Major Medi-Cal Budget Adjustments

Below we provide an overview of major Medi-Cal budget adjustments included in the May Revision, including a summary of new or revised spending proposals and budget solutions, a discussion of revisions to per-enrollee cost estimates for undocumented residents, our assessment of the administration's revised estimates for the Medi-Cal caseload and COVID-19-related policies, and a listing of large technical adjustments and modifications to previously approved proposals. With the exception of our assessment of the Medi-Cal caseload and COVID-19-related policies, we will be providing our assessment of other Medi-Cal proposals, namely the MCO tax proposal, in separate emails.

Lowers General Fund Costs for Medi-Cal in 2022-23 and 2023-24

Relative to the January budget estimates, the May Revision estimates lower General Fund costs for Medi-Cal in both 2022-23 and 2023-24. For 2022-23, the May Revision includes $30.9 billion General Fund—a reduction of $1.4 billion relative to the January estimate. For 2023-24, the May Revision includes $37.6 billion General Fund—a reduction of $1.1 billion General Fund. These adjustments are the net impact of various new or revised spending proposals and budget solutions, revisions to per-enrollee cost estimates for undocumented residents, updated fiscal estimates for caseload and COVID-19 related policies, as well as various other technical adjustments and modifications to previously approved proposals.

New or Revised Spending Proposals and Budget Solutions

Proposes Renewing and Increasing MCO Tax, Using Some of Revenues for Medi-Cal Provider Rate Increases. Shortly before May Revision, the administration released a revised managed care organization (MCO) tax proposal relative to what was assumed in Governor's January budget. The revised version would generate a net state fiscal benefit of $19.4 billion from 2023-24 through 2026-27 ($4.4 billion in 2023-24). The administration proposes three uses of these funds: (1) $8.3 billion ($3.4 billion in 2023-24) to offset General Fund spending in Medi-Cal; (2) $820 million ($98 million in 2023-24) to increase Medi-Cal payments for primary care, obstetric, and non-specialty mental health services; and (3) $10.3 billion ($923 million in 2023-24) to be set aside in reserve for future augmentations, which would be determined during the 2024-25 budget process. (We provided more information on this proposal in another May Revision email.)

Proposes Increased Funding for County Behavioral Health Departments to Implement CARE Act. In addition to $16.5 million General Fund included in the Governor's January budget, the May Revision proposes providing $50.8 million General Fund to county behavioral health departments for the implementation of the Community Assistance, Recovery, and Empowerment (CARE) program in 2023-24—increasing to total funding of $151.5 million in 2025-26 and ongoing. The additional funding includes a $15 million one-time grant to Los Angeles County in 2023-24 for start-up costs as it intends to begin its CARE program a year prior to its original start date and ongoing funding for grants to counties to implement the CARE program. After discussions with counties, the administration refined its estimates of county behavioral health costs. The upward revision includes funding for clinical assessments of participants, staff time in court proceedings, outreach and engagement, and providing notice to stakeholders.

References a New Behavioral Health Workforce Initiative. The Governor's January budget proposed $306 million General Fund ($6.1 billion total funds) over five years to Medi-Cal and the Department of Social Services for the Behavioral Health Community-Based Organized Networks of Equitable Care and Treatment (BH-CONNECT) Demonstration (formerly referred to as the California Behavioral Health Community-Based Continuum, or CalBH-CBC, Demonstration). In the budget year, the proposal includes $216,000 General Fund ($5.5 million total funds) in the DHCS budget. As a part of the BH-CONNECT demonstration, the administration proposed a new behavioral health workforce initiative. While funding is not included in the May Revision, we note that the Governor's May Revision budget summary references that the administration's new workforce initiative proposal would include $480 million in total annual funding over a five-year period. Annual funding would include federal funds and a non-federal share funded through designated state health programs and the state directed portion of Mental Health Services Act revenues. It is unclear how the proposed workforce initiative will be related to current behavioral health workforce initiatives.

Withdraws Proposed Delay of Behavioral Health Bridge Housing (BHBH) Funding and Replaces $500 Million General Fund With Mental Health Services Fund (MHSF). The May Revision withdraws the Governor's January budget proposal to delay $250 million in BHBH funding from 2023-24 to 2024-25. In addition, the May Revision proposes to replace $500 million General Fund for BHBH in 2023-24 with MSHF funding.

Sweeps Medi-Cal Drug Rebate Fund Reserve. As a budget solution, the administration proposes sweeping projected fund balances in the Medi-Cal Drug Rebate Fund. The fund collects federal and state-supplemental drug rebates, which in turn help offset General Fund spending on Medi-Cal. The sweep of the fund's reserve yields a one-time additional offset of $222 million in 2023-24.

Replaces $50.5 Million General Fund for CalHOPE With MHSF. As a budget solution, the May Revision proposes to replace $50.5 million General Fund for the CalHOPE program in 2023-24 with MSHF funding.

Significant Upward Revision in Per-Enrollee Costs for Undocumented Residents

The May Revision reflects significant changes in estimated per-enrollee costs for undocumented residents. Relative to the Governor's budget proposal in January these revised per-enrollee cost estimates result in increased General Fund costs of $279.6 million in 2022-23 and $1.9 billion General Fund in 2023-24. We provide additional information on these estimates in the paragraphs below.

Services Provided to Undocumented Residents Generally Not Eligible for Federal Funding. Historically, otherwise income-eligible undocumented residents have only qualified for a restricted set of Medi-Cal services including emergency- and pregnancy-related health care services. For these restricted services, the federal government pays for a portion of the costs according to standard federal-state cost-sharing rules. Over the last several years, and in a number of steps, the Legislature has expanded comprehensive Medi-Cal coverage to income-eligible undocumented residents. The state generally pays the full cost for providing services that are not eligible for federal cost sharing.

Revised Budget Assumes Significant Per-Enrollee Cost Increases for Undocumented Residents. The administration assumes significantly higher per-enrollee costs for undocumented residents than previously assumed—both for populations impacted by prior expansions of comprehensive Medi-Cal services and for the planned eligibility expansion for undocumented residents between the ages of 26 through 49. As a result, the May Revision adds over $2 billion dollars in net General Fund costs over the budget window. In the bullets below, we highlight various budget adjustments that reflect this net cost increase.

- ***Adjustments to Federal Payments and Deferrals.*** The state must repay the federal government to the extent claims for federal funding are later determined to have been made in error. Similarly, the federal government defers releasing federal funding for claims it believes were made in error until it can be determined whether the claims are eligible for federal funds. Since 2020, the administration has been working with the federal government to ensure federal dollars related to services for undocumented residents are claimed appropriately. Relative to the January budget, the administration estimates that federal repayments and deferrals related to undocumented residents will increase General Fund cost pressures by $982 million in 2023-24. Of this amount, $857 million is attributed to a combination of higher enrollment among undocumented residents than previously anticipated and the higher estimated per-enrollee costs.
- ***Updated Costs to Expand Eligibility for Comprehensive Medi-Cal to Undocumented Adults.*** The Legislature previously approved expanding eligibility for comprehensive Medi-Cal services to undocumented residents between the ages of 26 through 49 beginning January 1, 2024. The January budget previously estimated that the expansion would cost $634.8 million General Fund in 2023-24 increasing to over $2 billion General Fund at full implementation in 2028-29. The May Revision updates the estimated cost in 2023-24 to be $1.2 billion General Fund—an increase of about $578.3 million General Fund relative to the January budget estimate. (We note that based on these revised estimates, we estimate the expansion's costs would increase to roughly $2.9 billion General Fund in 2024-25 and continuing to increase to over $4 billion General Fund at full implementation in 2028-29).

- ***Non-Emergency Funding Adjustment.*** The non-emergency funding adjustment is a technical adjustment intended to ensure federal funds are not used to provide services for undocumented residents inappropriately by replacing federal funds budgeted in the fee-for-service and managed care base with General Fund for undocumented Medi-Cal enrollees when appropriate. Relative to the January budget, the May Revision increases this adjustment by $786.6 million General Fund in 2022-23 and $801.6 million General Fund in 2023-24. Of these amounts, the administration attributes $450 million to be due to increased caseloads for undocumented residents with the remaining amounts due to the higher per-enrollee cost estimates.

We are working with the administration to get a better understanding of the reasons for the large increases in estimated per-enrollee costs for undocumented residents. However, at this time, the administration has not shared sufficient detail to understand the basis for their assumptions and estimates. Consequently, we are unable to determine if these estimates are reasonable. If the revised per-enrollee costs are determined to be reasonable, this would mean that the costs associated with expanding Medi-Cal to undocumented residents are significantly higher than what has previously been assumed. When we receive additional information from the administration, we will report back. In the meantime, we recommend the Legislature request additional information from the administration, at upcoming May Revision budget subcommittee hearings, on the reasons and methodologies used to determine these revised estimates for per-enrollee costs. Such information will be important for ensuring appropriate funding is provided and understanding the fiscal impacts of moving forward with the planned expansion of comprehensive Medi-Cal services to undocumented residents between the ages of 26 through 49.

Caseload and Federal COVID-19-Related Policies

In our assessment of the Governor's Budget in January, we estimated that General Fund costs for Medi-Cal could be $1 billion lower than assumed by the administration due to overstated caseload costs and recent federal changes to COVID-19-related policies that the administration had not been able to incorporate. At that time, we found that the administration's 2022-23 estimates were reasonable but that their 2023-24 estimates were overstated by 270,000 enrollees. We also noted that federal actions announced in late 2022 and thus, not reflected in the Governor's Budget, that extended the availability of enhanced federal funding would reduce General Fund cost pressures for Medi-Cal. In this section, we provide our assessment of the administration's revised estimates.

On Net, Revised Estimates for Caseload Appear Reasonable. As part of the May Revision, the administration has revised its caseload estimates using more recent caseload data and information regarding the end-dates of COVID-19 policies. The administration has increased its 2022-23 caseload estimate by about 40,000 enrollees and reduced its 2023-24 estimate by about 260,000 enrollees. Based on recent caseload data, which are somewhat higher than we expected, we find these estimates to be reasonable.

Caseload Mix Could Vary Somewhat From Administration's Estimates, but Likely Not Materially Impactful to Fiscal Estimates. Similar to our assessment of the January estimates, we find that persons with disabilities caseload (which has been declining since 2014) remains somewhat overstated in the administration's revised estimates for 2023-24. However, we find that other caseload groups could be somewhat higher than the administration's projections—including childless adults, families, and seniors. These differences between our projections largely offset each other and do not result in a significant difference in our fiscal estimates.

Enhanced Federal Funding Estimates Appear Reasonable. As noted above, In January, the administration had not been able to incorporate recent changes to federal COVID-19 policies that occurred around the time of the release of its budget proposal. Notably, federal legislation that was enacted in December 2022 resulted in enhanced federal funding for Medi-Cal (which had been provided as part of the federal government's COVID-19 response) being ramped down over the course of calendar year 2023. Prior to this legislation, the enhanced federal funding was expected to end in spring 2023. The administration has now incorporated the ramp-down of the enhanced federal funding into their estimates resulting in a $17.3 million reduction in federal funds in 2022-23 and a $460 million increase in federal funds in 2023-24. We find these revised estimates to be reasonable.

Continuing to Evaluate Large Increase in Per-Enrollee Costs. While we find the administration's estimates for caseload and enhanced federal funding generally to be reasonable, we note that the administration assumes significant increases in per-enrollee costs in 2023-24. In particular, on a total-funds basis, the administration assumes a 34 percent increases in per-enrollee costs for childless adults and a 27 percent increase in per-enrollee costs for families. These assumptions result in billions of dollars in increased caseload costs. Our current understanding is that these increases in per-enrollee costs are largely related to the revised per-enrollee costs for undocumented residents, which we discussed earlier. However, we have reached out to the administration to get more details, including the extent to which these assumptions relate to the per-enrollee cost estimates for undocumented residents. Until additional information is provided, we are unable to determine if these revised cost estimates are reasonable. To the extent we receive additional information from the administration, we will report back. In the meantime, we recommend the Legislature request additional information from the administration, at upcoming May Revision budget subcommittee hearings, on the reasons and methodologies used to determine these revised estimates for per-enrollee costs. Such information will be important for ensuring appropriate funding is provided.

Technical Adjustments and Modifications to Previously Approved Proposals

The paragraphs below describe various technical adjustments as well as adjustments to previously approved proposals. We note that this section focuses on major adjustments and is not exhaustive of all changes made to the Medi-Cal budget in the May Revision.

Medi-Cal Drug Rebate Fund Offsets to General Fund Spending. Beyond the sweep of the Medi-Cal Drug Rebate Fund reserve noted earlier, the administration projects overall increases in drug rebates in 2023-24 relative to the Governor's January budget, yielding $708 million in additional General Fund savings. The administration attributes the higher level of rebates to the continued implementation of Medi-Cal Rx, which pays for all pharmacy benefits on a fee-for-service basis.

Change to Cash-Based Budgeting for Major Behavioral Health Initiatives. Medi-Cal is generally budgeted on a cash (as opposed to accrual) basis. When recent budgets provided DHCS with billions of dollars for BHBH, the Behavioral Health Continuum Infrastructure Program (BHCIP), and the Children and Youth Behavioral Health Initiative (CYBHI), the funding was originally budgeted on an accrual basis. The accrual approach for these programs recognized the multiyear costs of these large commitments upfront, whereas a cash-based approach would have arguably resulted in an overstatement of General Fund resources available in prior budgets. The May Revision changes the accounting for these programs to a cash basis, generally consistent with the rest of Medi-Cal. This shifts about $1 billion in General Fund costs from the budget window to the outyears.

Changes in Deferral Impacts. The federal government defers releasing funds to the state for claims potentially made in error. In cases where the federal government subsequently determines the claiming was not done in error, the deferred federal funds will be released and made available to the state. Relative to prior estimates, the May Revision adds increased General Fund cost pressures of $151.7 million in 2022-23 and decreased cost pressures of $338.4 million in 2023-24 associated with federal deferrals.

Hospital Quality Assurance Fee (HQAF) Offset to the General Fund. The May Revision assumes an additional $153 million General Fund offset in 2023-24 from the HQAF relative to the Governor's January budget. The increased offset reflects updates to the most recent version of the HQAF beginning January 2023, which the department submitted to the federal government for approval in March 2023. The department indicates that federal approval is pending.

Proposition 56 Updates. Over 2022-23 and 2023-24 combined, the estimated cost of the General Fund backfill for Proposition 56 commitments has increased from $88 million at Governor's January budget to $298 million at May Revision, an increase of $210 million. The increase results from $148 million higher estimated costs for Proposition 56 commitments and $62 million lower available Proposition 56 revenues.