

# **Pennsylvania Intergovernmental Cooperation Authority**



## **Health/Medical Benefits: Burning a Hole in The Budget**

**PICA Issues Report**

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**October 23, 2006**

**PENNSYLVANIA INTERGOVERNMENTAL  
COOPERATION AUTHORITY**

1429 Walnut Street, 14<sup>th</sup> floor, Philadelphia, PA 19102  
Telephone: (215) 561-9160 – Fax: (215) 563-2570  
Email: [pica@picapa.org](mailto:pica@picapa.org)

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## **INTRODUCTION**

Over the last five years, two costs have been rapidly devouring the City's budget: pensions and health benefits costs. Unless the City can control the growth in those areas, they will continue to consume more and more of the resources that could be used for essential services or to attack the many long-term issues facing the city. This report, which focuses on health benefits,<sup>1</sup> highlights the rapid increase in the City's health benefits costs, examines costs in other cities, describes actions other governments have taken in similar situations, and makes recommendations for controlling the City's costs.

## **RECOMMENDATIONS:**

Among this reports recommendations are:

- Develop and implement a plan for joint labor and management control of employee health care funds.
- Institute health management and wellness programs and tie those programs to incentives for participation.
- Enhance vendor management to ensure that the City is getting the best possible pricing.
- Make changes to health insurance plans if the other recommendations in this report do not lead to reductions in the growth of health benefits costs.

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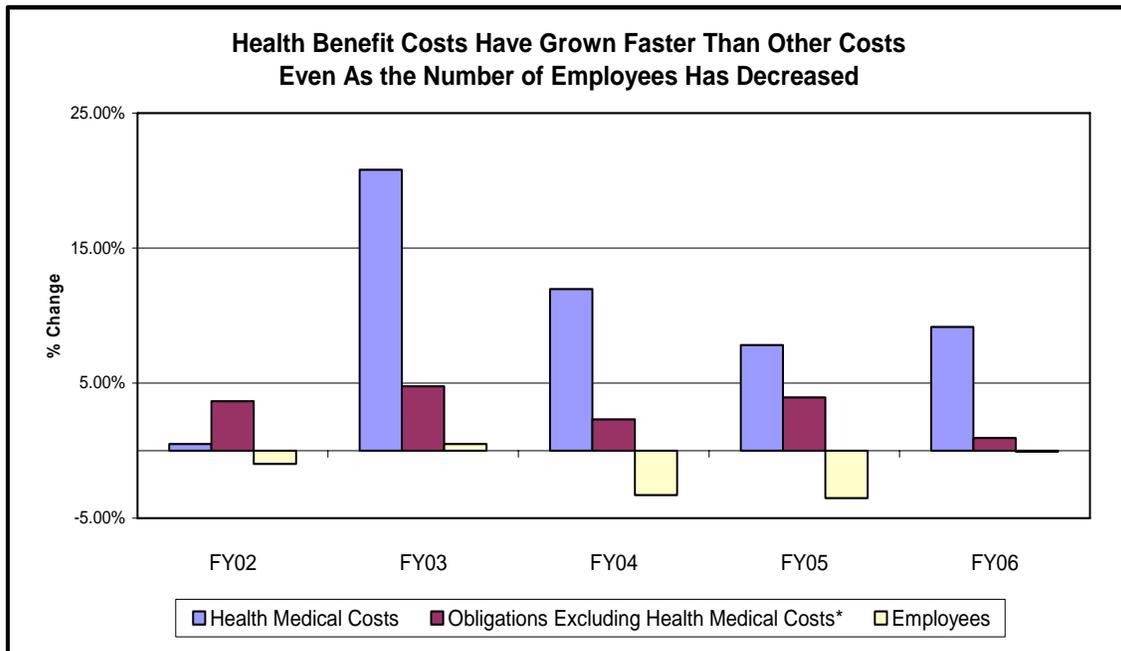
<sup>1</sup> PICA made recommendations about how to control Pension costs in its issue paper entitled "An Ounce of Prevention: Managing the Ballooning Liability of Philadelphia's Pension Fund," which can be found at <http://www.picapa.org>.

## BACKGROUND

### How Have the City's Costs Grown?

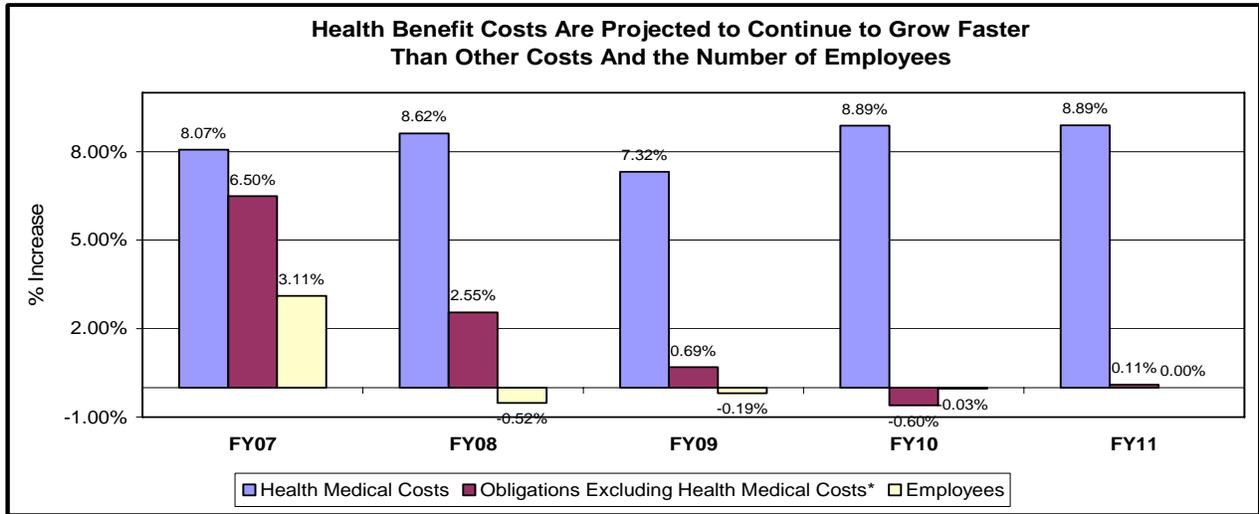
*The City's Health Care Costs Have Skyrocketed Over the Last Five Years Even Though the Number of Employees Has Declined.*

The City's health insurance costs increased by 60 percent from FY01 through FY06 – and are over \$112 million more annually than they were just five years ago. That increase is not only much larger than the change in the rest of the budget, but also came at a time when the City's number of general fund employees dropped by about seven percent.



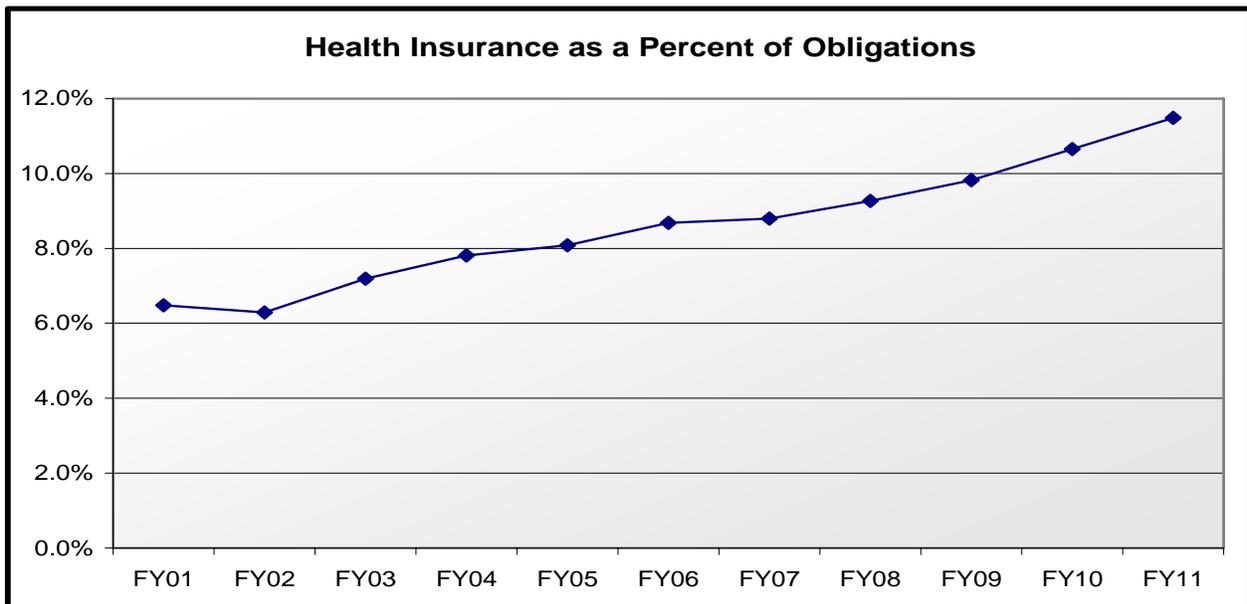
\* Includes all general fund obligations (debt service, pension costs, wages/salaries, contracts, materials, supplies and equipment, indemnities, etc.) except employee health/medical benefits

The rapid increases are expected to continue over the next five years. The FY07-FY11 Five-Year Financial Plan projects that health care costs will be \$147 million higher in FY11 than they were in FY06. Unfortunately, the Plan's projections may be optimistic as they assume that the City will be successful in appealing arbitration awards for the police and fire unions. The police award would provide increases of almost 16 percent in its first year and 10 percent in its second year while the fire award would give increases of 11 percent in its first year and 14 percent in its second and third years. Those awards would add tens of millions in costs beyond the amounts included in the Plan.



By growing dramatically faster than the rate of increase of overall obligations, health benefits are consuming a larger portion of the City’s general fund budget. As a percent of the city’s budget, health care costs are projected to have increased from 6.5% in FY01 to 11.5% in FY11 and will be even higher if the City’s appeals of the police and fire awards are unsuccessful. As is the case with the City’s rapidly increasing pension costs, unless the City can find ways to reduce its health benefits costs, it will have less money available to provide services and less money to tackle its key long-term structural issues including establishing a rainy day fund, investing in its infrastructure, making its tax structure more competitive, lowering its long-term obligations and reducing its unfunded pension liability.

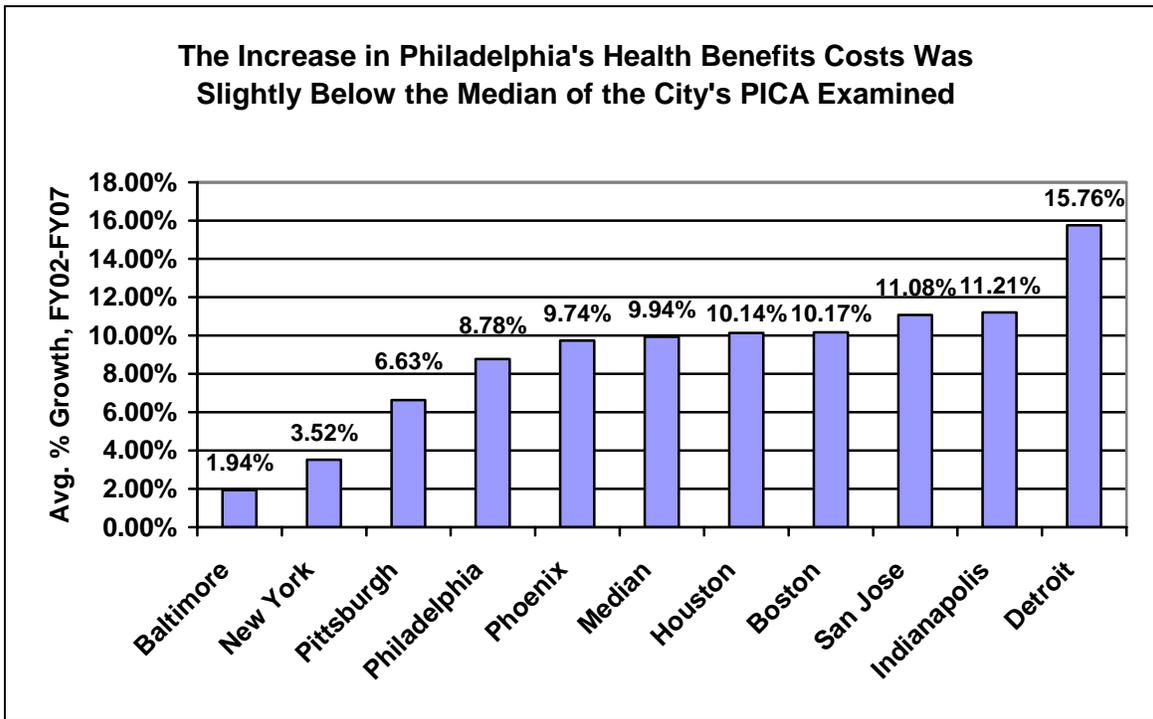
Faced with similar health insurance cost increases, Boston Mayor Thomas Menino said “If we save money on this issue, just think of how many more police and fire we can put on the streets.” Like Boston, if Philadelphia were able to control its benefits costs, it could put that money to use elsewhere.



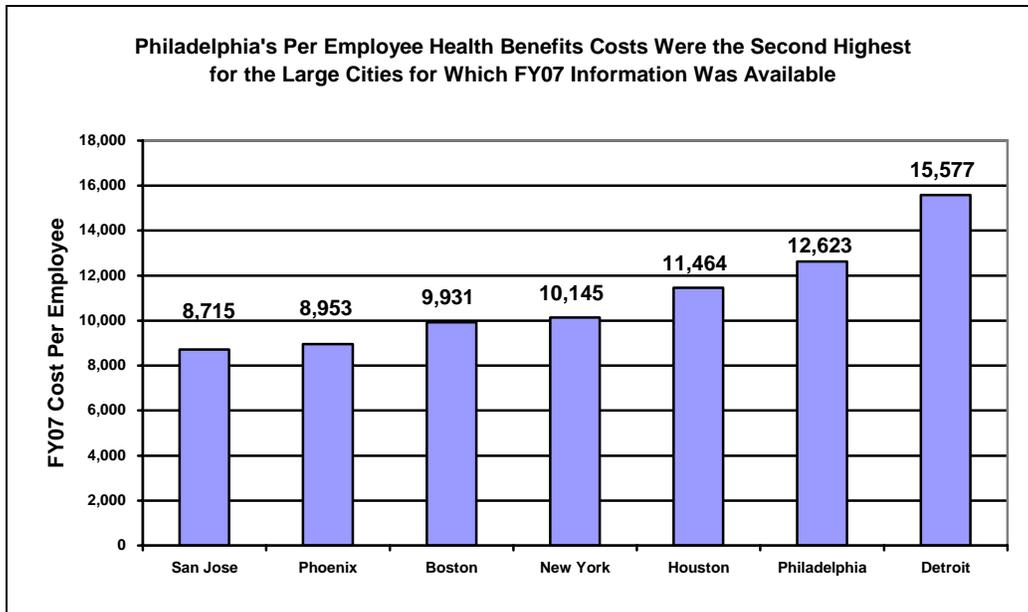
## How Have Costs Grown Nationwide?

*The Growth in the City's Health Care Costs Is Consistent with Growth in Other Jurisdictions.*

The rapid increase in health benefits costs is not unique to Philadelphia -- it is part of a nationwide trend that has affected local and state governments and private businesses. In fact, as the following graph shows, the City's growth rate in per employee health benefit costs from FY02 through the FY07 budget was slightly below the median for large cities for which information was available.



While Philadelphia's average growth was slightly below the median, its cost per employee was higher than costs for almost all of the other cities. In FY07, for cities for which information was available, only Detroit's per employee costs were higher than Philadelphia's.



Even though the growth in the City's cost is slightly below the median of the growth in other cities, the combination of the impact of that growth on the City's budget and the fact the City's costs are still higher than costs in almost all of the other cities PICA examined, makes it imperative that the City find a way to slow or reverse the trend of rapidly increasing costs. As will be discussed later in this paper, other jurisdictions have been implementing strategies to reduce their costs.

Before examining ways in which the City can slow or reverse the growth in its health insurance costs, it is important to know how the City's health insurance costs are managed.

### **How Does the City's Health Benefits Insurance System Work?**

*Most of the City's Employees Get Their Health Insurance Benefits from Plans Managed by Unions.*

All full-time city employees receive health care insurance unless they specifically waive coverage and give proof that they have coverage from somewhere else (such as being covered by a spouse's plan). In addition, retirees receive coverage for five years. Each of the City's four unions control their own health plans and most employees are enrolled in one of those plans. City employees who are not in a union, or who opt not to participate in their union's health plan, enroll in a plan run by the administration.

DC 33 has about one third of the participants in the City's health plans, while the FOP has about a quarter, the City-Administered plan has slightly over one fifth, DC47 has about 15 percent and the IAFF has about ten percent.

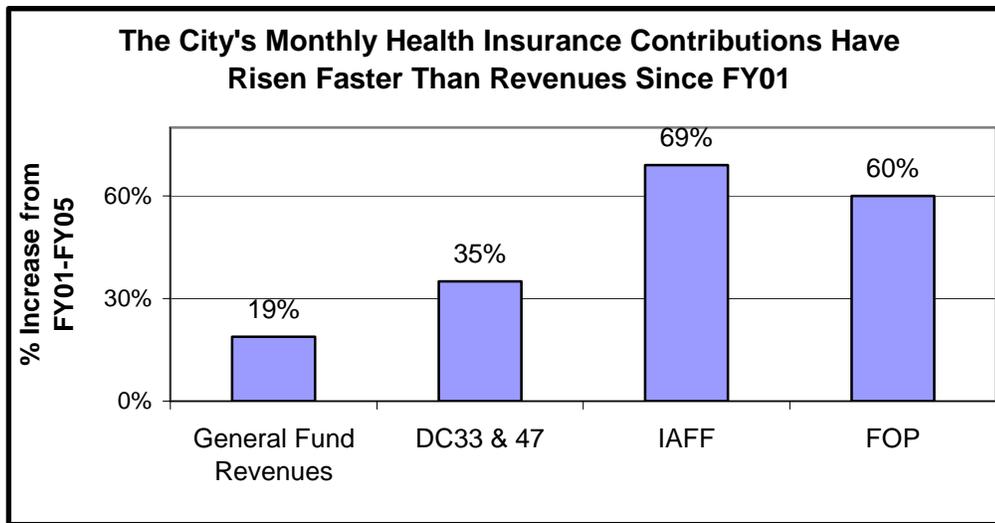
While the City is represented on the boards that run each of the union's funds, the unions have controlling representation on those boards. As a result, the City is unable to meaningfully participate in the management of any of the funds.

## How Have Employee Contributions Changed?

*The City's Contributions For Health Plan Participants Have Increased Substantially Since FY01*

Each month, the City makes payments to each of the union funds equal to a set amount for each participant in that union's plan. The amount of those payments has been established either through negotiated collective bargaining agreements for nonuniformed unions or through arbitration awards for uniformed unions. The unions use those payments from the City to both pay for health insurance coverage and for their administrative costs. The unions are responsible for designing the health care coverage packages their members receive and for setting benefit standards such as co-pays and deductibles.

The monthly contributions the City makes to each union have gone up dramatically over the last five years. The nonuniformed employees have seen the City's contributions to their plans increase by 35 percent per member per month since FY01, while members of the firefighters union have seen contributions go up by 66 percent and members of the Fraternal Order of Police have seen payments jump 60 percent during the same period.



## **WHAT ARE OTHER GOVERNMENTS DOING?**

*Other Cities have been taking steps to control their health insurance costs*

Given the growing importance of health care costs to state and local governments, the Government Finance Officers' Association has provided a series of recommendations on controlling those expenses. While national trends make controlling health insurance costs an enormous challenge, other cities have been taking many of the steps recommended by the GFOA.

### ***A. Changing Plan design***

Employers can change their plan design in a number of ways including:

- changing from an indemnity plan to a health maintenance organization, a preferred provider organization; a consumer driven health care plan or another type of plan;
- changing the plan's provider network so that fewer or different physicians are in the network;
- changing what kind of procedures are covered in the plan;
- limiting the number of visits that are covered. For example, only a certain number of visits to a chiropractor might be covered; and
- limiting the kinds of drugs that are covered by a plan. The plan could, for example, limit coverage to generic drugs.

### ***B. Vendor management***

There are a number of ways health plan managers can manage vendors including using a competitive bidding process and ensuring that providers are properly paying benefits to members. Vendor management is the main strategy used by San Jose to control its health care benefits costs. San Jose uses market pressure to keep its rates low by issuing a request for proposals every four years. In addition, San Jose uses an actuary to examine its providers' rate setting methodology to make sure the providers' rates are based on accurate utilization data and that their reserve policies are consistent.

### ***C. Individual health management***

A key tool that can be used to help hold down the increase in costs is to promote healthier lifestyles among participants, particularly those who are at higher risk of serious disease. Employers can contract with third parties who will target negative behaviors and lifestyles that put members' health at risk. Individual health management programs include wellness programs, disease management, and employee health education classes. In order to ensure that employees participate in these programs, employers can provide financial incentives. By investing in these prevention programs

employers can achieve savings by reducing the number of serious health problems that involve costly surgeries, hospitalization, and intensive care. Those types of serious problems typically account for the vast majority of a plan's costs.

There are examples of jurisdictions employing wellness and disease management programs to stabilize costs:

- South Carolina has hired a contractor who uses an information system to track patterns in claims occurrences to see whether early intervention can prevent more serious health problems.
- For the past ten years, the City of Asheville, North Carolina has implemented an innovative disease management program that has been very successful. For more information refer to the section "Asheville, North Carolina a Case Study in Disease Management".

The FOP has begun to implement some health management programs such as wellness screenings and member health education, but does not have the kind of program that has been implemented in Asheville.

#### ***D. Aggregation***

By joining different membership pools under one plan employers can achieve significant savings by increasing their purchasing power and reducing administrative expenses. Many cities have joined with their local unions and school districts to control costs. The City of Phoenix combines its union and non-union members under one plan and benefits from the increased purchasing power. Other cities with aggregated plans include Boston, Chicago, and New York City. While Philadelphia's health plan is fragmented, individual unions have pursued their own aggregation. The FOP, for example, has joined the Delaware Valley Healthcare Coalition, which includes unions from seven states.

#### ***E. Cost sharing***

Employers can control costs by increasing their employees' share of the premium, co-payments, and co-insurance. Generally, this strategy is effective for overly generous plans whose members are unaware of the true cost of the care they receive. In taking this approach, cities must be careful not to increase employee payments by so much that they dissuade participants from seeking preventive health care that can help avoid far more expensive health problems in the future.

The City of Cincinnati, in order to cope with rapid increases in its health care costs, has moved towards a consumer-driven health plan model by introducing deductibles, co-pays, and flexible spending accounts to its plan.

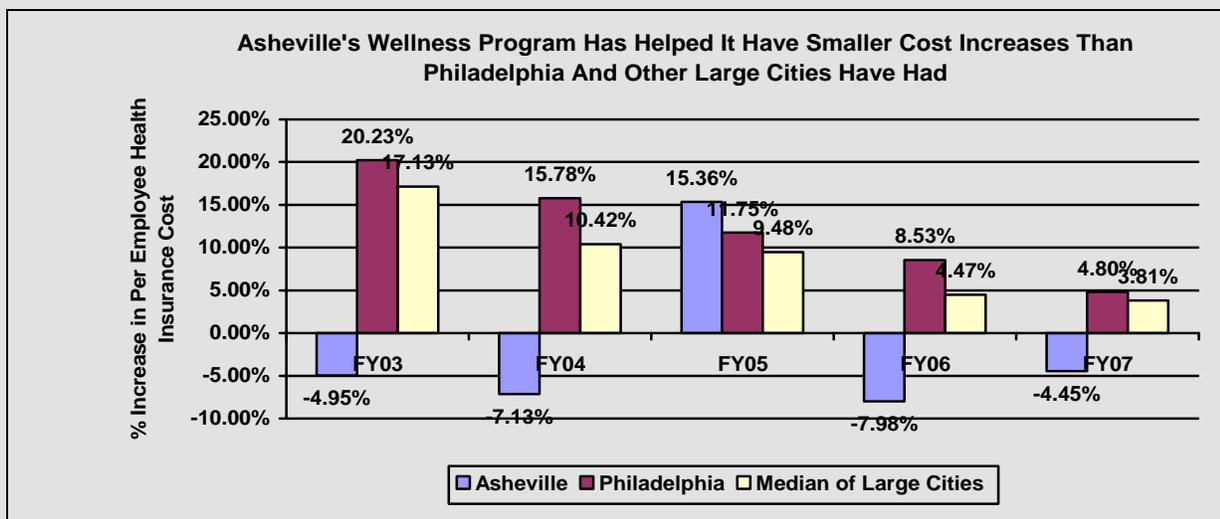
## CASE STUDY

### Asheville, North Carolina: A Case Study in Disease Management

While health care costs have been soaring in cities across the country, the City of Asheville, North Carolina has managed to control these costs for the past 10 years. Last year, Asheville was even able to reduce its total medical insurance costs. The City of Asheville attributes its success to an innovative disease management program implemented in 1997 known as “The Asheville Project”. Asheville has controlled the growth in health care costs by investing in programs designed to prevent patients from developing severe health problems requiring costly surgeries and hospital stays.

Unlike traditional disease management programs, the Asheville Project trained pharmacists to become counselors for diabetics. The pharmacists worked with physicians and other health care providers to educate patients and help them monitor their health and live healthier lifestyles. Diabetics who participated in the program were allowed to waive their co-pay fees and were given free monitoring equipment. In exchange, participants were obligated to attend self-care education classes and meet regularly with their pharmacist coach.

By educating participating diabetics in how to properly monitor and care for themselves, Asheville not only improved the health of participants, but also achieved significant savings. As a result of participants’ monitoring and taking better care of themselves, prescription claims and doctor visits increased. These increases, however, were offset by substantial reductions in expensive hospitalization costs. This tradeoff has controlled the growth of health insurance costs and saved the City of Asheville a considerable amount of money. As the following graph shows, the program has helped Asheville keep the percentage increase in its health care costs well below those of other cities.



The success of the diabetes program led Asheville to expand the program to target members with asthma, high blood pressure, cholesterol, and depression. Asheville credits these programs with helping to control health insurance costs as well.

## **Solving the Problem: Recommendations for Controlling Health Benefit Costs**

In Philadelphia, controlling health insurance costs is particularly difficult because health benefits are managed by five different entities --- four unions and the City. For the City to control costs it will have to obtain meaningful management sharing agreements with its unions. Establishing labor-management boards with equal representation would ensure that both labor and management were responsible for providing employees reasonable healthcare plans at the best possible price for taxpayers.

The City and its unions are already using some of the approaches recommended by the GFOA and implemented by other cities, but more can and should be done. The City should pursue a multi-stage approach. In the first stage, the City should attempt to reduce costs without affecting the benefits that health plan participants receive. The City can do this by taking the following steps:

### ***A. Make Someone Responsible***

The City should dedicate at least one employee full time to managing its health insurance costs. That employee's initial responsibility would be to implement the recommendations in this report. The City employee or employees tasked with managing health insurance costs should work closely with the joint labor-management boards that oversee the health funds.

### ***B. Encourage Healthy Behavior and Avoid Serious Illnesses***

The City should implement programs that encourage participants to maintain healthy lifestyles, with particular emphasis on identifying participants at risk of serious illnesses. The programs should be run by an outside consultant who would not share information on individuals with the City or the employees' unions. The consultant's task would be to improve the health of city employees and to reduce the incidence of serious illnesses that require surgery, heavy use of medication, and/or extended stays in hospitals.

In order to ensure that plan members participate in these programs, the City should consider offering financial incentives. For example, the City could offer to reduce required employee contributions for the cost of health insurance if employees participated in wellness programs.

### ***C. Vendor Management***

The City should continue to aggressively review insurers' billings to make sure that they are using accurate utilization data and that the City is getting agreed upon rates. In addition, the City should bid out its contracts at least once every three years.

#### ***D. Cost Sharing***

All of the City's plans should have meaningful co-pays and deductibles. While those co-pays and deductibles should not be so large that they dissuade participants from getting necessary care, they should be large enough so that participants understand that there are costs associated with any visit to a doctor or pharmacist.

#### ***E. Plan Design***

If the strategies described above do not lead to reductions in health care costs, the City should consider plan redesign including changes in the number of allowable visits, changes in what procedures are covered and changes in the types of allowable drugs.