

California's Fiscal Outlook— The Implications for Medi-Cal

LEGISLATIVE ANALYST'S OFFICE

Presented To:

Assembly Budget Subcommittee No. 1 on
Health and Human Services





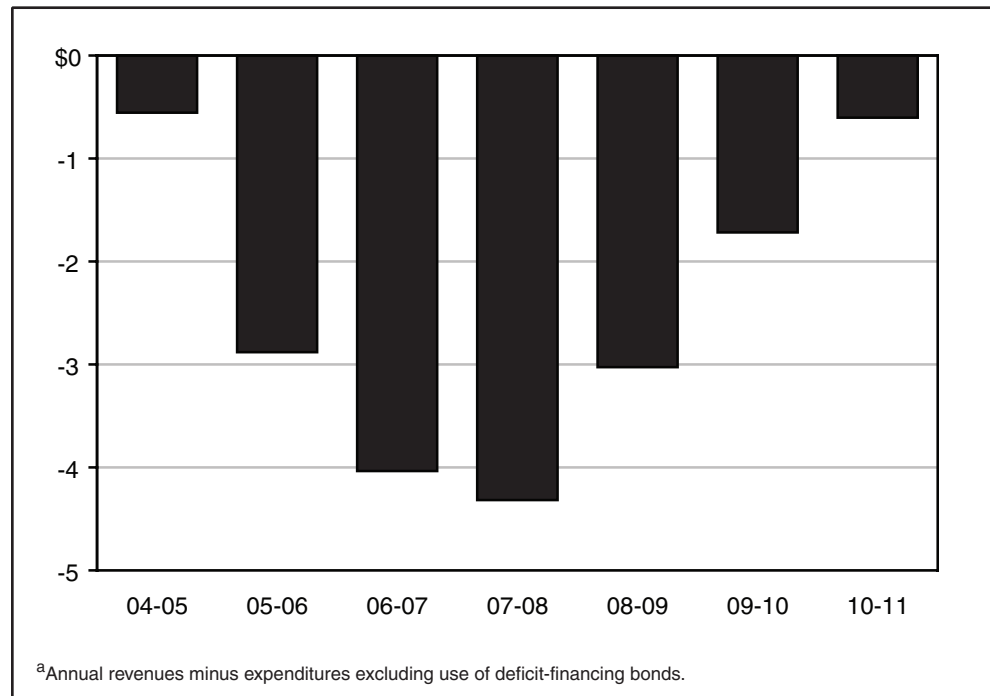
Overall Budgetary Forecast Has Improved . . .

- ***Eleventh Annual Projection.*** Today the Legislative Analyst's Office (LAO) has provided to the Legislature our *California's Fiscal Outlook*, the eleventh in a series of annual projections of the state's fiscal situation. It is important to note that our fiscal projections primarily reflect current-law spending requirements and tax provisions. They are not predictions of future policy decisions by the Legislature, nor are they our recommendations as to what spending and revenue levels should be.
- ***Budget Outlook Has Improved.*** The budget outlook for 2006-07 and beyond has improved considerably over the past year due to both a major increase in revenues and a significant amount of savings adopted in the 2005-06 spending plan.
- ***Reserve in Current Year.*** We now estimate the current year will end with a reserve of about \$5.2 billion, up by nearly \$4 billion from the estimate on which the *2005-06 Budget Act* was based.
- ***Budget Year Is Balanced.*** This large carryover reserve will be more than sufficient to keep the state's budget in balance in 2006-07 without any new program reductions or added revenues. This will be the case even though current-year projected expenditures are projected to exceed revenues by \$4 billion during that year.



... But State Still Faces Major Fiscal Challenges

Operating Shortfalls to Persist, but Narrow^a



- **Operating Deficits in Future Years.** While the improved outlook for the state is clearly very good news, the state still faces major challenges in achieving an ongoing balance between revenues and expenditures and getting its fiscal house in order. Even assuming continued steady economic growth, we project that multibillion-dollar operating deficits will persist throughout most of the forecast period, as seen above in the figure. Eliminating these shortfalls will require significant actions by the Legislature.
- **Projection Sensitive to Economic Downturn.** Beyond this, an economic downturn or even a sharp slowdown sometime in the next several years would add an additional several billions of dollars to the projected shortfalls. While this is not what we are forecasting, it could always occur.



. . . But State Still Faces Major Fiscal Challenges

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- ***Additional Actions Needed.*** For these reasons, it will be important for the Legislature to continue to take actions to minimize operating shortfalls, match any new or increased program funding with offsetting savings, avoid using the remaining deficit financing bonds in 2006-07, and build up budgetary reserves. We discuss these issues in more detail in our report.



General Fund Projection for Medi-Cal

Figure 1

Projected General Fund Spending for Major Programs

(Dollars in Millions)

| | Estimated | | Forecast | | | | | Average Annual Growth From 2005-06 |
|---|-----------------|-----------------|-----------------|------------------|------------------|------------------|------------------|------------------------------------|
| | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 | 2010-11 | |
| Education programs | | | | | | | | |
| K-14—Proposition 98 | \$33,971 | \$36,213 | \$38,216 | \$39,627 | \$42,056 | \$44,898 | \$47,797 | 5.7% |
| CSU | 2,419 | 2,553 | 2,659 | 2,765 | 2,877 | 2,989 | 3,097 | 3.9 |
| UC | 2,583 | 2,700 | 2,803 | 2,905 | 3,013 | 3,119 | 3,214 | 3.5 |
| Health and Social Services | | | | | | | | |
| Medi-Cal | 11,533 | 12,956 | 14,078 | 14,977 | 15,633 | 16,351 | 17,206 | 5.8 |
| CalWORKs | 2,095 | 1,985 | 2,621 | 2,461 | 2,587 | 2,719 | 2,852 | 7.5 |
| SSI/SSP | 3,417 | 3,564 | 3,685 | 3,930 | 4,207 | 4,489 | 4,796 | 6.1 |
| IHSS | 1,174 | 1,232 | 1,337 | 1,448 | 1,565 | 1,688 | 1,817 | 8.1 |
| Developmental Services | 2,122 | 2,273 | 2,476 | 2,669 | 2,921 | 3,195 | 3,513 | 9.1 |
| Other major programs | 4,356 | 4,727 | 4,878 | 5,035 | 5,082 | 5,473 | 5,700 | 3.8 |
| Corrections and Rehabilitation^a | | | | | | | | |
| Rehabilitation ^a | 6,467 | 6,991 | 7,355 | 7,622 | 7,876 | 8,129 | 8,382 | 3.7 |
| VLF-related payments | — | 1,187 | — | — | — | — | — | — |
| Proposition 42-related payments | — | 1,316 | 1,385 | 2,765 | 2,464 | 1,639 | 1,675 | 4.9 |
| Debt service on bonds | 3,565 | 3,926 | 4,331 | 4,846 | 5,295 | 5,713 | 6,061 | 9.1 |
| Other programs/costs | 7,810 | 8,537 | 9,286 | 9,868 | 10,307 | 10,713 | 11,269 | 5.7 |
| Totals | \$81,512 | \$90,161 | \$95,111 | \$100,917 | \$105,883 | \$111,114 | \$117,380 | 5.4% |
| (percentage change) | 6.8% | 10.6% | 5.5% | 6.1% | 4.9% | 4.9% | 5.6% | — |

^a Includes employee compensation costs.

- **Current Year.** As seen in the above figure, we estimate that General Fund spending for Medi-Cal local assistance (including benefits, county administration of eligibility, and other costs) will reach nearly \$13 billion in the current year, approximately the amount appropriated in the *2005-06 Budget Act*.



General Fund Projection For Medi-Cal

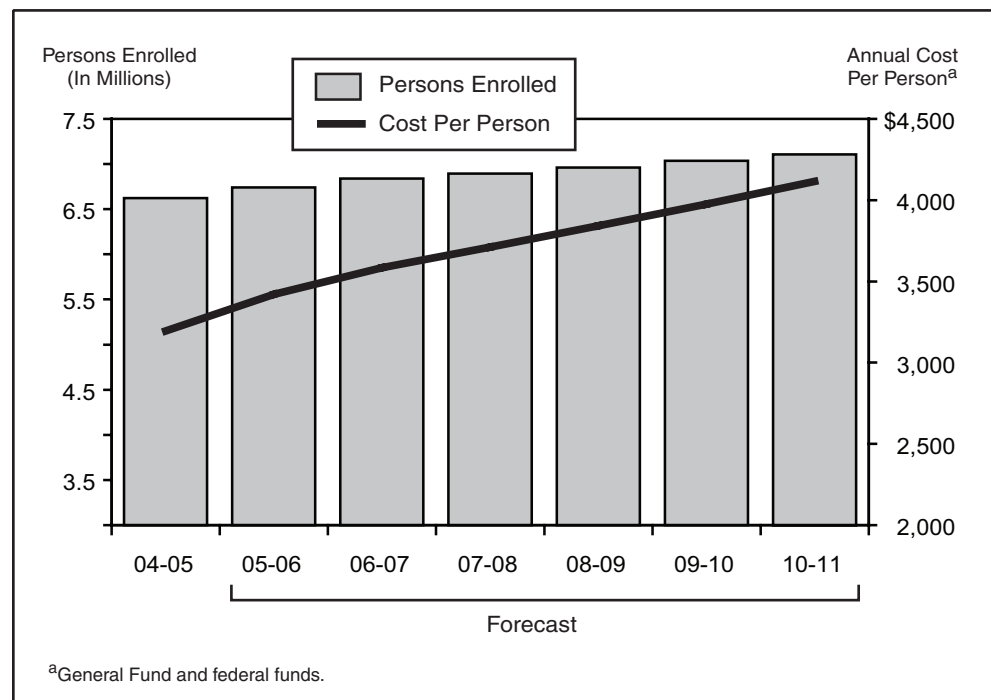
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- ***Budget Year.*** We project that General Fund support would grow to \$14 billion in 2006-07, an 8.7 percent increase from current-year expenditures. This reflects continued increases in caseload, costs and utilization of medical services, as well as various one-time changes in program costs.
- ***Beyond the Budget Year.*** By the end of the forecast period in 2010-11, we estimate that General Fund spending for Medi-Cal will reach \$17 billion, an average annual increase of 5.8 percent over the projection period—roughly the same growth rate that our office is projecting for General Fund revenues.



Key Factors in the LAO Forecast

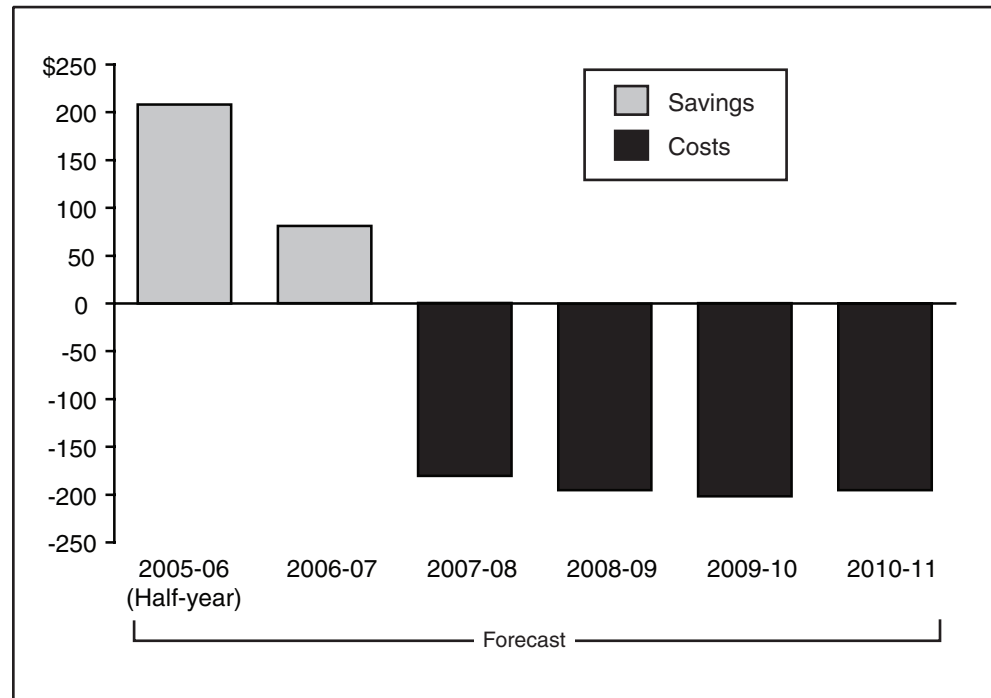
Medi-Cal Cost Per Person Increasing—Caseload Growth Modest



- **Cost of Health Care Services.** The average cost per person enrolled in Medi-Cal is projected to grow from about \$3,400 to \$4,100 during the forecast period. The most significant factor in our forecast is the assumption that the cost of most health care services provided to aged, blind, and disabled Medi-Cal enrollees will increase at an annual rate of between 5 percent and 7 percent from 2006-07 through 2010-11 because of increased utilization and costs. In contrast, our projection assumes that the average cost of health care services for most families and children would generally grow more slowly (up to 3.1 percent annually during the same period).
- **Medi-Cal Caseload Trend.** As shown in the figure above, caseload growth is moderating. Our forecast assumes growth commensurate with increases in state population or an annual increase of somewhat greater than 1 percent.



Effect of Medicare Drug Benefit on Medi-Cal



- **Net Savings Initially.** The new Medicare “Part D” benefit will result in significant net savings to Medi-Cal initially for persons who are both Medi-Cal and Medicare recipients beginning January 1, 2006.
- **Net Costs in Future Years.** However, the shift in drug coverage to Medicare will result in net costs to the state of about \$200 million annually beginning in 2007-08 because of the federal requirement that state reimburse the federal government for some costs.
- **Loss of Drug Rebates.** The state will also lose a substantial part of the revenues that it now receives in rebates from drug manufacturers because the state will no longer be providing drugs for persons eligible for Medi-Cal and Medicare.