states, states' own revenues would have to grow by 9 percent each year between now and 2008 just to restore the level of services that were in place before the recession, a level of revenue growth that is unlikely to occur. Cuts in federal aid to states, and the imposition of new federal mandates with significant costs, will make it more difficult for states to restore services that were cut during the fiscal crisis and may, in some cases, lead to additional reductions in public services.