The 2012-13 State and Federal Budget Proposals and Their Potential Effects on MemorialCare Health System

In any typical legislative term, the California State Senate and Assembly will introduce close to 3,000 new bills to debate, argue, amend, debate again and beg for support from communities, their colleagues and the administration. Among those 3,000 bills there is none that is more important than the state budget. On the other side of the nation, the U.S. Senate and House of Representatives will debate foreign and domestic policy, including the declaration of acts of war, appointments of cabinet members and foreign ambassadors, and national monetary policy. Again, none are more important than the federal budget. Yet, over the past 25 years, there have been only a handful of times that the state legislature has met its constitutionally mandated deadline to enact a balanced budget and we have not had a new federal spending plan in almost three years. On the state level, we are about to enter full budget season, and on the federal side, most Members of Congress and political pundits agree that there will not be many bills passed out until after the November election. Despite these detours, it is important for MemorialCare’s governance, leadership, management and staff to understand the budget processes and potential impacts on our health system.

State Budget Overview

California runs on a July 1 fiscal year and The State Constitution mandates that the Governor present a spending plan to the legislature no later than January, 10 for the upcoming year. In the weeks following that presentation, the non-partisan Legislative Analyst’s Office will submit an overview of the proposal along with conclusions and recommendations. The Senate and Assembly Budget Committees will break down into five subcommittees each devoted to a specific policy issue. As a health care provider, MemorialCare is focused on the Assembly Budget Subcommittee #1 and the Senate Budget Subcommittee #3, both devoted to Health and Human Services. During the spring, these subcommittees meet and will debate each and every line item within that policy issue. These ‘subs’ will make draft recommendations to either accept the governor’s budget proposal or add/subtract from each line and then submit these recommendations to their respective full budget committees no later than the last Friday in May. Each full committee will debate the recommendations put forth and allow a joint conference committee to reconcile any differences. This final version is presented to both houses of the legislature on their respective floors. The legislature has its own constitutional deadlines as well; a balanced budget must be enacted and submitted to the governor no later than midnight, June 15, giving the governor two weeks to review before the start of the new fiscal year.
Historically, California had been one of only four states which required a two-thirds majority of each house to pass the budget. Democrats hold a 25-15 lead in the Senate and a 52-28 lead in the Assembly, only two votes shy of that majority in each house. Voters adopted Proposition 26 in November, 2010 allowing the legislature to enact a budget, exclusive of tax increases on a simple majority (50%+1). If they miss the June 15 deadline, legislator’s pay is withheld until a budget is passed (and, it is not paid retroactively). Last year, Democrats did indeed pass a budget by June 15; however, it was vetoed by the governor because he felt it contained too many accounting machinations. A subsequent budget was passed and signed by July 1 (each legislator last two weeks’ pay).

**Governor Brown’s Proposal – An Overview**

Governor Jerry Brown released his 2012-2013 spending plan on Thursday, January 5, four days earlier than had been expected. The budget assumes a combined deficit of $9.2 billion between now and the end of the next fiscal year, June 30, 2013 ($4 billion in the current year and $5.2 billion in the budget year). The Governor is proposing to balance this deficit through programmatic cuts and new revenues, leaving the state with a $1.1 billion reserve. Balancing the budget is predicated upon voters accepting the governor’s tax initiative expected to be on the November ballot. This initiative will ask voters to temporarily increase the personal income tax for upper-income filers as well as increase sales and use taxes for the next several years (see below). The administration expects this plan to generate $6.9 billion in new revenue in 12-13. The total spending plan includes $92.6 billion in General Fund expenditures, $39.8 billion in state special funding, $5.0 billion of bond fund expenditures and $73 billion of federal funds. The spending plan is predicated upon three key proposals: the tax initiative, Proposition 98 funding and a revamping of the CalWorks and Child Care programs.

Shortly after the Governor announced his plans to sponsor the tax initiative, several Democratic-leaning organizations floated similar ideas and concepts as means to generate new revenue, primarily, the California Federation of Teachers (CFT). Brown’s original plan would have raised income taxes on Californians earning at least $250,000 annually and would have increased the sales tax by half cent. Both elements were slated to expire December 31, 2016.

On March 14, the Governor announced a compromise with the CFT and both will now revamp their proposals into one initiative. The newly revised plan will increase the sales tax by quarter of a cent and will still expire in four years. Personal Income Tax (PIT) will be increased by one percent for individuals who earn $250,000 or couples who earn $500,000 and by two percentage points for individuals earning $300,000/$600,000 for couples. The PIT increase would be in effect until December 2017. The compromise is expected to raise an estimated $9 billion over the next fiscal year, which is $2.1 billion more than in Brown’s initial proposal. Signature gathering is expected to commence in early April.
As always, Prop 98 funding for K-12 and community colleges is the largest single item in the state budget. The governor is proposing to spend $52.5 billion – the Prop 98 minimum guarantee. This funding might be reduced should the voters reject the tax initiative.

The Governor proposes to reduce CalWorks general fund spending by $1.4 billion through cuts in cash grants to CalWorks recipients and by further eliminating eligibility for subsidized child care and CalWorks employment services.

As has been the case for the past several years, the budget proposes to delay specified general fund loan repayments totaling $631 million. Many of these delayed payments are geared towards fee-driven accounts from which funds had been borrowed to fill past general fund deficits.

If voters reject the governor’s tax initiative, a minimum of $5.4 billion automatic reductions will be ‘triggered’ to take effect on January 1, 2013. Schools and community colleges would bear the brunt of these cuts $4.8 billion (90% of the triggers). Higher education and the judicial branch are also slated to receive cuts. The California Hospital Association (CHA), along with other trade associations is convinced that the Health and Human Services Agency will also bear some programmatic cuts; however, none are detailed in the proposal.

Currently, there is a non-codified agreement between CHA and the administration that will prevent the state from implementing any reductions in Medi-Cal rates at least until January 1, 2014. Phase III of the Hospital Provider Fee Program, which is still under scrutiny at the Centers for Medicare and Medicaid Services, is scheduled to run from July 1, 2011-December 31, 2013. The proposed formula provides for increased payments made to the state out of the fee program, reducing the total amounts payable to hospitals allowing CHA to advocate on our behalf that additional reductions would prove problematic for many of their members.

**Health Care Related Issues**

Though our direct Medi-Cal reimbursement rates seem to be secure this budget year, there are other health care related items in the governor’s budget proposal that could potentially impact MemorialCare Health System and any one of our facilities. Chief among these are a proposal to redirect certain Disproportionate Share Hospital reimbursements and a new mechanism to better coordinate care for the ‘dual eligibles’.

**DSH.** The 2005 Medicaid 1115 Waiver provided DSH eligible hospitals to receive supplemental ‘stabilization’ funds. These stabilization funds are intended to reimburse DSH facilities to help cover costs of providing services from 2007-08 through 2009-10. The original goal of the stabilization funding was to ensure that these payments would grow at a similar rate to that of designated public hospitals during the same time period. The budget proposes to redirect $42.9 million of
these funds to the general fund. The actual cost to hospitals is twice that amount, $85.8 billion including federal matching dollars. The State Department of Health Care Services (CDHCS) cannot calculate any DSH facility’s actual amount due until it reconciles the public hospital’s actual costs. MemorialCare, along with CHA, will oppose this reduction in supplemental DSH funding.

**Duals.** Medi-Cal beneficiaries who are also eligible for Medicare are known as ‘dual eligibles’. The governor is proposing to shift certain ‘duals’ from fee-for-service to managed care. By definition, this particular population consists of low income seniors and persons with disabilities with multiple chronic conditions. Due to these co-morbidities, ‘duals’ are typically the state’s most expensive and medically complicated users of service. Under the proposal, managed care plans would cover long term care services including In-Home Supportive Services (IHSS), Community-Based Adult Services and nursing home care. This shift would take place in 8-10 counties beginning January 1, 2013; Los Angeles County is expected to be chosen. The administration projects savings of $1 billion in 2013-14. Long Beach Memorial is exploring options of collaborating with L.A. Care in the coordination of services to this population.

The non-partisan Legislative Analyst’s Office (LAO) has tentatively concluded that the governor’s proposal does hold merit, but requires additional information before a final recommendation can be made. The LAO agrees that costs will be reduced and coordination of care will be improved. Since legislation in 2010-11 authorized four counties to begin this shift, and that prices has not been finalized, the LAO recommends the state wait and use the data driven by those four counties to determine how best to build the program.

**LAO Comments**

The LAO believes that the governor’s plan continues the state’s efforts in restoring a balanced budget. To finish the job the legislature began in earnest in 2011, many difficult and politically charged choices must be made. The governor’s proposal includes multiyear tax increases in addition to significant programmatic reductions in social service programs. The LAO does calculate the projected revenues, including these realized from the tax initiative lower than the administration’s calculations. The most substantive problem with California’s budget is that it has been, for many year, dependent upon payments from the wealthiest individuals. The Governor is proposing these Californians pay even more for the next few years. As personal fortunes may shift among these residents, billions of dollars can be eliminated from projected state revenues. If the Governor has in fact over calculated new revenues, the legislature will be called upon next year to further adjust. Additionally, the LAO cautions the governor and legislature on best ways to implement any triggered cuts. If the cuts proposed in this budget are realized, there will be increased uncertainty in the education system. As noted, additional cuts in Health and Human Services programs are expected. Though MemorialCare’s Medi-Cal reimbursements seem to be protected until January 1, 2014, there are many other ancillary line
items in the budget which may be susceptible to reductions and that may impact our enterprise.

In the next few months we will know whether the governor is successful in placing his tax initiative on the November ballot and how much of the budget the legislature accepts (or tweaks to their advantage, keeping in mind that 2012 is a pivotal election year).

Ah, the politics of state budgeting

The state legislature now sits with strong Democratic majorities, but not yet the super majorities required to raise taxes. The Senate is comprised of 25 Democrats and 15 Republicans with 27 required for 2/3 majority; the Assembly holds 52 Democrats to 28 Republicans with 54 votes required for 2/3. For years, it has proven quite difficult for Democrats to convince 2 Republicans in each house to break ranks and vote for a budget supported by a majority of Democrats. When speaking of state politics, it’s important to note that often times a group or conservative Democrats, known as the Mod (Moderate) caucus, will oppose their leadership and vote against the near-final version. On both sides of the political aisle, there are often repercussions for doing so. Two years ago, former Assembly Republican Minority Leader Mike Villiines was stripped of his leadership position; in 2008, there was a recall attempt against Assemblymember Jeff Miller. Also in 2010’ Assemblymember Anthony Portantino accused Speaker John Perez of decimating his office budget due to the fact that he did not vote for the Democrat’s budget.

As noted earlier Prop 25 allows the legislature to enact a budget on a simple majority vote as long as it does not raise taxes. The Governor can exercise his right to veto the entire bill, as he did in June of 2010, or, he can use his ‘blue pencil’ and line-item veto certain aspects of the bill. State Controller John Chiang has much influence on this process as well. In 2010, he judged the initial budget passed on a strict party-line vote as being unbalanced. This caused the legislature to be incompliant with Prop 25 and their pay was relinquished until a second version was passed one day before the start of the new fiscal year.

Every Republican member is on record opposing the governor’s tax initiative. They are also opposed to any scenario where taxes or fees are increased. They are committed to balancing the $9.2 billion deficit through programmatic cuts only. This being an election year, it will be interesting to see which side, if either gives in first. 2010 was the first year in over a decade in which the governor signed the final budget in time. Let’s see if that can be repeated, and if, so the ramifications will be for our industry and our system.

The Federal Budget – An Overview

On February 12, 2012, President Barack Obama submitted to Congress his budget proposal for the federal fiscal year 2013 (FFY 13) which begins on
October 1, 2012. The spending plan of $3.8 trillion forecast a deficit of $1.33 trillion for the remainder or FFY12 and a deficit of $901 in 2013. It calls for $3 trillion in programmatic reductions beyond the $1.2 trillion codified in the Budget Control Act of 2011 (BCA) agreed upon by the President and Congress last August as a means to avoid default. The proposal would reduce Medicare spending by $267 billion and Medicaid by $50 billion, both over the course of the next ten years. These figures have been reviewed by the non-partisan Congressional Budget Office and will be discussed below.

As is often the case, this budget proposal serves as a blueprint for the President’s public policy priorities. The initial proposal rarely, if ever, is brought to the Congressional floors for a vote. With this year’s election battle already in full gear, it is a safe bet that this plan will not see the light of day, while providing great political fodder for both sides. Our federal government has not benefited from a budget agreement for almost three years; we have been running on a series of Continuing Resolutions, CRs, which allows most departments to continue operating on their current levels. There are many members of Congress who believe that the BCA, in setting spending caps for this and year, renders the budget process rather moot. In 2011, the President submitted three separate budget proposals for FFY 12. This proposal mirrors many of the elements of those proposals, especially where it pertains to our industry.

According to the Washington Post on February 13 the spending plan shows annual deficits exceeding $600 billion for each of the next ten years, with the exception of 2018. This forecast is in direct contrast to the President’s pledge last September to hold the annual deficits below $600 billion. The President had committed to permit the debt held by outside investors to rise to $17.7 trillion by 2021 (73% of the overall economy). The Post concludes that the plan will increase that portion of the economy by an additional $1 trillion, bringing it to $18.7 trillion in that same time period, representing 76.5% of the economy.

The budget proposes to increase the tax burden of certain corporations. In similar fashion to Governor Brown’s tax initiative, the President is suggesting higher income taxes for individuals earning more than $200,000 and couples who earn over $250,000.

**Health Care Related Issues**

There are several health care related issues that hold potential impact on MemorialCare Health System. Among them are:

- A proposal to reduce the Medicaid provider tax from 6% to 4.5% in 2015 and phasing it down further to 3.5% by 2017, thereby saving the federal government $18 billion. Phase III of the Hospital Provider Fee which runs July 1, 2011-December 31, 2013 is currently awaiting final approval by the Centers for Medicare and Medicaid Services, CMS. MemorialCare has benefited greatly from the fee program since its inception. There are many ‘unknowns’ in this element of the plan making it impossible to calculate an
exact impact on our system. First, we do not know what the FMAP (Federal Medicaid Assistance Percentages) rate will be. There is a direct correlation between the fee formula and the FMAP. Secondly, and of utmost importance, is the fact that there is no guarantee the program will exist in California beyond 2014. In fact, there is considerable speculation within the industry and CHA that the program will indeed cease. Whereas MemorialCare’s benefit may end, we remain in a strong financial position; many of our competitors have come to rely on these funds for survival. If the program continues at the current formula, MemorialCare’s reduction might be $10 million. Our system’s estimated benefit from the current formula under CMS consideration is approximately $110 million over the 30-month period ending December 31, 2013. Much more to come on this issue.

- Medicaid Disproportionate Share Hospital (DSH) payments will be rebased with reductions of $8 billion beginning in 2021. The federal government has not calculated a formula for this rebasing, therefore it is impossible at this time to determine its impact on Miller Children’s Hospital Long Beach.

- Medicaid and CHIP, the Children’s Health Insurance Program, Healthy Families here in California, will be reduced beginning in 2017 through a single blended Medicaid rate. Though this is estimated to save the federal government $17.9 billion, the exact calculation is dependent upon the current FMAP rate. Once again, we cannot determine an exact impact on MemorialCare.

- The allowable Medicare bad debt claims will be reduced by $35 billion nationwide. The current rate we are allowed to claim is 70% and that will be reduced to 25% beginning in 2013. The three year average loss to MemorialCare is estimated to be $1.3 million. It is important to note that the agreement made in February to avert the 27.4% reduction in payments to physicians treating Medicare patients (SGR), lowered the bad debt rate to 65%, costing our system an estimated $148,000.

- Monetary penalties will be imposed upon hospitals that do not update Medicaid enrollment information, saving the government $90 million. MHS Compliance is working closely with each campus to ensure our policies and procedures are appropriate.

- Children’s Hospital Graduate Medical Education, CHGME, is slated to be eliminated. Based on a three year average, this line item might cost Miller Children’s $4.5 million. Your government relations team is working closely with the newly reframed Children’s Hospital Association (formerly National Association of Children’s Hospitals and Related Institutes), and the California Children’s Hospital Association to oppose this reduction and to ensure the program is reauthorized in the budget year.

- There is a proposal to expand the authority of the Recovery Audit Contractors (RAC). Impact to MemorialCare is difficult to calculate; once again, our Compliance Department is tracking its development.

- MedPAC has recently recommended that Inpatient rehabilitation facilities, along with skilled nursing facilities, home health agencies and long term
care hospitals will see their market basket updates revised. The government has not yet determined how the rate will be calculated.

As more details are released, government relations will work with MHS Finance to determine the impact on our system and this information will be disseminated as soon as possible.

**Congressional Budget Office Review**

The non-partisan Congressional Budget Office was founded in 1974 and has produced dozens of reports on presidential budget proposals as well as legislation carrying fiscal a federal fiscal impact. It advises the House and Senate Budget Committees, Appropriations, Finance and Ways and Means. A cost estimate is produced for every bill under these committee’s jurisdiction. CBO employees are appointed regardless of their party affiliation.

On Friday, March 16, the CBO released its preliminary report on the President’s budget. It agreed with the administration’s forecast of about $6 trillion added to the federal deficit over the next ten years. To the delight of The White House, the CBO is projecting $600 billion less in deficit spending. The CBO report agrees with the administration that public debt would rise to $19 trillion by 2022. Even though the administration is welcoming the CBO analysis that long term deficits will decrease, the report does warn against an increasing national debt.

Absent Congressional action, the Bush tax cuts will expire at the end of the year and the BCA ordered defense and entitlement sequestered cuts go into effect. If these reductions do indeed take effect, the CBO projects that the deficit will be reduced to $3 trillion over the next decade. These sequestered cuts are unpopular on both sides of the political aisle. Many Republicans are determined to reverse the $600 billion in defense cuts while many Democrats have promised to save the Medicare reductions to hospitals.

As might be expected, was quick to point out that the President has failed in his commitment to reduce federal spending. Representative Paul Ryan, the Chair of the House Budget Committee said ‘…[this] analysis serves as a disappointing reminder of this administration’s broken promises and failed leadership when it comes to averting the most predictable economic crisis in our history’. Data can always be maneuvered to support any particular position. We will be watching closely how the White House and Congress uses the CBO report to their advantage.

**The new Republican Medicare Proposal**

Last year, Rep. Ryan unveiled a radical new approach to Medicare spending. The basic tenet of the plan was to allow seniors to receive a fixed amount from the federal government to be used to purchase insurance in the private marketplace. If these funds were not sufficient enough to purchase the plan of choice, the beneficiary may either pay the difference out of pocket or choose a
less expensive plan. The proposal was immediately rebuked by the
administration, each Democratic member of Congress and especially the AARP
(one of the strongest lobbying groups in the nation). During the course of this
past year, Mr. Ryan forged a new tentative collaboration with Oregon Democratic
Senator Ron Wyden. The two, usually diametrically opposed to one another’s
policies have agreed to work together on a new proposal.

Ryan has said “people are ready to be talked to like adults, not like children.
They know something is wrong…” On March 20, the Chairman did release a
new and revised version of last year’s radical approach to Medicare reform. The
bill addresses many of the concerns raised by AARP and others. Yet, according
to the Chair of the Democratic Congressional Campaign Committee, New York
Rep. Steve Israel, “you can dress up a pig, but it’s still a pig.” Clearly, civility is
not a requisite for holding public office!

The new Ryan plan is basically the same as last year, with one major exception;
it provides seniors with the option to remain in traditional fee-for-service Medicare
if they so choose. Medicaid will be reduced by $810 billion over the next ten
years, as opposed to a reduction of $770 billion in the prior proposal. And, as
mentioned above, Medicaid will be block granted to states.

The defense and the discretionary domestic $1.2 trillion in sequestered cuts will
be alleviated for one year. The Medicare sequester cuts, approximately $6
billion/10 years, which are capped at 2% of our reimbursements, remain in place.

Under the Ryan plan, Medicare would transition to this new premium support
program in 2023. The amount of federal premium contribution would be
determined by competitive bid with the per capita cost of the program capped at
GDP growth plus 0.5%.

The ACA is addressed in the plan as well. The subsidies for low-income
individuals and the Medicaid expansion are rescinded. The Medicare age of
eligibility is raised two months per year until it reaches 67.

The Ryan plan is seen on Capitol Hill and in the media in much the same way the
Obama plan is seen – political showmanship. It is scheduled for a vote in the
House of Representatives sometime the week of March 26. The Democrat-
controlled Senate is not expected to even take it up for debate (the same tactic
used last year). Ryan acknowledges that the plan is not destined for passage. He
insists that he has unveiled it as a tool to be used in the Presidential election. As
of March 21, Rep. Ron Paul was the only Republican candidate to comment on
the plan, saying that it did not go far enough. (Last year, Speaker Gingrich
characterized it as “right wing social engineering”. The media has not paid too
much attention to the announcement. The Wall Street Journal reported it on page
A5 and the Washington Post on page B4. The former notes that it has no
chance of becoming law this year, but does opine that it ‘is a worthy marker’. 
Final Thoughts

As was noted in the beginning of this analysis, there is no greater responsibility of our elected officials than to enact the annual budgets. Each state is required to enact a balanced budget; not so for the federal government, which leads to the escalating deficits. In both the state and federal governments, there is an increased level of partisanship and discord. There are basic degrees of partisan disagreement on the appropriate involvement of government in our lives. In the simplest of terms, Democrats believe government can help create jobs and build the economy. Republicans believe that the private sector alone can spur the economy and government works best when it works least. Democrats hold a commanding, yet not a super majority in both houses of the state legislature. They hold a very slim lead in the US Senate while Republicans hold a strong lead in the House of Representatives.

There are several ‘third rail’ issues that are rarely debated in an election year. Among these are Medicare overhaul and an overwhelming tax increase on any particular demographic. Both those issues are front and center in the budget negotiations.

The MemorialCare Health System is greatly dependent upon fair and equitable reimbursement for the care we provide to the government’s beneficiaries, both in Medicare and Medicaid. It is incumbent upon us as good fiscal stewards of the community’s resources to advocate on behalf of our patients, their families and our communities for this fair reimbursement. As a not-for-profit health system, each dollar that is reduced in our reimbursements potentially translates to fewer programs offered. In light of our mission ‘to improve the health and well being of individuals, families and our communities through innovation and the pursuit of excellence’, any compromised reimbursements are simply unacceptable.

For more information on the state or federal budget proposals and processes, please call Peter Mackler, executive director of government relations at (714) 377-3946 or PMackler@Memorialcare.org.