

October 31, 2007

The Governor's Health Care Plan: State Fiscal Risks and Issues— October 2007

LEGISLATIVE ANALYST'S OFFICE

Presented to:
Assembly Health Committee
Mervyn M. Dymally
Chair





Governor's January and October 2007 Proposals Administration Annual Estimates

***Includes State and Federal Funds
(In Millions)***

	Governor's Health Proposal		
	January	October	Change From January
Expenditures			
Expand Medi-Cal and Healthy Families	\$2,639	\$1,995	-\$644
State purchasing pool coverage	4,970 ^a	5,650	680
County coverage for undocumented adults	1,000 ^b	— ^b	-1,000
Medi-Cal provider rate increase	4,040	4,255	215
State-funded interim premium payments for noncomplying individuals ("seamless enrollment")	—	570	570
State administration costs	—	487	487
Programs to combat obesity, diabetes, and smoking	300	363	63
Refundable tax credit	—	340	340
"Section 125" tax loss	900	270	-630
Total Expenditures	\$13,849	\$13,930	\$81
Revenue			
Federal funds	\$5,474	\$4,855	-\$619
Hospital provider tax	2,200	2,300	100
Lottery revenue	—	2,000	2,000
Physician provider tax	1,300	—	-1,300
Employer "pay-or-play" fee	1,000	1,485	485
Shift of county funds to state	1,000	1,000	—
Individual purchasing pool enrollee premium contributions	1,300 ^a	995	-305
Employer contributions for public coverage ("horizontal equity")	1,400 ^a	965	-435
Savings from existing state programs	203	550	347
Total Revenue	\$13,877	\$14,150	\$273
Net Savings	\$28	\$220	\$192
<p>^a In its January fiscal summary, the administration did not count \$2.7 billion in revenues and expenditures (\$1.3 billion from individuals, \$1.4 billion from employers) related to individual and employer contributions and coverage costs in the purchasing pool. These amounts are included here in the \$4.9 billion pool coverage expenditure as well as in the respective revenue amounts.</p> <p>^b The Governor's January fiscal estimate reflected \$1 billion in county funding (not shown here) and \$1 billion in federal funds to continue providing indigent care. The Governor's October fiscal estimate does not display these amounts, although counties' role in the October plan is the same as in the January proposal.</p>			



LAO Assessment of Major Fiscal Uncertainties in the Governor's Health Proposals

January Proposal	October Proposal
<p>Potential Legal Obstacles. Legal issues relating to a federal law governing employer health benefit plans (the Employee Retirement Income Security Act) may block key features of the Governor's plan.</p> <p>Availability of Federal and Local Funds. About \$1 billion in federal funds and \$1 billion in the revenue from counties assumed in the Governor's plan appear to be at risk.</p> <p>Economic and Demographic Risks. Costs of the plan could be higher than forecast to the extent that the uninsured population is larger, medical expenditure growth outpaces the growth in wages and payrolls, or the cost of providing coverage through the state pool is higher than anticipated.</p> <p>Caseload Flows From Private to Public Insurance. Although the administration's assumptions regarding movements between private insurance and new public coverage generally appear plausible, some uncertainties and potential risks remain.</p> <p>Potentially Understated Resources. The Governor's plan appears to overstate state revenue losses due to the requirement that employers offer Section 125 tax plans. The plan also does not account for some additional funds that could be available due to additional premium payments and the elimination of redundant programs.</p>	<p>Risk Is Unchanged. A July 2007 federal court ruling found that federal law preempted an employer health spending mandate in New York. This is the second such recent ruling.</p> <p>Risk Is Unchanged. Federal waivers and federal approval of children's health funding are still uncertain. Also, no details of the Governor's plan to obtain county funding were available at the time this handout was prepared.</p> <p>Risk Has Increased Somewhat. The risk that the state's medical expenditures would grow faster than revenue is increased because of the shift to lottery revenue. Risks regarding the actual number of uninsured and the pool's ability to negotiate low rates are unchanged.</p> <p>Risk Is Unchanged. Higher-income persons would be able to access unsubsidized coverage through the purchasing pool, but risks do not appear to have changed substantially.</p> <p>Unable to Assess Risk. The administration has amended its estimate of revenue losses and recognized certain administrative costs. However, at the time this handout was prepared, there was insufficient detail to assess whether the risk level had changed.</p>



Significant New Fiscal Components in the Governor's October Health Reform Plan

(In Millions)

Fiscal Component	Governor's Estimated Annual Amount (Millions)		LAO Comment
	Cost	Revenue	
Refundable tax credit	\$340	—	Since credit would be calculated based on premiums for the minimum coverage required under the mandate, it is possible that relatively few taxpayers would qualify.
State-funded interim premium payments for noncomplying individuals ("seamless enrollment")	\$570	—	Penalties for noncompliance with the individual mandate appear minimal, which could lead to the state making more interim premium payments. The administration has not yet determined how the individual mandate would be enforced, which could result in higher costs than those included here.
Department of Finance "trigger" provision	—	—	This provision could reduce risks associated with the availability of funds from the federal and county governments and the lottery.
Lottery revenues and education costs	—	\$2,000	See following page.



Major Risk That Lottery Plan Will Not Produce Projected Revenues

- ☑ Lottery May Be Underperforming, but Unknown How Much Investors Will Pay for It
 - The amount the private sector would pay to lease the Lottery is not known.
 - The amount would depend largely on the “strings attached” to the deal by the Legislature and voters.
 - The amount may not be known for two to five years.

- ☑ New Administration Plan to Use Lottery for Health Care Involves Major Risks
 - The administration’s estimates assume that (1) the Lottery is leased to the private sector for an “up front” payment of \$37 billion, (2) about \$6 billion of this payment is used to pay off the state’s deficit financing bonds, and (3) the remaining funds are invested to generate an annual revenue stream to the state of about \$2 billion.
 - The administration indicates that, under its plan, the \$2 billion proposed revenue stream would end after about 20 years. This would leave a major hole in health care financing.
 - K-12, community colleges, and university systems would lose the Lottery’s over \$1 billion annual distribution.
 - The administration proposes increasing Proposition 98 funding and university funding by a like amount.
 - Such an increase in education funding, absent other changes, would worsen the state’s overall budget situation.



Major Risk That Lottery Plan Will Not Produce Projected Revenues *(Continued)*

- A Less Optimistic Fiscal Estimate Would Be Preferable
 - If the Legislature wants to use Lottery funds for health care, it should count on *much less* money from the transaction than the administration assumes and restructure proposal to provide ongoing funding.
 - If investors pay more, the extra money could go into the health care program's reserves or be used for other state purposes.

- Policy Choices on the Lottery
 - Lease the Lottery or pursue other changes to improve Lottery performance?
 - The Legislature and voters would have to consider many details and make many choices in fashioning legislation under either scenario.
 - Use proceeds from Lottery lease for education, health care, or another state purpose?
 - Should the private sector pay for the Lottery up front, over time, or a combination of the two?
 - Whether and how to make up any Lottery funding no longer allocated to education?
 - How much revenue to assume *now* that a Lottery lease will generate for the state, when such a transaction would take *several years* to complete?



Governor's Health Proposals Updated LAO Assessment of Major Fiscal Uncertainties

(In Millions)

	Potential Annual Additional State Costs, January Plan		Range of Risk for Governor's October Plan
	Low Estimate	High Estimate	
Potential Additional Costs, Annual Basis			
Some federal matching funds unavailable	—	\$1,350	Similar
Medi-Cal coverage for childless adults	—	(250)	Similar
Hospital safety net care pool	—	(750)	Similar
State Children's Health Insurance Program funding	—	(350)	Similar
Revenue from counties unavailable	—	1,000	Similar
Higher number of uninsured persons	\$100	500	Similar
Health care cost inflation (by fifth year of plan)	400	Unknown above \$400	Similar
Higher cost of coverage in purchasing pool	250	Unknown above \$200	Similar
Subtotal Costs	(\$750)	(\$3,500 or more)	Similar
Less: Potential Additional Funds			
State revenue losses overstated	\$500	\$300	Unclear
Additional resources possible	100	50	Lower
Subtotal Revenues	(\$600)	(\$350)	Lower
New Components in Revised Plan:			
Refundable tax credit	—	—	Low
State-funded interim premium payments for noncomplying citizens ("seamless enrollment")	—	—	Moderate
Employer contributions for public coverage ("horizontal equity")	—	—	High
Lottery revenues and education costs	—	—	High
Total Net Cost Risk	\$150	\$3,150 or More	Higher



Additional Policy Issues for Legislative Consideration

- ☑
Affordability for Consumers. The Governor’s plan would generally limit families with incomes less than 350 percent of the federal poverty limit to paying no more than roughly 5 percent of their incomes for health insurance. The following table indicates what families are estimated to be currently paying for privately obtained coverage.

Percentage of Total Family Income

	Family Income Category (As Percent of the Federal Poverty Level)			
	101 to 200	201 to 250	251 to 300	301 to 400
Employer-Based Coverage				
Out-of-pocket	1.7%	1.1%	1.1%	0.9%
Premiums	4.2	2.7	2.8	1.7
Total spending	7.3	4.7	5.3	3.2
Non-Employer-Based Coverage				
Out-of-pocket	2.2%	1.4%	1.7%	1.6%
Premiums	11.0	10.5	5.0	4.6
Total spending	12.0	10.5	8.1	7.0

Note: Columns do not sum because the measure used is the median, not the mean.
 Source: Jacobs, et al., *Health Coverage Expansion in California: What Can Consumers Afford to Spend?*, UC Berkeley Labor Center and UCLA Center for Health Policy Research, September 2007.



Additional Policy Issues for Legislative Consideration

(Continued)

- ☑
Affordability for Businesses. The Governor's proposal would require businesses to pay up to 4 percent of their Social Security wages on health benefits. The following table reports recent spending by California firms on health care costs, weighted by number of employees. An alternative measure, averaged across firms regardless of firm size, indicates that firms on average spend 13.8 percent of Social Security wages on health care.

Percentage of Social Security Payroll

Number of Employees	All Workers	Workers With Employer-Sponsored Health Insurance
3 to 9	4.7%	9.2%
10 to 99	6.9	10.9
100 to 999	9.3	11.5
More than 1,000	7.9	11.3
Totals	7.9%	11.2%

Source: Graham-Squire, et al. California Healthcare: Firm Spending and Worker Coverage, UC Berkeley Labor Center, March 2007.