kaiser commission on medicaid and the uninsured

State Responses to Budget Crisis in 2004: An Overview of Ten States

Case Study - Colorado

Prepared by
John Holahan, Randall R. Bovbjerg, Terri Coughlin, Ian Hill, Barbara A. Ormond and Stephen Zuckerman
The Urban Institute

January 2004

THE HENRY J. KAISER FAMILY FOUNDATION

kaiser commission medicaid and the uninsured

The Kaiser Commission on Medicaid and the Uninsured provides information and analysis on health care coverage and access for the low-income population, with a special focus on Medicaid's role and coverage of the uninsured. Begun in 1991 and based in the Kaiser Family Foundation's Washington, DC office, the Commission is the largest operating program of the Foundation. The Commission's work is conducted by Foundation staff under the guidance of a bi-partisan group of national leaders and experts in health care and public policy.

COLORADO

Ian Hill

Background

At the outset of 2003, Colorado was looking at entering its third straight fiscal year in a serious deficit situation. Available estimates placed the Fiscal Year 2003-04 shortfall at nearly $900 million, or roughly 7 percent of the state's $13.4 billion General Fund budget. The previous year, the shortfall was only slightly less--$850 million. In the words of State Senator Andrew Romanoff (D), Senate Minority Leader, Colorado was mired in "the worst fiscal crisis since the Great Depression." Yet no relief was anticipated from the revenue side of the ledger; Republican Governor Bill Owens, a fiscal conservative, re-elected by an overwhelming majority in November 2002, pledged to not raise taxes "as long as I am Governor." The Republican-controlled Senate and House were of an identical mindset, and looked again to budget cutting as the primary solution to the state's deficit.

However, Colorado, a traditionally conservative state and currently ranked 43rd among states in total tax collections as a percentage of personal income, has less flexibility to trim spending than most states. Indeed, four laws passed over the prior decade combine to constrain the state's ability both to weather, and address, difficult budget times. First, the Taxpayer Bill of Rights (*TABOR*), passed by the voters as an amendment to the state constitution in 1992, made all tax increases subject to voter referendum and, therefore, unlikely. In addition, the law limits state government revenues and expenditures to the previous year's levels plus inflation and population growth. Thus, Colorado must refund excess revenue to the taxpayers and cannot retain

surpluses in good years to build reserves for future lean times. Furthermore, tying the coming year's expenditures to the previous year's revenue means that the state can not increase spending, even in good years, nor recover from budget cuts enacted during an economic downturn; in essence, once program cuts are made they become the new baseline for future budgeting purposes.

A second constraint began as a constitutional amendment that passed with all the best intentions. After years of cuts to K-12 education (cuts that were fueled by property tax decreases described below), Coloradans rallied behind the notion that the state needed to catch up. *Amendment 23* was passed in November 2000 requiring the state to annually increase spending on per pupil K-12 education by the rate of inflation plus enrollment plus one percent until 2010-11. Hailed as a boon for the state's children, *Amendment 23* allowed Colorado to increase spending on K-12 education by 11.4 percent in the two subsequent fiscal years, even while almost all other state departments were cutting their budgets. However, from another perspective, the law has effectively tied the hands of legislators by requiring them to devote ever-increasing proportions of the state's shrinking budget to K-12 education

Finally, two laws have dramatically limited the amount of revenues the state can collect from property taxes—1982's *Gallagher Amendment* and 2000's *Referendum A (the Senior Homestead Exemption*).[1]

Combined, these laws have made it virtually impossible for Colorado policy makers to raise taxes, build a surplus, or rebound from tough economic times.

[1] The senior property tax exemption (Referendum A) was reduced to zero in the last legislative session, as allowed under the legislation because of the budget crisis. A bill has been introduced in the current session to restore some portion of the exemption, but many legislators have predicted it won't pass because there are no other sources of revenue available to make up for the budget deficit.

Amendment 23 (which this year locked in K-12 expenditures at a level accounting for over 43 percent of General Fund spending), coupled with mandatory spending for persons entitled to Medicaid coverage, mean that fully 62 percent of the state's budget is spoken for, leaving less than 40 percent available for discretionary cutting.

The State Budget Situation and Policy Response

The roots of Colorado's deficits are similar to those of many states. The recession led to a doubling of the unemployment rate during 2001/2002 (it currently stands at 5.7 percent, slightly below the national average of 6.2 percent); the state economy was especially hard hit because of its heavy reliance on tourism (which declined precipitously after September 11) and high technology. Colorado depends more on capital gains taxes than any other state, a revenue source that has dramatically declined as a result of the stock market downturn. In addition, the state continues to suffer its worst drought in recorded history, hitting farmers and ranchers the hardest.

For FY 2002-03, the $850 million shortfall was made up through a combination of accounting measures and across-the-board cuts to state agency budgets. For example, some of the deficit was addressed by delaying state employees' June paychecks until July, effectively shifting $89.4 million in obligations to FY 2004. In addition, in May 2003, Governor Owens imposed a four percent cut on all state agencies (with the exception of K-12 education), and an additional six percent cut was called for later in the year, bringing the total to 10 percent. These cuts, at least in part, drove a reduction of approximately 1,000 jobs from state government over the course of the year. State support for mental health services was cut by approximately $30 million. Capital

construction projects less than 25 percent complete were also frozen, saving $24.2 million.

Actions to address the $900 million FY 2003-04 shortfall were a continuation of many of the same general strategies, as well as some new efforts. The state's higher education budget was reduced by more than $100 million (or 30 percent), even after many institutions were allowed to raise their tuition by at least 10 percent. In April 2003, legislation was passed to securitize 47 percent of the state's tobacco settlement revenue; the state expects to sell $530 million of its $1.2 billion revenue stream and receive upfront payment of $313 million. Two additional bills were passed that would have allowed the state to raise millions in case of fiscal emergency: one allowed the sale of up to $160 million of state buildings that would then be leased back to the state; the other allowed up to 60 percent in future tobacco proceeds to be securitized. Neither of these two bills has been implemented, however.

Medicaid and SCHIP

Medicaid spending accounts for roughly 19 percent of state spending and is the second largest line item in Colorado's budget (behind K-12 education). While the program is one of the leanest, nationally, due to its tight income eligibility thresholds and limited coverage of optional services and populations, the program continued to grow rapidly during the economic downturn due to increasing adult and child enrollment. Spending increases have also been fueled by rising rates of utilization, as well as medical cost inflation.

For FY 2002-03, the Medicaid program's share of imposed reductions totaled approximately $133 million. Over one-third of this amount--$36.4 million—was

achieved from service reductions, including hospital rate reductions and cost recoveries ($10.8 million), pharmacy reimbursement and prescription drug controls ($4.5 million), and the suspension of provider rate increases ($3.8 million). The remaining $96.4 million in savings were garnered from financing changes, particularly a $70 million savings from a switch to cash accounting (from accrual accounting), $7.5 million from one-time cost recoveries from HMOs; and $17.4 million from adjustments to upper payment limit (UPL) arrangements. (Under UPL, payments to providers are increased so that additional federal matching funds can be drawn, with the state share paid by intergovernmental transfers; the state gains when extra reimbursement is returned to the state by providers.)

The SCHIP program, called *Child Health Plan Plus* in Colorado, was held harmless in FY 2002-03. In fact, the program was expanded during the course of the year as the state carried out program enhancements that were passed in previous years. Specifically, *Child Health Plan Plus* added dental coverage to its benefit package. In addition, the state added coverage of pregnant women to SCHIP under a new Health Insurance Flexibility and Accountability (HIFA) waiver.

In FY 2003-04, however, the SCHIP program experienced severe cuts and Medicaid found itself in a state of flux. With regard to Medicaid, Colorado made national headlines when it announced that it would eliminate coverage of legal immigrants, a move that would result in 3,500 individuals losing coverage, for a savings of $8 million. At the time, eight other states did not cover this optional group, but Colorado would have been the first of the remaining 42 to stop benefits for this group. The cut was scheduled to go into effect on April 1, 2003, but the American Civil Liberties Union (ACLU) of Colorado filed a suit that temporarily blocked the provision.

An initial court ruling was made in favor of the state, but that decision was appealed by the ACLU and the outcome of that appeal was still pending at the time of this writing. Other cuts made to meet the FY 2003-04 Medicaid target included reduced funding for county transportation ($3.8 million); a change in reimbursement to Federally Qualified Health Centers ($1.4 million); additional prescription drug controls ($1.3 million); increases in copayments ($.5 million); and a one-month delay in medical payments that will shift between $20 and $25 million in costs to the following year. On the financing side, expenditures increased by $93.4 million through implementation of changes made in FY 2002-03, including the change to cost accounting (cost of $70 million) and upper payment limit adjustments (cost of $12.5 million), among others.

An important development not directly growing from the state's budget crisis, but certainly fueling the problem, pertains to Medicaid managed care. In less than one year, the state lost four of its participating health plans, and has suspended enrollment (effective April 2003) in it sole remaining prepaid plan—Colorado Access. This swift and dramatic change began in 2002 when Rocky Mountain HMO won a lawsuit against the state in which it claimed that the Medicaid program had underpaid the plan because its formula for calculating 95 percent of equivalent fee-for-service fees was incorrect. The judge presiding over the suit issued a summary judgment in favor of Rocky Mountain HMO, which opened the door for every other participating health plan to file similar suits. In total, Colorado Medicaid has had to pay out over $30 million in decisions thus far[2] and will likely face further obligations from other lawsuits.[3] The now-

[2] Comprising $21.5 million to Rocky Mountain HMO and $9.8 million to Community Health Care Plan of the Rockies.

[3] Qual-Med and Colorado Access allege that Medicaid has underpaid them by more than $100 million since the mid-1990s.

strained relationship between the HMO industry and the state Medicaid program has led to the recent decision by the state's Department of Health Care Policy and Financing to not renew Colorado's Medicaid 1115 waiver and to shift all Medicaid recipients into fee-for-service and primary care case management arrangements. State officials are describing this development as a cost-savings initiative, claiming that the "new" approach will be more efficient.

Meanwhile, *Child Health Plan Plus* was forced to impose an enrollment cap, effective November 2003. The cap, which will halt enrollment at a peak of roughly 53,000 children, is expected to be in place indefinitely. In addition, the legislature directed the program to discontinue its coverage of pregnant women a mere five months after starting this new coverage. Pregnant women already enrolled in SCHIP will retain coverage through the completion of their pregnancies, but no new pregnant woman enrollees were permitted after November 2003. The SCHIP program also discontinued its funding for mass media outreach and advertising. Each of these cuts was described as "very painful" for state legislators, as the SCHIP program continues to enjoy very strong bi-partisan political support and was held harmless for "as long as humanly possible."

The Future

At the time this case study was prepared, new revenue estimates actually came in higher than expected, giving state officials hope that economic recovery was around the corner. Specifically, the September 2003 General Fund revenue forecast for FY 2003-04 was higher than the June '03 estimate by $74.7 million. Furthermore, Colorado is also in a better fiscal position entering 2004 as a result of recent federal assistance—the Jobs and Growth Tax Relief Reconciliation Act of 2003 will distribute $227.1 million to Colorado

during FY 2003-04, with $80.8 million coming from increased Medicaid assistance and $146.3 million in the form of federal grants for specific purposes.[4]

However, the previous three years have had a sobering effect and state officials are not presuming that the future won't hold further fiscal challenges. Efforts are underway to modify *TABOR* and *Amendment 23* so that they would not hamper the state from addressing future budget shortfalls. At the time of this writing, a bi-partisan effort was underway in the legislature to devise amendments that would permit the state to more easily build "rainy day" funds during good times, and provide increased flexibility to raise spending faster than currently permitted by *TABOR* in years following budget cuts. The proposal would also protect *Amendment 23* but also allow the state to suspend its mandatory one percent K-12 increase during an economic downturn. The likelihood of these amendments passing is anything but assured, however, as both the Governor and many state legislators believe that laws like *TABOR* are "good things." For example, in his State of the State Address for 2003, Governor Owens called *TABOR* "an economic bulletproof vest" which controlled state spending during the boom years, and thus put Colorado in a better position (spending wise) when revenues turned down.

Health care advocates are particularly concerned about the potential long-lasting effects of recent budget cuts on low-income persons' ability to access needed care. A recent survey of physicians along the Front Range found that just 21 percent of Denver-area primary care physicians, on average, accept new Medicaid patients, but in some metro areas the number is as low as 9 percent. Similarly, 2003 saw an increasing number of reports from hospitals that serve Medicaid recipients and the indigent (including the

[4] However, the 2003 federal tax act will also reduce Colorado's income tax receipts by $58.5 million and FY 2003/04 and by $31.2 million in FY 2004/05.

largest—Denver Health and Hospitals) that patients were being turned away from emergency rooms unless their conditions were, indeed, emergencies. Advocates presume that such situations have arisen in the aftermath of continued cuts to hospital reimbursement rates.

An initiative emerging from the agency that administers Medicaid and SCHIP may hold potential to improve access for low-income Coloradans, however. Specifically, state officials are in the process of designing a new Medicaid Health Insurance Flexibility and Accountability (HIFA) waiver that would combine the resources of Medicaid, SCHIP, and state-funded Indigent Care Program (ICP), to maintain current coverage for all federally-mandated groups, and purchase a new SCHIP-like basic benefit package for optional groups and current ICP enrollees. Operating under the assumption that the SCHIP package will meet the needs of the vast majority of recipients, state officials are busy working on alternatives for providing "wrap around" benefits for persons needing additional care, such as children with special health care needs.

1330 G Street NW, Washington, DC 20005
Phone: (202) 347-5270, *Fax:* (202) 347-5274
Website: www.kff.org/KCMU

Additional copies of this report (#7002) are available
on the Kaiser Family Foundation's website at www.kff.org.