Office of the New York City Comptroller

Policy Brief

Office of Policy Management

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MORE THAN OUR FAIR SHARE: THE IMPACT OF THE GOVERNOR'S PROPOSED MEDICAID BUDGET ON NEW YORK CITY AND ITS HOSPITALS

On May 2, the State Senate and Assembly rejected the Governor's 2003-2004 Executive Budget and multi-year financial plan and passed their own budget legislation, which the Governor has threatened to veto. The Legislature's plan restored many of the deep cuts that the Governor had proposed, and raises new revenue to pay for those expenditures. The Governor strongly opposes the Legislature's budget and has vowed to use every means at his disposal to ensure that his veto is sustained. The resolution of this dispute will have an enormous impact on New York City's economy and budget.

A major area of contention is Medicaid. The State Executive Budget proposed to change the formulas for the local share of Medicaid costs in a way that would significantly increase New York City's expenses. New York City would be the only local government in the State that would have higher Medicaid expenses as a result of this shift. The Legislature eliminated this change.

In addition, under the Governor's plan, the State would make $1.5 billion in new cuts from State Medicaid funding for hospitals, nursing homes, home care and pharmaceuticals. It would also extend prior cuts that had been slated to sunset at the end of the year and reinstitute a tax on provider revenues. As measured by both inpatient and outpatient revenues, New York City's hospitals will suffer a disproportionately large loss in revenues compared with hospitals in the rest of the State, with the greatest impact being felt by the City's *public* hospitals. The Legislature has proposed to eliminate virtually all of these inequitable cuts.

Because Medicaid costs are shared with Federal and local governments, the hospital cuts will have a much greater impact on hospital budgets than the loss of the State savings alone. Under current formulas, which provide that the Federal government pays 50% and localities pay 25% of Medicaid charges, hospitals will lose $4 in revenue for every $1 in State savings on Medicaid hospital costs. The Health Care Association of New York State estimates that New York City hospitals will lose over a billion dollars per year under the Governor's plan.

To ensure that New York City and its hospitals are not burdened with these unfair and disproportionate cuts, the Legislature must override the Governor, should he carry out his threat to veto the Legislature's budget plan.

Elements of the Governor's Proposal

The key elements of the Governor's plan include:

- Changes in hospital reimbursement rates;
- Diversion of funds from the Community Health Care Demonstration Project, which helped "safety net" hospitals (those that serve a disproportionate share of Medicaid patients and the uninsured) become more competitive;
- Continuation of earlier cuts, which had been slated to sunset;
- Imposition of a tax on hospital revenues; and
- Changing the City and State responsibilities for funding Medicaid services.

Comparing the Financial Impact on New York's Hospitals

The Governor's 2003-2004 Executive Budget and multi-year financial plan focus on how much each Medicaid proposal would save the State. They do not include estimates of how specific Medicaid proposals would affect the revenues of each individual hospital or group of hospitals.

However, such revenue estimates have been prepared by two hospital trade associations, the Health Care Association of New York State (HANYS) and the Greater New York Hospital Association (GNYHA). HANYS is a statewide organization of 550 hospitals, nursing homes, and home care agencies from every part of the State. GNYHA represents approximately 100 private, not-for profit and public hospitals in New York City, Long Island, Westchester, the Hudson Valley, and Western New York.

Using standard data sources, including the State Health Department's "SPARCS" database[1] and the hospitals' institutional cost reports,[2] HANYS and GNYHA estimated the effects of the proposals on inpatient and outpatient Medicaid revenue for every hospital in the State (e.g., how much a specific hospital would lose or gain due to the proposed changes in the formula for reimbursing the cost of training its medical students).

Using these revenue projections, we calculated the relative impacts of the Governor's proposals on different sets of hospitals, as follows:

a) Revenue lost by the entire New York City hospital industry (including both public and private hospitals), as a percentage of the total revenue lost by <u>all</u> New York State hospitals;

b) Revenue lost by New York City municipal hospitals (the Health and Hospital Corporation) alone, as a percentage of the total revenue lost by <u>all</u> New York State hospitals.

We calculated each percentage twice, once using the HANYS estimates and once using the GNHYA estimates. Because both associations are comprised of both public and private hospitals and given HANYS statewide membership, we believe that the combination of the two calculations gives us a reliable estimate of relative impacts.

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[1] The Statewide Planning and Research Cooperative System ("SPARCS") database has data on hospital utilization.
[2] Institutional cost reports are official documents that are filed with Medicare and Medicaid reimbursement offices.

Findings:

A. The New York City Hospital Industry Operates 48% Of The State's Hospital Beds, But Would Lose 75% To 85% Of The Total Medicaid Revenue Lost By All Hospitals Statewide

When comparing the overall projected revenue loss by New York City hospitals with the total loss projected for all hospitals statewide, it is clear that New York City's hospital industry will be forced to absorb a disproportionate share of the State's proposed budget cuts. See Table 1, attached as an Appendix to this Policy Brief. Using revenue projections from HANYS, the statewide trade association, we calculated that the overall revenue loss to the City's local hospital industry would be 75% of the statewide total in State Fiscal Year 2003-4 and 80% of the statewide total in State Fiscal Year 2004-5. The percentages were slightly higher, but similar, when we used the revenue projections from the metropolitan area trade association. GNHYA's estimates indicated that, in both years, the local loss would be 84% of the statewide total.

New York City's public and private hospitals together operate only 48% of the hospital beds in New York State.[3]

1. Seventy Three Percent of the State's Interns and Residents Train at Hospitals in New York City,[4] Yet, New York City's Hospital Industry Accounts for 90% to 93% of the Graduate Medical Education Revenue Loss Statewide.

Using HANYS' projections of losses in graduate medical education revenue, we calculated that the City's overall hospital industry would lose 93% of the total statewide loss in Fiscal Year 2003-4 and 92% in Fiscal Year 2004-5. Using GNYHA's revenue projections, the City's overall hospital industry would lose 90% of the total statewide revenue loss in both years.

Of the local industry's loss, roughly 63% is from the revenues of the municipal hospitals. Approximately 37% would affect other New York City hospitals. As explained below, in Section B, this is due to the way in which the Governor proposes to modify the State's reimbursement formula.

2. The New York City Hospital Industry Will Lose 87% Of The Total Revenue Lost By All Hospitals Statewide Due to The Governor's Proposal to Reallocate Funds From the Community Health Care Conversion Demonstration Project.

Under former President Clinton, the Federal government funded a five-year "Community Health Care Conversion Demonstration Project" (CHCCDP), administered by the State Health Department. The purpose of the grant was to help hospitals that serve a disproportionate number of uninsured patients make the transition to a managed care environment – for example, by workforce training, technology

[3] As of March 24, 2003, New York City has 30,781 hospital beds, out of 64,322 statewide. About 80% of the hospital beds in New York City are at voluntary not-for-profit hospitals.

[4] According to the New York State Council on Graduate Medical Education, there are currently 11,679 interns and residents at New York City hospitals and 15,934 statewide. The State Health Department provided similar numbers for the period July 1, 2001 to June 30, 2002 (11,496 in city as a whole, and 15,722 statewide). The percentages are the same using either source.

enhancements and improving primary care. We are now in the last two years of the grant, with $350 million left to spend.

The Governor proposes to reallocate the $350 million in federal funds to other health programs in order to replace previously allocated state dollars that are being used to help close State budget gaps.[5] New York City hospitals will not recoup the money through the other programs -- which fall under the Health Care Reform Act (HCRA) – because they already are receiving the maximum they can from these other programs (e.g., indigent care pools). In addition, unlike CHCCDP, which targets New York City "safety net" hospitals, HCRA funds a much broader range of health care providers. For example, under the Governor's HCRA proposal, HCRA will help fund, among other things, physicians' medical malpractice premiums; hospital workers' wage increases; adult day care; and the State general fund, for about $100 million of Medicaid pharmacy expenditures. Indeed, the State Comptroller's Office notes that "…much of the new spending [in the Governor's HCRA 2003 Proposal] is designed to provide General Fund budget relief."[6]

Forty percent of the local industry's loss would be at municipal hospitals and 60% at other New York City hospitals.

3. The New York City Hospital Industry Would Absorb 75% to 90% of the Losses from the Governor's Plan to Change Various Other Reimbursement Formulas

Table 1 also contains information about other changes in hospital reimbursement formulas. For example, the local hospital industry would absorb 82% to 90% of the losses from eliminating a credit for getting people out of the hospital faster,[7] 78% to 83% of the losses from cutting per diem hospital rates (see Section B, below), and 78% to 81% of the losses from eliminating the Medicaid "trend factor" (see Section B, below).

B. New York City's Public Hospitals Operate Only 9% of Hospital Beds Statewide,[8] but Would Lose 26% To 29% Of The Total Medicaid Revenue Lost By All New York State Hospitals

New York City's municipal hospital system -- the Health and Hospitals Corporation (HHC) -- operates only about 18% of the hospital beds in New York City.[9] Yet, the municipal system will absorb the proportionally biggest Medicaid cuts. This is in large part because the proposed formulas often penalize hospitals for having eliminated beds or reduced residency programs.

When comparing HHC's overall projected revenue loss with the total loss projected for all New York hospitals statewide, it is clear that New York City's public hospitals will be forced to absorb an out

[5] Many of these funds were supposed to come from the tobacco settlement, but are no longer available because the Governor has committed them for other purposes.
[6] Office of the State Comptroller, *The Health Care Reform Act (HCRA): The Need to Restore Accountability to State Taxpayers* (April 2003), page 11.
[7] This is the proposal to "eliminate length of stay relief for volume adjustment". See Table 1.
[8] According to the State Health Department, as of March 24, 2003, there were 64,322 hospital beds in New York State, of which 5,626 were at HHC hospitals (9% of the total). The HHC number includes not only the beds at HHC's acute care hospitals, but also the 627 beds at HHC's two extended care hospitals, Coler and Goldwater.
[9] According to the State Health Department, New York City has 30,781 hospital beds, of which only 5,626 are at HHC (as of March 24, 2003).

sized share of the State's proposed budget cuts. See Table 3, attached as an Appendix to this Policy Brief. Using HANYS' revenue projections, we calculated that HHC's overall loss in Fiscal Year 2003-4 would be 27% of the statewide total. In Fiscal Year 2004-5, HHC's share would be 29%. The number was similar when we used GNHYA's revenue projections, which predicted a 26% loss in both years.[10]

1. The City's Public Hospitals Will Absorb 50% to 60% of the Cuts in Reimbursements for Training the State's Graduate Medical Students, Although it Trains Only 14% of Them.

The Governor's proposal that has the most disproportionate effect on HHC is the proposal to change the method for reimbursing hospitals for the costs of training interns and residents. HHC trains only 14% of the state's interns and residents,[11] yet it would incur 50% to 60% of the revenue loss. Using HANYS revenue projections, we calculated that HHC's revenue loss would be 60% of the statewide total in Fiscal Year 2003-4 and 53% in Fiscal Year 2004-5. Using GNYHA's revenue projections, the percentages were 57% and 49%, respectively.

This disproportionate effect is due to the way in which the State proposes to modify its reimbursement formula. Medicaid (like Medicare) reimburses hospitals for the "indirect" costs of training medical students -- for example, the money that is wasted when an inexperienced doctor orders more diagnostic tests than necessary, or the cost of providing opportunities for medical students to do research. One of the main elements in calculating those costs is the number of residents and interns for each hospital bed. The higher the ratio, the higher the reimbursement.

Logically, one would have expected the State to use the same years for both the numerator (number of residents and interns) and the denominator (number of hospital beds) of its formula. However, the state proposes instead to use the number of beds in ***1990*** and the number of interns and residents in ***either 1990 or in the current year, whichever is lower***. This approach penalizes hospitals that reduced the relative size of their residency programs during the 1990s. Using the current (lower) year, the number of students per bed would also be lower, and so would the size of the hospital's reimbursement. Hospitals that failed to downsize their residency programs therefore would lose less.[12]

HHC would lose more money because it downsized its residency programs. While HHC currently has 14% of the State's graduate medical students, in the early 1990s, it had about 25%. The effect on HHC would not be as disproportionate if the formula measured everything in the same year. Moreover, the effect on HHC is exacerbated by the fact the proposed formula also penalizes hospitals that reduced their number of hospital beds. HHC not only reduced the number of residents during those years, but

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[10] For a hospital by hospital breakdown of the percentage of Medicaid revenue that would be lost, see Appendix Table 2. Unlike our other tables, Table 2 is based on HHC's own revenue estimates. As discussed later, we use this table in order to compare different HHC hospitals to one another. HHC's revenue estimates are credible for such a comparison, since HHC has no incentive to bias its estimates in favor of one HHC hospital over another.

[11] According to the New York State Council on Graduate Medical Education, there are currently 2,177 interns and residents at HHC. There are 11,679 in the City as a whole and 15,934 statewide. The State Health Department provided similar numbers for the period July 1, 2001 to June 30, 2002 (2,182 at HHC, 11,496 in city as a whole, and 15,722 statewide). The percentages are the same using either source.

[12] The resident/bed ratio is not the only part of the formula. Other elements reduce the reimbursements in a more even-handed way.

also the number of beds. As discussed below, between February 1995 and March 2003, HHC eliminated over 38% of its acute care beds.

It is ironic that HHC is being penalized for reducing its residency programs. During the 1990s, the State Health Department gave hospitals financial incentives to reduce the number of interns and residents because it believed that the State was wasting money by training too many doctors. HHC downsized its residency programs far more than other teaching hospitals did. HHC is being penalized for following the State's policy direction, which helped the State save money.

2. HHC Will Lose 35% Of The Total Revenue Lost By All Hospitals Statewide Due to The Governor's Proposal to Reallocate Funds From the Community Health Care Conversion Demonstration Project.

As discussed earlier, this loss is primarily due to the Governor's plan to use federal CHCCDP funds to cover gaps in the State budget and to reallocate some of the funds to health programs that do not target New York City safety net hospitals.

3. HHC Will Absorb 30% of the Lost Revenues, Statewide, From the Governor's Plan to Cut Per Diem Hospital Rates.

Under Medicaid, most inpatient services are reimbursed at a standardized rate based on the patient's medical problems,[13] rather than how long the patient is in the hospital. However, some services are still reimbursed on a *per diem* basis, most notably inpatient psychiatric services and medical rehabilitation. Under the Governor's proposal, most of these rates would be reduced by 5%.[14]

HHC hospitals provide more of these services than do other hospitals. For example, out of all the care provided in New York City hospitals (measured in days of inpatient care), HHC provides only 17% of the general care (which includes most medical and surgical services), but 40% of the psychiatric care. [15] It also provides 26% of inpatient medical rehabilitation.

4. HHC Would Experience 25% to 27% of the Statewide Revenue Loss From Eliminating the Medicaid Trend Factor

Medicaid makes a yearly adjustment in hospitals' reimbursement rates to account for changes in their costs. This adjustment is not based on actual health care cost increases in New York, but rather on the federal consumer price index for all urban consumers. The Governor proposes to eliminate the 2003 cost adjustment. For technical reasons, this change would be implemented as a 2.4% decrease in rates.[16] Because HHC has a higher percentage of its patients on Medicaid than other hospitals across the State (and a lower percentage on commercial insurance or Medicare), this cut would have a greater effect on HHC.

[13] The classification of medical problems is called "diagnostic related groups" (DRGs)
[14] The exception is *per diem* HIV/AIDS rates.
[15] United Hospital Fund, *Health Care Annual: 2001 Update*.
[16] This is largely because the State is trying to recoup funds from a 2002 error in the hospitals' favor.

5. The Proposal to Limit Case Payment to Lower Of Group Average Or Blended Rate Would Cost HHC 16% to 22% of Statewide Revenue Reductions

From February 1995 to March 2003, HHC eliminated over 3,100 acute care hospital beds – 38% of its total.[17] This was part of a broader effort to "streamline" HHC's operations. During the same period, voluntary hospitals did not make comparable reductions in their own capacity. Unfortunately, under the Governor's proposal concerning blended and average rates, some of the HHC hospitals will be penalized for their bed reductions.

Medicaid pays different rates to different hospitals. Currently, the rate is a "blend" that takes into account each hospital's own unique costs and the average costs of a peer group of other hospitals. The peer groups are defined based on hospital costs and status in 1981. One of the peer group categories is "major public hospitals." Costs are measured in relation to the number of patients to calculate the cost per discharge.

Under the Governor's proposal, a hospital's reimbursement rate will be lowered if the hospital's costs are higher than the peer group average. The formula will no longer give any weight to the hospital's justifiably unique costs, but will simply limit payments to the maximum for all hospitals in that category.[18] However, hospitals try to reduce total costs, not just the cost per discharge. One way of reducing total costs is by eliminating hospital beds. This can have the paradoxical effect of making the cost per discharge more expensive if the remaining fixed costs are spread among a smaller number of patients.[19] In the past, State reimbursement formulas took such factors into account through what was called the "volume" adjustment, but the Governor proposes to drop this adjustment too. As shown in Table 2, changing the formulas is most likely to affect the HHC hospitals that had previously closed the most beds, such as North Central Bronx, Harlem and Queens.[20] This suggests that the formulas would penalize HHC for having tried to streamline its operations.[21]

C. Impact on City's Share of Medicaid Costs

In his budget bill,[22] the Governor also proposes to change how the City and State governments share the cost of funding the Medicaid program. Under current arrangements, the City and State both pay about 25% of all costs related to hospital care; the Federal government pays the other half. Under the Governor's proposal, localities would pay an additional 12% of inpatient and outpatient fee for service costs (37%, rather than 25%). In return, the State would take over the local share of pharmacy costs (i.e., the State would pay 50% of Medicaid gross pharmacy expenditure).

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[17] HHC had 8,109 acute care hospital beds in February 1995 and 4,999 in March 2003, according to statistics from the State Health Department and HHC. For a hospital by hospital breakdown of bed closures, see Table 2.

[18] The proposal does not work the other way around. In most cases, a hospital would not be rewarded for reducing the cost per discharge. If it costs were already below the average, it would still be paid based on the average cost.

[19] The Governor exempts most small rural hospitals from the cuts mandated under the proposal about "blended" and average costs.

[20] The statistics in Table 2 concerning the number of beds at each hospital are from the State Health Department (2003 numbers) and from HHC (February 1995 numbers that HHC reported to the State Health Department).

[21] Bed reductions are important factors explaining why some HHC hospitals would lose a higher percent of their Medicaid revenue than others, but they are not the only factors. One of the other factors is the kind of services each hospital offers. See point B (3) above.

[22] S1408/A2108), January 29, 2003, Part K, Section 1.

The Governor's Office explicitly acknowledges that New York City is the only part of the State where this "swap" would hurt the local government. The Memorandum in support of the bill says, "over the long term, all counties ***(excluding NYC)*** are expected to benefit."[Emphasis added][23]

In the City's Fiscal Year 2004, this "swap" would cost the City an estimated $255 million.[24]

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[23] January 29, 2003 Memorandum in Support of S1408/A2108,
[24] Office of the New York City Comptroller, "The Impact of the Governor's Executive Budget on New York City," March 21, 2003.

TABLE 1: IMPACT ON NEW YORK CITY COMPARED WITH STATEWIDE IMPACT

In-patient and Out-patient Medicaid Revenue That Hospitals Are Projected To Lose Under The Governor's Medicaid Proposals

New York City Hospitals (Both Private and Public) Together Have Only 48% of the Hospital Beds Statewide

	New York City Hospitals' Projected Revenue Loss As A Percentage Of The Amount Lost By All Hospitals In The State As A Whole			
	HANYS Projections		GNYHA Projections	
	SFY 2003-4	SFY 2004-5	SFY 2003-4	SFY 2004-5
TOTAL REVENUE LOSS, ALL PROPOSALS:	76%	80%	84%	84%
IMPACT OF SOME KEY PROPOSALS				
Revise formulas for reimbursing costs of graduate medical education	93%	92%	90%	90%
Eliminate alternative rate methodology, for certain hospitals (mental health)	59%	59%	60%	60%
Transfer of funds from Community Health Care Conversion Demo. Project	---	---	87%	87%
Cut per-diem hospital rates by 5% (AIDS services exempt)	78%	78%	83%	83%
Eliminate Medicaid trend factor - 2.4%	78%	78%	81%	81%
Limit case payment to lower of group average or blended rate	81%	81%	75%	75%
Reduce utilization of part-time clinics	---	---	---	---
Gross receipt tax	56%	56%	55%	55%
Freeze specialty clinic rates (AIDS services exempt)	82%	82%	83%	83%
Eliminate length of stay relief for volume adjustment	83%	82%	90%	90%

TABLE 2: COMPARISON AMONG DIFFERENT HHC HOSPITALS
PERCENTAGE OF MEDICAID REVENUE LOST UNDER 2003-4 STATE EXECUTIVE BUDGET

Name of HHC Hospital	Percent Medicaid Revenue Lost State Fiscal Year 2003--4	Number of Hospital Beds March 2003	Bed Reduction February 1995 To March 2003
North Central Bronx	19.6%	190	-56%
Harlem	18.7%	286	-61%
Queens	14.1%	200	-64%
Jacobi	13.0%	527	-36%
Metropolitan	12.8%	359	-41%
AVERAGE -- All HHC Hospitals	**11.1%**	**433**	**-40%**
Elmhurst	11.1%	525	-16%
Lincoln	10.9%	347	-48%
Kings Cty	10.1%	888	-29%
Bellevue	8.7%	912	-28%
Goldwater	8.3%	417	*
Coler	6.3%	210	*
Coney Island	5.8%	364	-31%
Woodhull	5.2%	401	-33%

*Numbers available only for acute care hospitals, not for the two extended care hospitals, Goldwater and Coler

TABLE 3: IMPACT ON HHC COMPARED WITH STATEWIDE IMPACT

In-patient and Out-patient Medicaid Revenue That Hospitals Are Projected To Lose Under The Governor's Medicaid Proposals

HHC Hospitals Have Only 9% of The Hospital Beds Statewide

	HHC's Projected Revenue Loss As A Percentage Of The Amount Lost By All Hospitals In The State As A Whole			
	HANYS Projections		GNYHA Projections	
	SFY 2003-4	SFY 2004-5	SFY 2003-4	SFY 2004-5
TOTAL LOSS, ALL PROPOSALS	**27%**	**29%**	**26%**	**26%**
IMPACT OF SOME KEY PROPOSALS:				
Revise formulas for reimbursing costs of graduate medical education	60%	53%	57%	49%
Eliminate alternative rate methodology, for certain hospitals (mental health)	40%	40%	40%	40%
Transfer of funds from Community Health Care Conversion Demo. Project	---	---	35%	35%
Cut per-diem hospital rates by 5% (AIDS services exempt)	29%	29%	30%	30%
Eliminate Medicaid trend factor - 2.4%	27%	27%	25%	25%
Limit case payment to lower of group average or blended rate	22%	22%	16%	16%
Reduce utilization of part-time clinics	17%	17%	---	---
Gross receipt tax	10%	10%	9%	9%
Freeze specialty clinic rates (AIDS services exempt)	9%	9%	30%	30%
Eliminate length of stay relief for volume adjustment	1%	3%	---	---