

## State Responses to Budget Crises in 2004: Florida

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### Background

While Florida ended state fiscal year (SFY 2002-2003) in better shape than most states, the outlook for the future is less sanguine. Voter-directed spending on several issues, including high cost initiatives on class size reduction in public K-12 education and the development of state-wide high-speed rail, cloud the picture for the out years. In addition, in recent years legislators have met much of the gap between revenues and expenditures by using non-recurring revenue to fund recurring expenditures, including Medicaid. Within the Medicaid budget, estimates of savings to be achieved by policy changes have sometimes been higher than actual savings, and caseload growth has exceeded projections in the more expensive eligibility categories, leaving the state with a carry-forward deficit at year-end reconciliation for the past three years that will need to be addressed eventually.

Insurance coverage is low in Florida for both children and adults relative to the national average. Forty-three percent of low income adults and 25.9 percent of low income children are uninsured as compared with 38.9 and 21.1, respectively, in the nation as a whole.<sup>1</sup> Employer-sponsored coverage is low with 61.8 percent of all adults and 56.8 percent of all children covered; the national averages for employer coverage are 67.0 and 63.3 percent, respectively. The state has fairly strict eligibility standards for Medicaid which are reflected in the program coverage rates—14.7 percent for low income adults and 42.2 percent for low income children—which are below the national averages of 18.1 and 45.6, respectively, for these groups. There is no state-sponsored general medical assistance program for people not

eligible for Medicaid and the State Children's Health Insurance Program (SCHIP).

Florida's governor, Jeb Bush, is a Republican, and both chambers of the legislature are controlled by the Republican party. The Republican leadership has established a fiscal environment that has been characterized as "frugal," with substantial pressure to limit the growth of state government; the size of government and the role of taxes remain the central political debates. The governor's stated priorities are literacy, economic diversification, and families.<sup>2</sup> The state has a large elderly population and one of the fastest growing child populations in the nation.<sup>3</sup>

The lack of a state income tax makes sales, business, and intangibles taxes important. Tourism represents a substantial part of the economy, and Florida's tourism industry has rebounded since the aftermath of September 11<sup>th</sup>, attracting a record number of tourists in 2002. Unemployment remains below the national average.<sup>4</sup> When Governor Bush was inaugurated in 1999, he inherited a \$3 billion surplus.<sup>5</sup> Tax cuts between 1999 and 2002 reduced annual state revenues by \$1.2 billion, with the cumulative reduction in tax payments since Governor Bush took office estimated at \$8.2 billion. While there were no tax cuts or increases in SFY 2002-2003,<sup>6</sup> Florida was one of only two states with a net decrease in estimated revenues based on actions affecting revenues for fiscal year 2004.<sup>7</sup> Tax changes in SFY 2003-2004 included decreases in corporate and other taxes and an increase in fees for a net decrease in revenues estimated at \$27 million.<sup>8</sup>

Budgetary reserves in general revenues are held in the working capital fund, which can be appropriated for general revenue purposes, and the budget stabilization fund, which can only be

used in the event of emergencies, such as hurricanes. All revenue is classified as recurring or non-recurring depending on whether the income stream is time-limited or not and, by practice not statute, only recurring revenues are to be used to fund recurring expenditures.<sup>9</sup> Some revenues are earmarked for certain purposes and held in trust funds, e.g., hospital tax revenues are deposited in the Public Medical Assistance Trust Fund (PMATF) and used to fund Medicaid expenditures. Trust funds make up 58 percent of the total state budget with the rest classified as general revenue.

Medicaid represents 23.5 percent of the total state budget of \$53.9 billion (SFY 2003-2004 general revenue and trust funds), and so is an important consideration in any budget talks. Changes in Medicaid policy designed to slow the growth in this program have resulted in a reduction in expenditures of at least \$100 million (relative to the rising baseline defined by expected growth in caseload and services given existing policies) in almost every year since 1993.<sup>10</sup> Growing caseload is one source of expenditure growth but pharmaceuticals are the biggest factor, in spite of substantial policy initiatives over the past several years aimed at containing this area of expenditure growth.<sup>11</sup>

## Florida's Budget Problem

Despite a 3 percent drop in the state's largest revenue source, sales taxes, total tax collections for SFY 2002-2003 were ahead of projections led by a 25 percent increase in collections from corporate taxes.<sup>12</sup> Combined sales and corporate tax collections are projected to be up by 4.6 percent for SFY 2003-2004.<sup>13</sup> Nonetheless, the shortfall going into current fiscal year (SFY 2003-2004) was estimated at about \$1 billion,<sup>14</sup> representing nearly two percent of the total budget. As was the case in SFY 2002-2003, the state had sufficient funds to cover the shortfall but these funds were from non-recurring sources. Appropriations from general revenues were \$21.6 billion, which represents a nominal increase of 2.7 percent over SFY 2002-2003 and is well over the national average increase of 0.2 percent.<sup>15</sup> This increase follows a 8.0 percent increase between SFY 2001-2002 and 2002-2003.<sup>16</sup>

Governor Bush's proposed SFY 2003-2004 budget (general revenue, trust funds, and other state funds) recommended an increase of 6.8 percent over the SFY 2002-2003 total state budget. The budget as passed represented an increase of 5.8 percent. Funding for K-12 education rose by 6.6 percent but more than half of the increase was slated to be used to address the requirements of the class size initiative. Community colleges faced a cut of \$4.3 million, and universities a cut of \$40.7 million. More of the cost of higher education has been shifted to students with tuition at community colleges rising by 7.5 percent and at universities by 8.5 percent. State government employment continues to decline, with a 3.2 percent decline between 2002 and 2003 followed by a 1.4 percent decline (1700 jobs) for the current year (2003-2004);<sup>17</sup> government salaries were increased 2.0 percent across the board (subject to a \$500 floor and \$1400 ceiling), and cost-sharing for health insurance premiums for state employees remained fixed.<sup>18</sup>

The legislature was unable to reach agreement on the budget at the end of the regular session. The Senate proposed new revenues while the House proposed additional tax cuts or new economic stimuli. Meeting in special session, the legislature compromised by agreeing not to impose new taxes but allowing some fee increases. The bulk of the shortfall was met through the use of \$1.0 billion in non-recurring revenues. The state issued bonds to cover the cost of the class-size reduction initiative, adding \$600 million to the state's debt, raising the state's total indebtedness to over \$20 billion.<sup>19</sup> Governor Bush intends to send the high speed rail initiative back to the voters.<sup>20</sup>

The crux of Florida's budget problem can be seen in the state's position at the end of SFY 2002-2003. The budget stabilization fund was intact, totaling \$959 million at the end of the budget year.<sup>21</sup> The total year-end balance (including the budget stabilization fund) was \$1.4 billion, or 7.0 percent of expenditures. While this balance is healthy, it has been declining over time as a percentage of expenditures. At the end of SFY 2001-2002 it was 10.0 percent of expenditures; at the end of SFY 2003-2004 it is projected to be 6.6 percent of expenditures.<sup>22</sup> Furthermore, most of the surplus is in non-recurring revenue and so its

use for funding recurring expenditures is ill-advised.<sup>23</sup>

## Cuts in Medicaid and SCHIP

The most contentious issue in the debates on the Medicaid budget in SFY 2002-2003 was funding for the medically needy program. This program was slated to be cut but funding was reinstated on a time-limited basis using non-recurring funds. Hospitals argued in favor of the program, saying that the costs of caring for those no longer covered under the program would show up in their uncompensated care bill. Continued funding for the program, with no time limitation specified, was approved at the end of SFY 2002-2003. Consideration was given both to raising the income limit and to strengthening the spend-down requirements for SFY 2003-2004. After costing out both of these changes, the legislature opted to continue the operation of the program unchanged, a decision that respondents reported was based chiefly on compassion rather than cost comparisons. Administrative changes in the program will not be felt by the beneficiaries. The necessary funding for the program was found in a \$29.1 million increase in voluntary contributions from counties as part of their existing upper payment limit (UPL) program and, since hospitals have a stake in seeing the program continue, by delaying the annual price level increase for hospitals from July 1<sup>st</sup> to October 1<sup>st</sup> for an estimated general revenue savings of \$5.6 million.

The Medicaid budget for SFY 2003-2004 is \$12.5 billion, of which \$3.5 billion comes from general revenue, \$7.1 billion from federal financial participation, \$404 million from trust funds, \$452 million in other state funds, \$95 million in tobacco settlement funds, and \$1.0 billion in grants and donations, chiefly from contributions by localities. The initial estimates for Medicaid spending showed a \$113 million (3.2 percent) general revenue shortfall. The legislature was not eager to revisit the sometimes acrimonious debate surrounding the medically needy program and so looked elsewhere for savings within Medicaid. The \$314 million in cuts (federal and state funds) was achieved through small savings across

many programs. The areas with the largest predicted savings were a cut in nursing home rates accompanied by postponement of a increase in the staffing requirement (\$19.5 million), institution of 2.5 percent coinsurance for certain drugs (\$26.8 million), expansion of the nursing home diversion program which promotes community based alternatives to institutional care (\$35.7 million), and institution of a \$15 co-payment for non-emergency use of hospital emergency departments (\$24.3 million). Nursing homes had had a scheduled rate increase funded in SFY 2003-2003 with non-recurring funds; this year that increase was eliminated, effectively decreasing nursing home rates for an estimated savings of \$27 million.

***State legislators, reluctant to revisit last year's bruising battle over funding for the medically needy program, instead capped enrollment in the state's SCHIP program to help address the budget problem.***

The state looked widely for savings as evidenced by the smaller but significant savings in areas such as eliminating circumcision (\$2.4 million) and transferring non-emergency transportation services from a state commission to a competitive procurement with capitated rates (\$11 million). Prior year cuts to adult hearing and vision were not restored, and adult dental remains limited to emergency care only. The "value-added" program that the state has in place with four major pharmaceutical companies was renewed. Under this program, the pharmaceutical companies provide disease management services free-of-charge in exchange for having their products not subject to the Medicaid preferred drug list. Supporters of the value-added program estimate savings at \$15.9 million in state funds last year, but detractors say that greater savings could be achieved by abandoning the deals and demanding larger rebates from the companies. Pharmaceuticals remain a target area for future cost savings. The one-third of the pharmaceutical budget that is unmanaged, chiefly in drugs for HIV/AIDS patients and for mental health, is seen as offering some potential for additional savings.

Fraud and abuse in pharmaceuticals is an area of ongoing concern.<sup>24</sup>

The state also applied for a state plan amendment to raise an additional \$33 million through an upper payment limit program for physicians. Managed care was expanded by further increasing the percentage of clients assigned to health maintenance organizations rather than the more lightly managed MediPass primary care case management program beyond the increase mandated last year. The state did not look to localities for additional help this year beyond the \$29.1 million in increased UPL program participation; a mandatory realignment of state-county responsibilities is scheduled for SFY 2004-2005, and the legislature chose not to impose new burdens in anticipation of this change.

One of the most difficult issues in this year's budget debates was funding the state's SCHIP program, Healthy Kids, which is not part of Medicaid. Enrollment in the program was capped with spending limited to the appropriation. State savings from this action were estimated at only \$300,000 because of the high federal match for SCHIP. Current expenditures, however, exceed the state's allotment and include carry-forward amounts from prior years. Outreach was eliminated, and a waiting list was established, which, by November 2003, had over 44,000 names.<sup>25</sup> A cap of \$750 was put on annual child dental benefits which allowed the state to decrease the capitation rate it paid to plans, saving an estimated \$1.3 million in state funds. Monthly premiums for children's programs were raised to \$15 per family per month for families with incomes under 150 percent of the federal poverty level and \$20 per family per month for those between 150 and 200 percent of poverty, for an estimated \$3.6 million savings in state funds.

## The Future

As was the case in SFY 2002-2003, the state's decision to rely on non-recurring funds to meet recurring expenditures has postponed some hard choices that will eventually have to be made. The state will need to find a source of recurring revenue to replace the \$1.03 billion in

non-recurring funds in the SFY 2003-2004 budget. In addition, unfunded expenditures have been accruing in Medicaid in the form of carry-forward deficits that will need to be addressed in the near future. Total Medicaid expenditures are calculated at the end of the calendar year, six months after the end of the fiscal year. When expenditures exceed the appropriation, the difference is carried forward into the next year. These deficits are in part a function of billing cycles but are also driven by the failure to fully realize savings that had been projected from program and policy changes. In some cases, the policy changes represented initiatives that had not been tried before and for which savings could not be reliably estimated. In other cases, implementation delays have meant that a full year's savings could not be achieved.

***While Florida ended its most recent fiscal year in better shape than most states, the outlook for the future is less sanguine.***

While some of the carry-forward deficits in Medicaid have been repaid, significant amounts remain. The remaining \$10.7 million general revenue carry-forward deficit in Medicaid from SFY 2001-2002 will be added to the projected carry-forward deficits of \$58.0 million for SFY 2002-2003 and \$113.6 million for the current budget year. The deficit for the current year is likely to be higher; Medicaid enrollment in the more costly categories began rising after the expenditure projections had been made for the current year, resulting in projected expenditure numbers that were recognized as overly optimistic very early in the fiscal year. Early estimates put the gap for Medicaid in SFY 2004-2005 at \$526.1 million in state funds, continuing the upward trend. The state is not confident that it will be able to live within the current appropriation for Medicaid, and a mid-year adjustment to institutional provider rates is expected to be necessary to bring expenditures into line with the appropriation.

The fiscal relief provided to the Florida through revenue sharing by the federal government totaled \$543 million, and the

temporary increase in the federal matching rate for Medicaid will yield \$413.4 million. The state has allocated \$310 million of the fiscal relief funds for economic development in the form of a one-time investment incentive for the establishment of a Florida branch of the California-based Scripps biomedical research center, to be matched by up to \$200 million in funds from the county in which the institution will be located.<sup>26</sup> The balance was deposited in the working capital fund and transferred to the general revenue budget as non-recurring revenue for allocation in the SFY 2004-05 budget. Because these funds are non-recurring, they do not solve the underlying budget problem of the imbalance between recurring expenses and recurring revenues, a problem that the state again decided not to address in the current fiscal year. The sticking point remains the role of taxes, with some believing that tax cuts will spur the economic growth that will lower demands on the social services budget and others asserting that tax increases are needed to bring in the funds to meet the commitments of the state in its social services program. In the same context, arguments have arisen on the role of trust funds in limiting budgeting flexibility and the role of tax exemptions in limiting the revenues that the state could collect without fundamentally altering the tax structure.

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## Endnotes

- <sup>1</sup> All of the coverage figures in this paragraph are from Urban Institute calculations using data from the Current Population Surveys, 2002 and 2003 Annual Social and Economic Supplements.
- <sup>2</sup> Governor Jeb Bush, State of the State Address, January 8, 2003, <http://www.stateline.org/stateline/?pa=state&sa=showStateOfStateSpeech&year=2003&state=FL>.
- <sup>3</sup> Kenneth Finegold et al., Social Program Spending and State Fiscal Crises, Assessing the New Federalism Occasional Paper no. 70, November 2003.
- <sup>4</sup> As of the first quarter of 2003. Adam Carasso and Roseana Bess, "The Disposition of Federal Dollars in Florida's Social Services: Informing a Federal Funding Maximization Strategy," Final Report to the Florida Philanthropic Network, The Urban Institute, June 2003.
- <sup>5</sup> Finegold et al.
- <sup>6</sup> National Governor's Association and the National Association of State Budget Officers (NGA/NASBO), Fiscal Survey of the States, November 2002, p. 11.
- <sup>7</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 12.
- <sup>8</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 12.
- <sup>9</sup> Finegold et al.
- <sup>10</sup> Finegold et al.
- <sup>11</sup> John Holahan et al., The State Fiscal Crisis and Medicaid: Will Health Programs Be Major Budget Targets? Overview and Case Studies, The Henry J. Kaiser Family Foundation, January 2003.
- <sup>12</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 39.
- <sup>13</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 41.
- <sup>14</sup> Bob Mahlborg, State budget woes mount," Orlando Sentinel, July 1, 2003, <http://www.orlandosentinel.com/news/local/state/orl-asecbudget01070103jul01.story>.
- <sup>15</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 28.
- <sup>16</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 28.
- <sup>17</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 34.
- <sup>18</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 37.
- <sup>19</sup> Randolph Pendleton, "State close to debt ceiling," Tallahassee Democrat, June 9, 2003, <http://www.tallahassee.com/mld/tallahassee/news/local/6045437.htm>.
- <sup>20</sup> Finegold et al.
- <sup>21</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 22.
- <sup>22</sup> NGA/NASBO, Fiscal Survey of the States, December 2003, p. 55.
- <sup>23</sup> Wenner, Kurt, "New General Revenue Estimates Are Increased, But Use of Non-Recurring Revenues Still Has Florida in a Hole for Upcoming Budget Year," Budget Watch, vol. 9, issue 2, Florida TaxWatch, [http://www.floridatxwatch.org/resources/pdfs/budgetWatchSeries/budgetwatch\\_non-recurring11-03.pdf](http://www.floridatxwatch.org/resources/pdfs/budgetWatchSeries/budgetwatch_non-recurring11-03.pdf).
- <sup>24</sup> Florida Officials Say They Will Increase Scrutiny of Medicaid Prescription Drug Fraud, Following Release of

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Grand Jury Report, Kaiser Daily Health Policy Report,  
December 19, 2003,  
[http://www.kaisernetwork.org/daily\\_reports/rep\\_index.cfm?hit=3&DR\\_ID=21441](http://www.kaisernetwork.org/daily_reports/rep_index.cfm?hit=3&DR_ID=21441).

<sup>25</sup> Donna Cohen Ross and Laura Cox, "Out in the Cold: Enrollment Freezes in Six State Children's Health Insurance Programs Withhold Coverage from Eligible Children," Kaiser Commission on Medicaid and the Uninsured, December 2003, <http://www.kff.org/medicaid/4159.cfm>.

<sup>26</sup> Scripps Florida Project, Biotechnology Research Institute & Campus, [http://www.co.plam-beach.fl.us/PubInf?EDO/Scripps\\_Florida.htm](http://www.co.plam-beach.fl.us/PubInf?EDO/Scripps_Florida.htm).