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THE SLOWDOWN IN MEDICAID EXPENDITURE GROWTH

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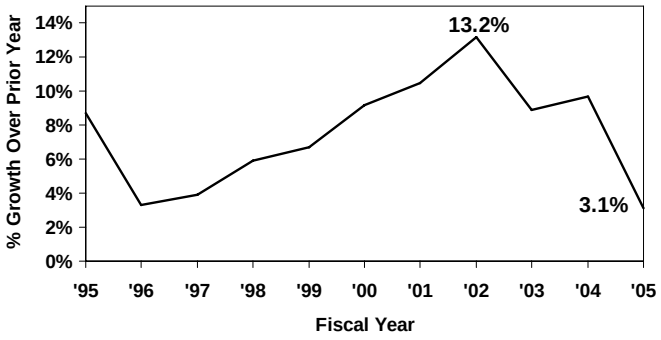
It is sometimes claimed that Medicaid expenditures are "out of control." A careful analysis of recent data and projections indicates, however, that Medicaid growth has slowed considerably in the last year or so, even before the enactment of the Deficit Reduction Act of 2005. Both the Administration and the Congressional Budget Office have recently lowered their projections of future Medicaid expenditures.

Federal Medicaid expenditure growth rates have fallen substantially in the past few years. As seen in Figure 1, annual growth in federal Medicaid expenditures, which peaked at 13.2 percent in fiscal year 2002, dropped to 3.1 percent by fiscal year 2005, the lowest level in more than a decade.[1]

FIGURE 1

Federal Medicaid Expenditure Growth: FY 1995 to 2005



Source: Office of Management and Budget, Historical Budget Tables, 2006

Moreover, Medicaid outlays through December 2005 indicate that federal expenditures in the first three months of fiscal year 2006 were only 3.6 percent higher than in the first three months of the prior year.[2] The Medicare drug benefit began in January and Medicaid growth is falling further now because the cost of prescription drugs for "dual eligibles" — people enrolled in both Medicaid and Medicare — is shifting from Medicaid to Medicare. The Federal Funds Information Service, a joint program of the National Governors Association and the National Conference of State Legislators, recently noted that expenditures for the first five months of fiscal year 2006 — through February 2006 —

[1] The federal Medicaid growth rate in 2005 was temporarily lowered because fiscal relief provided $6 billion in extra federal funding in fiscal year 2004. If we adjust for this temporary change, total (federal plus state) Medicaid expenditures in fiscal year 2005 rose a comparatively modest 6.7 percent.

[2] Based on monthly data about the amount states draw down from the U.S. Treasury for Medicaid.

were just 1.8 percent higher than in the first five months of last year.[3] (Drug costs for dual eligibles previously constituted roughly half of all Medicaid prescription drug costs.) Since Medicaid is based on federal matching of state expenditures, the federal trends imply that average state Medicaid expenditures also are growing more slowly in fiscal year 2006. Some states, of course, grow faster than average, while others grow more slowly than average.

Expenditures currently are growing more slowly in Medicaid than in Medicare. Medicare outlays reported by the Department of Treasury were 6.9 percent higher in the first five months of fiscal year 2006 than in the comparable period of 2005, without including the additional costs of the new Medicare drug benefits.

It is too early to know all the reasons for this marked slowdown in Medicaid expenditures. Some plausible factors include:

- *Overall Health Cost Slowdown.* There has been a somewhat broad deceleration in health care costs, affecting the private health sector as well. New national health expenditure estimates indicate that annual health expenditure growth declined from 9.1 percent in 2002 to 7.4 percent in 2005 and is expected to slow further through 2007.[4] A key factor influencing Medicaid expenditures is underlying changes in health care costs overall.

- *Overall Economic Recovery and Medicaid Enrollment.* Between 2001 and 2004, the economy was weak, unemployment was high, poverty was rising and the number of people without private health insurance was climbing. Medicaid enrollment grew to meet the strong needs in those years and kept the ranks of the uninsured from rising even higher.[5] Since then, the economic recovery has continued, and unemployment has declined. Research indicates that Medicaid is responsive to the economy; enrollment grows when unemployment rises and contracts when unemployment declines.[6]

  The main factors that affect overall Medicaid expenditure growth are changes in the number of people enrolled and changes in the costs of health care per beneficiary, which in turn are affected by the prices paid for health care and the amount of health care services used. Regrettably, data about national Medicaid enrollment in 2005 or 2006 are not yet available, so we do not know the extent to which the slowdown in Medicaid expenditures is due to changes in enrollment or to changes in expenditures per beneficiary.

  The overall Medicaid expenditure growth rate in 2006 is sufficiently low that it seems likely that Medicaid enrollment has stabilized or perhaps even declined this year. It is too early to know if

[3] Vic Miller, "Medicaid Spending Slows Amid General Spending Dip," Federal Funds Information Service, March 14, 2006.

[4] C. Borger, et al., "Health Spending Projections Though 2015: Changes on the Horizon," *Health Affairs* web exclusive, Feb. 22, 2006.

[5] J. Holahan and A. Cook, "Changes in Economic Conditions and Health Insurance Coverage, 2000 to 2004," *Health Affairs* web exclusive, Nov. 1, 2005.

[6] Stan Dorn, Barbara Smith and Bowen Garrett, "Medicaid Responsiveness, Health Coverage and Economic Resilience," Joint Center for Political and Economic Studies, Sept. 2005.

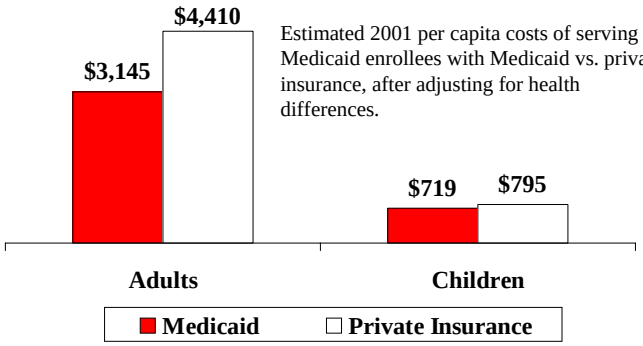
enrollment slowdowns are due to broad reductions in the demand for Medicaid because of the economic recovery or due to eligibility cuts in a handful of states like Tennessee.[7]

- *State Policy Actions.* Surveys conducted for the Kaiser Commission on Medicaid and the Uninsured have shown that in recent years, states have undertaken an array of initiatives to contain costs. For example, for 2006 every state either froze or reduced payment rates for at least some health care providers, 41 states took steps to control drug costs, 14 states restricted eligibility, 16 restricted benefits and 13 increased copayments.[8]

  These policy changes suggest that states have been trying to hold down the cost of Medicaid benefits per enrollee. It is important to remember that Medicaid already is an efficient form of health insurance. Analyses by economists at the Urban Institute found that the per beneficiary cost of Medicaid is substantially lower than the amount it would cost to insure the same beneficiaries through private health insurance (Figure 2).[9] Moreover, data also suggest that Medicaid expenditures per beneficiary have been rising more slowly than private health insurance premiums.[10] The lower cost of Medicaid suggests that proposals to make Medicaid benefits more like those in private insurance are unlikely to produce noticeable savings, and could even increase costs, unless the range of medical benefits provided is substantially reduced.

FIGURE 2

Medicaid Costs 30% Less for Adults and 10% Less for Children, Than Private Insurance



Estimated 2001 per capita costs of serving Medicaid enrollees with Medicaid vs. private insurance, after adjusting for health differences.

Source: Hadley and Holahan, Inquiry, 2004

- *Changes in Federal Matching Rates.* In fiscal year 2006, federal Medicaid matching rates fell for 29 states and rose for nine others. The Federal Funds Information Service suggests this may have

[7] Hurricane Katrina may have a modest effect. According to data from CMS' State Payment Management System, Medicaid drawdowns for Louisiana and Mississippi are lower so far this year than last year, probably because large numbers of people evacuated and many health care facilities were shuttered. But these reductions were largely offset by higher drawdowns in Texas and some other states that received evacuees. The Deficit Reduction Act provides additional federal funds to help cover state expenditures for certain Katrina-related Medicaid costs.

[8] For example, see V. Smith, et al., "Medicaid Budgets, Spending and Policy Initiatives in State Fiscal Years 2005 and 2006," Kaiser Commission on Medicaid and the Uninsured, Oct. 2005.

[9] Jack Hadley and John Holahan, "Is Health Care Spending Higher under Medicaid or Private Insurance?" *Inquiry,* 40 (2003/2004): 323-42. Medicaid costs are lower, in part, because Medicaid payments to health care providers are often lower than private insurance payments.

[10] John Holahan and Arunabh Ghosh, "Understanding the Recent Growth in Medicaid Spending, 2000-2003," *Health Affairs* web exclusive, January 26, 2005.

a modest effect lowering federal Medicaid expenditures.[11]

- *Federal Administrative Actions.* The federal government has taken actions to curb states' use of Medicaid intergovernmental transfers and similar financing mechanisms. This could also be slowing federal Medicaid expenditures, although there are no reliable estimates of the impact.

Projections of Future Growth

Both the Congressional Budget Office (CBO) and the Administration have lowered their multi-year projections of federal Medicaid expenditures substantially since last year (Table 1).

TABLE 1

Revised Estimates of Federal Medicaid Expenditures

	FY 2007	FY 2007-11	Avg Annual Growth FY 2006-11
	($ in billions)		
Congressional Budget Office			
Jan. 2005 baseline	$205.2	$1,214.6	8.0%
Mar. 2006 baseline without DRA	$199.9	$1,175.1	7.4%
Change from Jan. 2005	-$5.3	-$39.5	-0.5%
Mar. 2006 baseline with DRA	$199.3	$1,167.0	7.3%
Change from Jan. 2005	-$5.9	-$47.6	-0.7%
Office of the Actuary, CMS			
Feb. 2005 baseline	$205.3	$1,226.6	8.4%
Feb. 2006 baseline with DRA*	$201.1	$1,164.2	6.8%
Change from Feb. 2005	-$4.1	-$62.4	-1.6%

"DRA" = Deficit Reduction Act

* Unlike 2005, the 2006 Administration baseline includes savings due to proposed administrative changes. For comparability, we excluded the impact of the administrative changes proposed in 2006.

CBO has scaled back its five-year estimates of Medicaid expenditures by $48 billion since January 2005, a four percent reduction. Most of the reduction ($40 billion) was for technical reasons, due to changes in program trends. A small portion ($8 billion) of the reduction is due to changes in the Deficit Reduction Act.

The Administration's projections of Medicaid expenditures fell more, by $62 billion over five years, or five percent. This estimate includes both technical revisions and the estimated effects of the Deficit Reduction Act.

Even the revised projections may be too high. The initial level of federal Medicaid expenditure growth in fiscal year 2006 (1.8 percent for the first five months) is considerably lower than either CBO or the Administration most recent produced in their estimates. CBO and the Administration have assumed Medicaid growth rates in 2006 of 4.5 percent and 5.2 percent, respectively. If the final fiscal year 2006 growth in Medicaid expenditures remains about 2 percent, actual Medicaid expenditures will be about $4 to $6 billion less than the amounts CBO and the Administration currently project. And because base 2006 expenditures would be lower, cumulative Medicaid expenditures in the five years from 2007 through 2011 could be billions of dollars lower than the amounts now projected.

[11] Vic Miller, *op cit.*

Conclusions

There has been a significant slowdown in Medicaid expenditure growth. Medicaid expenditures grew rapidly earlier in the decade. That growth occurred when the economy was weak, needs were high and health care costs were surging. The responsiveness of the Medicaid program during the downturn helped keep millions of low-income Americans insured at a time when private insurance coverage was receding and poverty was rising. In 2005 and so far in 2006, by contrast, Medicaid expenditure growth has ebbed to its lowest level in more than a decade.