

The State Budget and AHCCCS

The Issue

With revenues and spending out of alignment, elected officials are once again challenged to balance the state budget. Governor Ducey's FY 2016 Executive Budget proposal, which focuses on spending cuts to address the state budget's long-term structural deficit, includes payment cuts to AHCCCS providers and a reduction in certain disproportionate share hospital (DSH) payments to private hospitals, shifting these federal funds instead to the state general fund.

Against this backdrop, legislators have filed suit over restoration of Prop. 204 and the mechanism for funding it—a hospital assessment. If the assessment is found unconstitutional, patients could lose access to Medicaid services, the state budget would fall further into deficit, and hospital uncompensated care would once again spiral upward.

AzHHA's Position

AzHHA members appreciate the fiscal challenge elected officials face in balancing the current year and FY 2016 budgets, as they too struggle to balance their own budgets. A series of AHCCCS rate cuts and freezes has resulted in hospitals being paid less than 70 percent of cost, a situation that is not sustainable over the long term. However, hospitals also recognize that they must and can be part of the solution to the state's budget woes.

The hospital assessment, which pays for restoration of Prop. 204 and Medicaid expansion, is helping to alleviate pressure on the state general fund by shifting the cost of the Prop. 204 program, including TANF parents, to the assessment—an annual savings of more than \$250 million to the state. And, with uncompensated care down, hospitals are once more contributing to Arizona's economic engine. However, proposed cuts to AHCCCS payments threaten this recovery and could jeopardize access to care within certain communities and for certain types of services. Moreover, payment cuts will impede investments in delivery reforms that are improving quality and reducing overall system costs.

AzHHA opposes arbitrary cuts to provider reimbursement as a mechanism for achieving further cost-containment within AHCCCS, and believes rates should be restored after many years of cuts. Over the longer-term, policymakers and stakeholders must work together to implement real reforms that will incentivize innovations that improve outcomes and drive down the cost of care. However, in the short term, we recognize some sacrifice may be necessary to address the current state budget deficit. As such, hospitals pledge to do what is in their power to absorb the payment cuts proposed by Gov. Ducey in his original Executive Budget proposal, effective for FY 2016. Moving forward, we urge policymakers to work collaboratively with providers to develop a more sustainable AHCCCS program.

Background

In response to the “Great Recession” and as outlined in the following table, lawmakers approved, and the AHCCCS Administration implemented, a series of payment cuts to hospitals beginning in FFY 2009. Specifically, rates were frozen beginning Oct. 1, 2008, and then cut by 5 percent on Oct. 1, 2010 and by another 5 percent on Apr. 1, 2011. Other policy changes included reductions to outlier and DSH payments, and the imposition of a 25 day inpatient benefit limit. For 2015, these cuts total \$911.1 million, a revenue loss which has been incorporated into the new APR-DRG payment methodology. As part of the regulation implementing the APR-DRG system, the AHCCCS Administration also eliminated the inflation factor that was part of the previous tiered per diem statute. As such, there is no longer a statutory mechanism for recognizing and funding the cost of inflation.

Hospital Payment Cuts Since 2008

Note	Description	Dollar Amount	Percentage
(1)	AHCCCS FFY 2011 Inpatient and Outpatient Payments	2,398,147,831	
(2)	Estimated 2010 impact of Outlier Model Change	82,700,000	
(3)	Rate Increases that were eliminated:		
(a)	10/1/2008		3.6%
(b)	10/1/2009		2.1%
(c)	10/1/2010		2.6%
(d)	10/1/2011		3.0%
(e)	10/1/2012		2.6%
(f)	10/1/2013		2.5%
(g)	10/1/2014		2.9%
(g)	Cumulative Lost Rate Increases		21.0%
(4)	Impact of eliminating rate increases on hospital payments	502,751,348	
(5)	October 2010 5 percent rate cut impact	119,907,392	
(5)	April 2011, 5 percent rate cut impact	119,907,392	
(6)	Impact of imposing 25 day limit effective 10/1/2011	77,817,532	
(7)	State Funded DSH reduction	16,862,200	
(8)	CAH Payment Increase	(8,800,000)	
(9)	Total Reductions	911,145,864	
(10)	Percentage impact on 2014 payments		38%
(11)	State General fund saving	287,275,405	

In addition to reimbursement cuts to hospitals and other AHCCCS providers, lawmakers also froze enrollment of Prop. 204 childless adults into AHCCCS beginning July 2011. The freeze resulted in a spike in the cost of hospital uncompensated care (UC), from \$412 million in 2010 to \$756 million in 2012 and \$876 million in 2013. When Gov. Brewer proposed lifting the childless adult enrollment freeze and funding it with a hospital assessment and enhanced federal match rate, AzHHA offered unwavering support. It was the right thing to do for patients; it would honor the will of the voters who passed Prop. 204; it would alleviate pressure on the state general fund by shifting Prop. 204 costs to the assessment; and it would reduce hospital UC.

Since the enrollment freeze was lifted in January 2014, hospitals report a 38 percent decrease in UC.¹ With uncompensated care down, hospitals and related ancillary service providers are once more in a position to fuel Arizona's economic engine. However, uncertainty remains. While one would expect hospital margins to improve with a reduction in UC, this has not happened. The average hospital margin has actually declined from 3.3 percent in 2013 to 2.2 percent in 2014. Moreover, 29 percent of reporting hospitals state they incurred a loss from operations in December 2014.² The major factor for these losses is underpayment by government payers, particularly AHCCCS.

Analysis

Hospitals and healthcare systems play an important role in the overall health of the Arizona economy. Arizona hospitals employed nearly 83,000 persons in 2012 with payroll and benefits of \$5.75 billion. Direct expenditures totaled more than \$12 billion, with an overall impact of \$25 billion to the Arizona economy.³ Over the last year, the healthcare sector—in part due to Medicaid restoration and expansion—began to add jobs at a pace not seen in several years. In Arizona, healthcare employment grew by 5.5 percent in 2014 compared to total non-farm employment growth of 2.5 percent. Overall, healthcare made up 24 percent of the Arizona job growth in 2014.⁴ Moreover, healthcare sector jobs are well-paying. Hospital workers—because they are highly skilled—tend to earn more than the average worker. For 2013 the average weekly earnings of a hospital worker was \$1,052 compared to \$787 for all service providing industries.⁵

¹ This number is based on monthly data reported to AzHHA as of Dec. 2014. Seventy-nine percent of hospitals, based on inpatient cases, responded to the November survey.

² Data is derived from AzHHA's December 2014 statewide hospital survey.

³ Source: Avelere Health using BEA RIMS multipliers based on BLS data and data reported to the American Hospital Association.

⁴ *Arizona Employment Report*, January 22, 2015. Arizona Office of Employment and Population Statistics.

⁵ Source: American Hospital Association based on BLS data.

Much like the aero-space and defense industry, the economic contributions of the healthcare sector are in large part dependent on the policy decisions of government payers. Because of the way the U.S. health system is structured and Arizona's mix of demographic and economic conditions, patients with government-sponsored health insurance and the uninsured make up a large portion of our hospitals' payer mix.⁶ Payment cuts by government payers reverberate throughout the system, impacting not just patients and providers, but also local communities, businesses and the state's economy.

Depending on the hospital's payer mix, the services they deliver, and whether the hospital is a sole community provider, AHCCCS rate cuts can have multiple effects:

- Hospitals with a diverse payer mix will attempt to shift additional losses to commercial insurers and businesses—a "hidden healthcare tax."
- Hospitals with high Medicaid utilization or a high concentration of Medicaid, Medicare, and self-pay patients will not be able to cost-shift. They will absorb the losses by reducing services and ultimately staff, further exacerbating Arizona's slow economic recovery.
- Sole community hospitals, many of which are not able to cost-shift, will evaluate high-cost services such as obstetrics and pediatrics, and whether they can continue to offer these services at a loss. If these services are discontinued at a sole community hospital, all patients lose access to these services, not just AHCCCS members.
- All hospitals will have fewer resources to invest in innovative practices that are improving quality and driving down the long-term cost of care.

Rather than a constant ratcheting of payment cuts, which results in an unpredictable business environment for healthcare providers, AzHHA believes the long term sustainability of the AHCCCS program lies in innovative reforms that will improve quality, promote better health outcomes, and incentivize efficiency. Such reforms can provide a significant return on investment for Arizona taxpayers.

Our Position

As a result of Prop. 204 restoration and the further expansion of AHCCCS, Arizona's healthcare sector is once again hiring and contributing to the state's economic recovery. Patients have access to

⁶ On average, 71 percent of hospital inpatient cases fall into this category, as does 73 percent of emergency department visits. Source: Intellimed, based on encounter data reported to the Arizona Department Health Service's inpatient discharge database and emergency department database.

medical services, and hospital uncompensated care is down. Because the costs of expansion and the underlying Prop. 204 program have been shifted to a hospital assessment and enhanced federal match rate, the state general fund is in better shape than it otherwise would have been under the pre-freeze funding methodology. **For these reasons, AzHHA is committed to defending Medicaid restoration within the context of our 2015 state budget priorities.** AzHHA will do all it can to preserve the statutes and funding that have enabled restoration to occur, at least until such time as other options are adopted that can move the program into the future—a future that must include covering the Prop. 204 population.

Arizona hospitals are paid less than 70 percent of cost for treating AHCCCS patients due to numerous years of payment cuts. The gap between payment and the cost of caring for AHCCCS patients will continue to grow without a rate adjustment. AzHHA believes a rate increase is very much warranted. However, given the state budget deficit, we recognize an adjustment is not possible in the short term, and that some additional level of sacrifice may be necessary. As such, we:

1. **Oppose any rate cut above the 3 percent cut proposed by Gov. Ducey in his original Executive Budget proposal.** After FY 2016, policymakers should move to begin restoration of funding.
2. **Support delaying the effective date of the rate cut until no sooner than July 1, 2015.** An April 1, 2015 start date does not give providers enough preparation time to adjust their own budgets.
3. **Support maintenance of existing DSH funding levels and allocation methodologies for fiscal years prior to 2015.** We oppose changes that would result in smaller allocations to hospitals than those proposed by Gov. Ducey in his original Executive Budget proposal.
4. **Oppose any funding reductions to the Critical Access Hospital Pool and Rural Inpatient Reimbursement Pool.**

Over the longer term, AzHHA believes much more can be done to reform the AHCCCS program and in doing so develop a better and more sustainable policy that will put the state's funding of healthcare and health needs on stable footing and improve the structural deficit. The AzHHA Board of Directors has approved the development of a *Medicaid Futures Policy* initiative to explore reform options.

AzHHA is committed to working with Gov. Ducey, legislative leadership, the AHCCCS Administration, and others to develop the best set of thinking and options regarding the future of the Medicaid program in Arizona.

Table Notes

- (1) Figure is the sum of *AHCCCS Inpatient and Outpatient Payments 2011* located on the AHCCCS website on 2/9/15:
<http://www.azahcccs.gov/commercial/HospitalSupplements/HospitalSupplements.aspx>.
- (2) *AHCCCS Outlier Report to JLBC (November 2006)* projects 2010 expenditures at \$253.4M without the Outlier change, and \$170.7M with the Outlier change, resulting in the \$82.7M reported in the schedule.
- (3) The rate increases that the hospitals have foregone is from the CMS website on 2/10/15, the section titled actual regulation market basket updates. Hospitals used to receive these until 10/1/2008 when they were eliminated because of state budget issues.
- (4) The figure is the product of (2) and (3)(g)
- (5) The figure is the product of 5% and (1)
- (6) Figures provided by AHCCCS in personal correspondence with AzHHHA
- (7) AHCCCS provides historical DSH payments at the hospital level. In 2009, DSH payments from AHCCCS were 26.1M. In 2011, DSH payments from AHCCCS dropped to \$9.3M.
- (8) AHCCCS estimate of the impact of the 2015 increase in CAH payments to hospitals
- (9) This figure is the sum of (4) - (7)
- (10) This figure is the ratio of (8) divided by (1)
- (11) The state federal assistance Medicaid Percentage (FMAP) for 2015 is 68.46%. Accordingly the state match is 31.54%. This figure is multiplied by the total reductions to estimate the annual state impact