UPDATE: Estimated Increases in State of California Employee and Retiree Benefits Costs and General Fund Expenditures Caused by Doubling the MICRA Cap

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I. FINDINGS

Using the actuarial report commissioned by State Controller, John Chiang, we determine that doubling the MICRA cap would cost California state taxpayers an additional $1.6 to $2.8 billion in state retiree and employee benefit obligations over the next 10 years. Moreover, doubling the MICRA cap could cost the state's general fund an additional $640 million in the 2012-13 budget year. The cost increases from doubling the MICRA cap represent significant portions of, and are sometimes larger than actual budgeted expenditures on many state departments; we provide illustrative examples.

II. INTRODUCTION

The State of California bears tens of billions of dollars in costs related to the provision of medical and dental benefits ("MDBs") for active and retired employees. The State Controller, John Chiang, retained Gabriel Roeder Smith & Company ("GRS") to prepare and present the State of California Retiree Health Benefits Program GASB NOS 43 and 45 Actuarial Valuation Report dated June 30, 2011 ("Chiang Report"). Among other calculations, the Chiang Report presents the cost of projected benefits (for active and retired employees) for the next 10 years under "pay-as-you-go", "partial", and "full-funding" policies of $87.8 billion, $65.1 billion, and $50.3 billion, respectively.[1]

[1] See "State of California Retiree Health Benefits Program: GASB NOS. 43 and 45 Actuarial Valuation Report as of June 30, 2011", pp. 15, 19. (Released February 2012.)

The Chiang Report states that under the pay-as-you-go funding scenario, the State is assumed to finance retiree MDBs from assets available in the general fund where the costs are paid as they come due each year. The Chiang Report estimates that if costs are paid on an annual basis, over the course of 10 years the total cost to taxpayers will be $87.7 billion for current and retiree MDBs. This payment option is the most likely scenario given the traditional payment structure for state governments and California's projected multi-year budget deficits forecasts.

Under the full-funding scenario, the State is assumed to set aside funds for the Annual Required Contribution ("ARC") in a separate trust, earmarked solely for retiree MDBs. This fund will earn investment income and it is assumed the original capital investment plus the income earned will cover all medical and dental costs for 10 years. Under this scenario, over the course of 10 years the total cost to taxpayers is estimated to be $50.3 billion for current and retiree MDBs.

Under the partial-funding scenario, the State is assumed to set aside 50% of the capital used in the full-funding scenario, thereby requiring the State to make additional state budget allocations each year to fully fund MDBs. Under this scenario, over the course of 10 years, the total cost to taxpayers will be $65.1 billion for current and retiree MDBs.

In an effort to determine the impact on these estimated costs from doubling the Medical Injury Compensation Reform Act ("MICRA") cap (which provides for unlimited economic compensation but imposes a $250,000 ceiling on non-economic damages), we overlay a cap-doubling cost impact factor directly onto the figures presented in the Chiang Report. Additionally, to determine the impact of doubling the MICRA cap on California State spending beyond MDBs, we overlay the cost impact factor onto projected California general fund expenditures for four state health-care programs.

III. DOUBLING THE MICRA CAP WILL SIGNIFICANTLY INCREASE THE STATE'S COST OF PROVIDING MDBS

First, we decomposed the 2011 Actuarial Present Value of Projected Benefits into annual figures for each of the three models contained in the Chiang Report; see Exhibits 1-3: Panel A. This process required the estimation of a growth rate for the benefit increases year over year. These rates were approximated by the growth rates observed in the Supplemental Projections; see Exhibit 4.[2] The discount rates applied are given in the Chiang Report. With the growth rates and discount rates and the final net present value figure, one can iteratively solve for the annual breakdown of the net present value ("NPV").

Next, having solved for the annual costs, one can superimpose the estimated increased costs (in percentage terms) from the doubling of the MICRA cap. This cost increase is

[2] We fully recognize the limitation to this approach, namely we have estimated an annual growth rate based on the calculated growth rates of the valuations of projected actuarial liabilities provided in the Supplemental Projections. However, not having access to the necessary data and tables directly, we are confident our estimate is the best alternative. Should the necessary data and tables be provided to us, we are prepared to redo this analysis. The growth rate from 2017 to 2018 is assumed to be the equal to the growth rate from 2016 to 2017.

taken to be 3.14%.[3] In effect we increase the nominal benefits by the estimated cost of removing the cap; see Exhibits 1-3: Panel B.[4]

Finally, the difference between the annual expected costs of each of these annual decompositions (with the cap and without) is the estimated increase in the cost to California taxpayers providing MDBs caused by doubling the MICRA cap. This analysis is repeated for each of the three models presented in the Chiang Report. Summary results are presented in Table 1 below.

Table 1: OPEB Actuarial Valuation Results as of June 30, 2011 and Estimated Cost Increases Attributable to MICRA Cap Increase ($ in '000s)

	Pay-As-You-Go	Partial Funding	Full Funding
Projected Benefits	$87,775,982	$65,117,872	$50,256,780
Adjusted Projected Benefits	$90,528,034	$67,159,521	$51,832,488
Total Increase in Costs	**$2,752,052**	**$2,041,649**	**$1,575,708**

[3] Kessler and McClellan, "Malpractice law and health care reform: optimal liability policy in an era of managed care." Journal of Public Economics 84 (2002) 175–197. Also, Hamm, Wazzan, and Frech, "MICRA and Access to Healthcare, MICRA Helps Lower Healthcare Costs, Ensuring Patients Have Access to Healthcare", November 2008. *An average reduction of 3.04% corresponds to a subsequent increase of 3.14% [(1/(1-0.0304))-1 = 0.0314].*

[4] Doubling the cap would have the same effect as removing the cap entirely. See "MICRA and Access to Healthcare, MICRA Helps Lower Healthcare Costs, Ensuring Patients Have Access to Healthcare". Hamm, Wazzan, Frech. November 2008. Page 43.

IV. DOUBLING THE MICRA CAP WILL SIGNIFICANTLY INCREASE REQUIRED GENERAL FUND EXPENDITURES

The increase in health care costs to California caused by doubling the MICRA cap can be similarly estimated by utilizing the Governor's enacted 2012-13 budget and calculating the General Fund expenditures with and without the cap; see Exhibit 5. Summary results are also presented in Table 2 below.

Table 2: Impact on General Fund Expenditures
($ in '000s)

	Dept. of Health Care Services Medical Care Services (Medi-Cal)	Dept. of Developmental Services Community Services Program	Dept. of State Hospitals In-Patient Services Program	Dept. of Corrections and Rehabilitation Adult and Juvenile Health Services
2012-13 General Fund Expenditures	$14,691,437	$2,321,001	$1,342,659	$2,038,476
2012-13 Adjusted General Fund Expenditures	$15,152,748	$2,393,881	$1,384,818	$2,102,484
Total Increase in Costs	**$461,311**	**$72,879**	**$42,159**	**$64,008**

V. THE COST TO THE STATE FROM DOUBLING THE MICRA CAP IS COMPARABLE TO, AND IN SOME CASES EXCEEDS, IMPORTANT BUDGET ITEMS

The cost increases estimated to incur from doubling the MICRA cap are significant. To illustrate these figures in "real life" terms, we have compared these costs to a number of items contained in the 2012-2013 California State Budget; see Exhibit 6A through 6G.[5] We found that the employee and retiree healthcare benefits cost increase on FY 2012 benefits under the pay-as-you-go policy was approximately equal to California's spending for the Department of Child Support Services and more than half of the total state funding for the Department of Parks and Recreation.[6] The estimated cost increase to the FY 2012 Medi-Cal budget would be 63% of the state budget for the Department of Forestry and Fire Protection.[7]

We have also compared these cost increases to the recent data on the cost of incarcerating inmates in California State Prisons.[8] Each prisoner costs the state approximately $46,000 per year. The 2011 annual cost increase of $295,597,486 therefore represents approximately 6,426 inmates under the pay-as-you-go policy. We have also compared these cost increases to average teacher's salary of $67,871.[9] The 2011 annual cost of $295,597,486 therefore represents approximately 4,355 California teachers under the

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[5] http://www.ebudget.ca.gov. The 2012 annual costs increase is contrasted with the 2012-13 state budget.

[6] See Exhibit 6A.

[7] See Exhibit 6D

[8] See Legislative Analyst's Office: Governor's Realignment Plan—Criminal Justice. January 25, 2011.

[9] California Department of Education, http://www.cde.ca.gov/ds/fd/cs/documents/j90summary1011.pdf, Accessed 5/4/2012.

pay-as-you-go policy. In other words, if the increased cost of providing health benefits, in the event that the MICRA cap is doubled, was to be offset completely through a reduction of inmates, 6,426 inmates would have to be released. Or similarly, if it were offset completely through a reduction in teachers, 4,355 teachers would have to be let go.

We also compared the cost increase resulting from a doubling of the MICRA cap to the police and firefighter salaries from 2010.[10] On average, California police officers made $92,976 and firefighters took home $113,882. The MICRA cost increase on 2011 benefits (discounted to 2010) under the pay-as-you-go policy is the equivalent to 2,911 police officers salaries and 2,375 firefighter salaries.[11]

Lastly, we looked at California's cost per pupil and total budget for school books and supplies. According to the CA Department of Education, the statewide average spending per pupil was $8,323 in the 2010-11 budget year.[12] At that amount, the 2011 MICRA pay-as-you-go benefits cost increase would cover educational expenses for 32,521 K-12 students. Furthermore, California spent $113,349,165 on books and supplies in the 2010-11 budget year.[13] The 2011 MICRA pay-as-you-go benefits cost increase would be 2.4 times that amount.[14]

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[10] Reese, Phillip. "Updated: See what California pays police, firefighters." *The Sacramento Bee*. http://www.sacbee.com/2011/03/03/3446569/see-average-police-firefighter.html, Accessed 5/4/2012.

[11] See Panel D in Exhibit 1. The 2011 Annual Increase in Costs (PV) is discounted to 2010 and divided by the 2010 average police and firefighter salaries. *Ex. [282,868,408/(1+.045) / (92,976)] = 2,911*

[12] http://www.cde.ca.gov/ds/fd/ec/currentexpense.asp, Accessed 5/4/2012.

[13] California Department of Education, School Fiscal Services Division. http://www.ed-data.k12.ca.us/_layouts/EdDataClassic/finance/financereportforstate_counties.asp?tab=2&reportNumber=4&level=04&fyr=1011, Accessed 5/4/2012.

[14] 2011 cost increase discounted to 2010 dollars. *[282,868,408/(1+.045) / (113,349,165)] = 2.38*

VI. APPENDIX – DATA

A. Description of Data Used for MDBS Analysis

The Chiang Report provides summary results from a series of interrelated analyses. It does not provide a breakdown of the annual value of projected benefits but rather provides the net present value of the 10-year totals for each of the three models. First, we determined that the recreation of the report's interdependent tables and analyses was unfeasible with the data and files available to us. Though we did not have an annual breakdown of the aggregate figures and/or the data and models used in the Chiang Report, we were able to locate certain backup materials to the State of California Retiree Health Benefits Program GASB NOS 43 and 45 Actuarial Valuation Report dated June 30, 2008 in the Supplemental Projections dated November 5, 2008 ("Supplemental Projections"). These present several additional data points including the net present values projections of Actuarial Liabilities for 2008 through 2017 under the three different funding policies.[15]

B. Description of Data for General Fund Analysis

The California Governor's Proposed Budget for 2012-13 detailed projected program-level expenditures within each department of the state government.[16] There are at least four health care programs whose budgets would be affected by the MICRA cap: the

[15] See "Re: State of California Retiree Healthcare Benefits - GASB Closed Group Projections," GRS, November 5, 2008.

[16] http://www.ebudget.ca.gov

Department of Health Care Services' Medi-Cal program, the Department of State Hospitals' In-Patient Services Program, the Department of Corrections and Rehabilitation's Adult and Juvenile Health Services program, and the Department of Developmental Services' Community Services Program. Since the Governor's Enacted Budget for 2012-2013 only itemized General Fund expenditures at the department level, the Proposed Budget was used to determine each program's portion of their respective department's budget. This portion was then applied to the Governor's Enacted Budget Department level General Fund expenditures in order to estimate Program level General Fund expenditures for the programs affected by the MICRA cap.