Fred's id

2/7 JC

Good summary. I have DECISION agreed with asap your JC recommendation JRB

THE WHITE HOUSE
WASHINGTON

February 1, 1982

TO: JAB III

RE: Illinois Medicaid Waiver

Attached is a decision memo prepared by OMB on this issue by Fuller/Darman.

Schweiker has already granted the waiver. It has been argued that ~~WH~~ must review, or at least agree not to assert the right of review. Thus the need for a decision.

OMB worries that the waiver will end up costing the govt more money, especially in the first and second years. HHS disputes this. Rich Williamson argues very well for approving the HHS waiver, and I agree with his points.

Among them:

1. This is very important to Thompson politically.

2. It ties in well with Federalism; a disapproval would probably indicate a lack of faith in the states.

3. "States as laboratories"-- this is a worthy experiment; also, devolving responsibilities to the states does not mean we have to like how they handle them.

4. The waiver is subject to review at the end of each year in the 5 year period-- thus, no serious harm can be done to the budget if HHS is wrong and OMB right.

Schweiker has written a very good memo on this subject, too, and it is attached if you have doubts. He is out on the limb a bit here (I sense), and we should probably back him if there is any uncertainty on the issue.

Very strong opposition to the waiver is coming from the Illinois Hospital Association, who argue that the state is planning to impose controls on health care costs (this is accurate) and that such a measure is contrary to Reagan's philosophy (also true). However, federalism by its nature implies that some states will handle programs on their level in a different way than this Administration.

Recommendation

I recommend we approve the HHS waiver.

I do not feel a meeting of the parties concerned (one option) would accomplish anything except to increase the lobby pressure. We know what the issues are and where everyone stands-- the views cannot be reconciled.

JC

THE WHITE HOUSE

WASHINGTON

To Ciccoui - 2/1/82 MDT

January 30, 1982

MEMORANDUM FOR ED MEESE
JIM BAKER

FROM: RICHARD DARMAN
CRAIG FULLER

SUBJECT: ILLINOIS MEDICARE/MEDICAID WAIVER

copies sent to DD, CF, KD 2-9-82

We have received material on this matter from interested White House and departmental sources.

The issue is whether to allow HHS to grant a medicare/medicaid waiver with regard to a demonstration project proposed by the State of Illinois. The State created the Illinois Health Finance Authority in an effort to reduce health care costs. After thorough review, HHS granted approval of the demonstration project on December 30, 1981. The program would begin on May 1, 1982.

The comments received are attached.

Highlighted Arguments

In favor of the waiver:

-- Governor Thompson is a strong supporter and a major spokesman for federalism and he wants this waiver very much.

-- This program would make the states more responsible

-- The waiver lasts for 5 years but is reviewed annually and the U.S. could "bail-out" if the cost became excessive.

-- The demonstration project will not result in additional costs to medicare or medicaid...a cap will limit expenditures to approximately what they would have been without the demonstration.

-- The demonstration has considerable business and labor support. Additionally, Senator Percy supports along with Congressmen from the area.

-- Local opposition comes primarily from the Illinois Hospital Association which has a history of opposing measures which would reduce or control health care costs.

-- While the waiver should be reviewed under the Paperwork Reduction Act, Boyden Gray advises that such jurisdiction can simply be established and then waived for the sake of moving forward.

Arguments in opposition to the proposed waiver:

-- We should carefully consider the implications of supporting hospital price controls.

-- The proposal could actually cost the federal government hundreds of millions of dollars not just in the first year or two, but forever (OMB)

We trust you will want to review the arguments and perhaps meet with the parties with an interest in this matter. Please advise. Unfortunately, this matter has been delayed and a early decision is necessary.

___approve the HHS waiver

___hold the granting of an HHS waiver

___schedule a meeting with the interested parties.

cc: Ed Harper
C. Boyden Gray
Rich Williamson
Don Moran

MEMORANDUM

OFFICE OF THE VICE PRESIDENT

WASHINGTON

January 18, 1982

MEMORANDUM TO CRAIG FULLER

FROM: C. Boyden Gray CBG

RE: Jurisdiction Over the Illinois Health Finance Authority Waiver Under Executive Order 12291 and the Paperwork Reduction Act

Summary

You have asked whether Secretary Schweiker's grant of a waiver sought by the Illinois Health Finance Authority (IHFA) is subject to the jurisdiction of Executive Order 12291 and the Paperwork Reduction Act.

I conclude that it is subject to the Order and the Act, but that their requirements may be waived immediately if the Administration wants to proceed with the waiver. The Order and the Act are designed more to be coordination and management tools to preserve issues for high-level review than final determinants of policy. If the Administration decides to proceed with the waiver, however, I would strongly recommend that jurisdiction under the Order be asserted and then waived in order to preserve the integrity of the White House review mechanisms (i.e., to avoid another school lunch regulation problem).

Background

The Illinois Health Finance Authority, a state rate-setting body, seeks to conduct a five-year experimental state-wide program of rate regulation of inpatient hospital services. As a prerequisite to implementing this program, which would involve all hospitals in the State of Illinois, IHFA submitted to the Secretary of the Department of Health and Human Services an application for a waiver of generally applicable statutory and regulatory requirements governing reimbursement under Medicare and Medicaid. The application details the regulations for which the waiver is sought and provides proposed IHFA regulations to be applied as substitutes. The application also contains a number of reporting forms which Illinois hospitals would be required to submit (in addition to existing Medicare or Medicaid forms) in order to obtain reimbursement under the program.

On December 30, 1981, the Secretary granted IHFA's application for the waiver, releasing IHFA and Illinois hospitals from compliance with existing Medicare and Medicaid regulations and substituting IHFA's regulations and reporting requirements as detailed in its application.

Executive Order 12291

In order to assure that regulations promulgated by agencies in the Executive branch were well-reasoned, coordinated, and subject to presidential oversight, President Reagan on February 17, 1981, signed Executive Order 12291. The Order sets forth a number of requirements which must be satisfied before an Executive branch agency may promulgate certain rules. The IHFA waiver is subject to jurisdiction under the Order if it is within the class of "rules" which the Order addresses.

Section 1(a) of the Order defines a "rule" as "an agency statement of general applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the procedure or practice requirements of an agency." The definition goes on to exclude from the Order's jurisdiction only those rules which are governed by specific hearing provisions, promulgated with respect to a military or foreign affairs function, or related to agency organization, management, or personnel.

The agency action the IHFA seeks would govern the policies and procedures by which reimbursement under Medicare and Medicaid is made for inpatient hospital services rendered by every hospital in the State of Illinois once the experimental program is in full effect. Although styled as a "waiver," the action by the Secretary in approving IHFA's application is an agency statement of general applicability binding upon all hospitals in one of the nation's most populous states. Moreover, the action is to have future effect throughout the term of the experimental program in prescribing the policy and procedures in implementing federal health care financing statutes in Illinois. As such, the Secretary's action must be deemed to constitute a "rule" within the meaning of that term as used in Executive Order 12291 and subject to the Order's jurisdiction.

In effect, this jurisdiction requires that the Secretary's action satisfy the general benefit - cost requirements of Section 2 and the regulatory impact analysis and review requirements of Section 3.

However, Section 6(b) (4) of the Order provides that the Director of the Office of Management and Budget, subject to the direction of the Presidential Task Force on Regulatory Relief, may waive the requirements of a regulatory impact analysis and review. Consequently, assuming the Secretary's actions to be consistent with the general benefit-cost requirements of Section 2, a waiver of the Section 3 analysis and review requirements would bring the Secretary's grant of the waiver into compliance with the terms of the Order.

Paperwork Reduction Act

Among the purposes of the Paperwork Reduction Act is the minimization of the "federal paperwork burden for individuals, small businesses, state and local governments, and other persons." 44 U.S.C. § 3501(1). To this end, the Act provides that the Director of the Office of Management and Budget will review and approve "information collection requests" proposed or sponsored by an agency. 44 U.S.C. § 3504(c)(1); 3507 (a)(3). The IHFA waiver is subject to the jurisdiction of the Act if the forms required to submitted under the waiver of Illinois hospitals to IHFA in order to obtain reimbursement under Medicare and Medicaid for services rendered are deemed to be information collection requests proposed or sponsored by the Department of Health and Human Services.

The Act defines "information collection request" as a "written report form, application form, schedule, questionnaire, reporting on recordkeeping requirement, or other similar method calling for the collection of information." 44 U.S.C. § 3502 (11). The Act defines "collection of information" to include the solicitation of facts by an agency through the use of written report forms calling for answers to identical questions posed to, or identical reporting on recordkeeping requirements imposed on, ten or more persons ...." 44 U.S.C. § 3502 (4). The forms required to be submitted under the waiver by all hospitals in the State of Illinois as a condition to reimbursement for inpatient hospital services under Medicare or Medicaid unquestionably involve the "collection of information" as that term is used in the Act. Moreover, the forms detailed in the IHFA application clearly constitute "information collection requests." To the extent the submission of these forms by Illinois hospitals seeking Medicare and Medicaid has been required by the Secretary in his approval of the application as a condition of such reimbursement, the forms must be deemed to be information collection requests "conducted or sponsored" by the Department. Consequently, the action of the Secretary, to the extent it involves the requirement that certain data collection forms be submitted by Illinois hospitals seeking Medicare and Medicaid reimbursement, is within the jurisdiction of the Paperwork Reduction Act.

The Act prohibits agencies from collecting information through any information collection request that does not have a current "control number" assigned to that request by the Director of the Office of Management and Budget. 44 U.S.C. § 3507 (f). The reporting forms contained in the IHFA application have not yet been submitted to OMB for clearance and do not have current control numbers. In order to be in compliance with the Act, the Secretary must submit the forms for OMB review under the criterion set forth in the Act and for the assignment of a control number.

Alternatively, upon certain findings by the Secretary, the Director may in effect waive the requirement of OMB review as a condition of the collection of data and immediately assign a control number. This alternative, which would permit data collection on unreviewed forms for a period of ninety days, would bring the Secretary's action in granting IHFA's application into immediate compliance with the Act. However, the forms would have to be submitted to OMB for review and clearance for use after the ninety-day period expires.

THE SECRETARY OF HEALTH AND HUMAN SERVICES
WASHINGTON, D.C. 20201

January 18, 1982

MEMORANDUM TO: CRAIG FULLER
Assistant to the President
For Cabinet Affairs

FROM: Richard S. Schweiker
Secretary

SUBJECT: Illinois Medicare and Medicaid Waiver

Background

The Illinois State legislature reduced Medicaid hospital expenditures by $106 million for FY 82. It also created the Illinois Health Finance Authority. In an effort to meet its legislative mandate, the Governor's office developed a series of projects designed to meet the needed budget reductions. One of these projects is the establishment of a state-wide hospital prospective payment system involving all third party payors; i.e., Blue Cross, commercial insurors, Medicare and Medicaid. The State requested the necessary Federal Medicare and Medicaid waivers to participate in this project. Following the submission of the required research applications and lengthy discussion with industry representatives, the Department approved the State's request on December 30, 1981. The project will begin implementation on May 1, 1982, continue through April 1987 and is reviewable on an annual basis.

The Office of Management and Budget has objected to the Department's approval of this waiver citing legal, financial, philosophical and public concerns. This Department's response to these concerns is stated below.

Application of Executive Order 12291

I have reviewed the letter and spirit of the Executive Order with respect to this issue and believe that it does not apply to Medicare/Medicaid waivers.

OMB expressed the view that authority to approve this waiver is subject to the regulatory review provisions contained in Executive Order 12291. A petition recently filed by the Illinois Hospital Association with the Director of OMB and the Vice President claims that because the waivers in question constitute "a major federal regulatory initiative," approval thereof without a regulatory impact analysis and prior OMB clearance violated Executive Order 12291.

The Executive Order definition of a "regulation" or "rule" is taken directly from the definition in the Administrative Procedure Act (APA). The APA requires that rules be promulgated by notice and comment rulemaking, unless the rule is "interpretative", or constitutes a general statement of policy or of agency organization, procedures, or practice. Accordingly, if waiver approvals were "regulations" subject to the Executive Order, then by law HHS would also be required to subject waiver approvals to notice and comment rulemaking. However, not even the Illinois Hospital Association suggests that rulemaking is required and, in our view, no court would be likely to so hold. In fact, the Department has approved large numbers of demonstration projects and waivers over the years and, to our knowledge, has never been required to go through rulemaking.

Since approval of the Illinois waiver request does not fall within the threshold definition provided in the Executive Order, we do not believe that any of the requirements in the Executive Order, including the preparation of a regulatory impact analysis and submission to OMB for review, would apply to the granting of these waivers. A more in-depth legal opinion to this issue is provided as an addendum.

Financial Impact of Project

This demonstration will not result in additional costs to the Medicare and Medicaid programs. The project includes a Medicare and Medicaid cap limiting the increase in the Department's financial liability over the duration of the demonstration to the U.S. average rate of increase in costs for community hospitals.

Medicare and Medicaid would recover excess payments should aggregate payments exceed the cap over the term of the demonstration. Since the trend of Illinois hospital costs has been similar to the nationwide average over the past four years, the proposed cap will limit Medicare and Medicaid's liability to approximately what they would have been without the demonstration.

A component of the Illinois system requries that third-party payer discounts be set. The Illinois Health Finance Authority is currently holding public hearings to set these discounts. Until the Medicare and Medicaid discounts are established savings to the Federal government are difficult to project.

State Flexibility to Achieve Cost Savings

OMB and hospital representatives argue that approval of this request represents Federal imposition or endorsement of a strict regulatory scheme on hospital providers in Illinois. They claim this project amounts to government sponsored price control and represents an unhealthy precedent for this Administration in the health field.

Although the demonstration project is being conducted with Federal authority, the Department believes it constitutes primarily a State not a Federal initiative. Conforming Federal programs to rules established by the State, for a limited period of time, simply increases the State's flexibility to manage it own affairs. Moreover, experimentation of the kind Illinois is undertaking will ultimately allow the Department to determine the most effective and least burdensome method for curtailing Federal health care costs. It is well known that the costs of Federal health care programs have been increasing at a very fast rate. We believe that the Department's approval of the waiver is consistent with the Administration's regulatory policy; to cooperate with States to test the workability of methods designed to reduce such costs.

Public Considerations

The Illinois Health Finance Authority (IHFA) Prospective Payment Demonstration received widespread support from business, labor, and insurance companies. The Illinois Health Care Coalition is a broad based organization with strong business support. The participants in this coalition include corporations such as Chrysler, Caterpillar, Quaker Oats Company, Republic Steel and and Standard Oil of Indiana. A complete list of the coalition membership is attached. Labor support for this project includes the International Brotherhood of Electrical Workers Local 165 and Laborers Welfare Fund.

It should be noted that the Illinois Hospital Association strongly advocated creation of a State rate-setting authority in Illinois while it lobbied strenuously against the Carter Administration's hospital cost containment bill. The Federal proposal having been defeated, the Assocation not surprisingly now opposes any State attempts to control costs as well.

A few hospitals such as University of Chicago Medical Center and Michael Reese Medical Center have voiced support for this demonstration.

Governor James Thompson, has personally given his unqualified endorsement of this project. Congressional interest has been centered in both Senator Charles Percy (R) and Congressman Edward Madigan (R) who have been strong advocates of the prospective payment demonstration. Congressmen Railsback (R) and Erlenborn (R) have also expressed their strong support, while opposition has been limited to Congressmen Simon (D), Annunzio (D) and McClory (R).

There is vigorous attempt to delay the implementation of the project hoping that a strong lobbying effort will enable a repeal of the IHFA authority to occur this spring in the Illinois legislature. Reinforcing his support for the project, Governor Thompson is on record as having indicated he would veto such a bill should it be enacted.

Attachments

Tab A - DHHS Legal Opinion

Tab B - Membership - Illinois Health Care Coalition

DEPARTMENT OF HEALTH AND HUMAN SERVICES
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20201

THE GENERAL COUNSEL

MEMORANDUM

TO : The Secretary
Through: ES_____
US_____

FROM : Juan A. del Real
General Counsel

SUBJECT: Applicability of Executive Order 12291 to Illinois Medicaid and Medicare Waiver

Executive Order 12291

Pursuant to your request, we have reviewed a petition recently filed by the Illinois Hospital Association with the Director of OMB and the Vice-President. The petition claims that waivers recently granted by the Department with respect to an Illinois hospital rate-setting demonstration project constitute "a major Federal regulatory initiative" and therefore are subject to Executive Order 12291. We disagree with both the petition's premise and its conclusion.

Executive Order 12291 sets forth certain requirements relating to the promulgation of "regulations" or "rules" by Federal agencies. In the Executive Order the term "regulation" or "rule" is defined as "an agency statement of general applicability and future effect designed to implement, interpret, or prescribe law or policy, or describing the procedure or practice requirements of an agency ...." 1/

1/ The Executive Order definition of a "regulation" or "rule" is taken directly from the definition in the Administrative Procedure Act (APA). 5 U.S.C. 551(4). The APA requires that rules be promulgated by notice and comment rulemaking, unless the rule is "interpretative", or constitutes a general statement of policy or of agency organization, procedure, or practice. Accordingly, if waiver approvals were "regulations" subject to the Executive Order, then by law HHS would also be required to subject waiver approvals to notice and comment rulemaking. However, not even the Illinois Hospital Association suggests that rulemaking is required and, in our view, no court would be likely to so hold. In fact, the Department has approved large numbers of demonstration projects and waivers over the years and, to our knowledge, has never been required to go through rulemaking.

It seems clear that approval of the Illinois waiver request does not fall within the definition of "regulation" or "rule" contained in the Executive Order. First, approval of the waivers is not an agency action of "general applicability," since the waivers will be applicable only in the State of Illinois. While this Department may, as the petition suggests, use the information obtained from the conduct of the Illinois demonstration project in "assessing the national applicability" of rate setting to health care reimbursement, the project does not now have any application on a national basis. Further, HHS approval of the waivers is not "designed to implement, interpret or prescribe law or policy" or to describe generally applicable "procedure or practice requirements" of the Department. To the contrary, the effect of the waiver will simply be to set aside Federal policy and procedure temporarily in one State, permitting instead that State's requirements to govern.

The fact that Illinois imposes statutory or regulatory requirements on hospitals within the State does not convert Federal approval of the demonstration project into the promulgation of a rule; nor does waiver approval become rulemaking simply because the Federal Government participates in the experiment by conforming Medicare and Medicaid reimbursement principles to those established by the State for the period of the demonstration project. In fact, the statutory authority under which waivers may be granted clearly restricts their application to "experiments and demonstration projects," which inherently are of a focused, limited nature. Thus, the waivers permit a specific, circumscribed exception from generally applicable law, rather than "implement, interpret, or prescribe law or policy" in any way that would have general applicability, as the Executive Order definition of "regulation" requires. Of course, once the demonstration project has been completed, the Department may consider whether its results warrant proposing a change in law or policy, to make all or part of the experimental system generally applicable. At this point, the Executive Order may well apply to the Department's actions, but certainly not before.

Since approval of the Illinois waiver request does not fall within the threshold definition provided in the Executive Order, we do not believe that any of the requirements in the Executive Order, including the preparation of a regulatory impact analysis and submission to OMB for review, would apply to the granting of these waivers. Additionally, we disagree

with the Illinois Hospital Association petition's characterization of the demonstration project and waivers as a "major Federal regulatory initiative" which is "contrary to the objectives of Executive Order 12291." Although the demonstration project is being conducted under Federal authority, it constitutes primarily a State and not a Federal initiative. Conforming Federal programs to rules established by the State, for a limited period of time, simply increases the State's flexibility. Moreover, experimentation of the kind Illinois is undertaking will ultimately allow the Department to determine the most effective and least burdensome method for curtailing Federal health care costs. It is well known that the costs of Federal health care programs have been increasing at a very fast rate. Under these circumstances, we believe that it is fully in line with the Administration's regulatory policy to cooperate with States to test the workability of methods designed to reduce such costs, before proposing to implement any of these methods on a nationwide basis. 2/ In fact, Congress itself has authorized such experimentation in the statute under which the waivers have been granted.

For these reasons, our view is that neither the letter nor the spirit of Executive Order 12991 has been violated by the approval of the Illinois waiver request, and that there is no sound basis for the Illinois Hospital Association's claim to the contrary.

2/ We understand that cost savings are expected from the Illinois demonstration project and waivers and that, in any event, costs will be "capped" so that, over the period of the project, they will be limited to the normal costs which would have been incurred without the waivers. Detailed information on the effect of this cap, and projected cost savings, is available from HCFA.

BUSINESS/UNION PARTICIPANTS - ILLINOIS HEALTH CARE COALITION

In Support of Illinois Waiver

Admiral Division of Magic Chef, Inc.
Caterpillar Tractor Co.
Central States Welfare Fund
Chicago Tribune
Chrysler Corp.
Commonwealth Edison Company
FMC Corporation
Frank Foundries
Gould, Inc.
Harris Bank & Trust Company
Hart Schaffner & Marx
Illinois Central Gulf Railroad
Illinois Tool Works
Inland Steel Company
International Brotherhood of Electric Workers
International Minerals & Chemical Corp.
Jewel Companies, Inc.
Laborers' Welfare Fund
Milwaukee Railroad
Motorola, Inc.
Nalco Chemical Corp.
Peoples Energy Company
Quaker Oats Company
Republic Steel Company
Santa Fe Industries, Inc.
Sears, Roebuck & Company
Sherwin-Williams Company
Standard Oil of Indiana
Stone Container Corporation
Trans Union Corporation

* * * * * *

Additional Corporations in support

Consolidated Foods, Inc.
Signod Corp.
Beatrice Foods Corp.
Zenith Corp.
Pittway Corp.
Sundstrain Corp.
Mobil Corp.
(Montgomery Wards)
(Container Corporation of America)
Midas International
Masonite Corp.
IMB Corporation
Illinois Federation of Labor
United Automobile Workers of Illinois

These corporations represent over $200 Billion annually

THE WHITE HOUSE

WASHINGTON

January 18, 1982

MEMORANDUM FOR CRAIG FULLER

FROM: RICH WILLIAMSON

SUBJECT: ILLINOIS MEDICARE/MEDICAID WAIVER GRANTED BY HHS

In our meeting January 15, 1982, five issues were raised regarding the Illinois waiver. Those issues were:

1. Legal considerations
2. Cost considerations
3. Political considerations
4. Price control considerations
5. States' rights

It was agreed that arguments related to these issues would be submitted to your office on Monday, January 18, 1982, for inclusion in a decision memorandum.

I have prepared the following comments related to the political issue and the states' rights issue.

1. Political

This waiver is very important to the Governor. His opponent in the 1982 Illinois Gubernatorial election is former Senator Adlai Stevenson. Stevenson is basing his campaign on the argument that Thompson has been guilty of mismanaging the state. This waiver would allow Governor Thompson to counteract Stevenson's argument with regard to the health portion of the state's business.

Governor Thompson has been an exceptionally strong spokesman for the President's economic recovery plan. He represents a major industrial state which contains one of the largest media markets in the country. His comments related to the ability of states to absorb the Administration's budget cuts and to administer the Administration's block grants have been very helpful.

Governor Thompson has made himself available on very short notice to testify on behalf of the Administration before Congress. On one occasion he rearranged his schedule and appeared before Congress on less than 48 hours' notice. His testimony regarding the proposed HHS health block grant effectively counteracted the Administration's critics.

Governor Thompson's public support for the proposed Federalism initiative will be crucial. Major elements of that Federalism initiative significantly impact the

State of Illinois. Governor Thompson, in his role as Chairman of the Republican Governors' Association, will be needed to develop unified support by the nation's Republican Governors for the Federalism proposal.

2. States' Rights

The President's approach to Federalism has placed major emphasis on the idea that states should be made more responsible for the significant decisions which affect the states' citizens. Allowing the state to set up a "rate control commission" responsible for setting reimbursement levels of all health care costs within the state of Illinois is consistent with the President's Federalism position.

In addition, one of the cornerstones of the President's Federalism approach is that there is a value to having states serve as laboratories exploring different approaches to problem solving. The Illinois proposal should be viewed in light of this.

Please note that although the waiver is for five years, it can be reviewed after each year. If a significant cost shift has occurred or legal problems have developed, the Federal government can withdraw the waiver.

Finally, we must remind ourselves that devolving responsibility to the states means allowing them to take actions that we disagree with as well as those we may endorse.

13 JAN 1982

THE WHITE HOUSE

WASHINGTON

January 13, 1982

MEMORANDUM TO EDWIN MEESE III

FROM: RICHARD S. WILLIAMSON

SUBJECT: THE REAGAN ADMINISTRATION HAS JUST ENDORSED PRICE CONTROLS (AKA MEDICAID WAIVER FOR ILLINOIS)

Ed Harper has just sent you a "RUSH DECISION" memorandum on the above matter.

Subsequent to this memo, I had a discussion with Don Moran, and OMB is in agreement that any decision should be delayed for 24 hours until we have a chance to staff out the points raised. By noon tomorrow such staffing-out will be done and we will sit down with OMB. A redraft of Harper's decision memo will be sent to you, if necessary.

Craig REF: Above memo + Harper memo (attch'd)
Can we suspend implementation of Schweiker decision until above staffing has been completed?
If we can, let's do so!
Thanks
Ed

cc: David Stockman
Craig Fuller
Ed Harper
Don Moran
Ed Thomas
Jim Jenkins

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

January 13, 1982

RUSH DECISION

MEMORANDUM FOR: EDWIN MEESE

FROM: EDWIN HARPER

SUBJECT: The Reagan Administration has just endorsed price controls (aka Medicaid Waiver for Illionis)

Secretary Schweiker has just granted the State of Illinois a waiver which enables the state to impose a state-wide system of price controls on hospitals. (President Carter granted the State of Maryland the only comparable type of waiver.) I believe that this is a fundamental breech with the President's philosophy.

The waiver can cost the Federal government hundreds of millions of dollars not just in the first year or two but forever unless this situation is remedied. The cost comes through the fact that the waiver will allow the state to shift health care costs from the state (Medicaid, where the state pays 50%) to the Federal government (Medicare, where the state pays 0%).

The Illinois hospitals strongly object to Secretary Schweiker's having granted the waiver on the grounds that the Secretary did not follow procedures established in Executive Order 12291 which calls for OMB's review of major regulatory changes. This is in fact the case.

Thus, the issue is the political/policy one of whether or not the waiver ought to be rescinded. The attachments provide additional background.

Recommendation

That the Secretary of HHS be asked to rescind the waiver for further study.

_____ Approve _____ Disapprove _____ See Me

cc: Dave Stockman
Martin Anderson
Rich Williamson
Don Moran
Jim Jenkins

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

January 12, 1982

MEMORANDUM FOR ED HARPER

FROM: Don Moran

IN RE: Illinois State Hospital Rate Commission

As you ponder the question of whether we should assert jurisdiction under the Executive Order over the waiver HHS/HCFA granted to the State of Illinois to establish its hospital rate commission, please consider the following:

(1) Unlike the situation in Medicaid, where waivers are used to grant states flexibility in meeting program requirements, the purpose of this waiver has nothing to do with permitting copayments or other innovations. The purpose of this waiver is to give the state the power to use Medicare (100%) reimbursement decisions to enforce hospital price controls.

As you know, under Medicare, we don't pay individual patient hospital bills, but rather reimburse hospitals on the basis of the share of their total budget that is reasonably attributable to the cost of caring for Medicare beneficiaries. Currently, we have federal definitions of "reasonable costs", to which a hospital is entitled to receive reimbursement if the care is provided.

Under the Illinois scheme (which is duplicated, to my current knowledge, only in Maryland under a Carter-granted waiver), the State of Illinois would be delegated as the determiner of "reasonable cost" for the hospitals in its state. They will define "reasonable cost" at whatever level they establish under their state-wide price control scheme.

(2) You also asked why price controls will mysteriously increase Medicare costs. It turns out that this has nothing to do with program start-up pending terrific savings later on. It has everything to do with the existing set of incentives facing Illinois, or any other state, under the present reimbursement system.

As indicated above, we pay "costs", rather than posted patient charges or per-service/day prices for Medicare. In most states, so does Medicaid and Blue Cross. Medicaid uses, in general, the Medicare definitions, while Blue Cross uses, in many cases, a somewhat different methodology.

All of the rest of a hospital's patients -- those paying out of their own pockets and those covered by so-called indemnity insurance that reimburses folks for covered expenses --pay the posted rate. The percentage paying charges rather than costs varies among hospitals; some hospitals have very few charge paying patients (government hospitals and urban community hospitals).

In any event, whenever one insurer attempts to unilaterally improve its position by getting tougher on reimbursement reviews, the hospital has a powerful incentive to offload costs on the others in the system. The easiest way, for a while, is to offload it on the charge payers through price hikes. There are elasticities, however, in the case of those whose indemnity insurance plans require coinsurance, and eventually this well runs dry.

There is a contention -- which I believe exists in some cases -- that the net effect of cost-shifting over the years has been to lower Medicare per/patient reimbursements at the expense of everybody else. Hence, the estimates of the Illinois rate scheme are based on the assumption that when the regulators finally sort things out, Medicare will "pay its fair share"; hence the cost increases. Over time, however, it is argued that the cost efficiencies achieved via price controls will outweigh this one time rectification of the count.

I doubt it. The reason, of course, is that the State is not a disinterested party in this transaction. Illinois pays 50% of the costs of Medicaid reimbursements, and 0% of the cost of Medicare. Assuming they are rational (and Jim Thompson is nothing if not rational), they are going to "correct historical inequities in reimbursement" in a fashion that will permanently favor their end of the deal.

This fact, over and above the historical experience since Diocletian, should give us pause as we ponder bestowing Ronald Reagan's blessing on hospital price controls.

The only countervailing argument is that the President's principles of Federalism recognize the Constitutional right of any State to make the area within its borders uninhabitable.

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

January 4, 1982

TO: CRAIG FULLER

FROM: RICHARD S. WILLIAMSON Rich

SUBJECT: MEDICAID WAIVER -- STATE OF ILLINOIS

Secretary Schweiker has approved a request by the State of Illinois for a waiver on certain Medicaid restrictions. This would permit Illinois to provide co-payment and other matters.

A number of states are seeking such waivers and are getting them from Dick Schweiker.

Dick Schweiker called me on December 30 to tell me he was taking this action but also to apprise me that there might be some resistance from OMB. Apparently, OMB is concerned because this waiver, while providing a net savings to the Medicaid system over a period of years, in the first year or two might provide greater federal spending. We should go on record that before any final action is taken on this, in the event OMB wishes to oppose Secretary Schweiker on this matter, I would like to weigh in on behalf of the State of Illinois.

cc: Edward Harper
Donald Moran
James Medas

Ed: Since you got this memo by cc, I'll send the attached from Dean Burch which makes a strong case that HHS was in error. Thought you'd be interested in the attached.

Rich

IN THE MATTER OF APPLICATION
OF THE ILLINOIS HEALTH FINANCE
AUTHORITY FOR WAIVER OF STATUTORY
AND REGULATORY MEDICARE AND
MEDICAID REIMBURSEMENT REQUIREMENTS

To: Vice President George H. Bush
Chairman, Presidential Task Force
on Regulatory Relief

and

David A. Stockman
Director, Office of Management
and Budget

REQUEST FOR REVIEW AND
SUSPENSION OF WAIVER

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INTRODUCTION AND SUMMARY

On or about December 31, 1981, the Department of Health and Human Services (HHS) approved an application by the Illinois Health Finance Authority (IHFA) -- a state rate setting body -- for a waiver of Medicare and Medicaid statutory and regulatory requirements, for the purpose of conducting a purported five-year experimental system of hospital rate regulation, under federal sponsorship, in the state of Illinois. IHFA admitted in its projections that granting the requested waiver would commit the federal government to hospital rate regulation in Illinois beyond the requested experimental period.

The waiver application seeks implementation of a prospective system of hospital rate regulation under Section 402(a)(1)(C) of the Social Security Act (42 U.S.C. §1395b-1(a)(1)(C)), to obtain information for use by the federal government in assessing the national applicability of such a system. By its terms, the system constitutes a major federal regulatory initiative which would involve the participation of almost 300 hospitals, would increase costs to the federal government in excess of $600,000,000 over a five-year period, and would impose regulatory compliance costs on Illinois hospitals in excess of $13 million annually.

Contrary to Executive Order 12291 (February 17, 1981), HHS failed to prepare a Regulatory Impact Analysis (RIA) on this matter and circumvented the review procedures of the Order in acting on the application. Further, HHS failed to comply with

the requirements of the Paperwork Reduction Act of 1980 (44 U.S.C. §3501 et seq.) concerning the obtaining of Office of Management and Budget approval of information collection requests sponsored by federal agencies (id., §3507).

The Illinois Hospital Association, whose 270 member hospitals will be aggrieved by the decision of HHS granting this waiver, requests that the Office of Management and Budget (OMB) direct HHS to conduct an RIA of this system in accordance with Executive Order 12291, and to suspend the waiver until a determination is made by OMB that this federally sponsored regulatory initiative is consistent with the Executive Order and the President's program on regulatory relief. Further, in accordance with 44 U.S.C. §3507, it is requested that OMB direct HHS to submit to the OMB Director all the reporting, recordkeeping and other information collection requests to be distributed to hospitals under this project.

REQUIREMENTS OF EXECUTIVE ORDER 12291

1. Executive Order 12291 requires that federal agencies conduct RIAs of major rules and regulations. For purposes of this Order, a regulation or rule constitutes an agency action of general applicability and future effect designed to implement, interpret, or prescribe law or policy. (§1(a)). The Order excludes only administrative actions governed by specific hearing provisions, regulations with respect to a military or foreign affairs function, or regulations related to agency organization, management, or personnel. (§1(a)(1)-(3)).

2. A "major rule" under the Order entails any regulatory initiative likely to result in an annual effect on the economy of $100 million or more; a major increase in costs or prices for consumers, individual industries, federal, state, or local government agencies, or geographic regions; or significant adverse effects on competition, employment, investment, productivity, or innovation. (§1(b)).

3. The application of Executive Order 12291 is not limited to regulations promulgated through notice and comment rulemaking (§3(c)(1)). It encompasses agency actions of general applicability and future effect whether as policy statements, guidelines, or manuals, as well as actions taken at a local level that can have a major application on a national basis. See June 5, 1981 letter of James C. Miller, III, Administrator for Information and Regulatory Affairs, Executive Office of the President, Office of Management and Budget.

4. The Director of OMB is empowered to designate any proposed or existing regulatory action as a major rule. (§6(a)(1)).

5. Completion of an RIA is the only way to determine whether this regulatory initiative meets the objectives of the Executive Order and complies with the President's program on regulatory relief. See June 6, 1981, Interim Regulatory Impact Analysis Guidance, Executive Office of the President, Office of Management and Budget.

REGULATORY ACTION

6. The proposed system of hospital rate regulation in Illinois falls within the terms of Executive Order 12291. It is a significant regulatory action taken at a local level, under federal sponsorship, which would have major application on a national basis, would substantially increase annual federal Medicare and Medicaid costs, and would adversely affect competition among and impose additional regulatory burdens on hospitals in the state of Illinois.

7. In its April 6, 1981 waiver application, IHFA requested that HHS approve the imposition of "hospital rate regulation" for a state having neither a history of rate-regulation nor a history of financially troubled hospitals. Thus, HHS has approved as a matter of policy, and the federal government would be funding, a system which has the stated intention that: "[i]f the experiment is successful in Illinois . . . hospital rate regulation can be successful in areas of the country which have traditionally rejected any form of regulation." (Waiver Application at 63). Such a policy is directly contrary to the objectives of Executive Order 12291.

8. The proposed system for Illinois has been described as one which "can serve as a model for the rest of the country," and which, by its own terms, "will prove that all types of hospitals in all socio-economic and geographic regions can be placed on the same rate review system." (Waiver Application at 65).

9. Over the proposed five-year life of the project, significant increases in current Medicare and Medicaid payments for

inpatient hospital services are projected. With almost 300 Illinois hospitals required to participate, total federal expenditures under the experimental system would exceed $1 billion annually. Preliminary estimates by the Illinois Hospital Association show that an additional $9 million would be incurred for reporting requirements alone, in addition to the $4 million expended to meet current federal regulatory reporting requirements. The following estimates show projected cost increases over five years of the experiment:

	Projected Federal Payments Under Medicare Program With IHFA System	Projected Federal Payments Under Medicare Program Without IHFA System	Projected Yearly Increase in Federal Funds Under IHFA System	Projected Cumulative Increase in Federal Funds Under IHFA System
1982	$1,902,263	$1,879,141	$ 23,122	$ 23,122
1983	2,307,940	2,207,510	100,430	123,552
1984	2,769,867	2,593,825	176,042	299,594
1985	3,270,307	3,047,744	222,563	522,157
1986	3,719,469	3,581,100	138,369	660,526

Numbers in Thousands

9. The need for an RIA is underscored by the fact that the IHFA cost estimates -- as accepted by HHS -- incorporated significant mathematical errors and faulty assumptions. Over a five-month period, IHFA performed two estimates of Medicare cost

increases under the proposed system, and these varied by $143,146,829, with the latter estimate showing increased Medicare costs to the federal government of $167,273,000. The Illinois Hospital Association's conservative estimates, shown in the foregoing table, indicate increased costs of $660,526,000 by the end of 1986. IHFA made an initial projection of $7,933,481 in additional Medicaid costs, but failed to revise this estimate as it had revised the initial Medicare estimate. HHS made no request for a revision. Applying the same changes in methodology as used by IHFA for the two Medicare projections, however, estimated additional Medicaid costs to the federal government under the revision would exceed $54,979,023.

10. This system will adversely affect competition among Illinois hospitals. Considerable public testimony given by investment bankers and others during hearings on the competitive disadvantages to hospitals which would result from this system has been ignored by HHS. Since the potential for adverse effects on competition falls within the scope of Section 1(b)(3) of Executive Order 12291, and the system itself would extend for over five years, an RIA is appropriate.

APPLICATION OF THE PAPERWORK REDUCTION ACT OF 1980

11. The Paperwork Reduction Act of 1980, 44 U.S.C. §3501 et seq., imposes affirmative obligations on federal agencies which conduct or sponsor the collection of information through the use of identical reporting or recordkeeping requirements imposed on ten or more individuals, corporations, or the like.

44 U.S.C. §§3502(4)(A) and (14), 3506, and 3507. Specifically, agencies are prohibited from sponsoring the collection of information unless they have first submitted to the Director of OMB the proposed information collection request, copies of pertinent regulations and other materials specified by the Director, and an explanation of actions taken to comply with Section 3507(a)(1)(A)-(C) of the Act including attempts to reduce regulatory burdens on those required to furnish information.

12. The agency may not conduct or sponsor such collection of information unless the Director of OMB has approved the proposed information collection requests, or the period for review of such requests by the Director has elapsed. 42 U.S.C. §3507(a)(3). The Director is prohibited from approving any information collection request for a period in excess of three years. 44 U.S.C. §3507(d).

13. In granting the IHFA waiver application, which will extend for over five years, will include extensive reporting and recordkeeping requirements to be imposed on almost 300 hospitals in Illinois, and will result in some $13 million in additional regulatory compliance costs, HHS failed to obtain OMB approval of the reporting, recordkeeping and other information collection requests to be used in the project, in accordance with Section 3507 of the Paperwork Reduction Act of 1980.

REQUESTED ACTION

On behalf of its 270 member hospitals, the Illinois Hospital Association requests that OMB: (1) Declare that the proposed Illinois system of hospital rate regulation is a "major rule" within the terms of Sections 1(b) or 6(a)(1) of Executive Order 12291; (2) Direct HHS to conduct an RIA in accordance with that order; (3) Direct HHS to submit to OMB the reporting, recordkeeping and information collection requests to be utilized under the IHFA system, in accordance with the Paperwork Reduction Act of 1980; and (4) Suspend the waiver until a determination has been made by OMB that this regulatory initiative is consistent with Executive Order 12291, the Paperwork Reduction Act, and the President's program on regulatory relief.

Respectfully submitted,

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