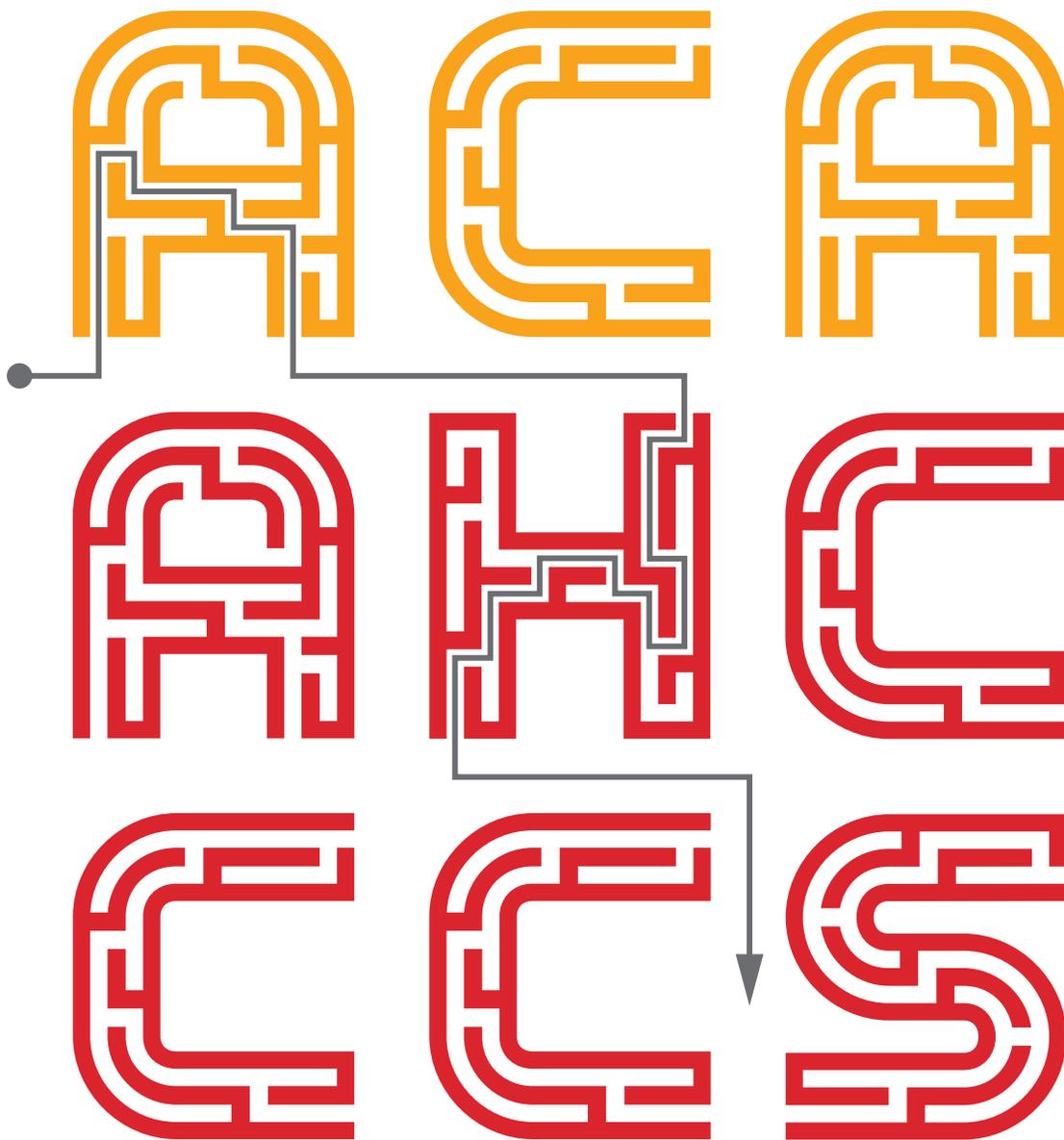


## The Affordable Care Act and Arizona's Medicaid Program

Where We've Been and Where We Could Be Headed



**July 2017** This report aims to provide an overview of the historical impact of the ACA on Arizona's Medicaid Program and concludes with questions that stakeholders will need to consider moving forward.

# An Introduction to the ACA and Medicaid

Since its establishment in 2010, the Affordable Care Act's (ACA) many provisions have become interwoven throughout Arizona law. In response to recent Congressional dialogue and action, many Arizonans are weighing the implications of further healthcare reforms. How has the ACA impacted Arizona's Medicaid program? What would a repeal of the ACA mean for Arizonans currently covered by Medicaid? What would a repeal mean for Arizona's economy? While policy and political debates about the future of the ACA persist, this report aims to pause, reflect and provide an overview of the historical impact of the ACA on Arizona's Medicaid Program, known as the Arizona Health Care Cost Containment System (AHCCCS), and KidsCare, the state's Children's Health Insurance Program (CHIP). It concludes with questions that lawmakers and other stakeholders will need to consider as Arizona's Medicaid program moves forward.



IT IS IMPORTANT TO UNDERSTAND HOW THE ACA HAS IMPACTED ARIZONA'S HEALTHCARE DELIVERY SYSTEMS AND ECONOMY, AND WHAT A REPEAL COULD MEAN FOR ARIZONA RESIDENTS.

## History

Medicaid is the primary source of health coverage for the country's low-income and disabled populations. While Arizona's Medicaid program, AHCCCS, has been in operation since 1982, the passage of the ACA has made many notable changes to the program, including its expansion to over 426,000 newly-enrolled individuals (see Chart 2). To understand the full impact of the ACA on the state's Medicaid program, and in turn, the potential cost of a repeal, it is necessary to review the history and background of Medicaid in Arizona.

By all accounts, AHCCCS was a pioneer program, the first Medicaid program of its kind in the country. At the time of its inception, all other states with Medicaid programs employed a fee-for-service model, under which the enrollee sees a provider and the provider bills the state for services rendered. Arizona's Medicaid system, however, operates under an alternative managed care model, a system that saves the state money while providing a more streamlined approach to healthcare delivery.

## Arizona's Medicaid Managed Care Model

Under a managed care model, the state contracts with multiple insurance companies, known as Managed Care Organizations (MCOs). These health plans contract directly with providers and pay for medical services rendered to the Medicaid enrollee, much like a traditional insurance plan. Enrollees are able to choose the best health plan for their individual needs based on each plan's provider network.

Payment is rendered by the state to the health plans through a "prospective capitation rate" system, whereby AHCCCS pays its contracted MCOs before any costs are accrued by the MCO. The MCO then pays the provider a negotiated rate on behalf of its enrollees. Thus, no money changes hands between the state and

the enrollee. MCOs determine rates using an actuarial process to predict the cost of the prospective population. That prediction is the basis for bids submitted by the MCOs to earn contracts with AHCCCS, and for negotiated rates to be paid by the state to the MCOs.

AHCCCS is a \$12 billion dollar program serving approximately 1.9 million individuals and families throughout Arizona with more than 60,000 healthcare providers across the state.<sup>1</sup> The program is funded through county, state and federal funds, and operates under a federal research demonstration waiver, known as the Section 1115 demonstration waiver, which has been in place since Arizona adopted its Medicaid program in 1982. This waiver allows for Arizona’s unique public-private partnership to operate its managed care model – a model which must be approved by Center for Medicare & Medicaid Services (CMS) every three to five years.<sup>2</sup>

On September 30, 2016, Arizona received federal approval for a five-year extension to its existing federal demonstration waiver with certain modifications focusing on personal responsibility and healthy behaviors. Under the new waiver, personal financial contributions will be mandatory for certain adult groups, and incentives will be provided for healthy behaviors. Financial participation in the form of capped co-pays and premiums will be required for adults who are part of the “New Adult Group” which includes Proposition 204 childless adults and expansion adults.<sup>3</sup> These categories are discussed later in further detail. The new program will be known as AHCCCS Choice, Accountability, Responsibility, Engagement (CARE).



# The ACA's Impact on Medicaid in Arizona

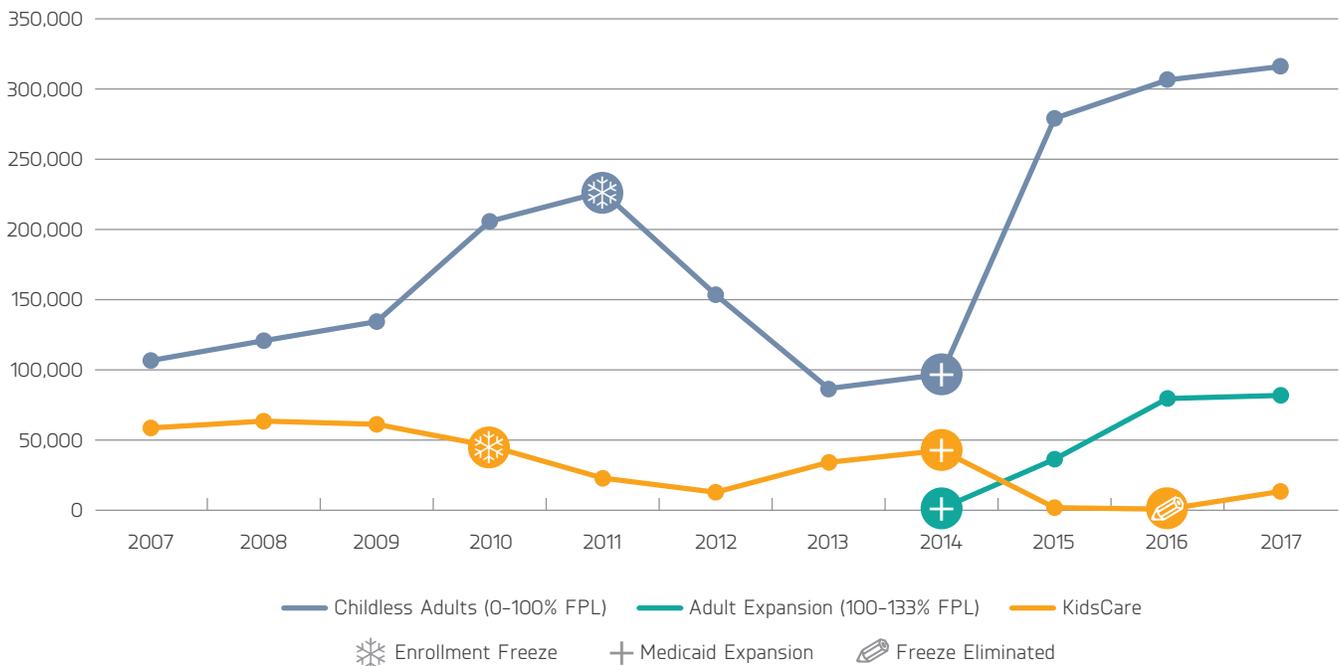
## Medicaid Eligibility

The number of individuals in Arizona eligible for and receiving health coverage through AHCCCS has increased significantly since the passage of the ACA. Expanded eligibility for the traditional Medicaid program represents the most significant change to Medicaid under the ACA (See Chart 1). As of July 2017, AHCCCS has experienced a net gain of approximately 426,000 members due to provisions within the ACA (See Chart 2). The majority of this growth came from the restoration of coverage for the childless adult population and Medicaid's eligibility expansion to children and adults earning up to 133% of the Federal Poverty Level (FPL) – roughly \$15,800 for an individual or \$32,300 for a family of four in 2016. The FPL represents an income measurement used by the U.S. Department of Health and Human Services to determine eligibility for Medicaid, CHIP, and other federal programs and benefits.



In 2000, Arizona voters passed an initiative known as Proposition 204, which expanded eligibility to childless adults earning up to 100% FPL (roughly \$11,880 for an individual). The childless adult coverage was to be funded by tobacco

FIGURE 1 AHCCCS Enrollment Trends by Population BY NUMBER OF MEMBERS ENROLLED



Source: Arizona Health Care Cost Containment System. (n.d.). [Population by Category; Population highlights]. AHCCCS Document Archive. Retrieved from <https://archive.azahcccs.gov/>

## CHART 1 Medicaid Eligibility Pre- and Post-Expansion

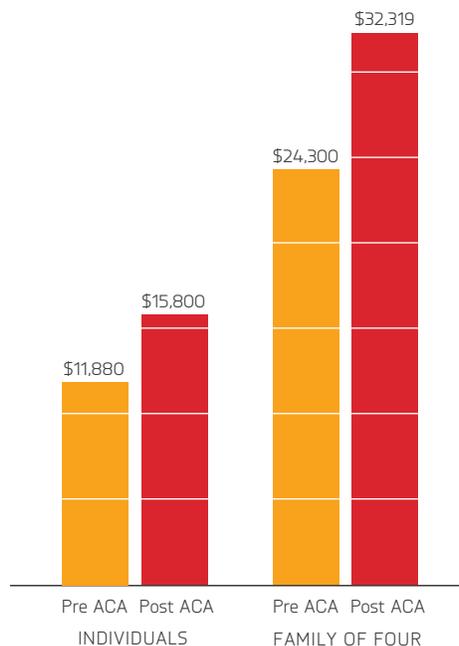
Population	Arizona Eligibility Pre-Expansion (Upper Limit)	Arizona Eligibility Post-Expansion (Upper Limit)
Babies Ages 0-1	140% FPL	140% FPL
Children Ages 1-5	133% FPL	133% FPL
Children Ages 6-9	100% FPL	133% FPL
Children Ages 9-18	100% FPL	133% FPL
Parents	22% FPL	133% FPL
Childless Adults	100% FPL (enrollment was frozen from '11-'14)	133% FPL
Adult Expansion Population	0% FPL	133% FPL
Pregnant Women	150% FPL	150% FPL
Elderly, Blind, Disabled	75% FPL	100% FPL
KidsCare	200% FPL	133-200% FPL (children under 133% FPL transferred to traditional Medicaid)
Long-Term Care (ALTCs)	Combination of assets and income	Combination of assets and income

Sources: Arizona State Legislature. (2016). Expansion of Medicaid Eligibility. Retrieved from <http://azleg.gov/jlbc/psaxsmedicaid.pdf>; Arizona State Legislature. (2016). Arizona Long Term Care System. Retrieved from <http://www.azleg.gov/jlbc/psaxsaltcs.pdf>; Arizona State Legislature. (2015). FY 2015 Baseline. Retrieved from <http://www.azleg.gov/jlbc/15baseline/axs.pdf>

litigation settlement proceeds and “supplemented, as necessary, by any other available sources, including legislative appropriations and federal monies.”<sup>4</sup> Arizona was one of only six states to expand Medicaid coverage to this population. In 2011, however, as a result of the fiscal challenges related to the Great Recession, the Arizona Legislature enacted – and then-Governor Jan Brewer signed into law – an enrollment freeze on this population. The freeze lasted from 2011 to 2014.

In 2014, in direct response to increased financial incentives offered by the ACA, Arizona restored eligibility to the Proposition 204 childless adult population earning up to 100% FPL, and expanded Medicaid eligibility to children and adults earning up to 133% FPL.<sup>5</sup>

FIGURE 2 AHCCCS Eligibility by Income PRE- AND POST-EXPANSION



Source: Medicaid and CHIP Payment and Access Commission. (2016). MACStats: Medicaid and CHIP Data Book. Retrieved from [https://www.macpac.gov/wp-content/uploads/2016/12/MACStats\\_DataBook\\_Dec2016.pdf](https://www.macpac.gov/wp-content/uploads/2016/12/MACStats_DataBook_Dec2016.pdf)

CHART 2 AHCCCS Enrollment Growth Due to ACA DECEMBER 2013-JULY 2017

Population	Enrollment Growth <sup>6</sup>
Adult Expansion	82,199
Child Expansion	73,603
Childless Adults (Prop 204)	249,024
KidsCare*	21,098
<b>TOTAL</b>	<b>425,924</b>

\* Represents growth since September 2016, when KidsCare was reinstated

Source: Arizona Health Care Cost Containment System. (n.d.). [Population by Category; Population highlights]. AHCCCS Document Archive. Retrieved from <https://archive.azahcccs.gov/>

# ACA Funding and Arizona’s Medicaid Program

The ACA, as originally enacted, required states to implement coverage for the Medicaid expansion population up to 133% FPL. However, the U.S. Supreme Court ruled that the federal government could not require states to adopt the new, wider eligibility standards, so Medicaid expansion became optional for each state.<sup>7</sup>

After a long, hard fought legislative battle in Arizona, and due in large part to the creation of a coalition comprised of moderate Republican and Democratic legislators, then-Governor Jan Brewer and healthcare and business interests, the legislature voted to both expand Medicaid coverage and lift the freeze on the childless adult population.<sup>5</sup> The vote was based largely on two factors: 1) the enhanced Federal Medical Assistance Percentage (FMAP) (i.e., the amount of money the federal government matches the states to defray the cost of Medicaid) and 2) the creation of a hospital assessment to pay the state’s share of the costs.



FEDERAL MATCHING RATES ARE A COMPLICATED, BUT IMPORTANT ISSUE.

Federal matching rates are a complicated, but important issue. For every dollar the state spends, the federal government contributes two or more dollars depending on the population served. The ACA committed the federal government to fully fund states’ costs associated with Medicaid expansion, thereby incentivizing Arizona to expand Medicaid eligibility. In 2016, the 100% federal match rate for the adult expansion group dropped to 95%; and in 2020, it falls to 90%. Children in the expansion population are funded 100% by the federal government through 2019, at which point the FMAP falls to 3:1 (See Chart 3).

In addition to expanding Medicaid eligibility to individuals earning 100-133% FPL, the ACA also provided incentives for states to cover childless adults – a population not covered by most states. Arizona, however, had already voted to cover childless adults under Proposition 204, and therefore was one of six states ineligible to receive enhanced federal funding for this population. In other words, under the ACA, Arizona’s childless adults were not considered part of the expansion population. The 44 states that had not previously covered this population were eligible for full federal funding for this coverage. To address this inequity, the ACA offered an enhanced federal match specific to the six states already providing coverage for childless adults. The match started at 83% and increases to 90% by 2020 (See Chart 3).

CHART 3 FMAP Dollars Received Pre- and Post-ACA

Population	FMAP Pre-ACA	FMAP Post-ACA
Children Ages 6-9	3:1	100% until October 1, 2019; then back to 3:1
Children Ages 9-18	3:1	100% until October 1, 2019; then back to 3:1
Childless Adults	2:1	83.62% in 2014; increased to 90.28% in 2017. Settles at 90% in 2020 and forward
Adult Expansion Population	Not previously covered	100% until 2016; drops to 95% in 2017; 90% in 2020 and forward
KidsCare	3:1	100% until October 1, 2019; then back to 3:1

Source: Arizona State Legislature. (2016). Expansion of Medicaid Eligibility. Retrieved from <http://azleg.gov/jlbc/psaxsmcicaid.pdf>

# Hospital Assessment

As part of the legislation expanding Medicaid and restoring coverage for childless adults, the state created the Hospital Assessment Fund, which is designed to finance the state's portion of Medicaid expansion and coverage to childless adults.<sup>5</sup> Many states throughout the country employ unique provider assessment models as a tool to finance Medicaid. The basic structure allows hospitals or providers to make payments to the state, which are used to trigger federal matching funds at a predetermined FMAP rate, the cost of which is eventually returned to the provider in the form of Medicaid reimbursements. Arizona's hospital assessment is implemented by AHCCCS and is based on hospital discharges. Hospitals are in support of the assessment because, even though it represents a new expense, the corresponding reduction in uncompensated care supports hospitals in fulfilling their missions. Uncompensated care is the cost to hospitals and providers to treat uninsured individuals.

The assessment has been the subject of ongoing litigation since the passage of Medicaid expansion in 2014. Legislators who opposed Medicaid expansion sued the state, arguing the assessment is not a fee but a tax requiring a two-thirds vote for passage.<sup>8</sup> Those who voted in favor of Medicaid expansion argued the assessment was a fee, not a tax, and only required a simple majority vote for passage. The Maricopa County Superior Court, in 2015, held that the assessment is a fee that was lawfully enacted by the state legislature.<sup>8</sup> The ruling was immediately appealed, and in March 2017, the Arizona Court of Appeals reaffirmed the Superior Court's ruling, stating once again the assessment was legally enacted.

Although Arizona's Medicaid expansion has survived two court cases to date, the legislation includes a "circuit-breaker" provision, which stipulates that the hospital assessment and coverage for the expansion population will be automatically repealed if: a) the federal match falls below 80%; b) the ACA is repealed; or c) the hospital assessment becomes insufficient to cover the cost of the expansion or childless adult populations.<sup>5</sup> As a result, funding for Arizonans covered under Medicaid expansion and Proposition 204 would be eliminated. Arizona would then have to decide whether to continue funding coverage for childless adults and the expansion population.

THE HOSPITAL ASSESSMENT AND COVERAGE FOR THE EXPANSION POPULATION WILL AUTOMATICALLY BE REPEALED IF THE FEDERAL MATCH FALLS BELOW 80% OR IF THE ACA IS REPEALED.



## KidsCare/CHIP

KidsCare is Arizona's Children's Health Insurance Program, which is operated by AHCCCS and funded through state and federal dollars. KidsCare provides coverage to children whose families earn too much to qualify for AHCCCS but not enough to purchase private insurance on the individual market. Historically, the program provided coverage for children of families earning up to 200% FPL.

Under the ACA, children's healthcare was most notably impacted by Medicaid's expansion to cover all children whose families earned up to 133% FPL. This meant that some children who had been previously eligible under CHIP could instead be covered by traditional Medicaid. In Arizona, that provision led to 26,300 children transferring from KidsCare to traditional AHCCCS.<sup>9</sup> From a federal perspective, the remaining children whose families earned between 133-200% FPL were then able to qualify for CHIP. In Arizona, however, KidsCare enrollment had been frozen since January 2010 – a policy decision made in direct response to the state's budget deficit during the Great Recession. Therefore, children between 133-200% FPL were unable to find coverage from traditional Medicaid nor KidsCare. During the freeze, KidsCare members could continue coverage in the program, but no new members were permitted to enroll. Due to a number of factors, including fluctuations in income, failure to pay premiums, and changing life circumstances, the freeze resulted in an enrollment reduction from 45,800 children in 2010<sup>10</sup> to 528 children in 2016.<sup>11</sup>

In May 2016, due in large part to a 100% FMAP, Arizona enacted legislation that lifted the KidsCare freeze, and AHCCCS began enrolling new members on September 1, 2016.<sup>12</sup> Should the federal government decide to reduce the 100% FMAP, KidsCare enrollment would be frozen yet again. As of May 2017, enrollment in KidsCare had increased to nearly 20,000 members, and that number continues to grow.<sup>13</sup>

## Enrollment Increases in AHCCCS and KidsCare

As a direct result of the ACA, AHCCCS's population has increased by more than 426,000 members (see Chart 2). This includes adult and child expansion populations, childless adults, and KidsCare. AHCCCS also experienced an increase in enrollment by the previously eligible but not enrolled population due to the publicity surrounding expansion, often referred to as the "woodwork effect." It is impossible to know exactly how many enrollees fell into this population because enrollment of these individuals cannot be distinguished from the base population.

## Prescription Drug Rebate Program

A little known, but highly impactful provision in the ACA is the expansion of prescription drug rebates. The ACA amended Medicaid's outpatient prescription drug program to require pharmaceutical companies to provide rebates for drugs dispensed to Medicaid beneficiaries in states that utilize MCO programs. Prior to the ACA, these rebates were only available in states that utilized fee-for-service Medicaid programs. Arizona currently receives more than \$100 million in rebates annually to offset costs to the general fund.<sup>14</sup>

A FREEZE ON KIDSCARE ENROLLMENT IN JANUARY 2010 RESULTED IN AN ENROLLMENT REDUCTION FROM 45,800 CHILDREN IN 2010<sup>10</sup> TO 528 CHILDREN IN 2016.<sup>11</sup>



# Repealing and Replacing the ACA: Implications for Medicaid

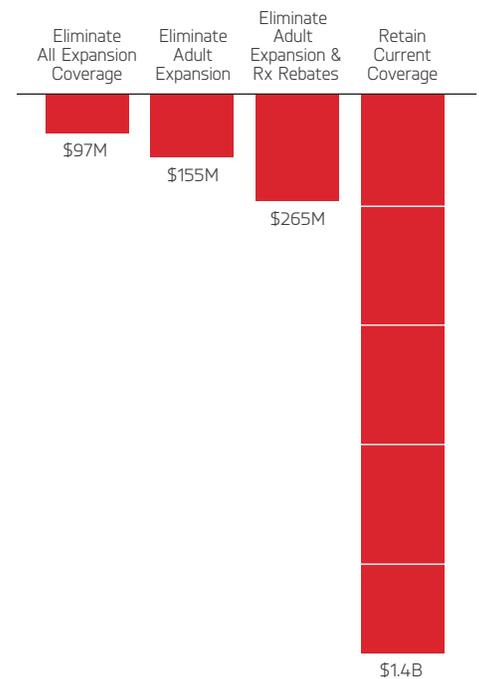
As Congress continues to debate ACA reforms, uncertainty about the future of Arizona’s healthcare system grows. What is clear is that the ACA has had a significant impact on Arizona’s economy, both in terms of increased federal dollars entering the state and reductions in uninsured individuals through Medicaid expansion.

According to local officials, a full repeal of Medicaid expansion would result in the loss of an estimated \$3.2 billion in federal matching funds coming into the state in the first year<sup>15</sup> and the loss of the prescription drug rebate program, responsible for more than \$100 million in federal funds coming into the state annually.<sup>14</sup> One study estimates the repeal of all ACA and Medicaid funding would result in the loss of 62,659 Arizona jobs, roughly half of which would constitute reductions in Arizona’s healthcare workforce.<sup>16</sup>

Should the ACA be repealed, Arizona will be forced to choose between various options to alter its Medicaid program; and each option is likely to cost the state more than it’s currently paying. On the low end of the spending spectrum, if Arizona chooses to eliminate all coverage expansions, including traditional Medicaid for children and adults and the restoration of coverage for childless adults, but retain coverage for all other previously-eligible populations, the state will spend an additional \$97 million dollars per year (due to the loss of the enhanced FMAP).<sup>12</sup> The cost to retain coverage for children in the expansion population but eliminate all adult expansion coverage is estimated at \$155 million per year.<sup>17</sup> If the state eliminates all coverage expansions and loses the prescription rebate program, it will cost an additional \$265 million to retain coverage for all previously eligible populations.<sup>17</sup> Finally, on the high end, the cost to retain current coverage for all expansion populations is \$1.4 billion dollars per year due to the loss of the enhanced FMAP, which must be backfilled with state dollars.<sup>17</sup> These figures are contingent on any final repeal and replace package and its financing structure.

Additionally, a repeal could result in the loss of coverage for approximately 430,000 adults and children covered under Medicaid, including the adult and child expansion populations and the childless adult population (See Chart 2). Consequently, hospital uncompensated care costs would rise, potentially forcing hospitals to increase cost in other areas. Since the passage of the ACA in Arizona, uncompensated care has dropped by \$541 million – from roughly 8% to 2.7% of total hospital expenses.<sup>18</sup>

FIGURE 3 ACA Repeal Scenarios and the Cost to Arizona’s General Fund  
DOLLARS PER YEAR



Source: Arizona State Legislature. (2017). Arizona Health Care Cost Containment System. [Appropriations Committee Hearings presentation]. Retrieved from <http://www.azleg.gov/jlbc/18ahcccsjlbcpres.pdf>

IN ARIZONA, UNCOMPENSATED CARE HAS DROPPED BY \$541 MILLION SINCE 2014.

There are many approaches the federal government could take to repeal and replace the ACA's provisions related to Medicaid. Assuming any scenario includes a repeal of the newly eligible populations, the potential ramifications will likely include:

- an increase in the state's rate of uninsured;
- an increase in uncompensated care costs;
- increased pressure on state budgets;
- pressure on commercial rates; and
- a reduction in state economic activity.

## Medicaid Finance Alternatives

Several general concepts have emerged during ongoing efforts by Congress to find a replacement plan. The current Medicaid program is designed to allow all eligible individuals to participate in the program with no waiting lists or enrollment caps, and states are guaranteed a federal match rate with no limit on annual spending. The federal match fluctuates with both enrollment growth and healthcare cost increases. Under the two most common replacement scenarios cited by Congress, this guaranteed entitlement for eligible individuals would end, as would the guaranteed federal match. In its place, Congress would finance state Medicaid programs through per capita caps and/or block grants.

A per capita cap program would set caps on the amount of federal dollars provided per enrollee. This model could take many forms. The cap could be a set amount for all enrollees, or separate caps could be imposed for separate coverage

groups (children, adults, people with disabilities, etc.). Dollar amounts provided to states would be the sum of the per enrollee amount multiplied by the number of enrollees in each group.<sup>19</sup> To produce federal savings, the cap amount per enrollee must be less than the amount needed to cover the enrollee under current law. Federal funding would increase as enrollment grows. While this approach does address enrollment growth, it does not address continued increases in healthcare costs. To address this shortcoming, a modifier would be included to adjust for the cost of inflation. Such modifiers are likely to be formed as a variant of the Consumer Price Index.

A federal block grant program would provide states with a single, preset dollar amount to spend on Medicaid each year. To produce federal savings, the block grant amount would need to be less than anticipated costs needed to cover all enrollees. A block grant program would not provide funding increases commensurate with enrollment growth.

To understand what these changes would mean for Arizona, it is important to understand AHCCCS' historical spending performance compared to the nation. AHCCCS is often mentioned as a low-cost, efficient Medicaid program. In 2013, AHCCCS' per member spend was nearly \$2,000 less than the national average (\$5,821 versus \$7,766, respectively), and its spend per each aged member was over \$7,000 less than the national average (\$12,321 versus \$19,912, respectively).<sup>20</sup> If funding formulas for an alternative financing model are based on each state's historical spending habits, Arizona will perpetually be locked into receiving significantly less federal funding. Conversely, less-efficient states will forever receive greater federal funding. Future fluctuations in

healthcare costs, due to expensive new drugs or disease outbreaks, would force Arizona to decide between spending additional general fund dollars or cutting costs. Such cost-savings would likely include reduced provider reimbursements, reduced Medicaid eligibility, or reduced benefit packages. This speaks to the imperative for any financing alternatives to include a formula which accurately accounts for state-specific inflation and flexibility for unexpected costs. In response to this concern, Governor Ducey has called for either program's payments to be "...largely aligned with national averages," rather than based on current state spending.<sup>21</sup>



# Concluding Thoughts

While it is not clear what the final congressional repeal and replace package will look like, there is a clear risk that all or a portion of Medicaid expansion coverage could be eliminated, and the traditional federal-state partnership could be significantly altered, placing more risk and costs onto states. Without adequate financing and careful consideration, repealing the ACA is likely to result in a greater number of uninsured Arizonans, increased uncompensated care for Arizona's healthcare industry, and increased pressure on the state's budget. This raises a number of questions about methods to lessen the personal and financial impact to the state and its residents.

Once Congress acts, Arizona's political leadership will need to answer critical questions about the future of the state's Medicaid program and the state budget. For example:

- Can Arizona afford to maintain coverage for people covered under Medicaid expansion?
- If Medicaid funding is cut, how can Arizona mitigate the negative impacts to its most-vulnerable citizens?

- If Arizona continues covering certain populations, will the state backfill federal cuts with funding from other areas, such as education?
- How can Arizona ensure that Medicaid changes don't impede the state's growing economy?

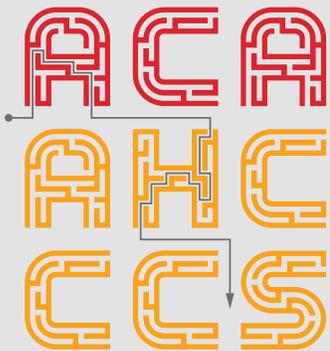
Arizona's Medicaid program is largely considered a success due to its ability to provide quality coverage for more than one-quarter of the state's population; and it does so while holding costs significantly below national averages. Arizona's healthcare leadership and legislators took a risk in 2014 by expanding Medicaid eligibility – a risk that has paid dividends to Arizona's economy and its citizens. While Congress' actions will undoubtedly have a significant effect on Arizona, eventually, critical decisions regarding the future of AHCCCS will be placed in the hands of Arizonans and their elected officials. Medicaid coverage and financing may be complex (and sometimes ugly), but it's important for Arizona to continue moving forward for the sake of its economy and its people.

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**The Affordable Care Act and  
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