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A "Long-Term" Solution to a Medicaid Problem

One of the fastest growing segments of state budgets is Medicaid, the federal-state health insurance program for the poor. And the fastest-growing segment of Medicaid for most states is long-term care — care delivered primarily to the elderly in their own homes or in nursing homes.

- More than 40 percent of those who turn 65 will spend some time in a nursing home, which can cost an average of $38,000 for a year's stay.
- Of those who enter a nursing home, 55 percent will stay at least a year and 21 percent will remain longer than five years.

The spending explosion in long-term care is in large part a direct result of perverse federal income tax incentives that subsidize insurance for current medical expenses but penalize insurance for long-term care expenses. However, both the U.S. House and Senate have passed legislation to correct this tax inequity. Let's take a closer look.

The Short-Term Financial Crisis in Medicaid. Medicaid expenditures for long-term care have been increasing by about 15 percent annually since 1990, causing costs to double every five years. From a total Medicaid budget of $132 billion in 1993, nearly $42 billion — almost one-third of the budget — went to long-term care. And without reform, that number will continue to grow. According to the Health Care Financing Administration (HCFA):

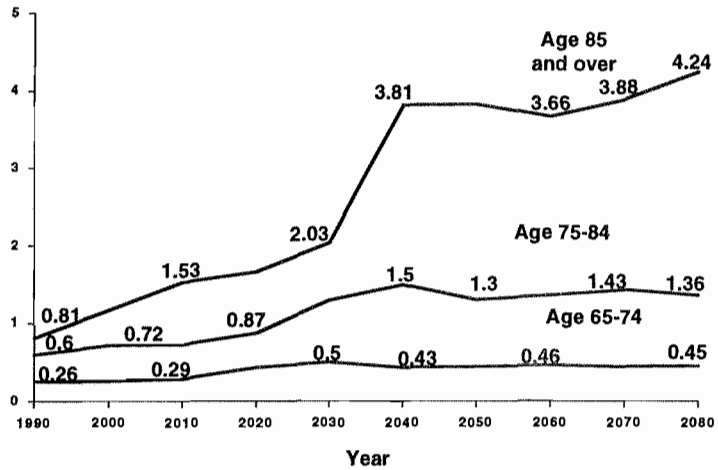
- In 1992, Medicaid paid for 47.6 percent of all nursing home care, while Medicare (for the elderly) paid for only 4.6 percent.
- By the year 2025, Medicaid is expected to pay for 67 percent of all nursing home care.

So while solving the long-term care problem will not solve all of Medicaid's problems, it certainly will help.

The Long-Term Financial Crisis in Medicaid. Without fundamental reform, things will get worse as the U.S. population ages. For example, the U.S. Census Bureau estimates that:

- The number of Americans age 85 and over will increase from 3.26 million in 1992 to 18.9 million by the year 2050 — a nearly 500 percent increase.
- Between 1990 and 2050, the nursing home population will increase by 2.5 times, but those in nursing homes age 85 and over will triple. [See the figure.]

Projected Number of Nursing Facility Residents by Age Group (millions)



Source: *Projections of the Population of the United States by Age, Sex and Race: 1988 to 2080*, U.S. Department of Commerce, Bureau of the Census, January 1989.

While the federal government can do very little about the growing number of elderly, it can implement policies that encourage people to provide for their senior years. Identified below are some of the needed reforms.

Good Reform: Block Grants. As part of Medicaid reform, Congress intends to end the Medicaid entitlement program, block grant federal funds to the states and let state legislatures determine how best to spend the money on health care for the poor. As a result, states will have more control over their long-term care dollars and can disqualify the nonpoor.

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Good Reform: Enforce Estate Recovery. Although the elderly have more assets than any other segment of the population, nearly half of those who enter a nursing home get Medicaid assistance. One reason is that many people either "spend down" or hide their assets in order to qualify for Medicaid's means-tested benefits.

The Omnibus Budget Reconciliation Act of 1993 (OBRA) requires each state to look back three years when determining eligibility for long-term care services to see if a Medicaid recipient has transferred money or other assets to other persons, such as their children. Furthermore, when a Medicaid recipient dies, the state is expected to recover from the deceased person's estate some of the past cost of providing long-term care.

Many states have been lax in enforcing these OBRA provisions. The result has been that Medicaid-financed nursing home services intended for the elderly poor sometimes go to those with substantial assets. While laws prohibiting "spousal impoverishment" — in which one spouse becomes poor because of the other spouse's nursing home costs — should remain in force, states also should enforce the estate recovery law. One source has estimated that enforcement of the OBRA 1993 provisions could save $25 billion over five years.

Good Reform: Tax Fairness. There is a private market for long-term care insurance, which covers nursing home care and in-home services. For example:

- The number of long-term care policies sold grew at an average annual rate of 29 percent between 1987 and 1992.
- By December 1993, almost 3.5 million people had private long-term care policies.

Although most of these policies were sold in the individual market, an increasing number of employers offer coverage to their employees. According to the Health Insurance Association of America, the number of people covered by employer-provided long-term care insurance has increased from 20,000 in 1988 to more than 400,000 in 1993.

This remarkable growth occurred despite the fact that long-term care insurance is discriminated against under the tax law. Under current law, every dollar of health insurance premiums paid by an employer escapes federal, state and local income taxes. As a result, government in effect pays up to half the premium — a generous subsidy that encourages employees to overinsure for current medical expenses. The federal government also provides a 30 percent tax deduction for self-employed workers who purchase their own health insurance. But there is no tax incentive for those who purchase long-term care insurance. Buyers must pay taxes first and buy long-term care insurance with what's left over.

If Washington really wants to tackle the Medicaid problem, it can start by giving the same tax break to long-term care insurance as to employer-provided health insurance. It can encourage (not require) employers to either provide long-term care insurance as part of the overall benefits package or make it available to employees who want to buy it with pretax dollars. And it should give individual long-term care insurance purchasers at least the same tax break that self-employed people currently get for buying health insurance.

Most importantly, the federal government should not tax as income disbursements of benefits to long-term care policyholders. Neither health insurance benefits nor life insurance benefits are taxed as income. Long-term care benefits should be no different.

Benefits of Reform. Currently, both the House and Senate have adopted legislation that will permit people to purchase long-term care insurance with pretax dollars, either directly or through a Medical Savings Account, and remove the tax penalty applied to those who file claims. This is an important step in the right direction.

Just consider the potential benefits of reform:

- Switching to private-sector long-term care policies will encourage seniors and their families to act more responsibly in providing for the future.
- The use of long-term care insurance to cover in-home health care costs (not covered by Medicaid) will likely reduce nursing home admissions.
- Tax fairness will make long-term care insurance affordable to working people and protect them from most of the costs of nursing home care after they retire.
- Finally, reducing the number of people turning to Medicaid to pay for nursing home care will help to restore the integrity of Medicaid by allowing the government to gain some control over the exploding Medicaid budget.