



September 16, 2008

**The State's 2008-09 Spending Plan Does Not Include Structural Reforms.
Maintains Medi-Cal Cuts Until March, despite Court Order**

After the longest delay in the state's history, California Legislators finally passed a state budget plan in the early morning hours on Tuesday, September 16, 2008. The budget was a disappointment to those hoping for meaningful structural budget reform. Instead of long term solutions, the spending plan would be held together by temporary revenue tricks, and questionable fiscal assumptions. The budget also includes cuts to education, health care, social services, and transportation, although program cuts are more modest than what was proposed by the Governor in his January budget proposal. Unfortunately, it is projected that the state's revenue picture is unlikely to improve in the next fiscal year. As a result, the newly passed 2008-09 budget would leave the state in a financial hole before the 2009-1010 fiscal year has even begun.

In a press conference late afternoon on Tuesday, September 16, 2008, Governor Schwarzenegger said that he would veto the budget Legislature's passed on Tuesday morning given that it does not include the structural budget reforms he had requested and extends the state's fiscal problems into the next fiscal years. He also indicated that he expects the Legislature to override his veto. If they do, the Governor said he would veto the bills on his desk. He then modified his statement, noting that he would look at all bills individually.

Revenue

In order to minimize cuts to health, education, social services and other programs, the budget assumes a host of new sources of revenue. These new revenue sources include the following:

Increase in Withholdings. The state would generate billions by essentially borrowing from tax payers. The amount of taxes withheld from taxpayer checks would increase, but would be refunded without interest.

Early Tax Collection. Taxpayers who file quarterly would have to pay more of their taxes earlier in the year. Also those who earn more than \$1 million and experience a jump in income would no longer receive extra time to pay taxes on that increase. Early tax collection also includes requiring limited liability companies to prepay taxes currently not be due until the next fiscal year.

Net Operating Loss. This provision would change what businesses can write off as losses. The plan would generate revenue by suspending the tax credit for business losses reported in the previous year. The loss of this write-off would be offset by a future corporate tax break that would be implemented in 2010.

Tax Amnesty. Revenue is also expected to be generated by people taking advantage of reduced penalties for taxes owed from previous years if they are paid off now.

Borrowing Against the State Lottery. The budget expects to generate \$5 billion in 2009-2010 and another \$5 billion in 2010-2011 by securitizing the State Lottery. No revenue is expected to be generated by this proposal in the current fiscal year. This plan to essentially borrow from the State lottery must be approved by voters.

Health Care Cuts

This budget rejected almost all of the health care cuts proposed by the Governor in January. The vast majority of health care cuts and changes were related to Medi-Cal provider reimbursement rates.

Medi-Cal Reimbursement Rates. The Budget includes a restoration of almost all of the 10% Medi-Cal reimbursement rate cut effective March 1, 2009. However, it does maintain a 1% reimbursement rate cut in perpetuity. The CMA and other provider groups successfully petitioned the courts for a preliminary injunction to stop the Medi-Cal reimbursement rate cuts. As a result, those cuts were restored as of August 18th, 2008. We believe this restoration includes the 1% cut that would take effect March 1, 2009.

Despite our successful legal efforts, the budget assumes that the Medi-Cal reimbursement rate cut for most fee-for-service providers will eventually be implemented and will achieve retroactive and on-going savings from August 18, 2008 until March 1, 2009. The budget also assumes on-going savings associated with the 1% rate cut effective March 1, 2009. Because of our legal efforts, any attempt by the Department of Health Care Services to implement the cut would be in contempt of court. Even though the budget scores a rate cut as a savings, the budget does set aside over \$200 million to comply with the court ruling if the state loses their appeal.

Not all providers will be receiving the nearly full restoration. Only half of the 10% Medi-Cal reimbursement rate cuts for pharmacists and long-term care facilities will be restored on March 1, 2009. Additionally, managed care plans will receive the actuarial equivalent cut to the provider cuts outlined above.