



## THE WORST PRESCRIPTION FOR CALIFORNIA'S ECONOMY: Analyzing the Economic Impacts of Health and Human Service Cuts

In order to fill California's \$24 billion budget deficit, Governor Schwarzenegger has proposed a budget that would make severe cuts to spending on vital health and human services programs. In June, the joint Budget Conference Committee approved a budget that accepted some of the Governor's proposals, made other spending cuts, and increased revenues.<sup>1</sup> This brief describes the significant negative economic impacts of the proposals, especially with respect to health care.

Due to the nature of public health care programs and the significant financial participation of the federal government, the negative economic impacts of the cuts are significantly greater. Specifically, **the economic impacts of the Governor's proposed budget cuts include:**

- **California will lose \$7.5 billion in federal funds for health, human service, and other programs next year alone.**
- **Over 600,000 Californian jobs will be lost.**
- **The state's economy (GDP) will shrink by more than two percent.**
- **Over two million more Californians will lose health coverage, increasing the number of uninsured by one-third.**

The Budget Conference Committee budget package will still have a significant impact on the economy, but far less severe than the Governor's proposal. Specifically, **the economic impacts of the Budget Conference Committee budget package include:**

- **California will lose over \$1.2 billion in federal funds for health and other programs this year alone.**
- **About 220,000 Californian jobs will be lost.**
- **The state's economy (GDP) will shrink by almost 1.3 percent.**
- **An estimated 550,000 more Californians will lose health coverage.**

While the state faces significant financial challenges, there are better budget choices for California than the ones the Governor has proposed. For example, **cuts to health care have four times the negative economic impact of a high-income tax increase.** As such, the Legislature should consider revenues in their approach to the budget, which would result in fewer lost jobs and a less significant negative impact on the economy.

## Direct Loss of Health Coverage & Access to Care

The Governor's budget proposal has a direct and significant negative effect on the access to health care for millions of Californians. Under the Governor's budget proposal, almost 2 million Californians overall would directly lose health coverage, and another 400,000 would lose coverage due to job and economic impacts. Millions of more Californians would have reduced benefits and face increased barriers in access to health care.<sup>2</sup> A large and consistent body of research has shown that the uninsured live sicker and die younger, leading to a less productive workforce.<sup>3</sup>

Children are especially hard hit by the proposed cuts – up to 1.5 million children could lose coverage under the Governor's proposal and up to 475,000 children could be denied coverage under the Conference Committee package.<sup>4</sup> In addition, the Governor's proposal would eliminate CALWORKS assistance for nearly 1 million children and 300,000 adults.

Given the type of spending cuts and the populations affected, there is a direct economic effect from the loss of coverage and access to care. For many of the Californians affected by the health care cuts, the cuts are real and the programs they rely on are literally a lifeline that allows them to work, go to school, live at home, and function in society. The health care cuts that reduce access will destabilize family finances and increase medical debt, which contributed to three out of every five bankruptcies filed in 2007.<sup>5</sup>

## Significant Loss of Federal Funds

Cuts to state spending on Medi-Cal and Healthy Families are problematic because they result in the significant loss of federal funds, thereby intensifying the economic impacts by more than double.

This is especially bad timing for California to be forgoing available federal funds. The federal government usually matches state Medi-Cal spending dollar for dollar, however, the American Recovery and Reinvestment Act of 2009 (ARRA) contained a provision that temporarily increases the matching rate until December 1, 2010. This means that under the increase, for every \$1 the state spends on Medi-Cal, the federal government will pay \$1.60 (instead of \$1). For Healthy Families, the federal government pays even more, almost \$2 for every dollar the state spends on the program.<sup>6</sup>

The Governor has proposed a budget that would cut \$2.4 billion from health care spending in the current fiscal year,<sup>7</sup> as well as billions more from other health and human services programs (see Appendix 1). However, when considering that the cuts result in \$7.5 billion in lost federal funds,<sup>8</sup> California's health and human services programs will be cut by about \$10 billion overall this year alone under the Governor's budget.

In contrast, the Budget Conference Committee package would cut at least \$1.5 billion from health care spending this year (see Appendix 1), and cut 800 million from various human services programs (see Appendix 1). It is estimated that the Budget Conference Committee package would result in a loss of \$1.24 billion in federal funds for the state in the budget fiscal year.<sup>9</sup>

## Stretching the Health & Human Service Dollar Further

Spending on health care generates economic activity, supports jobs, and produces income as it “ripples” through the economy, and becomes greater than the original amount spent. Economists call this phenomenon a “multiplier effect” (see Appendix 2). For example, one recent analysis estimated that \$1 million in state spending on social programs in California generates about \$25,000 in sales taxes that go back to the state and local governments.<sup>10</sup>

Conversely, when spending on health care is cut, it has a negative economic effect that is even greater than the original amount cut. This impact is further exacerbated because the addition of federal funding creates a significant increase in purchasing power. Therefore, when health care spending is cut, the effects resonate throughout the economy.

The Governor’s proposed budget, which focuses exclusively on spending cuts not only on health but also in education and other social services, will result in 630,000 lost jobs and an overall 2.2 percent reduction in the overall economy, as measured by GDP.<sup>11</sup> This comes at one of the worst economic times, when more than one out of ten Californians is already unemployed (the state’s current unemployment rate is 11 percent).<sup>12</sup>

The Budget Conference Committee package is estimated to have a significant impact, albeit less severe than the Governor’s proposal, on the state’s economy. Under the Conference Committee package, 220,000 jobs California will be lost and the state’s economy will shrink by almost 1.3 percent.

### Better Budget Choices

The Governor and the Legislature can make better budget choices for the people of California – which means looking at approaches to balancing the budget other than just cuts to critical health and human services programs. The economic impact of the Governor’s “cuts-only” budget is severe, resulting in 2.3 million more uninsured, 630,000 lost jobs, and a contraction of the economy of 2.2 percent (Table 1).

**Table 1: Economic Impact of California Budget Solution Scenarios**

	<b>Governor’s cuts-only approach</b>	<b>Conference Committee approach</b>	<b>Mixed approach</b>	<b>Revenue-based approach</b>
<b>Increase in uninsured</b>	2,300,000	550,000	100,000	70,000
<b>Loss in jobs</b>	630,000	220,000	144,000	100,000
<b>Change in GDP</b>	-2.20%	-1.34%	-1.03%	-0.75%

Source: Analysis by UC Berkeley Center for Labor Research and Education (June 12 and 17, 2009).

In contrast, a purely revenue-based approach to balancing the budget would have a far less significant impact on the economy. (This happens for the reasons listed above, such as the matching federal funds and greater multiplier effect of spending.) Approaching the budget gap with revenues would result in only 150,000 more uninsured, 100,000 lost jobs, and a contraction of the economy of less than one percent (0.75 percent).



Filling the budget deficit with a mix of spending cuts and revenue increases would still have a negative effect on the economy, but may be more politically feasible for lawmakers to compromise on. A mixed approach, evenly divided between cuts and revenue solutions, would result in 100,000 more uninsured, 144,000 lost jobs, and a contraction of the economy of about one percent (1.03 percent).

The Budget Conference Committee adopted a budget package that uses a mixed approach, but disproportionately relies on spending cuts. Specifically the Conference Committee package includes \$13 billion worth of spending cuts, and \$2 billion in additional revenue through increased oil and tobacco taxes. The economic impact of the Budget Conference Committee package is estimated to result in 550,000 more uninsured, 220,000 lost jobs, and a contraction of the economy of 1.3 percent.

### Spending Cuts vs. Tax Increases

There are a number of revenue options that policymakers could consider which would have a less severe economic impact. For example, one option is to increase the income tax on higher-income taxpayers. Because these taxpayers can deduct their state tax from their federal tax and have a tax bracket of about 35 percent, they receive approximately 35 cents of every dollar in state taxes paid when they file their return.

As shown in Table 2, a \$1 billion cut to Medi-Cal eligibility(such as that proposed by the Governor) would have **four times** the negative economic impact as that of a \$1 billion increase for the highest-income tax payers.

**Table 2: Impact of Medi-Cal Cuts vs. Upper-Income Tax Increase**

	Medi-Cal Cuts	Upper-Income Tax Increase
<b>State/taxpayer cost</b>	- \$1 billion in state spending on Medi-Cal enrollment	- \$1 billion in income taxes paid to state by highest-income taxpayers
<b>Change in federal dollars</b>	- \$1.6 billion in federal funds due to enhanced ARRA match	+ \$350 million returned to highest-income taxpayers through itemized deductions on federal income tax return
<b>Total economic impact</b>	- \$2.6 billion from California's health care system	- \$650 million from the highest-income taxpayers

In conclusion, the economic impacts of the Governor's proposed budget cuts will be severe and negative: Over two million Californians will lose health insurance, the state will lose billions in federal funds, hundreds of thousands of jobs will be lost, and the economy will contract significantly at one of the worst economic times. There are better budget choices that include revenues which would have a far less negative effect on the state's economy.



This issue brief was prepared by Health Access, a statewide coalition of consumer, labor, ethnic, senior, faith, and other organizations that has been dedicated to achieving quality, affordable health care for all Californians for over 20 years. Please visit our website and read our daily blog at [www.health-access.org](http://www.health-access.org).



**APPENDIX 1**  
**Select Health Care Cuts Budget Proposals**

<b>Category</b>	<b>Governor's Proposal</b>	<b>Budget Conference Committee Package</b>
<b>Medi-Cal flexibility</b>	\$1 billion from rolling back Medi-Cal eligibility levels	\$1 billion from Medi-Cal for "federal funds which are past due"
<b>Healthy Families Program</b>	\$366 million from the elimination of Healthy Families Program	\$70 million from reduced spending in the Healthy Families Program and creating a waiting list
<b>Community-based services</b>	\$167 million from elimination of Adult Day Health Services Benefit, Multipurpose Senior Support Program, and others	\$25 million from reducing Adult Day Health benefit and making other anti-fraud reforms
<b>Coverage for legal immigrants</b>	\$125 million from reduced coverage for legal immigrants	Rejected Governor's proposal
<b>Mental health care</b>	\$92 million from reduced support for mental health managed care programs and county Early, Periodic Screening, Diagnosis and Testing (EPSDT) programs	\$117 million from reduced support for mental health managed care programs county EPDST programs
<b>Substance abuse services</b>	\$98.8 billion from reduced rates for Medi-Cal substance abuse treatment and reduced support for Prop. 36 Substance Abuse and Crime Prevention Act	Adopted Governor's proposal
<b>Long-term care services</b>	\$76 million from increased long-term care fees and reduced rates	Adopted Governor's proposal
<b>AIDS/HIV programs</b>	\$80 million from reduced support for AIDS treatment programs and HIV education and prevention programs	\$35 million from reduced support for AIDS treatment programs and HIV education and prevention programs
<b>Medi-Cal "state-only" benefits</b>	\$34 million from elimination of non-emergency services, post-partum care, dialysis, non-digestive nutrition, and breast and cervical cancer treatment	Rejected majority of Governor's proposal (adopted elimination of ancillary services in Institutions for Mental Disease)
<b>Community clinic funding</b>	\$34 million from reduced funding for Rural Health Services Program, Seasonal Migratory Worker Program, Indian Health Program, and Expanded Access to Primary Care Program	\$14 million from reduced funding for Rural Health Services Program, Seasonal Migratory Worker Program, Indian Health Program, and Expanded Access to Primary Care Program
<b>Maternal, child and adolescent health grants</b>	\$20 million from elimination of maternal, child, and adolescent health programs in local jurisdictions	\$8 million from reduced funding for maternal, child, and adolescent health programs in local jurisdictions
<b>Hospital payments</b>	\$24 million from reduction of Medi-Cal payment rate to private hospitals by 10 percent	Rejected Governor's proposal and reduced Distressed Hospital Fund by \$24 million
<b>Dental care</b>	\$3 million from elimination of children's dental disease prevention program	Adopted Governor's proposal
<b>Certified application assistors</b>	\$3 million from elimination of state payments for certified application assistors for Medi-Cal and Healthy Families	Adopted Governor's proposal
<b>Anti-fraud efforts</b>	\$48 million from increased Medi-Cal anti-fraud efforts	\$36 million increased Medi-Cal anti-fraud efforts
<b>Family planning services</b>	\$37 million from reduced Medi-Cal payment rate for family planning services	Rejected Governor's proposal
<b>Proposition 99 tobacco tax funds</b>	\$60 million redirected from county health clinics, Breast Cancer Early Detection Program, Asthma, MRMIP high-risk pool, Access for Infants and Mothers (AIM) programs, and rural health and consumer assessment projects	\$11 million redirected from MRMIP high-risk pool, Access for Infants and Mothers (AIM) programs

## APPENDIX 2

### The Multiplier Effect & Lessons for Health Care

The multiplier effect refers to the idea that an initial amount of public spending will lead to increased consumer spending and so results in a total economic effect greater than the initial amount spent.

For example, a dollar spent on a public health program directly pays for a health care service, but it also indirectly pays for the supporting auxiliary goods and services that support the original health care service.<sup>13</sup> From that dollar spent: workers and suppliers get paid, jobs are preserved, state revenue increases in the form of taxes, and workers use their incomes to purchase their own goods and services, thereby stimulating the economy through consumer spending.

Some important lessons of the multiplier effect for health care:

- **Health care spending creates jobs.** The California Hospital Association has estimated that for each California hospital job created (e.g., a surgeon), another one and a half additional jobs are created (e.g., in administration, allied health, medical equipment, etc.).<sup>14</sup>
- **Public spending has a positive economic impact.** A recent study of the major health and human services programs in California found that there is an overall multiplier effect of 1.32, which indicates that there is a 32 percent boost to the state economy above and beyond the dollars received by the service providers.<sup>15</sup> This is primarily because the recipients of the payments have a higher propensity to spend it, rather than save it, which helps further stimulate the economy.
- **Public spending has a greater economic effect than tax cuts.** President Obama's Council of Economic Advisors (CEA) has noted that different policies have different economic impacts. In a major report during the stimulus debate,<sup>16</sup> the CEA used economic models where a tax cut has a "multiplier of roughly 1.0 after about a year and a half, and spending has a multiplier of about 1.6."<sup>17</sup>

## REFERENCES

- <sup>1</sup> "Summary of the 2009-2010 State Budget Conference Committee Actions," (June 17, 2009).
- <sup>2</sup> K. Jacobs, "Economic Consequences of Proposed California Budget Cuts," UC Berkeley Center for Labor Research and Education (June 12, 2009) and additional analysis on June 17, 2009.
- <sup>3</sup> Institute of Medicine, "America's Uninsured Crisis: Consequences for Health and Health Care," (February 2009).
- <sup>4</sup> Analysis by members of the 100% Campaign.
- <sup>5</sup> D. Himmelstein, *et al.*, "Medical Bankruptcy in the United States, 2007: Results of a National Study," *The American Journal of Medicine* (August 2009).
- <sup>6</sup> Technically the federal government pays about \$1.86 for every dollar the state spends on the Healthy Families Program.
- <sup>7</sup> Health Access, "Budget Update: Health Care Cuts in the Ongoing Budget Crisis," (June 1, 2009).
- <sup>8</sup> K. Jacobs, "Economic Consequences of Proposed California Budget Cuts," UC Berkeley Center for Labor Research and Education (June 12, 2009).
- <sup>9</sup> Analysis by K. Jacobs of the UC Berkeley Labor Center (June 17, 2009).
- <sup>10</sup> J. Haveman, *et al.*, "Spending on County Human Services Programs in California: An Evaluation of Economic Impacts," Child and Family Policy Institute of California (March 17, 2009).
- <sup>11</sup> K. Jacobs, "Economic Consequences of Proposed California Budget Cuts," UC Berkeley Center for Labor Research and Education (June 12, 2009).
- <sup>12</sup> Unemployment data for April 2009 from California Employment Development Department, (May 22, 2009).
- <sup>13</sup> Kaiser Commission on Medicaid and the Uninsured, "The Role of Medicaid in State Economies: A Look at the Research," (January 2009).
- <sup>14</sup> California Hospital Association, "A Report on California Hospitals and the Economy," (January 2009).
- <sup>15</sup> J. Haveman, *et al.*, "Spending on County Human Services Programs in California: An Evaluation of Economic Impacts," Child and Family Policy Institute of California (March 17, 2009).
- <sup>16</sup> C. Romer & J. Bernstein, "The Job Impact of the American Recovery and Reinvestment Plan," (January 9, 2009).
- <sup>17</sup> C. Romer, "The Case for Federal Stimulus: The Likely Effects of the American Recovery and Reinvestment Act," (February 27, 2009).