City and County of San Francisco **Department of Public Health**

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TO:	Edward A. Chow, MD President, Health Commission
THROUGH:	Mitchell H. Katz, MD Director of Health
FROM:	Colleen Johnson Assistant Director of Policy and Planning
DATE:	September 25, 2002
RE:	2002-03 State Budget Update and State Legislative Highlights

This memo will provide an overview of the State budget and the impact on the San Francisco Department of Public Health and will highlight two pieces of legislation that are significant for San Francisco. This information will be presented to you at your October 1, 2002 Health Commission meeting. A more detailed report of the full 2001-02 Legislative session will be provided at the November 5, 2002 Health Commission meeting.

LEGISLATIVE HIGHLIGHTS

AB 915 (FROMMER)

On September 21, 2002, the Governor signed AB 915 (Frommer), a State bill sponsored by the City and County of San Francisco and the Department of Public Health. AB 915 establishes the Medi-Cal Outpatient Certified Public Expenditure Program to allow local health jurisdictions and the University of California to use local general fund dollars to obtain federal financial participation for the unreimbursed costs of providing hospital outpatient services and adult day health services to Medi-Cal patients.

The Department currently spends approximately $10 million in local general fund dollars to cover the unreimbursed cost of providing hospital-based outpatient services for Medi-Cal beneficiaries. Statewide, estimates show that public hospitals spend approximately $140 to $160 million for under-reimbursed Medi-Cal outpatient services. For adult day health care, the Department spends approximately $320,000 to cover the unreimbursed cost of providing services to Medi-Cal beneficiaries. AB 915 will enable the Department to use these expenditures to draw down federal financial Medicaid funding at the federal matching assistance percentage of approximately 50 percent. In fiscal year 2002-03, the Department estimates that it will be able to receive $5 million in supplemental Medicaid reimbursement from this new program.

In order to implement AB 915, the State Department of Health Services must prepare a Medicaid State Plan Amendment and submit it to the Centers for Medicare and Medicaid Services for their approval. In the coming weeks, the Department will be working with the California Association of Public Hospitals and Health Systems and the State Department of Health Services to develop an implementation plan for this program. The Department appreciates the commitment, support and assistance of the Mayor's Office and the California Association of Public Hospitals and Health Systems for their advocacy for this important program. The Department will continue to be active in moving this critical program forward.

AB 2197 (KORETZ)

On September 18, 2002, the Governor signed AB 2197 (Koretz), which provides Medi-Cal benefits to Californians with HIV who meet the financial requirement but who are not considered disabled. Prior to AB 2197, low-income persons with HIV had to wait until their disease progressed to AIDS, the last stage of HIV infection, before they would be considered eligible for Medi-Cal. However, treatment for HIV disease has changed significantly over the years. Early interventions are critical in maintaining good health. In many cases, persons with HIV can avoid severe illness and costly acute care by gaining early and ongoing access to health care and treatment. Early intervention ensures access to needed immunizations, prophylaxis treatment, and ongoing immune status monitoring.

AB 2197 was written to be cost neutral, that is, no additional state or federal expenditures will be required to expand Medi-Cal to this population. In order to meet this budget neutrality requirement, AB 2197 provides that Medi-Cal expansion to persons with HIV will be funded from savings derived from moving Medi-Cal beneficiaries with AIDS into Medi-Cal managed care. It is anticipated that 1,700 low-income Californians living with HIV disease will benefit from this legislation in the first year.

A QUICK REFRESHER ON THE CALIFORNIA BUDGET PROCESS

By January 10th of each year, the Governor releases his proposed budget for the fiscal year that begins the following July 1st. Called the Governor's Budget, this budget estimates revenues for the upcoming fiscal year and describes proposed spending, staffing and policy changes. The Governor's Budget is an important indicator of the Governor's policy priorities and direction.

After introduction of the Governor's Budget, the Assembly and the Senate each introduce a separate budget bill identical to the Governor's Budget for independent hearing and consideration by each house. Budget hearings are generally held by the Legislature beginning in March and lasting through May.

In early May, while the Legislature is holding its budget hearings, the Governor releases a revision to the Governor's Budget released in January. This budget is called the May Revision and updates General Fund revenues, expenditures and reserve estimates based on the latest economic forecast. The May Revision may also include new spending, staffing or policy changes.

Usually in late May, each house passes its own version of the budget. A conference committee comprising Budget Committee members from each house then meets to resolve any differences between the Senate and Assembly versions of the budget. Simultaneously, the Big Five (the Governor, the Speaker of the Assembly, the Senate President Pro Tempore, and the Minority

Leaders of both houses) meet, if needed, to come to compromise on major issues and secure the required 2/3rd vote in each house.

Each house of the Legislature votes on identical budget bills along with the accompanying budget trailer bills that include legislation needed to implement the budget. The Legislature is required by the State Constitution to pass the budget prior to June 15th.

The State Constitution requires that the Governor sign or veto the budget bill by July 1st. The Governor may reduce or veto (also referred to as "blue pencil") amounts or language within the budget bill. However, the Governor may not increase funding or add budget language. With regard to trailer bills, the Governor may only sign or veto these bills as they were submitted and may not alter budget any trailer bill language. The budget bill and the budget trailer bill become law immediately after they are signed.

As you know, the Legislature has rarely met its Constitutional deadline of June 15th for passage of the budget. There is no penalty for noncompliance with this deadline and budget stalemates are becoming increasingly common. Though the State continues to operate, budget delays can impact State reimbursement to private contractors and certain State employees.

2002-03 STATE BUDGET

2002-03 BUDGET OVERVIEW

On September 5, 2002, the Governor signed a $98.9 billion state budget, after the longest budget stalemate in California's history. The budget allocates $79.2 billion in 2002-03 General Fund revenues and transfers, a 7.1 percent increase over 2001-02, and provides for a $1.035 billion reserve, which represents 1.3 percent of budgeted General Fund expenditures. The Budget provides $76.7 billion in General Fund expenditures, a 0.2 percent decrease from 2001-02. This budget, along with mid-year spending reductions in 2001-02, addresses a $23.6 billion gap between revenues and expenditures.

The Governor used his blue pencil to veto $235 million from the budget submitted to him by the Legislature, the largest share (75.3 percent) of which comes from spending reductions in Health and Human Service programs. The budget also includes billions of dollars in loans and gives the Governor authority to make unspecified reductions in State administration up to $750 million. Though most of the vetoed funds were allocated for health care, social service and county programs, the cuts were less severe than anticipated and the budget still retains many of the programs the Governor had previously proposed for significant reductions.

THE BUDGET STALEMATE

The budget stalemate occurred over a disagreement on how to increase revenue to bridge the budget deficit. In order to secure the necessary 2/3rd vote, one Republican Senate vote and three Republican Assembly votes were needed. The Senate was able to secure its Republican vote early on and passed its version of the budget on June 29th. The Assembly, however, had greater difficulty in securing the three Republican votes it needed.

Assembly Republicans had opposed the tax package included in the Senate's version of the budget, which included a one-year increase in the vehicle license fee (VLF) and an increase in the cigarette tax of 50 cents per pack. They had also opposed the Assembly Democrats' alternative tax package that included a $2.13 per pack cigarette tax increase. The final budget signed by the Governor excluded most of the tax increases contained in the budget agreement passed by the Senate.

The final agreement also included passage of a State Constitutional Amendment, ACA 11, which when fully implemented will allocate three percent of General Fund revenues for infrastructure. ACA 11 allocates 50 percent of the infrastructure funds for state projects and 50 percent for local government projects, excluding schools and community colleges. ACA 11 will appear on the 2004 statewide primary ballot. Estimates suggest that in 2006-07, ACA 11 will redirect approximately $950 million from the General Fund, increasing to about $4.4 billion in 2015-16. Inclusion of ACA 11 in the budget deal was a critical factor for securing Assemblyman Keith Richman's (R-Northridge) support for the budget.

BRIDGING THE BUDGET GAP

The budget shortfall was primarily attributable to rising unemployment, slowing personal income growth, and a sharp falloff in capital gains and stock options in 2001-02 and the current year. The final tax package signed by the Governor increased 2002-03 revenues by $2.4 billion. In contrast, the tax package the Senate passed in June would have raised $3.9 billion.

In order to bridge the budget gap, the budget contains the following:

- $7.5 billion in program reductions;
- $4.5 billion from borrowing against the state's future tobacco settlement funds;
- $2.0 billion in loans;
- $1.7 billion in education spending deferrals and reductions;
- $2.9 billion in fund shifts, accelerations, and transfers;
- $2.4 billion in additional revenues from the temporary suspension of the teacher tax credit and a temporary suspension of businesses' net operating loss deductions, as well as other tax changes;
- $1.1 billion in assumed increases in federal funding; and
- $1.1 billion from restructuring state debt.

Many of the above provisions accelerate, but do not increase, the total amount of revenues the State receives, in effect borrowing from future years to balance the budget in the current year.

The final budget package also gives the Governor the ability to reduce State operations by up to five percent, or $750 million. The five percent reduction is not a required reduction, but may be implemented as necessary and we do not know how these cuts may impact the Department.

HEALTH-RELATED PROVISIONS

The Governor reduced spending for health and human services programs by $177 million, which represents 75.3 percent of the $235 million that the Governor cut from the Budget. Following are the major changes to health programs impacting the Department that were included in the final budget.

Medi-Cal

- *Disproportionate Share Hospital (DSH) Program* – Increased the State's DSH administrative fee by $55.2 million, from the current level of $29.8 million to a total of $85 million. In his May Revision, the Governor had proposed to raise the DSH administrative fee by an additional $31 million. The Legislature, however, rejected this proposal and only the $55.2 million increase was included in the final budget. This is estimated to result in reduced revenues at San Francisco General Hospital of approximately $2 million.

- *Provider Rates* – For a general fund savings of approximately $100.8 million, reduced provider rates, holding harmless rates for California Children's Services, non-emergency medical transportation, home health, and family planning physicians. In his veto message, the Governor stated that restoration of these provider rate reductions would be a priority and outlined a procedure to restore funding. Reductions to provider rates are anticipated to have a minimal effect on the Department because the majority of the Department's Medi-Cal services are reimbursed under a prospective payment system.

- *Quarterly Status Reporting* – No change to current practice. The Governor's proposal to reinstate quarterly status reporting failed. Though the Governor's May Revision attempted to reinstate quarterly status reporting for Medi-Cal (for a general fund savings of $155.4 million), the Legislature rejected this proposal and it was not included in the final budget. Quarterly status reporting requires that Medi-Cal beneficiaries submit proof of eligibility every three months, rather than annually as is currently the case. Under this rejected reporting system, beneficiaries who do not submit this information or who no longer qualify are disenrolled from Medi-Cal. Thus, the savings that would have accrued as a result of the reinstatement of quarterly status reports would have been a reduction of 250,000 current beneficiaries from the Medi-Cal rolls.

- *Express Lane Eligibility* – No change to current practice. The Legislature's attempt to implement express lane eligibility in fiscal year 2002-03 failed. In his May Revision, the Governor had proposed postponing the implementation of express lane eligibility until July 2005, for a general fund savings of $25.8 million. The Legislature had restored partial funding ($6 million general fund) for the implementation. However, the Governor vetoed this funding and, as a result, express lane eligibility will not be implemented in the upcoming year. Express lane eligibility, when implemented, will simplify enrollment in Medi-Cal by making children enrolled in the National School Lunch Program automatically eligible.

Healthy Families

- *Parent Expansion* – No change to current program. The Legislature's attempt to fund the Healthy Families parent expansion in fiscal year 2002-03 failed. The Legislature included in its budget $52.4 million to implement the Healthy Families parent expansion effective October 1, 2002. The Governor, however, vetoed all funds allocated for the parent expansion, delaying this expansion indefinitely. The parent expansion, approved by the federal government on January 24, 2002, will, when funding is allocated for this purpose, expand Healthy Families coverage to an estimated 300,000 parents earning up to 200% of the federal poverty level.

- *Healthy Families Bridge* – No change to current practice. The Legislature's attempt to extend the Healthy Families bridge from one month to two months failed. The Legislature had included $7.7 million general fund to extend the bridge coverage for children transitioning from Medi-Cal to the Healthy Families Program to two months. However, the Governor vetoed this expansion and the budget maintains funding for the current one-month bridge.

Mental Health

- *Children's System of Care* – Reduced by $13.8 million. The Governor's May Revision had proposed elimination of the Children's System of Care Program. The Legislature rejected this proposal and submitted to the Governor a budget that provided $33.8 million for the program. The Governor used his line item veto power to reduce this amount by $13.8 million in the final budget. This reduction is expected to reduce the Department's current funding of $1 million by $420,000.

- *Integrated Services for Homeless Adults Program (AB 2034)* – Reduced by $10 million. The final budget provides $55.6 million for this program. The funding that was cut was to be allocated to expansions in certain counties, not including San Francisco. However, recent communications with the State Department of Mental Health indicate that there could be additional cuts of up to eight percent for all counties. This would mean a reduction of $184,000 to the $2.3 million grant the Department currently receives.

- *Services to Special Education Pupils (AB 3632)* – Imposed a moratorium on reimbursement beyond $1,000. Though this impacts cash flow, counties will ultimately be reimbursed for these expenditures. The education budget trailer bill, which accompanied the budget and has not yet been signed by the Governor, would also impact this program. That bill clarifies that counties are entitled to 100 percent cost reimbursement. The Governor has until September 30, 2002 to sign the bill and it is expected that he will do so.

- *Early and Periodic Screening, Diagnosis, and Treatment (EPSDT)* – Implemented 10 percent county share of cost on growth. Although the Legislature rejected this proposal, the Governor intends to implement this policy change administratively and suggests that a match requirement would "give counties an incentive to control costs." It is not clear whether the Governor has the authority to require a county share of cost absent statutory authority. However, the Department estimates that implementation of this share of cost would reduce Department revenues by $80,000 in the current fiscal year.

- *Adult Systems of Care* – Eliminated all State funding ($2 million). There is no impact on the Department, as only Stanislaus and Los Angeles counties received this funding.

Substance Abuse Services

- *Community Treatment Programs* – Reduced by $7.5 million. The Department of Alcohol and Drug Programs will reduce county treatment programs by $7.5 million in a yet-to-be determined manner. As a result, the impact is unknown at this time.
- *Drug Court Partnership Program* – Appropriates $4.9 million to the modified Drug Court Partnership Program. This program will focus on felons to reduce recidivism and will use funding transferred from the Department of Corrections. The previously funded Drug Court Partnership program was scheduled to sunset in 2003 and is replaced by this modified program. The Department currently receives approximately $300,000 for the drug court program. Preliminary distribution discussions indicate that the Department may be eligible for a small increase in its allocation, however, those determinations are not yet final.
- *Perinatal Services* – Uses $1.5 million federal Substance Abuse Prevention and Treatment (SAPT) funds to restore partial funding to perinatal services. This transfer allows the Department to receive continued funding for its perinatal services program. Additionally, because California will receive an increase in its SAPT block grant, other block grant funded programs will be minimally impacted.

Trauma Services

The Governor's budget includes $20 million for trauma services. The Legislature's budget had originally allocated $25 million for trauma services and the Governor vetoed $5 million of that amount, leaving a $20 million statewide appropriation. Based upon the Department's allocation in fiscal year 2001-02, it is anticipated that the Department will receive approximately $750,000, $188,000 less than last year's allocation.

Supportive Housing

The final budget includes no funding for the Supportive Housing Initiative. The Governor eliminated the $17.5 million from his January budget proposal, citing his support for a housing bond that will be on the November 2002 ballot. This does not impact current funding for the Department's supportive housing initiatives.

HIV/AIDS Programs

Funding for most of the State's HIV/AIDS programs were maintained at their 2001-02 funding levels. However, the final budget included an increase of $20.4 million increase to fully fund the AIDS Drug Assistance Program to fully fund the program and an additional $2 million for to provide resistance and viral load testing to low-income Californians.

Children's Health and Disability Prevention (CHDP) Program

The final budget provides $8.8 million to implement the CHDP Gateway Program. CHDP currently provides health assessments but does not provide follow-up treatment. Most of the children covered under CHDP are also eligible for comprehensive health care under Medi-Cal or

Healthy Families. The budget provides for the use of the CHDP program as a gateway to streamline enrollment into these comprehensive health care programs. Under this plan, pre-enrolled children will be immediately eligible for up to two months for a CHDP health assessment and for comprehensive medical care provided through the Medi-Cal or Healthy Families programs.

LOOKING FORWARD

THE REMAINDER OF 2002-03

It is likely that there will be additional budget cuts in fiscal year 2002-03. Among other things, the State budget relies on $1.1 billion in increased federal funding, $300 million of which is anticipated Medi-Cal revenues. Given the current direction of the federal government, any action appropriating more funding for California this session seems unlikely. In fact, it is more likely that Congress will not pass a 2002-03 budget before it adjourns in October 2002, but rather will pass a continuing resolution to keep the government operating at existing funding levels until Congress reconvenes in January 2003.

2003-04 STATE BUDGET DEFICIT

The State budget deficit is anticipated to exceed $10 billion in fiscal year 2003-04. Because of the methods the State used to meet its $23 billion deficit in the 2002-03 budget, California's budget problems will be exacerbated in fiscal year 2003-04 and beyond. The 2002-03 budget relied on several one-time revenue boosts, revenue accelerations and expenditure deferrals, did not enact permanent tax increases, and did not make deep budget cuts. As stated earlier, the budget essentially borrows from future years to balance this year's budget. To make matters worse, the accounting shifts and revenue transfers that assisted the State in balancing its budget on paper have already been used, making them unavailable to bridge next year's funding gap. It is arguable that the impact of a $10 billion deficit in 2002-03 will be felt more significantly than the current year $23 billion gap.

DEPARTMENT OF FINANCE BUDGET LETTERS

The State Department of Finance (DOF) sent budget letters to all State departments regarding preparation for the 2003-04 budget year. While DOF is anticipating improvements to the State's fiscal picture, "[i]t is nearly certain that currently authorized expenditures and statutorily required expenditure adjustments will exceed available resources, barring additional corrective actions." DOF has directed all agencies to make permanent budget reductions of 20 percent. Additionally, in making these reductions, agencies were directed to consider "restructuring program responsibilities between state and local governments."

REALIGNMENT

Realignment, established in 1991, represented a major change in the state and local government relationship. Under realignment, dedicated sales tax and vehicle license fee revenues provide counties with a stable source of funding to support certain mental health, social services, and health programs that were transferred from State to county responsibility. All indications are that the State Legislature will take a new look at Realignment funding in 2003, and, given the State's anticipated financial picture, these discussions will be extremely difficult. The Department currently receives approximately $145 million, 15 percent of the total budget, in realignment funding for mental health, public health and indigent health care services.