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THE POTENTIAL IMPACT OF ELIMINATING TENNCARE AND REVERTING TO MEDICAID: A PRELIMINARY ANALYSIS

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Summary

On November 10, Tennessee Governor Phil Bredesen announced, "I have set in motion a process to dissolve TennCare and replace it with a traditional Medicaid program."[1] The governor estimated that 430,000 low-income Tennesseans could lose TennCare coverage if the state eliminates the eligibility expansions instituted under its TennCare waiver and reverts to a more traditional Medicaid program.

This plan to curtail eligibility is the most recent development in an ongoing debate over the future of TennCare. In September, Tennessee submitted a waiver request to the federal government to restructure TennCare substantially, stating that the proposed changes were necessary to save the state money.[2] Last week, the Governor asked the federal government to table the waiver request, contending that pre-existing court orders under which the state is operating make it necessary to eliminate coverage for about 430,000 Tennesseans instead, nearly one-third of those now enrolled. About 120,000 of the 430,000 Tennesseans who would lose coverage are children. The Governor said he is not yet committed to eliminating coverage for these people but will move to do so if the court orders are not removed or substantially modified.

This paper analyzes the potential effect of the proposed coverage elimination on Tennessee's budget, the state economy, and health care providers in the state. Providers would incur increased costs for uncompensated care if coverage is terminated for several hundred thousand state residents. The analysis provided here is a preliminary assessment of the impact of eliminating TennCare, based on documents currently available.

The preliminary analysis finds:

- *Eliminating TennCare apparently would not produce the level of savings for the state budget that the Governor seeks, unless the replacement of TennCare by a smaller Medicaid program is accompanied by other substantial cuts in health care coverage, such as substantial reductions in health care services for those remaining eligible under Medicaid.* A February 2004 report by McKinsey and Company, the consulting firm that the state hired to examine TennCare options,

[1] Speech by Gov. Phil Bredesen and related materials from the Governor's Communication Office, Nov. 10, 2004.

[2] For a summary of the proposed TennCare amendments, see Kaiser Commission on Medicaid and the Uninsured, "Tennessee Section 1115 Waiver Amendment Proposal Fact Sheet," Oct. 27, 2004.

indicated that the state would not realize large budget savings simply by terminating TennCare and reducing the number of people covered. McKinsey noted that ending TennCare would result in a reduction in federal funding for certain hospital payments and require an increase in the amount paid from state coffers for those hospital costs, largely offsetting the savings from insuring fewer people. McKinsey consequently concluded that other cuts in benefits also would be needed to achieve the level of savings the Governor sought.

Statements by the Governor in recent days confirm that significant coverage reductions are being considered, such as limiting the number of prescriptions covered under Medicaid to four per month or limiting the number of physician visits to ten per year. Such steps could have harsh impacts on people who have disabilities or serious medical conditions and thus need more health care. The depth and nature of the health care cutbacks under consideration appear to be more severe than was initially suggested.

- *The reductions in state expenditures associated with the switch from TennCare to Medicaid would cause the loss of almost twice as much in federal funding, which would lead to a substantial reduction in business activity and employment in the state.* The Governor's office has stated that the reversion to traditional Medicaid would save at least $650 million in state funds in state fiscal year 2005-2006. If so, it would trigger the loss of at least *$1.2 billion* in federal matching funds, because the federal government funds 64.81 percent of TennCare expenditures. Economic analysis, based on a model developed by the U.S. Department of Commerce, indicates that the loss of $1.2 billion in federal funds would lead to a reduction in business activity in the state of at least $1.6 billion and a loss of at least 14,500 jobs in fiscal year 2005-2006.

- *The loss of TennCare coverage would create serious financial problems for Tennessee health care providers.* Most people who lost TennCare coverage would become uninsured. They would, however, still need medical care. As a result, many or most of these people would attempt to obtain free or reduced price health care from hospitals, clinics and other providers across the state. As a result, uncompensated care would increase significantly. Based on earlier studies conducted by the Urban Institute on the relationship between lack of insurance and uncompensated care, the uncompensated care sought by Tennesseans losing coverage would amount to between roughly $230 million and $450 million a year. Such large increases in uncompensated care could lead to substantial financial losses for health care providers.

These matters are examined in more detail below.

Cutbacks Could Be More Severe Than Initially Indicated

When he announced plans to end TennCare on November 10, Governor Bredesen said this could cause 430,000 Tennesseans to lose coverage. More recent statements by the Governor indicate that additional health coverage cutbacks also are on the table. The Governor said last week that he is considering imposing restrictions on medical benefits, such as limiting coverage of prescription drugs to four per month or reducing the number of physician visits to ten per year for those who remain covered.[3] The Governor also suggested that the state might seek to reduce the number of managed care plans available from seven to one, giving beneficiaries fewer choices in health care plans.[4] It is possible that the state will consider further restrictions or cutbacks, such as requiring that beneficiaries with incomes below the poverty line make copayments for health services.

Any such steps would be taken in addition to eliminating coverage for several hundred thousand low-income Tennesseans. As a result, those who remained covered would likely receive more limited health care coverage and have fewer health care choices.

The reasons for these additional cuts can be found in a February 2004 report by the consulting firm McKinsey and Company, which was engaged by the state to examine strategic options for TennCare.[5] The McKinsey report is cited as having provided the foundation for the changes the governor proposed in TennCare earlier this year, and a key McKinsey staff person, J.D. Hickey, recently became the new TennCare director. The McKinsey report concluded that ending TennCare, and thereby terminating coverage for several hundred thousand people, would not save much money unless other benefit reductions also were adopted.

The McKinsey report specifically examined the option of ending TennCare and reverting to traditional Medicaid. The report estimated this would terminate coverage for about 260,000 people. (One reason that the McKinsey estimate differs so much from the Governor's estimate that 430,000 people would lose coverage is that the McKinsey report appears to have assumed that a large number of children currently participating in TennCare would be covered instead under the State Children's Health Insurance Program, thereby reducing the overall number of people who would lose coverage. This assumption about SCHIP, however, may have been incorrect.[6] The state has not released the basis for its current estimate that 430,000 people would lose coverage. There also could be other reasons for the difference in the estimates, including details of the new proposal that the Governor has not yet disclosed.)

The McKinsey report issued last February concluded there would be relatively small net savings associated with the reduction in coverage from replacing TennCare with a smaller Medicaid program. The report stated, "The significant savings associated with reducing coverage for 260,000 people (approximately 20 percent of total TennCare enrollees and approximately 20 percent of total TennCare costs) would likely be largely offset with the loss of

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[3] Anita Wadhwani, "Medicaid May Carry Benefit Limits," *Nashville Tennessean,* Nov. 12, 2004. Whether these restrictions would apply to all of those remaining on Medicaid or just some groups is not clear.

[4] Associated Press, "Blue Cross Could Get Bigger Role with Demise of TennCare," Nov. 11, 2004.

[5] McKinsey and Company, "Achieving a Critical Mission in Difficult Times — Illustrative Strategic Options for TennCare," Part 2, Feb. 11, 2004, pages 84-90.

[6] Federal SCHIP legislation requires that states not reduce Medicaid eligibility for children below the eligibility levels that were in place before SCHIP was enacted in 1997. If the replacement of TennCare with a much smaller Medicaid program resulted in a reduction in eligibility for some Tennessee children below the eligibility levels that were in place in Tennessee in 1997, those children might not be eligible for federal funding under SCHIP.

If Health Benefits Are Reduced, Will Tennessee Be Like Other States?

In discussing possible reductions in the scope of coverage under the Medicaid program that would replace TennCare, Governor Bredesen has said the state might limit coverage of prescription drugs to four prescriptions per month and limit physician visits to ten per year. He stated that Tennessee's revamped program would "look much like other Medicaid programs. It would be consistent with the mid-range of benefits. Not Mississippi, but not Massachusetts, either."

In fact, the limits mentioned by the governor are not consistent with the mid-range of benefits provided by state Medicaid programs. A survey of Medicaid benefits among all states shows such benefit limitations would be exceptionally harsh when compared to Medicaid programs in other states, including many states in the South. Only four states — Arkansas, Nevada, Oklahoma and South Carolina — impose a limit of four or fewer prescriptions per month. (Florida has a limitation of four *brand name* prescriptions per month, but additional generic drugs may be prescribed.) Tennessee would be among the bottom five states in this area. Only one state (New York) limits the number of physician visits to ten or fewer per year, and exemptions are frequently granted. Tennessee would be in the bottom two states here and possibly at the very bottom, depending on the exemptions it allowed.

Such coverage limitations can have serious medical consequences for people who have disabilities or chronic diseases, because such individuals have more serious health problems and generally require more health care visits and more medications.

Sources: Anita Wadhwani, *op cit.* Kaiser Commission on the Future of Medicaid and National Conference of State Legislatures, "Medicaid Benefits" (http://207.22.102.105/medicaidbenefits

the Section 1115 waiver and the resulting changes in the federal funding formula." The report explained that issues related to how the state accounts for certain hospital expenses could result in substantial increases in state costs. Specifically, McKinsey noted that if the TennCare waiver were eliminated, Tennessee would have to stop using its current flexible Certified Public Expenditure approach of accounting for certain hospital funds. Tennessee would have to shift to a more restrictive accounting approach, which would require the state to contribute a larger share of these costs from the state (rather than the federal) budget. McKinsey estimated that the resulting increase in state costs would offset much of the savings that the state would achieve from eliminating coverage for those covered under the TennCare waiver. The report found that replacing TennCare with a traditional Medicaid program "would therefore require Tennessee to contribute additional money from state funds, largely offsetting the savings from reducing enrollment."

The McKinsey report indicated that to generate substantial savings, the elimination of TennCare would need to be coupled with other cost-cutting measures, such as those the Governor now is apparently considering.

The Economic Effects of Eliminating TennCare

Governor Bredesen is seeking to reduce TennCare expenditures to save money for the state Treasury. Any reduction in state expenditures for TennCare or Medicaid, however, leads automatically to a reduction in federal matching funds. Tennessee's current federal matching rate is 64.81 percent. In other words, each dollar in TennCare expenditures costs the federal government 64.81 cents, while costing the state 35.19 cents.

For each dollar that the state saves in *state* expenditures by reducing TennCare costs, the state consequently loses $1.84 in *federal* matching funds. Because these federal funds contribute not only to health care coverage but more broadly to economic activity and employment in the state, reductions in TennCare of the magnitude now being considered would have a significant impact on the state economy.

Table 1

How Much Would Eliminating TennCare Affect Economic Activity and Employment in State Fiscal Year 2005-2006?*

Minimum State Savings	$650 million
Minimum Loss of Federal Matching Funds	$1.166 billion
Minimum Reduction in Total TennCare Expenditures	$1.816 billion
Estimated Impact of the Loss of Federal Funds	
Economic Activity Loss	$1.636 billion
Estimated Jobs Lost	14,150

*State fiscal year 2005-2006 runs from July 1, 2005 to June 30, 2006.

The Governor's office estimates that eliminating TennCare and reverting to Medicaid would save the state at least $650 million. The Governor's office has stated: "At the very least, returning to traditional Medicaid will eliminate the projected $650 million TennCare shortfall the state is facing in the 2005-2006 fiscal year."[7] This statement indicates that $650 million is the minimum estimate of state savings under the new proposal. A reduction of that amount in state expenditures would cause the loss of at least $1.2 billion in federal matching funds and lead to an overall reduction of $1.8 billion in total (state plus federal) TennCare expenditures. (See Table 1.)

The effect of such reductions would be felt throughout Tennessee's economy. Health care workers use income generated by TennCare payments to pay their mortgages, buy food, buy fuel for their cars, and meet other costs. Reductions in TennCare payments to health care providers thus would be felt elsewhere in the state economy. Although the budgetary savings from the state's share of TennCare spending might be used to reduce the state's deficit or for other activities that create jobs and income in the state, the loss of the *federal* matching revenue would create economic losses that would not be offset.

An estimate of the effect of the loss of federal matching funds on the Tennessee economy can be derived from an economic model developed by the U.S. Department of Commerce's Bureau of Economic Analysis.[8] Such an analysis indicates that a loss of $1.2 billion in federal

[7] See footnote #1.
[8] The methodology is described more fully in Leighton Ku, "Will The New TennCare Cutbacks Help Tennessee's Economy?" Center on Budget and Policy Priorities, July 8, 2004. A recent review of research about the economic impact of Medicaid on state economies finds that, largely as a result of federal matching funds, Medicaid increases

matching funds would lead to an overall loss of $1.6 billion in business activity in the state, along with the loss of about 14,500 jobs.[9]

Most of the loss in economic activity and employment would occur in the health care sector, as hospitals, clinics, pharmacies and other health care providers lost revenue and, in turn, were forced to reduce staff and payroll. But some losses would occur in other areas of the economy, such as the retail and real estate sectors, as workers who lost income or jobs as a result of the decrease in federal matching funds reduced their retail purchases or encountered difficulties meeting rent or mortgage payments.

What Effect Would the Coverage Elimination Have on Health Care Providers?

When people lose health care coverage, their needs for medical care do not disappear. Most low-income people who lose coverage become uninsured, and many then seek free or reduced price health care from health care providers, including public and private hospitals and clinics. A study by researchers at the Urban Institute found that, on average, uninsured patients incur medical expenses about half as large as those incurred by fully insured patients.[10] The study estimated that about 60 percent of the health care expenses that uninsured people incur are met through the provision of uncompensated care by health care providers. (Most of the remaining costs are met through out-of-pocket expenses borne by the uninsured.)

To develop an estimate of the impact that the resulting increase in uncompensated care would have on Tennessee health care providers, we assumed that between 260,000 people (the McKinsey estimate) and 430,000 people (the Governor's estimate) would lose coverage if TennCare were terminated, and that between two-thirds and four-fifths of these people would become uninsured. (A study in Oregon found that 72 percent of those who lost coverage under that state's Medicaid waiver program became uninsured.[11] Some of the remaining people would retain other insurance coverage such as Medicare, and a modest number would be able to secure private health insurance.) We base the medical costs of people who would become uninsured on average per capita expenditures under TennCare (excluding costs for long-term care and payments made by TennCare to the Medicare program). We apply the findings of the Urban Institute study that uninsured patients consume about half as much medical care as those who are

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economic activity and employment in states. Kaiser Commission on Medicaid and the Uninsured, "The Role of Medicaid on State Economies: A Look at the Research," April 2004.

[9] The loss in business activity is greater than the $1.2 billion loss of federal funds because the federal funds that would be forgone have a ripple effect that magnifies their impact on the state economy. For example, a newly employed health care worker may cut back her purchases in local stores, causing a loss of income to the storekeepers, who in turn may reduce their purchases from vendors as well as their own consumption.

[10] Jack Hadley and John Holahan, "How Much Medical Care Do the Uninsured Use and Who Pays for It?" *Health Affairs* web exclusive Feb. 12, 2003. Uninsured people have other health needs that go unmet, but about half of these needs are met through a combination of uncompensated care and self-payment.

[11] Robert Lowe, et al. "Changes in Access to Primary Care for Oregon Health Plan Enrollees and the Uninsured," Oregon Health and Science University, Report for the Office of Oregon Health Policy and Research, Aug. 2003.

uninsured and that about 60 percent of the care that uninsured individuals receive is provided as uncompensated care.[12]

Based on these calculations, we estimate that the loss of TennCare coverage would lead to an increase in the demand for uncompensated care in the state ranging roughly from $230 million to $450 million a year. In other words, newly uninsured patients would seek uncompensated medical care from health care providers equal to about $230 million to $450 million in value each year.

The providers that would be asked to absorb these costs, many of which are state- or county-owned facilities or non-profit organizations, would face the need to pick up substantial costs that previously had been paid for through TennCare and financed in significant part by federal matching funds. Similarly, low-income Tennesseans would have to bear additional out-of-pocket health care costs, the majority of which previously had been covered by federal funds.

Unfortunately, most of the health care providers that would be asked to care for newly uninsured patients would simultaneously experience large reductions in revenue because of the loss of TennCare payments. The net effect would be that the health care providers would lose TennCare payments for health care services provided to patients who had lost eligibility but still be asked to provide a significant part of that care on an uncompensated basis.

The combined losses could force a number of health care facilities, especially those that serve large numbers of low-income or uninsured patients, to reduce services. It is possible some health care facilities could have to close. If so, the TennCare cutbacks would have repercussions that go beyond TennCare beneficiaries and result in reduced access to medical care for a broader group of Tennesseans.

Conclusions

As this analysis indicates, if Governor Bredesen implements the plan to eliminate TennCare and revert to a more traditional Medicaid program, there will be serious consequences for low-income Tennesseans, health care providers, and the Tennessee economy. Moreover, the proposed cutbacks the Governor is considering may be more severe than initially suggested, since ending coverage for several hundred thousand people apparently would not produce the level of savings he seeks.

The cuts under consideration would reduce state expenditures. But they also would lead to a reduction in federal matching funds nearly twice as large as the amount that the state would

[12] We computed an average expenditure per TennCare enrollee of $5,792, based on data from the Governor's Communication Office (see footnote 1). We excluded the cost of long-term care services because these would not be considered uncompensated medical care. We also deducted payments made by TennCare to Medicare, because such payments would likely continue. Based on the state's Medicaid expenditure report to the federal government for fiscal year 2003, we reduced the average per capita costs by 24 percent to account for these two exclusions. We then assumed that 50 percent of the remaining medical expenditures would be incurred by patients losing TennCare coverage and that 60 percent of those expenditures would come in the form of uncompensated care, based on the Urban Institute research. (These Urban Institute estimates are based on national data. We would expect actual experience in any particular state to vary somewhat from the national estimates.)

save. The reduction in federal matching funds would have negative economic consequences, creating a ripple effect through the state economy. The coverage elimination also would increase financial pressures on health care providers, which would experience a sudden, large increase in demand for uncompensated health care.