SENATE FISCAL AGENCY
MEMORANDUM

DATE: February 3, 2006

TO: Members of the Michigan Senate

FROM: Steve Angelotti, Fiscal Analyst
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RE: Congressional Action on S. 1932, the Deficit Reduction Act of 2005

On February 1, 2006, the United States House of Representatives adopted the Conference Report on S. 1932, the Deficit Reduction Act of 2005. President Bush is expected to sign this act. The Conference Report includes a number of provisions related to human services programs that will affect the State of Michigan, especially the Medicaid program and the Department of Human Services budget.

What follows is an overview of the major provisions by category, based on information provided by the National Council of State Legislatures, the Congressional Budget Office (CBO), and other sources.

PROVISIONS AFFECTING MEDICAID AND MI-CHILD

Pharmaceutical Rebates

Current Law: Rebates paid by manufacturers to States are set as a percentage of the average wholesale price (AWP) paid to manufacturers. States are permitted to use Medicaid preferred drug lists to reduce pharmaceutical expenditures.

Conference Report: The Conference Report would change the basis for payment from 150% of the wholesale price to 250% of the average manufacturer price, effective January 1, 2007.

Effect on Michigan: The provision would lead to significant savings for the State as the basis for reimbursement would change to a lower cost basis.

Long Term Care Asset Transfer

Current Law: The assets of a person in a nursing home applying for Medicaid are subject to a 36-month look back period (60 months if a trust is involved). This look back period exists to see if assets were transferred in order to qualify the patient for Medicaid.

Conference Report: The Conference Report would extend the look back period to 60 months for all applicants. Those with home equity over $500,000 would not be eligible for Medicaid.

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Effect on Michigan: These provisions would save money both for the Federal government and the states.

Home and Community Based Waiver

Current Law: States may seek waivers to cover home and community based services. Michigan's waiver program has been in existence for nearly a decade.

Conference Report: The Conference Report would direct that, beginning in FY 2006-07, states would not have to seek a waiver to continue their home and community based waiver programs.

Effect on Michigan: The provision would make it easier for Michigan to continue its current program without having to go through a lengthy renewal process.

Medicaid Cost-Sharing

Current Law: Nominal copayments, not exceeding $3 for most services, are permitted in Medicaid. If a Medicaid client states that he or she cannot afford a copayment, the provider is not allowed to require the person to pay the copayment as a condition of receiving services.

Conference Report: The Conference Report would allow cost-sharing not to exceed 10% of the cost of service for those between 100% and 150% of the poverty level. The Conference Report would allow cost-sharing not to exceed 20% of the cost of service for those above 150% of the poverty level. Premiums would be allowed for those over 150% of poverty as long as the premiums did not exceed 5% of income. The Conference Report would permit providers to refuse to provide services to those who are unwilling to make copayments.

Effect on Michigan: The provisions would allow a significant expansion of copayments and premiums, which, if implemented in Michigan, would lead to savings for the State.

Alternative Benefit Design

Current Law: With a few exceptions, benefits offered for any Medicaid eligibility group in a state must be offered to all eligibles.

Conference Report: States may provide a limited benefit package to certain non-disabled, non-pregnant adults who have previously been eligible for the program.

Effect on Michigan: This provision would allow the State to limit benefits for certain populations without seeking a waiver, and thus could lead to savings.

Medicaid Managed Care Quality Assurance Assessment Programs (QAAPs)

Current Law: Federal law allows for QAAPs, where a provider class is taxed and then some of that revenue is used to increase Medicaid rates. In general, most providers in a provider class receive more from the Medicaid increase than they pay in the tax. However, those providers with few or no Medicaid clients will end up paying more in tax and are net losers.

Federal law defines provider classes as including "hospital services", "long term care services", and "Medicaid managed care services". Because the managed care reference specifically mentions "Medicaid", many states, including Michigan, have been able to implement managed care QAAPs that tax only Medicaid managed care organizations and not all managed care organizations. This loophole has allowed the State to ensure that all participants in the health maintenance organization (HMO) and community mental health (CMH) QAAPs have been net winners, effectively leveraging large amounts of Federal dollars to supplant GF/GP.

Conference Report: The "Medicaid managed care" loophole would be closed, effective October 2009 (FY 2009-10) for those states such as Michigan which already have managed care QAAPs.

Effect on Michigan: The provision, eliminating the "Medicaid managed care" loophole, would lead to a GF/GP cost increase of at least $120 million in FY 2009-10 for Michigan.

Federal Medicaid Assistance Percentage (FMAP) Calculation

Current Law: The FMAP rate (the Medicaid match rate) is adjusted each year based on a state's personal income growth relative to that of other states. Due, in large part, to an unusual one-time pension adjustment made by General Motors Corporation, Michigan's match rate for FY 2005-06 was set lower than was originally projected, costing the state at least $40 million.

Conference Report: House and Senate provisions that would have increased Michigan's FMAP rate were not included in the Conference Report.

Effect on Michigan: No effect.

Coverage of Disabled Children

Current Law: Children who meet disability and income standards are eligible for Supplemental Security Income (SSI), which conveys categorical eligibility for Medicaid. Children who meet disability standards but whose families have higher incomes are not eligible for SSI or Medicaid.

Conference Report: The Conference Report would allow states to opt to provide Medicaid to children who would meet the SSI disability standards and whose family income is below 300% of the poverty level.

Effect on Michigan: The State could opt to cover the group denoted in the bill, although the State would have to pay for about 43% of the net costs of the coverage less premiums.

State Children's Health Insurance (SCHIP/MIChild)

Current Law: States may cover children whose family incomes are too high to qualify for Medicaid, up to 200% of the poverty level, through the SCHIP program. In Michigan the SCHIP program is known as MIChild. States have been allowed through the waiver process to use unused SCHIP dollars to expand coverage to low-income adults, both adults with children and childless adults. In Michigan this program is called the Adult Benefits Waiver (ABW).

Conference Report: The Conference Report would limit the ability of states to use SCHIP dollars to cover childless adults, but would grandfather those waiver programs already approved by the Federal government.

Effect on Michigan: The grandfather provision in the bill would mean there should be no effect on the State.

PROVISIONS AFFECTING THE DEPARTMENT OF HUMAN SERVICES (DHS)

The reauthorization of the Temporary Assistance for Needy Families (TANF) Program was included in the Conference Report.

Below are highlights of the changes in human service programs, TANF, Child Welfare, Child Support Enforcement and Low-Income Home Energy Assistance Program (LIHEAP). The impacts of these changes on Michigan are significant and will result in the reduction of Federal funds received by Michigan and potential increased state spending to comply with new Federal requirements. The changes being considered by the Congress will immediately impact on these programs, but the impact on the State budget will not be apparent until FY 2007-08.

TANF Program

Michigan, like the other states, receives block grant Federal funds as a result of the Federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996, which amended the Social Security Act. This legislation eliminated and replaced the Aid to Families with Dependent Children and related programs, Emergency Assistance, and the Job Opportunities and Basic Skills programs. Each State receives a specific amount of annual Federal funds in the form of a block grant to the State. In return the states are required to maintain a minimum level of state funding and meet the work participation requirements for welfare recipients outlined in the Federal law.

The original authorization for the TANF grants expired in Fiscal Year (FY) 2002 and has been extended 12 times; the most recent extension is through March 31, 2006. The conference agreement includes a 5 year extension of the basic TANF grant. The conference agreement funds the block grants to states at the current level of $16.5 billion through FY 2010. Michigan's share of this total funding is $775.4 million annually. In addition to the basic block grants to states, the conference report funds supplemental grants at $150.0 million per year through FY 2008. Currently supplemental grants are funded at $319.0 million per year for a high performance bonus for meeting program goals. A new supplemental grant would be funded to provide for healthy marriage promotion and responsible fatherhood programs; no more than $50.0 million annually to be competitively awarded for activities promoting responsible fatherhood and no more than $2.0 million provided to tribes for child welfare services demonstration projects.

Changes in TANF Work Requirements

The current block grant provides a caseload reduction credit against the work participation rate based on the decline in the state's welfare caseload since FY 1995. Michigan's welfare caseload has declined by 123,040 cases since FY 1995. This caseload reduction credit, coupled with the success of placing welfare recipients in jobs, has made it possible for Michigan to meet the required work requirements. The conference agreement base year for caseload decline is FY 2005 which would be in effect October 1, 2006. This change in the base year used to calculate the caseload reduction credit means that Michigan loses the ability to use the credit to meet the work participation requirements. Instead of credit for caseload decline, Michigan will have a current caseload that is greater than the base year caseload. This change will mean that Michigan will not be in compliance with the required work participation rate. The State would be out of compliance and subject to a penalty consisting of a 5% reduction in the Federal block grant or $38.8 million. This $38.8 million penalty provision also requires that the State replace the lost Federal funds with increased State funds.

The second impact on states for failing to meet the work participation requirements involves an increase in the minimum level state funding that is required to receive the Federal block grant. Michigan is currently required to maintain a state funded level of $468.6 million. This represents 75% of the average state expenditures on welfare programs prior to the authorization of the TANF program. The penalty for failing to meet the work participation requirement increases the required state minimum contribution from 75% to 80% of the average state expenditures prior to the authorization of the TANF program. This will result in a $31.2 million increase in State expenditures.

Supplemental TANF Grants

The Conference Report includes reductions in the overall level of supplemental TANF grants. Michigan has benefited by receiving $17.0 million of these supplemental grants based on the state's work participation rates for welfare recipients. Based on the changes in these work participation rates Michigan will no longer be eligible for these supplemental funds. The result would be a $17.0 million decline in the overall level of Federal TANF revenues received by Michigan.

Additional Work Requirement Penalties

The State could become liable for additional financial penalties the following fiscal year for failing to meet the minimum work participation rates. The work participation rates for eligible cases do not change; 50% for one-parent families and 90% for 2-parent families. The families receiving assistance under separate state programs will be included in the work participation rate calculation, not included in current law. The required number of work hours (30 hours for single parents with a child over 6 years of age and 20 for a parent of a child 6 or less years of age) does not change. Michigan has been deferring a portion of the caseload from work requirements as a benefit of the declined caseload credit. With that benefit gone, the State will have to increase the State's current 22% work participation rate that was reported to the Federal government for the last quarter of FY 2005 by approximately 28% in order to meet the 50% rate requirement. That percentage equates to approximately 15,500 Family Independence Program (FIP) cases that are "expected to work". In order to meet this additional work requirement, the state will have to incur additional expenditures to transition these recipients in jobs. The projected cost estimate of this transition to work will be approximately $419 per case per month for a total annual cost of $77.9 million. This additional cost will have to be paid out of existing Federal or state appropriations or additional state appropriations will be needed.

Child Care Services

The states receive Federal Child Care and Development Fund dollars to subsidize child care services for low-income families who are TANF recipients transitioning from public assistance through eligible work activities or former TANF recipients. An increased need for child care program services is related to the increase in the number of cases required to work. The conference agreement includes an additional $8.3 billion over 5 years in Mandatory Child Care and Development Fund authorization. The states are required to match this allocation with state dollars. This creates a significant cost shift to the states in the child care program costs. For example, the Michigan work participation rate is currently at 22% and therefore requires an increase in the reported cases that work at last 30 hours per week. Approximately 80% of that increase may require increased day care services for those families. At an average monthly cost of $605 per case, the annual cost estimate is approximately $90.2 million Gross, $34.2 million GF/GP.

Increased Federal Authority over States

The Secretary of the U.S. Department of Health and Human Services under the conference agreement has new extended authority to determine and provide oversight of states' related activities that may be counted as work activities, how to count and verify reported work hours, and determine who is a work-eligible person. A new penalty, a reduction of the state's grant of one to five percent, is included for states found not in compliance with the improved work participation verification procedures. It is uncertain as to whether this increased Federal oversight authority will directly impact on Michigan. If the Federal government imposes penalties on Michigan as a result of this oversight function the size of the penalty could range from between $7.8 million to $38.8 million.

Child Support Enforcement Administration

The Conference Report contains several significant changes to the funding of the Child Support Program. Under current law states are eligible for performance incentive funds based on the success of child support enforcement collection efforts. Under the conference report states will no longer be eligible for these incentive funds which are also used to draw down additional Federal funds. During FY 2004-05 the State earned $29.0 million in performance incentive funds which will be used to fund child support program costs. These expenditures are then reported to the Federal government and used to obtain additional Federal funds. This means that State will lose approximately $58.0 million. This loss of funds will impact on both State collection efforts and efforts of local Friend of the Court offices. The conference report also lowers the administrative match rate from 90% to 66% for paternity establishment laboratory costs.

Other changes in the child support enforcement collection and distribution mechanisms include a new fee. A mandatory $25 fee will be charged by states to families for whom at least $500 of support has been collected through the Program; half of the fee is retained by the State, the other passed to the Federal government. A new financial incentive for distributing more child support to current and former TANF families will be provided to states. The Federal government will pay a share of the passed through support to recipients as long as the support did not reduce the family's welfare benefit. However, this policy will negatively impact the estimated

$47.7 million child support collections appropriated in the DHS budget that is used to offset State assistance payments.

Low Income Home Energy Assistance Program (LIHEAP)

The conference agreement includes an increase of one-time emergency funding of $1.0 billion for FY 2007 in addition to the already allocated $5.1 billion authorization per year from FY 2005 to FY 2007. The emergency funds would provide assistance to low-income families to help offset anticipated higher energy costs caused by Hurricane Katrina and Hurricane Rita. This provision has a sunset date of September 30, 2007; no funds shall be available after that date. Michigan received 10.7% of the gross allotment of FY 2005 emergency funds and 6.2% of the first allotment of emergency funds for FY 2006. Michigan would be allocated approximately $62.0 million in FY 2007 if the state were allotted a share equivalent to the percentage of the first allotment of FY 2006 emergency funding. However, the allotment would not impact the State's FY 2006 appropriation as the current State appropriation of Federal LIHEAP funds includes sufficient authorization to meet the additional Federal allocation.

Overall Fiscal Impact on the Michigan Budget

Table 1 provides a summary of the overall fiscal impact on the State of Michigan budget from the changes to the TANF and related programs that are currently pending before the United States Congress. With the exception of the increased Federal funds from the LIHEAP program, these changes will impact the State budget beginning in FY 2007-08. The table separates the loss of Federal funds from the potential increase in State appropriations that might result from the changes. The estimated loss of Federal funds from the changes totals $113.8 million. This includes $38.8 million from the loss of TANF funds from the elimination of the caseload reduction credit, $17.0 million from Michigan's loss of supplemental TANF funding and $58.0 million from the loss of various Federal administrative funds for child support enforcement programs. If these losses of Federal funds do occur the State of Michigan will be forced with the decision to replace these Federal funds with State appropriations or to reduce the overall size of programs funded. The estimated increase in State appropriations totals $182.1 million.

The first two items, $38.8 million of increased State spending from the elimination of the caseload reduction credit and $31.2 million from the increased level of State maintenance of effort, appear to be funding that the State will be forced to make to conform with new Federal requirements. The additional State appropriations of $77.9 million to move more welfare recipients into jobs and $34.2 million for the related child care cost for these recipients are not mandatory expenditures, but they may be necessary to avoid the loss of additional Federal funds. Finally, the Conference Report does include an increase of Federal funds for the low income energy assistance program. These funds will be available to assist the home heating needs of low income Michigan residents.

Table 1

Federal TANF Reauthorization Potential Fiscal Impact on Michigan (millions of dollars)			
Issue	**Loss of Federal Funds**	**Increased State Appropriations**	**Increase in Federal Funds**
Elimination of TANF Caseload Reduction Credit	$38.8	$38.8	
Increased State Maintenance of Effort		31.2	
Elimination of Supplemental Grants	17.0		
Additional Work Requirement Expenditures		77.9	
Additional Child Care Services Expenditures		34.2	
Child Support Enforcement Administration	58.0		
Low Income Energy Assistance			10.0
TOTAL	**$113.8**	**$182.1**	**$10.0**

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