

NLWJC - Kagan

DPC - Box 029 - Folder 012

Health - Medicaid Cap

October 3, 1997

MEMORANDUM TO THE CHIEF OF STAFF

cc: Sylvia Matthews, John Podesta, Bruce Reed, Gene Sperling, Frank Raines, Rahm Emanuel, John Hilley, Mickey Ibarra, Jack Lew, and Josh Gotbaum

FROM: Chris Jennings

RE: NEW YORK AND THE PROVIDER TAX ISSUE

On Monday, we (DPC, OMB and HHS) will brief you on the status of our Medicaid provider tax enforcement plans for New York and other states who may be out of compliance with current law and regulations. As you well know, this issue is extremely controversial. Therefore, it is critically important that ~~the~~ we have Administration-wide agreement and understanding on how we will announce our position on outstanding provider taxes and on how we will subsequently negotiate with affected states. This memo provides you with background information to help prepare you for the Monday briefing.

BACKGROUND

Financing scheme. During the late 1980s, many states established financing schemes that had the effect of increasing their Federal Medicaid funds without using additional state resources. Typically, states would raise funds from health care providers (through provider taxes or "donations"), then pay back those providers through increased Medicaid payments. Since the Federal government pays at least half of Medicaid payments, the provider taxes or donations would be repaid in large part by Federal matching payments. Using this mechanism, the state was left with a net gain because it only had to repay part of the provider tax or donation it originally received. This led to an unprecedented drain on the Federal Treasury — the major reason why Federal Medicaid costs more than doubled between 1988 and 1992.

The law and regulatory interpretation of the law. Because provider taxes and donations were effectively siphoning off potentially billions of dollars from the Federal Treasury, the Congress limited states' use of these schemes in a bill enacted by President Bush in 1991. It is important to note that the subsequent regulatory interpretation of these limits -- the very regulations that we are now planning to enforce -- was negotiated with the states and the National Governors' Association in 1993.

States' continued reliance on impermissible provider taxes and our enforcement record.

Despite the new law and the regulations, many states continued to use provider taxes that at least appeared to be out of compliance. To date, these possibly impermissible taxes total an estimated \$2 to 4 billion and, in the future, will cost billions more. In response, HCFA issued letters and discussed its concerns about certain taxes with states, but -- for a variety of reasons -- never took any final action (called a "disallowance"). Unfortunately, this has meant that a number of states have continued using these taxes, believing that HCFA might never enforce the law, or that if they did, they could seek recourse through the White House or the Congress. (In fact, since we do not have a good track record on enforcement, budget examiners at CBO and in the Administration have already written off Federal revenue raised through these provider taxes; this is important to know since it means we could waive past "abuses" retrospectively and it might not be scored as a cost.)

The New York provision in the balanced budget. To ensure that New York would never be vulnerable to Medicaid provider tax enforcement actions, Senator Moynihan and Senator D'Amato successfully added a provision to the Balanced Budget Act to exempt all of its provider taxes (it has dozens), both retrospectively and prospectively, from disallowances. Both in writing and orally we repeatedly objected to this provision. Moreover, we provided alternative statutory language that would have addressed about two-thirds (over \$1 billion worth) of the problem. As you know, however, the Senators (through their staff) rejected our offer and insisted on their original provisions.

Line-item veto and New York's reaction. In announcing the line-item^{veto} veto on August 11, we raised concerns about the cost and ramifications of singling out as permissible one state's provider taxes. Although our actions were generally viewed as responsible and defensible by those who know the program and/or who are budget experts, the same clearly cannot be said of New York's political establishment. The Governor's office, the New York Congressional delegation, the Mayor, providers and unions reacted strongly and negatively to the veto. Among a host of complaints, they charged that they were singled out and were never made aware that this provision could be subject to the line-item veto. Most recently they have criticized us for our delay in getting back to them and our willingness to support fixes for the other two vetoed provisions without addressing their problem.

Review of provider taxes in New York and other states. In August, we began a review of the options to address provider taxes in New York and other states. At the time, we well knew that this action would force us to finally attempt to move to enforce laws against provider taxes in all 36 states that may be out of compliance. We also knew that we had to take this position to support our justification for the line-item veto that no individual state be singled out for special treatment.

Wednesday's actions. We believe that our discussion with New York next Wednesday about their provider tax status necessitates that we concurrently release similar information to every other potentially affected state. Three types of actions resulting from this comprehensive review will be announced. First, HCFA will clarify its interpretation of the law and correct the regulation affecting one of the largest New York provider taxes. These policy clarifications will provide relief to 10 states, the largest amount (over \$1 billion) going to New York.

Second, HCFA will issue letters to 9 other states notifying them that one or several of their taxes may be impermissible. Two more states, New York and Louisiana, will also receive this news, but it will be in a letter that also provides some good news about other provider taxes in their states. HCFA will immediately contact these states to begin discussions. The letters do not contain final decisions nor are they legally binding; however, they tell these states that, without further information, HCFA could conduct an audit.

Third, HCFA will ask another 17 states for more information on one or more of their provider taxes, to assess if they are permissible. (Nine other states who are in one of the top two categories will get similar requests.) For these states, we simply do not have sufficient information to determine the legality of at least some of their taxes. As we discuss this issue with these states, however, we will also make certain they are aware that they may be eligible for waivers that make their taxes permissible and/or that the provision of additional information may well clarify the legality of their taxes. [NOTE: All states affected are listed in the attached document; dollar amounts are not listed because we will not know them until/unless the states are audited.]

Discussions and negotiations. The follow up to these letters will be, we hope, immediate discussions between HCFA and the states. Our primary goal is to protect the Federal Treasury prospectively. We may have to trade getting only a fraction of the retrospective disallowed taxes in return for expeditious agreements to prevent future use of impermissible taxes. However, the Department of Justice, which must approve all settlements, has not yet decided how it will evaluate these settlements. This information is crucial to HCFA's ability to negotiate with states in good faith.

Implications. Very few of the states who receive notices will be pleased. For example, although HCFA is relieving approximately two-thirds of New York's past impermissible tax claims (worth over \$1 billion), there is still at least \$500 million in taxes that HCFA probably cannot consider legal. The New York delegation has already put us on notice that nothing less than a "hold harmless" solution is acceptable. They define this as meaning that they want us to waive all current taxes both retrospectively and prospectively; in other words, they want the provisions we line-item vetoed.

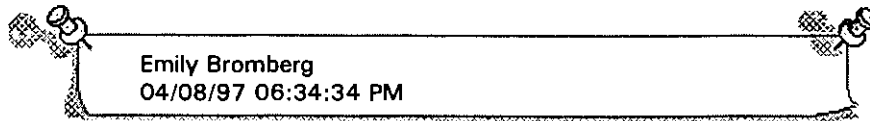
Those states most displeased will be the 10 others receiving letters that say that we believe that one or more of their provider taxes clearly appear to be out of compliance. They are: Hawaii, Illinois, Indiana, Louisiana, Maine, Massachusetts, Minnesota, Missouri, Nevada, and Tennessee. Governor Carnahan, who met with Jack Lew recently to discuss Medicaid issues, made it clear that he considers his taxes legal and will go to court if necessary. There is no question that Missouri has the largest problem — they could owe nearly \$1 billion.

Another complication is that we anticipate that many of these states will appeal to you or the President to over-ride these preliminary or subsequent decisions. Since this is an enforcement action, we all need to be extremely careful about intervening. We must ensure that you and others who might be talking with Governors are well briefed on the issues, arguments and process.

Finally, some states will inevitably seek legislative solutions, like New York's balanced budget provision. While we probably should not encourage this action (for the same reasons that we vetoed the New York provision), we also should not foreclose the possibility that some type of comprehensive legislative clarification could be helpful as we aim to end the practice of illegitimately using provider taxes.

Roll-out strategy. Obviously, our rationale and process for explaining our enforcement actions is crucial. DPC/NEC and OMB are working with HHS and HCFA to ensure that we have an effective roll-out. This will include how we provide information to the Congress, the states, interested providers and unions, experts who will validate our enforcement action and influence elite media coverage, and -- of course -- a carefully orchestrated New York strategy.

We will provide more details of the roll-out on Monday. We thought providing you this information first, however, would facilitate a more efficient discussion of this issue and how we are going to deal with it.



Record Type: Record

To: Christopher C. Jennings/OPD/EOP, Nancy A. Min/OMB/EOP, Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc: John L. Hilley/WHO/EOP, Jacob J. Lew/OMB/EOP, Gene B. Sperling/OPD/EOP, Jill M. Blickstein/OMB/EOP

Subject: govts and medicaid

The NGA has sent a letter requesting a POTUS meeting with the Medicaid Task Force (Miller, Chiles, Dean, Leavitt, Voinivich, Thompson) for late April or early May. It is clear from conversations with Ray, Executive Director of NGA, (who says he's calling Jack and Chris) and from the Dems that the purpose of the meeting is to make clear to the POTUS their opposition to the per capita cap and to reiterate that they will not support children's health initiative unless we drop the cap. Ray is pretty worked up as are the Dems. They say they've heard from committee staffers that for us the cap and disproportionate share cuts are not negotiable and must have in the budget talks.

Any advice on a response? The Govs plan to meet with the leadership on the Hill as well. Even the Dems are saying this is a huge fight for them--and they are saying that our plan forces them to reduce benefits and cuts kids off.

File Health -
Medicaid caps

E X E C U T I V E O F F I C E O F T H E P R E S I D E N T

13-Jan-1997 02:29pm

TO: (See Below)

FROM: Christopher C. Jennings
 Domestic Policy Council

SUBJECT: Pear article on Medicaid

Robert Pear just called. He is doing an article on Medicaid and where we are going to end up re savings and per capita cap/DSH policy. (Melissa S. told me last week that he was fishing around the Department for info).

He did not mention any savings number, nor even ask me to give him one. However, he seems to be doing an article that focuses on the per capita cap issue and the negative response the Hill Democrats and the advocates group have to reports that we are maintaining our past policy. I said I could neither confirm or deny that was the case. I did say that our past policy had a combination of savings from a per capita cap and DSH savings, and that we always say that our next policy will start with a review of our last budget. He said it did not matter because he has it on "good authority from other Administration sources" that we are maintaining our per capita cap proposal.

He also was fishing for a story about how Donna Shalala was the only Administration rep who opposed the per capita cap, but that her views were shoved aside by the White House. I did not play into that game.

I do not think there is anything we can do on this one. In the end, it might not end up being so bad for us. However, I thought I should give you all a heads up. I am always concerned whenever Robert is about to write a story.

cj

Distribution:

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