Adverse Reaction:
Proposed Health Budget Cuts Would Lead to Increased Health Insurance Premiums

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Executive Summary

The health care cuts proposed in the May Revision budget under discussion in the legislature are estimated to deny Medi-Cal health coverage for more than one million Californians when fully implemented. As shown in this analysis, **the resulting increase in the number of uninsured could increase the cost shift for California families with employer-based health insurance by 22 percent—in 2009, that would be an additional cost of more than $290 per family.**

To the extent that the budget passed by the legislature will create more uninsured persons—and the proposed budget currently under consideration certainly looks as if it would—cost shifting will grow. In addition, **other cuts to Medi-Cal, including both benefit cuts and significant provider rate cuts, could add to the cost shift**, resulting in even further premium increases. The best way to resolve unfair, inequitable and economically inefficient cost shifting is to create a comprehensive, universal system of coverage.

Introduction

Decisions about the state budget impact the state's health care system as a whole, with the consequences reaching far beyond those who depend directly on publicly funded programs such as Medi-Cal and Healthy Families, or publicly funded institutions such as county hospitals and clinics and community clinics. The debate over the state health budget affects all Californians and how much they pay for health care.

Every year, health care providers in California provide millions of dollars of life-saving care for the uninsured. Some of that care is paid for by the uninsured themselves, some of it by public funds, but ultimately, much of this cost is shifted to those who can pay – patients with health insurance. By charging patients with insurance more than they otherwise would, providers pass on the cost of the uninsured to insurers, who in turn pass the cost on to individual policyholders in the form of higher premiums.

As of August 10, 2008, the 2008-09 state budget has not yet passed. The May Revision budget proposal would substantially reduce spending for Medi-Cal, California's Medicaid program, which provides health coverage for more than six million low-income individuals and their families. If fully implemented, the May Revision budget proposal in California could cause more than one million individuals to be denied Medi-Cal coverage, according to one estimate.[1] Budget decisions (including proposed provider rate cuts as well as other benefit cuts) could reduce Medi-Cal spending by well over $1 billion in state and federal funds, with the impact increasing as the cuts reach full implementation and as health care costs continue to rise.[2]

This paper calculates the amount of cost shifting under the proposed May Revision to the budget. This budget proposal would increase cost shifting by at least 22 percent, raising the additional cost of premiums from 9.6 percent in 2006 to 11.7 percent under the new budget, based on using the same methodology as the New America Foundation. **This increase from budget cuts would mean the average California family in employer-sponsored insurance will pay an additional $290 in premium dollars on top of the existing cost shift in 2009.** This will add to the already rapid rate of growth in health care premiums in California**.**

The economic impact seems clear: **Passage of Medi-Cal budget cuts will increase the health care premiums of all Californians with insurance, adding to the already rapid growth in health care premiums.**

The Importance of Health Insurance

Health insurance is a practical pre-requisite to successfully accessing the health care system. Compared to the insured, the uninsured receive reduced amounts of care and generally receive lower quality care.[3] The existing research also shows the uninsured live sicker and die younger.[4]

This happens despite the fact that the uninsured pay higher out-of-pocket costs for care (both in real dollars and as a percentage of income.) For those who need care who are uninsured or underinsured, their choice is often to delay treatment or to seek care that could cause significant financial hardship.

While the uninsured are less likely to get care, are both charged more and pay more in out-of-pocket costs to get health services, and are more likely to face bankruptcy, there is still a significant amount of care for the uninsured that is left unreimbursed. Those costs have to be absorbed by the health care providers, and in turn, by other payers in the health care system.

Broad Academic Support for Healthcare Cost Shifting

The measurement of cost shifting can be challenging. However, there is no debate over the existence of cost shifting in our healthcare system, with a broad array of experts having published a range of estimates. This paper relies on the methodology used by the New America Foundation, as frequently cited during California's health reform effort in 2007. The other analyses of cost shifting due to the rate of the uninsured include:[5]

- **Families USA: 10.6 percent cost shifting.** Professor Ken Thorpe of Emory University, writing for FamiliesUSA, a national consumer advocacy organization, found that cost shifting in California is at 10.6 percent, with a national rate of 8.5 percent. Thorpe also found 12 states with higher rates than California.[6]

- **New America Foundation: 9.6 percent cost shifting.** In December 2006, the New America Foundation released an analysis of the cost-shift in California. Titled "A Premium Price," that paper found health insurance premiums are roughly 10 percent higher than they otherwise would be due to the cost-shift from the uninsured to the insured. This cost-shift—also called a "hidden tax"—was frequently cited by supporters of health care reform to help illustrate the broken and fragmented nature of our health system.

- **Institute for Health Policy Solutions: 5 to 6 percent cost shifting.** Rick Curtis of the Institute for Health Policy Solutions published findings that California's cost shift is approximately 6 percent of private insurance premiums.[7]

- **Hoover Institution: 2.8 percent cost shifting.** Even conservative health policy experts have estimated there is some cost shifting in the system, although their estimates on the cost shifting created by the uninsured are much lower. John Cogan *et al* estimated that the cost shift "at most" due to the uninsured is 2.8 percent.[8] (The report's central finding was a cost-shift due to low payment rates in public programs, which was found to be more than 10 percent.[9])

Med-Cal Budget Cuts Will Increase Cost Shifting

California is now facing a historic budget deficit, estimated to be at least $15 billion.[10] To close this shortfall, the proposed budget under consideration by the legislature would reduce Medi-Cal enrollment and payments to Medi-Cal providers. This section considers how those budget proposals could increase the number of uninsured, thus driving up cost shifting.

Rate of Uninsured in the May Revision

Most Californians, like most Americans, receive their health insurance through work. Some low-income Californians, as well as many low-income children, receive no- or low-cost health insurance through Medi-Cal. A vital program for providing access to needed care, Medi-Cal accounted for more than one out of every six dollars spent on California healthcare in 2004.[11]

However, as shown in Table 1, if California decision-makers choose to make the budget cuts proposed by the Governor in the May Revision, and if those cuts are fully implemented over the next few years, Medi-Cal enrollment could be substantially reduced.

TABLE 1: Medi-Cal Enrollment Reductions Relevant to Cost Shifting Analysis[12]

May Revision Proposed Health Care Budget Cuts Include:	**Number of Californians Impacted When Cuts Are Fully Implemented:**
Deny Medi-Cal coverage to low-income working parents. Parents earning more than $975 or working more than 100 hours per month with a family of three will no longer be eligible for public programs.	**429,000** Parents
Deny benefits for legal immigrants. Legal, low-income immigrants would only be eligible for a limited benefits package.	**80,600** Legal Immigrants
Increase paperwork to reduce enrollment. Medi-Cal beneficiaries will need to report their incomes every three months – two to four times more often than currently required – to maintain coverage.	**6,794** Adults **471,500** Children
Increase monthly premiums for Healthy Families enrollees. Premiums will rise by between 27 and 77 percent, pricing many lower-income families out of the program.	**60,000** Children
TOTAL NEWLY UNINSURED CALIFORNIANS:	**1,047,894**

Cost Shifting Calculation for the Uninsured

The proposed budget could cause a profound increase in cost shifting from the uninsured to insured, both because of the increase in the number of uninsured and the decrease in Medi-Cal reimbursements to providers. To re-estimate the cost shift by taking into account the more than one million newly uninsured Californians due to the proposed 2008-09 budget cuts, the authors used the same approach as used by the New America Foundation in its December 2006 paper, "A Premium Price."

This paper uses the assumptions given in the 2006 paper and changes only the number of uninsured, based on full implementation of the proposed 2008 May Revision. This approach isolates the impact of the new budget. Readers who want to understand the complete methodology are encouraged to see that paper, but the key assumptions are that, in 2006: [13]

- Eight percent of health dollars in California that year were spent on the uninsured.
- About 20 percent of Californians were uninsured.
- Forty percent less care is received by the uninsured than the insured,[14] with those individuals paying for between 30 and 50 percent of their health care costs out of pocket,[15] and leaving approximately 60 percent of the total cost of the care for the uninsured to be cost shifted to the insured.

Adding more than one million additional uninsured Californians to that calculation increases the percentage of uninsured in the state, and therefore the total spending on care for the uninsured. Using the original methodology, the amount of the cost shift increases from 9.6 percent to 11.7 percent of the average family premium—or a 21.8 percent increase. The jump in the cost shift is driven by the assumption that the increase in the number of uninsured[16] would in turn increase the amount of uncompensated care in the state. **For the average California family with employer-sponsored health insurance, this means that the cost shift of the May Revision health budget cuts would be more than $290 in 2009.** This is based on a projected average 2009 family premium for employer-based coverage in California of $13,998.[17] For this premium, the cost shift at the New America finding of 9.6 percent is estimated to be $1,338; and the cost shift at 11.7 percent found in this paper is $1,631.

Analytic Assumptions and Limitations

It is important to understand that the increase in cost shifting is only an estimate. There are factors that could both increase and decrease the amount. This analysis makes the same assumptions present in the December 2006 report, and further assumes the following.

Use of the May Revision Budget Proposal

As of this writing on August 10, 2008, no budget has been approved. The May Revision budget proposal is used as the basis for analysis. The only other budget in negotiations is one approved by the Budget Conference Committee, supported by the Democratic majorities in the Legislature. That budget rejected many—but not all—of the proposed Medi-Cal cuts. The cuts they approved include establishing semi-annual status reports, increasing Healthy Families premiums, and suspending enrollment reforms. It has been estimated that these cuts would decrease children's coverage enrollment by more than 250,000 children. This paper does not seek to quantify the cost shift from the Conference Committee report, but would postulate that such an additional cost shift would exist, but would be proportionately smaller than the estimate under the cuts in the May Revision.

Assumptions that Understate the Cost-Shift: Underinsurance and Underpayments

This paper does not attempt to quantify the size of the cost-shift due to underinsurance in public programs, thereby likely understating the total size of the cost-shift. Individuals and families are underinsured when their health insurance policies do not offer needed benefits, protect them from high health costs, or provide poor access to care due to low provider payment.[18] Underinsured individuals, particularly those who are low-income, avoid needed care. Indeed, in terms of obtaining needed care in a timely manner, the low-income underinsured are more akin to the uninsured than to those with adequate coverage. And when these individuals seek care and cannot pay, the cost is often shifted onto the insured.

While there is ambiguity in trying to interpret data between the indirect spending by government on health care and the underinsured, especially in California,[19] there are several reasons to think that the cost shift could be substantial. The proposed Medi-Cal cuts would have a significant impact on providers, and existing research suggests that could lead to greatly increased cost shifting. One study found that private providers charge 22 percent more than costs to cover public sector losses.[20] Others have claimed to find a significant cost shift from public programs to the insured of approximately 10 percent of premium payments.[21] California's health reform effort in 2007 was in part predicated on the fact that cost-shifting would be reduced by increasing Medi-Cal payment levels. There are two sources of underinsurance in the budget discussion not accounted for by this analysis.

- *Reduced Benefits and Underinsurance.* The proposed budget reductions would add to underinsurance by eliminating a series of benefits for an estimated 2.5 million Californians with Med-Cal coverage.[22] This includes dental benefits, optometry, speech therapy, and seven other services. This proposal would have several cost shift impacts, resulting from those who get the care and cannot afford to reimburse the provider; and those who don't get the care and then require additional care (a dental infection leading to an emergency room visit, for example).

- *Reduced Payment Rates.* Funding levels for California's Medi-Cal program and healthcare safety net are already among the lowest in the nation. According to a 2007 study, California ranks 49th out of the 50 states and the District of Columbia for federal spending per beneficiary.[23] Now, California policymakers are debating cutting program spending even lower, meaning even fewer federal matching dollars will support the safety net and subsidize care for the uninsured. The proposed budget could reduce Medi-Cal provider payment rates by well over $1 billion for physicians and hospitals in state and federal funds. [24] This increases the overall cost shift burden on to California's families.

Assumptions that Possibly Overstate the Cost-Shift: Changing Utilization and Spending Patterns

There are several assumptions that could overstate the cost-shift findings, including that:

- *All those losing Medi-Cal coverage will become uninsured.* It is unlikely that those being dropped from Medi-Cal would be able to find affordable health insurance coverage as individuals or would be covered through employment-based coverage. Already, the number of the uninsured, particularly at lower income levels, is increasing in a weakening economy with decreasing rates of employer-sponsored insurance.

  Yet, to the extent that some of those exiting Medi-Cal enrollees will find other sources of coverage, the cost-shift will be lower than estimated. In fact, the increase in the number of uninsured is expected to occur over time, and it is possible that the health care market could use that time to find other ways to absorb the costs to account for the uninsured beyond increasing premiums.

- *There will be a consistent care utilization pattern, despite changing population mix.* This study assumes that those currently on Medi-Cal will become uninsured and will then have the same utilization and spending patterns as the currently uninsured population, which is a lower utilization rate when compared to those with health insurance. However, in 2006, children—who generally use less medical care than adults[25]—comprised 21 percent of the uninsured under consideration. The estimated impact of the May Revision budget on health coverage shows a disproportionate impact on children, with about half those facing the loss of coverage being under age 19. This shift in the uninsured mix would likely affect the total size of the cost shift from the uninsured, perhaps by as much as several percentage points. The analysis holds the population constant at the 2006 level.

- *There will be a consistent cost shift pattern, although the newly uninsured are leaving a notoriously low-payer in Medi-Cal.* This analysis does not consider the possible net cost-shift effect that could result from transferring a population from being in Medi-Cal (and the cost-shift that occurs there) to being uninsured with a different cost-shift effect. Instead, this analysis duplicates the December 2006 methodology and does not consider the possible impact of low Medi-Cal payments. As a result, this analysis could overstate the net cost-shift effect.

Conclusion

Cost shifting creates a cycle of uninsurance. As increases in cost shifting makes premiums become unaffordable for employers, individuals and families continue to lose coverage. Millions of Californians will lose access to low-cost routine care that can help them stay healthy or manage chronic conditions. When the uninsured seek care because they have no choice, that care will typically be delivered in the emergency room where unpaid costs are more likely to be shifted to the insured population.

The best way to resolve unfair, inequitable and economically inefficient cost shifting is to create a comprehensive, universal system of coverage. Regardless of the specific approach, a system where everyone pays their fair share will reduce the need for cost shifting.

As California continues to suffer from its fragmented healthcare system, it is important to understand how changes to the budget could affect all Californians. **To the extent that the budget passed by the legislature will create more uninsured persons—and the proposed budget currently under consideration certainly looks as if it would—cost shifting will grow.** Using the December 2006 New America Foundation methodology, cost shifting could increase by 22 percent under the May Revision budget (for a rate of 11.7 percent) as compared to the rate previously found by the New America Foundation (at 9.6 percent).

ABOUT THE AUTHORS

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ABOUT THE HEALTH ACCESS FOUNDATION

Health Access Foundation is the statewide health care consumer advocacy organization. For over 20 years, it has worked with a broad coalition of consumer and constituency groups working for the goal of quality, affordable health care for all Californians.

Our contact information is Health Access, 1127 11th Street, Suite 234, Sacramento, CA 95814. (916)497-0923. More information, including a daily blog, other studies and other materials, on both budget and health policy issues, is available at the website: http://www.health-access.org

ENDNOTES

[1] Health Access, "Not Just a One-Time Cut," June 25, 2008.
[2] *Ibid.*
[3] Institute of Medicine, *Coverage Matters: Insurance and Health Care* (Washington: National Academy Press, 2001); Fairbrother, Gerry and Arfana Haidery, *NAF Health Policy Issue Brief: How Health Insurance Stability Impacts the Quality of Health Care*, November 2005.
[4] Institute of Medicine, *Hidden Costs, Value Lost: Uninsurance in America*, National Academy of Sciences, 2003.
[5] Section based on: Len M. Nichols and Peter Harbage, **"**Estimating the Hidden Tax on Insured Californians due to the Care Needed and Received by the Uninsured," New America Foundation, May 2007.
[6] Families USA, *Paying a Premium: The Added Cost of Care for the Uninsured*, June 2005.
[7] Institute for Health Policy Solutions, *Covering California's Uninsured: Three Practical Options*, California HealthCare Foundation, October 2006.
[8] John Cogan et al, "The Uninsured's Hidden Tax on Health Insurance Premiums in California: How Reliable is the Evidence?," Hoover Institute, 2007. http://www.hooverpress.org/productdetails.cfm?PC=1278
[9] Public health programs have the potential to shift costs when their provider reimbursement rates are lower than costs ot the prevailing market, creating an incentive for providers to charges to the insured.
[10] California Legislative Analyst's Office, "Overview of the 2008-09 May Revision," May 19, 2008. http://www.lao.ca.gov/2008/bud/may_revise/may_revise_051908.aspx
[11] Based on data from the National Health Expenditure Project in the Office of the Actuary at the Centers for Medicare and Medicaid Services and California HealthCare Foundation, "Health Care Costs 101: California Addendum," 2006.
[12] Health Access, "Not Just a One-Time Cut," June 25, 2008.
[13] Calculation: 20 percent uninsured multiplied by 40 percent of the level of care equals 8 percent. In 2004, total health care spending in California was $169 billion, per: California HealthCare Foundation, Snapshot: California Addendum, Health Care costs 101, 2006. For purposes of this paper, this spending is grown forward at 8.5 percent.
[14] Kominski GF, Roby DH, Estimating the Cost of Caring for California's Uninsured. Los Angeles: UCLA Center for Health Policy Research, 2004. Also See: Kominski GF, Roby DH, Cost of Insuring California's Uninsured, Los Angeles: UCLA Center for Health Policy Research, 2005.
[15] Kominski GF, Roby DH, Estimating the Cost of Caring for California's Uninsured. Los Angeles: UCLA Center for Health Policy Research, 2004.
[16] The uninsured would increase by 1.1 million more from 2006 to the May Revise budget (from 6.7 million to 7.8 million).

[17] Estimated premium is based on author's analysis of the weighted average of California premiums in 2007 using data from: California HealthCare Foundation, "California Employer Benefit Survey 2007," December 2007. The premium was then grown out to 2009 using projections for growth in private insurance from the Nation Health Expenditure dataset from the Centers for Medicare and Medicaid Services.
[18] Cathy Schoen, M.S., Michelle M. Doty, Ph.D., and Sara R. Collins, Ph.D., and Alyssa L. Holmgren, "Insured But Not Protected: How Many Adults are Underinsured?," The Commonwealth Fund, June 2005. http://www.commonwealthfund.org/publications/publications_show.htm?doc_id=280812
[19] Peter Harbage and Len Nichols, *A Premium Price: The Hidden Costs All Californians Pay in Our Fragmented Health Care System*, December 2006, available at: http://www.newamerica.net/files/HealthIBNo3.pdf.
[20] Allen Dobson, Joan DaVanzo, and Namrata Sen *The Cost-Shift Payment 'Hydraulic': Foundation, History, And Implications*, Health Affairs, January/February 2006; 25(1): 22-33.
[21] Daniel P. Kessler, "Cost Shifting in California Hospitals: What Is the Effect on Private Payers?," California Foundation for Commerce and Education, June 2007. http://www.cfcepolicy.org/NR/rdonlyres/92176667-50FF-4C2F-A47B-B66CE79D4998/24/CFCE_Cost_Shift_Study.pdf. And: John Cogan et al, "The Uninsured's Hidden Tax on Health Insurance Premiums in California: How Reliable is the Evidence?," Hoover Institute, 2007. http://www.hooverpress.org/productdetails.cfm?PC=1278
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