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THE AFFORDABLE CHOICES INITIATIVE: AN OVERVIEW

In the State of the Union address, President Bush announced a new health care proposal to change the tax treatment of health care by replacing the tax preference provided to employer-based coverage with a standard health insurance deduction for individuals and families. A companion initiative, Affordable Choices, would permit states to redirect funds paid to hospitals and other health care institutions to initiatives that would provide the uninsured with private insurance. Although no new federal funds will be available, Affordable Choices is intended to support state efforts to provide health insurance to those who will not benefit from the President's tax proposal.

To date, few details are available explaining the Affordable Choices initiative. Nevertheless, the proposal raises a number of important issues and questions.

What Is the Affordable Choices Initiative?

The Affordable Choices initiative would allow states to reprogram current spending on institutions to expand private health insurance coverage to the uninsured and those who are difficult to insure because of high-cost medical conditions. According to the description of Affordable Choices, states could adopt a number of different strategies for expanding coverage: offer premium assistance to low-income populations to purchase health insurance; establish high risk pools for those unable to purchase insurance in the private or group markets; or facilitate pooling of individuals and small businesses to improve the affordability of private insurance. The primary requirement is that states use the funds to promote access to private, not public, insurance.

This initiative is intended to supplement the tax-based proposal by assisting those who are low-income and will likely not receive a large-enough tax benefit to offset the cost of purchasing insurance. The tax deductions will also not likely improve the ability to purchase insurance of those who have difficulty purchasing private insurance at any cost because of high medical needs. Affordable Choices is intended to provide states with the flexibility to use existing funds to fill in these gaps in coverage.

Issues and Questions

What funds will be available to states through Affordable Choices?

The Affordable Choices initiative does not provide any new federal funding to states, but rather, allows them to redirect certain existing funds. Nor does it specify which funds will be made available to states beyond "institutional payments." The primary sources of institutional payments made to safety net providers currently in the Medicaid program include Medicaid Disproportionate Share Hospital (DSH) payments, Medicaid supplemental provider payments, also known as Upper Payment Limit (UPL) payments, and Medicaid payments to hospitals for Graduate Medical Education (GME). The Medicare program also makes direct payments to hospitals, including Medicare DSH, GME and capital payments. It is unclear whether these payments will also be made available to states.

Medicaid DSH payments are an important source of uncompensated care financing for safety net hospitals. Federal DSH funds are made available to states through statutorily defined allotments, and these allotments vary widely across the states. In FY 2007, the federal share of total DSH allotments was capped at $10.3 billion.

Upper payment limit and GME payments constitute other sources of payments to hospitals and other institutional providers. UPL payments are mainly paid to public hospitals and nursing homes, while GME payments support medical education programs at teaching hospitals. Accurate data on the amount of UPL payments paid to providers are not available, although UPL payments have declined in recent years as a result of tighter regulations governing these payments. Only a small number of states make GME payments, amounting to about $360 million per year.

At the same time that the Administration is proposing to provide states with new flexibility to redirect institutional payments, other budget proposals and regulations would severely limit the overall amount of available funds. Earlier this year, the Administration released regulations strictly regulating payments to public providers, which would effectively eliminate much of the available UPL funds. In addition, in his budget, the President proposed eliminating Medicaid GME payments. In total, these proposals would cut funds potentially available through Affordable Choices by at least $5.8 billion over five years.

How will funds be distributed across states under Affordable Choices?

Because states have significant discretion over whether and how much to pay providers under the Medicaid program, they have relied on institutional payments, such as DSH and UPL, to varying degrees. Consequently, while some states will have access to significant amounts of funds, others will not. Looking specifically at Medicaid DSH payments for which we have relatively good data, a simple analysis of available DSH funds per uninsured state resident revealed that these funds range from a high of $1,121 per uninsured resident in New Hampshire to a low of $2 per uninsured resident in Wyoming. An important unanswered question is whether and how the federal government will redistribute funds across states.

Will Affordable Choices lead to coverage for the low-income uninsured?
One of the goals of the Affordable Choices initiative is to promote the accessibility of private coverage. Many people are currently uninsured because they do not have access to employer-based coverage and cannot find or purchase affordable insurance in the non-group or private market. Coverage available in the non-group market is often more expensive and less available than group coverage offered by employers because there is no pooling of risk across large groups and insurers can deny coverage based on a number of different factors including health status.

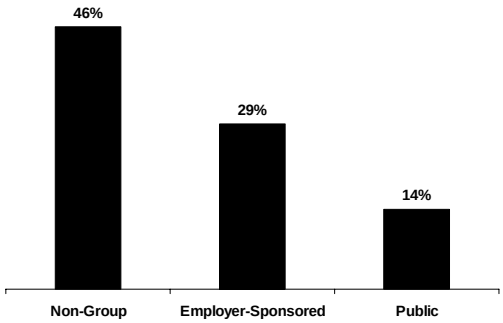
To the extent that states use the funds through Affordable Choices to adopt significant reforms to the non-group insurance market, improvements in the availability and affordability of insurance in this market will benefit not only those populations targeted by Affordable Choices, but all individuals and families who purchase insurance in this market. However, if states fail to make such market changes, insurance in the non-group market will likely remain unattainable for the low-income, even if subsidies are provided.

Will coverage under Affordable Choices be adequate?
Information on Affordable Choices makes clear the intent to provide "basic, private insurance at affordable prices." However, it is unclear what constitutes basic insurance. The proposal suggests that states should consider eliminating benefit and premium mandates, but without such consumer protections, available insurance plans may leave many newly insured with insufficient coverage. In addition, for low-income individuals, health plans with high deductibles may offer little protection if the individuals cannot afford to pay required out-of-pocket costs. Nearly half of low-income individuals insured in the non-group market have high out-of-pocket costs (Figure 1). While some coverage is important, insufficient coverage may not significantly increase access to care or reduce reliance on safety providers for uncompensated care.

Will Affordable Choices support current state efforts to expand coverage?
Descriptions of the Affordable Choices initiative suggest that states may only access funds if they provide private coverage to the uninsured. This proscriptive requirement seems at odds with other similar Administration initiatives, such as the Health Insurance Flexibility and Affordability (HIFA) Medicaid waivers, which allow states greater flexibility in the design of coverage options. Moreover, a number of states have already developed proposals to expand coverage to the uninsured, which rely on combination approaches that include expansions of both public and private coverage. For example, universal coverage proposals in both California and Illinois include an expansion of Medicaid to poor adults as one component of a broader strategy. How these types or proposals will be treated under the Affordable Choices initiative remains unclear.

Figure 1

Proportion of Low-Income Insured Families with High Out-of-Pocket Burden, by Type of Coverage



Note: Non-elderly families only. Low-income means <200% of federal poverty level. "High burden" defined as out-of-pocket spending (excluding health insurance premiums and dental care) exceeding 5% of family income.
SOURCE: Shen, Y and McFeeters, J. "Out-of-Pocket Health Spending Between Low- and Higher-Income Populations: Who Is at Risk of Having High Expenses and High Burden" Medical Care 44(3): March 2006.

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How will Affordable Choices affect safety net providers?
The Affordable Choices initiative calls for taking money from safety net providers to finance coverage expansions. However, even in an environment of expanded coverage, safety net providers remain an important part of the health care delivery system. And, short of universal coverage, funding for safety net providers will still be needed. A number of states have already obtained Section 1115 Medicaid waivers to use DSH and, in some cases, UPL payments to finance coverage expansions, including Iowa, Maine, Massachusetts, Michigan, and Tennessee. The experiences of these states shows that while inroads toward addressing the problem can be made, the available DSH and UPL funds are not sufficient to cover all uninsured residents and most coverage expansions are limited. Consequently, most states, even Massachusetts which hopes to achieve near universal coverage, continue to support safety net providers with direct payments to ensure access to care for those who remain uninsured.

Conclusion

The Affordable Choices initiative is designed to encourage and support state efforts to expand coverage to the uninsured by allowing them to use existing funds in new ways. Affordable Choices may create new opportunities for some states that have access to significant DSH funds. However, not all states will benefit due to more limited reliance on DSH and UPL payments by some states.

Beyond Affordable Choices, more federal funding will be necessary to expand coverage in a significant way. Without sufficient funding to achieve significantly expanded or universal coverage, the importance of a viable safety net of providers for those with no other way to access needed care will remain.

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