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# News Release

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For Immediate Release

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## **Tobacco Tax Increase: Meeting Current Obligations First**

The Massachusetts Taxpayers Foundation today called on the Legislature to dedicate any revenues from the proposed increase in the tobacco tax to meet the Commonwealth's long list of underfunded health care obligations.

The Foundation noted that all of the proposed fiscal 2002 budgets -- from the Governor, House and Senate - - fail to address adequately the yawning gap in funding for several major health care programs, including basic Medicaid, 1996-97 Medicaid expansions, Medicaid provider rates and the senior pharmacy program.

"While the merits of a further cigarette tax increase are debatable, there is no debating the need to adequately fund the state's existing health care commitments," said MTF President Michael J. Widmer.

The current proposal would hike the cigarette tax by 50 cents per pack, to \$1.26, the highest in the nation. The proposal would use the additional tax revenues, along with federal reimbursements, to expand the Medicaid program to cover an additional 75,000 residents, primarily childless adults with incomes below 133 percent of the federal poverty level and parents up to 200 percent of the poverty level. A portion of the \$325 million proposal would also be used to support existing health insurance programs and expand community-based health outreach initiatives.

The Foundation cited four areas that should be addressed before the state further expands Medicaid rolls (see attachment for details):

- Surging costs of the current Medicaid program, which will total at least \$5.1 billion next year and are growing 10 percent annually, have greatly exceeded the Commonwealth's initial appropriations in each of the past two years. It is a virtual certainty that the amount included in the 2002 budget will not fully cover these soaring expenses.
- Funding for the 1996-97 health care expansions has proven to be insufficient, as the initially assumed savings from reduced demands on the uncompensated care pool have not materialized. As a result,

the state is now forced to use other resources to fill a funding gap that will exceed \$120 million in 2002.

- Medicaid reimbursement rates are woefully inadequate -- falling several hundred million dollars short of meeting health care providers' costs -- exacerbating the financial problems of a number of hospitals, nursing homes and other care givers, while mounting deficits in the uncompensated care pool are further weakening hospitals' finances.
- The new open-ended senior pharmacy program is already proving difficult to fund. The program's financing is based on questionable assumptions about the ability to attract enough premium-paying members to offset individuals whose costs are fully subsidized by the state. Also, with prescription drug expenses rising 20 percent annually, the program costs will escalate dramatically in just a short period.

In addition, the Foundation identified a fundamental inconsistency in paying for the proposed health insurance expansions, whose costs would inevitably rise, with a revenue source, the cigarette tax, that is already falling and would decline even faster as a result of the tax increase. Since the Legislature approved a 25-cent-per-pack tax increase in 1997, tobacco tax revenues have dropped 13 percent, from \$301 million in 1998 to \$262 million in 2001.

“The Foundation certainly supports the goal of reducing the ranks of the uninsured, but the Commonwealth's first priority must be to meet its current health care obligations,” said Mr. Widmer. “While the incremental approach to expanding health insurance has been successful in reducing the number of uninsured Massachusetts residents, paying for these expansions is an ongoing and costly responsibility.”

Founded in 1932, the Massachusetts Taxpayers Foundation is an independent, nonprofit organization which conducts research and policy analysis on state and local taxes, government spending and the economy. Dedicated to the public interest, MTF ranks as one of the largest and most effective organizations of its kind in the country. The Foundation has won five prestigious national awards in as many years for its work on capital spending, business costs, management of state budget surpluses, and reform of the MBTA.

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Attachment

**Current State Health Care Costs -- Huge and Growing Rapidly**

The proposal to increase the tobacco tax and use the new revenues to further expand Medicaid eligibility comes at a time when the state is already struggling to pay the cost of its current health care programs.

Cost pressures throughout the health care system are driving up expenditures for both Medicaid and employee health insurance, the Commonwealth's two largest health care programs. Together, these programs comprise one quarter of the \$23 billion annual state budget, and their costs are rising 10 percent a year.

This cost escalation is intensified by the Medicaid program's 1996-97 expansions, which have added over a quarter of a million people to the health insurance rolls and have proven to be much more costly than originally anticipated. The expanded Medicaid enrollment was supposed to be funded by a 25-cent-per-pack increase in the cigarette tax and monies diverted from the uncompensated care pool, but these sources have proven to be inadequate and the Commonwealth must now use other revenues to finance these health insurance expansions.

In addition, these cost pressures do not take into account the state's inadequate Medicaid reimbursement rates to health care providers: The Commonwealth's payments to hospitals, nursing homes, physicians, home health agencies, and other caregivers fall well short of the costs of the services provided. Further

complicating this picture, Massachusetts has recently launched a new, open-ended senior pharmacy program, funded solely with state revenues, that could cost hundreds of millions of dollars annually in just a few years.

*Spiraling health care costs*

As state revenues have slowed, cost pressures are accelerating throughout the Commonwealth's health care system, placing enormous pressure on the state's already tight budget. Spending on Medicaid and employee health insurance, which combined totals \$5.4 billion in 2001, has risen by 20 percent in the past two years, following several years of low single-digit increases in the 1990s. Surging Medicaid costs have required major supplemental appropriations in both 2000 and 2001, with another large supplemental a virtual certainty in 2002.

Just as health insurance premiums in the private sector are rising at a sharply higher rate, the state can expect close to 10 percent annual increases in health care spending for at least the next several years due to a variety of national and local factors. Initial savings that had been achieved through managed care have largely run their course; hospitals and physicians are demanding major increases in payments from insurers, and managed care plans are responding to consumer complaints by loosening restraints on care. These pressures are compounded by large increases in pharmaceutical spending, greater use of

expensive new technologies, and rising long-term care costs, none of which is likely to change in the near future.

These national trends are intensified by a number of circumstances particular to Massachusetts: After considerable market disruption in the late 1990s, insurers are raising premiums to stabilize their financial positions; a large number of hospitals, nursing homes and other caregivers are swimming in a sea of red ink; and the Commonwealth's elderly population is increasing faster than the national average, driving up spending for long-term care.

#### *Prior expansions and uncompensated care*

The Commonwealth's financial dilemma is exacerbated by the unsustainable financing plan associated with the 1996-97 health care expansions, which increased Medicaid enrollment 33 percent in less than five years.

The state originally planned to pay for this increased enrollment with revenues from a 25-cent-per-pack increase in the cigarette tax and a transfer of funds from the uncompensated care pool, which is used to offset hospitals' expenses for providing free care to the uninsured. However, the ongoing decline in tobacco consumption has reduced the state's cigarette tax revenues below expectations, the amount of free care provided by hospitals has not fallen as anticipated, and expansion-related health care costs are greater than originally projected. These three factors have produced a funding gap that will exceed \$120 million in 2002, requiring the state to identify other revenues to support the additional Medicaid caseload.

The initial financing plan assumed that reducing the number of uninsured residents would greatly reduce the amount of uncompensated care provided by hospitals and therefore create a surplus in this account. The Commonwealth then planned to transfer \$100 million each year from the

\$345 million free care pool to pay for the Medicaid expansions. However, the surplus needed to finance these transfers has not materialized. The uncompensated care pool is now running a deficit, with a \$45 million shortfall this year and a probable shortfall of at least that much in 2002.

Recognizing the dire financial condition of many hospitals and the mounting free care deficit, the administration's 2002 budget proposed appropriating \$240 million from the tobacco settlement trust fund to provide one-time relief for these institutions. The bulk of the funds were to be used to reduce hospitals' payments into the uncompensated care pool and to increase the funding available from the pool to cover free care costs. Although the House and Senate wisely rejected tapping such a large portion of the tobacco trust fund for this purpose, the free care deficit must still be addressed.

#### *Underfunding of providers' costs*

The run-up in Medicaid expenses is occurring despite the fact that the state fails to fully cover providers' costs, a longstanding unfunded obligation of the Commonwealth that must be addressed. Over the past decade the state has used its purchasing power to hold Medicaid reimbursement rates below the actual cost of care, essentially requiring providers to subsidize this public health care program. This policy, combined with cutbacks in federal Medicare funding, has contributed to the financial problems confronting many providers, most notably nursing homes and hospitals.

**Nursing Homes** As the primary purchaser of nursing home care, the state has a responsibility to establish a Medicaid reimbursement rate that fairly compensates nursing homes and reflects the increases in wages and salaries necessary to attract and retain qualified staff. According to the Massachusetts Extended Care Federation, an industry trade group, the state pays, on average,

\$20 a day below the actual per-person cost of care.

With over 70 percent of nursing home residents paid for by Medicaid, the ability of nursing facilities to use other payers (i.e., Medicare and the private sector) to subsidize below-cost Medicaid payments is clearly limited. Inadequate reimbursement rates and rising labor costs, among other factors, have forced over 50 nursing homes to close since 1999, and a number of facilities are reportedly on the verge of closing. A nursing home industry proposal to adjust the Medicaid reimbursement rate would increase the Commonwealth's budget by as much as \$200 million annually.

**Hospitals** The state's inequitable Medicaid payment rates have also adversely affected the state's hospitals, with two-thirds of these facilities losing money each of the past four years, double the national average. According to the federal Medicare Payment Advisory Commission, the Commonwealth reimburses hospitals an average of 75 cents for each dollar of care provided to Medicaid patients, the sixth lowest payment-to-cost ratio in the nation. Across the country, the average Medicaid reimbursement rate covers almost 97 percent of hospitals' costs.

In response to a rising chorus of complaints and the closure of several facilities, the state commissioned an independent study of the adequacy of Medicaid rates paid to hospitals and community health centers. While the study has not yet been released publicly, preliminary reports confirm the hospital industry's contention that Medicaid rates are grossly insufficient and contribute significantly to the poor financial condition of the state's hospitals. The Massachusetts Hospital Association estimates that providing 100 percent reimbursement for Medicaid patients would increase state payments by at least \$200 million a year.

### *Open-ended senior pharmacy program*

Adding to these mounting health care costs, the state has recently launched an open-ended senior pharmacy program, which offers prescription drug benefits for up to 850,000 Massachusetts residents aged 65 and over who are ineligible for Medicaid, as well as for low-income disabled residents. Under the plan, enrollees offset a portion of the program's costs by absorbing an annual deductible and paying monthly premiums and drug co-payments based on their annual income, while the Commonwealth subsidizes these costs for low-income residents. Funded entirely with state revenues, this first-in-the-nation program will require major and accelerating state appropriations; in the first year of the program there is already disagreement between the House and the Senate over the funding of this initiative.

The program runs the risk of adverse selection, i.e., enrolling primarily those residents with high prescription drug needs and those whose costs are fully subsidized by the state, while failing to sign up residents with limited prescription drug needs and middle and upper-income individuals who are charged a monthly premium. This inability to spread the risk across a large representative pool - and enroll enough paying members who will draw less on the prescription drug benefits -- will increase the state's cost per participant and is a prime reason why the private insurance market does not offer this type of coverage.

In addition, with prescription drug expenses rising 20 percent each year, the availability of a state-funded prescription drug benefit may encourage private employers to drop such coverage from their existing retirement health packages, thereby transferring the costs to the Commonwealth and increasing the state's financial burden.