

*Forthcoming in
February...*

Budget Options for New York City

...revised and expanded

Clause in Medicare Bill Blocked Hundreds of Millions in Potential City Savings

A little-noticed provision in the Medicare bill passed last November will translate into some savings for the city when the new prescription drug benefit goes into effect in 2006. But because of a clause added to the bill just before its enactment the savings for the city are substantially less than they might have been.

The savings, roughly \$34 million in federal fiscal year 2006, will derive from the new drug benefit covering the cost of prescriptions for the roughly 350,000 city residents who are eligible for both Medicare and Medicaid. Once the law goes into effect, the new Medicare Prescription Drug Benefit shifts the responsibility for providing prescription drugs to these dually-eligible beneficiaries from Medicaid, which is partially funded by the city, to Medicare, which is entirely federally funded.

The resulting fiscal relief for both the city and state is expected to be minimal, however, since the law also contains a "clawback" clause requiring states to reimburse the federal government for a substantial portion of these prescription drug costs. Without this clawback, New York City would have realized approximately \$300 million more in savings in 2006. But the law also includes another provision that should temporarily provide some additional funds for the city's financially ailing public hospitals.

Medicare and Medicaid. Created in 1965, Medicare is a federally funded health insurance program covering more than 41 million American seniors, regardless of their income levels or previous medical history. Medicare offers seniors basic health care coverage, including inpatient hospital services, skilled nursing facility access, outpatient hospital services, and physician visits. The addition of a prescription drug benefit is the largest change to Medicare since the program's inception.

Prior to the passage of the Medicare Prescription Drug Benefit, Medicaid covered the cost of providing prescription drugs to the dual eligibles. Medicaid is a federal- and state-funded health care safety net program covering more than 40 million low-income individuals across the country. It provides health care services to individuals whose income and resources fall below certain thresholds. Each state participating in the Medicaid program is entitled to receive federal matching funds for actual expenditures at a rate varying from 50 to 77 percent, depending on the state's per capita income. New York State's federal matching rate is 50 percent.

Unlike most other states, New York State also requires localities to contribute 25 percent of the cost of providing acute care services, which includes pharmaceuticals, to Medicaid beneficiaries. As a result, New York City is required to reimburse the state for 25 percent of all pharmaceutical expenditures made on behalf of its Medicaid-eligible residents, including the dual eligibles. The state covers an additional 25 percent of these acute care expenditures, while the federal government is responsible for the remaining 50 percent.

Clawback Costs. Once the law goes into effect in 2006, Medicare will cover the cost of providing prescription drug benefits to those dual eligibles who enroll in the plan. But the fiscal relief for the city will be greatly reduced by the clawback requirement. Although the clawback clause was not completely unexpected—a similar concept had been included in the bill that passed the House of Representatives—the reimbursement rate is larger than many analysts had anticipated. The new law requires states to reimburse some portion of the cost of providing prescription drugs to dual eligibles in perpetuity, while the clawback clause included in the original House bill would have resulted in the federal government taking over all of these costs in New York by federal fiscal year 2011.

The clawback provision essentially requires states to reimburse the federal government for much of the expenditures they would have made if the new law had not been enacted. In 2006, the reimbursement rate will be equal to 90 percent of the state's estimated prescription drug expenditures on dual eligibles, with the rate decreasing to 75 percent by 2015

and beyond. Barring a change in current state policy, New York City will remain responsible for 25 percent of the prescription drug expenditures made on behalf of its residents. Assuming a 10 percent annual growth rate in the cost of prescription drugs, IBO estimates that the new law will limit New York City's savings to approximately \$34 million in federal fiscal year 2006, rising to \$253 million in federal fiscal year 2015. Under the same conditions, but in the absence of the clawback clause, New York City would have realized Medicaid savings of

approximately \$337 million in 2006, increasing to over \$1 billion by 2015.

Alternatively, if prescription drug costs continue to grow at the current national annual average of approximately 15 percent, New York City would save \$39 million in federal fiscal year 2006 and \$430 million in 2015. Without the clawback provision, New York City would have saved \$385 million in 2006 and more than \$1.7 billion in 2015.

Formula Penalizes Some States. Currently, states are not required by the federal government to offer prescription drug benefits to their Medicaid beneficiaries. As a result, the range of prescription drug benefits afforded to Medicaid beneficiaries varies widely by state. Because Medicare is a federal program, the new Medicare drug benefit will eliminate this state-by-state variation. However, the reimbursement formula outlined in the clawback clause penalizes those states currently offering the most comprehensive prescription drug benefits.

The reimbursement formula for each state depends on the state's average prescription drug expenditures per dual eligible. For the purpose of the clawback formula, the state's prescription drug expenditures per dual eligible are calculated by using federal

fiscal year 2003 as a baseline and adjusting it annually by the average national increase in prescription drug costs. The reimbursement rate is based on state expenditures only. Federal matching funds are not considered in the clawback equation.

States' prescription drug cost per dual eligible in 2003 largely

depended on the range of Medicaid prescription drug coverage offered by the state in that year. The average state spent approximately \$1,070 per dual eligible on prescription drugs in 2003, IBO estimates using an Urban Institute analysis of Medicaid Statistical Information System data. In contrast, New York State's combined state and local expenditures on prescription drugs in 2003 totaled approximately \$1,300 per dual eligible. In this way, New York and other states currently offering more generous Medicaid prescription drug benefits will

Estimated City Savings Using Different Assumptions Of Annual Growth in Drug Costs			
<i>Dollars in millions</i>			
	Federal Fiscal Years		
	2006	2010	2015
10 percent annual growth			
With the Clawback Clause	\$33.7	\$91.5	\$252.1
Without the Clawback Clause	\$337.3	\$548.8	\$1,008.5
<i>Difference</i>	<i>(\$303.6)</i>	<i>(\$457.4)</i>	<i>(\$756.4)</i>
15 percent annual growth			
With the Clawback Clause	\$38.5	\$124.9	\$429.8
Without the Clawback Clause	\$385.5	\$749.2	\$1,719.3
<i>Difference</i>	<i>(\$346.9)</i>	<i>(\$624.3)</i>	<i>(\$1,289.4)</i>
SOURCE: IBO.			

be paying more for the new Medicare benefits provided to its dually-eligible residents than states offering less generous coverage prior to the new law's passage, despite the fact that once the law goes into effect, their dual eligibles will be receiving the same level of coverage.

Benefit for HHC. The new Medicare Prescription Drug Benefit also contains provisions likely to benefit the city's Health and Hospitals Corporation (HHC). Of particular importance to HHC, which is facing a substantial budget shortfall in 2004, is the temporary increase in the Disproportionate Share Hospital payments provided under the new law.

Disproportionate share payments are additional Medicare and Medicaid funds provided to states by the federal government to compensate those hospitals that serve a disproportionately large number of low-income patients. The Medicare Prescription Drug Benefit provides for a 16 percent increase in these payments to states in federal fiscal year 2004. The increase serves

to counteract the effects of the Balanced Budget Act of 1997, which reduced disproportionate share payments for many states through federal fiscal year 2002. The reduction in these payments states received as a result of the Balanced Budget Act of 1997 is often referred to as the "DSH Cliff."

Disproportionate Share Hospital payments to states will remain at the 2004 level until the new rate equals the payment the state would have received under the previous law. For New York, the increased payment will likely cease in federal fiscal year 2009.

In federal fiscal year 2001, the most recent data available, the Health and Hospitals Corporation received approximately 34 percent of New York State's disproportionate share funds. Assuming the distribution levels remain constant, HHC can expect a \$50 million increase in disproportionate share funds in federal fiscal year 2004.

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