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FEDERAL AID TO STATE MEDICAID PROGRAMS IS FALLING WHILE THE ECONOMY WEAKENS

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Despite the economic downturn that is affecting most areas of the country, the proportion of Medicaid costs that the federal government bears is declining in more than half the states in fiscal year 2002, which began on October 1. The Medicaid matching rate, which establishes the share of Medicaid expenditures the federal government covers, is dropping for 29 states because the economies of these states improved in the late 1990s. Yet economic conditions are now deteriorating; many states' Medicaid expenditures will rise more rapidly than had earlier been anticipated, as more workers are laid off and their families become income-eligible for Medicaid, while many states' revenues will fall further behind amounts projected earlier. The reductions in the federal matching funds, which will necessitate equal increases in states' contributions from their general funds, will exacerbate states' weakening fiscal status and increase the likelihood that they will act in the middle of a downturn to scale back their Medicaid programs.

A temporary increase in federal Medicaid matching rates would help reduce the pressure on states to cut back health insurance coverage for low-income families and individuals. It also would offer fiscal assistance to states with ailing budgets, lessening the need for the states to cut programs or raise taxes in the middle of a recession. Such state actions would further dampen the economy and offset some of the stimulative effects of federal actions to spur the economy.

The Medicaid financing system is designed so states and the federal government jointly cover the costs of health insurance for low-income people. The federal government pays a certain percentage — higher in poorer states and revised annually — of every state's expenditures for health care benefits provided under Medicaid. To measure the relative incomes of states and compute the Medicaid matching rate, the federal government compares the average per capita personal income for each state with the national average per capita income. States with lower relative per capita incomes have higher federal matching rates. Every state receives at least a 50 percent matching rate.

The annual calculations are based on averages for each state of per capita income for the three most recent years for which these data are available on a state-by-state basis. The Medicaid matching rates for fiscal year 2002 are based on state per capita income data for the

years 1997, 1998 and 1999.[1] The rates for fiscal year 2001 were based on 1996, 1997 and 1998 data. Thus, changes in states' Medicaid matching rates in 2002 were triggered by changes in their economies that occurred between 1996 and 1999. More recent economic trends are not reflected in the new matching rates.

The Medicaid matching rates for fiscal year 2002 include reductions in matching rates for 29 states (Table 1). The states with reduced match rates will lose about $565 million in federal funds as a consequence — and be required to raise their state general fund contributions for Medicaid by that amount — than if the fiscal year 2001 matching rates were still in effect.[2] In 22 states, the reductions in projected federal funding exceed $10 million: Alaska, Arizona, Florida, Georgia, Kentucky, Louisiana, Minnesota, Mississippi, Nebraska, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota Texas, Utah, Virginia, Washington and Wisconsin. In light of these matching rate reductions and states' deteriorating economic conditions, the National Conference of State Legislatures has proposed that states in which the Medicaid matching rate is falling be "held harmless" and retain their fiscal year 2001 matching rate, while states in which the rates are rising shift to the fiscal year 2002 rate.[3]

The reduction in Medicaid matching rates has worsened an already bleak fiscal outlook for many states. In August, the Congressional Budget Office projected that Medicaid expenditures in 2002 would be nine percent higher in 2002 than in 2001, while states projected that their revenues would rise just 2.4 percent. Rising Medicaid expenditures — primarily caused by escalating health care prices and utilization, forces that also are driving up private health insurance premiums — were already a source of serious concern to states. The repercussions of the terrorist attacks on September 11 are leading most analysts to expect even higher state Medicaid costs — because the economic downturn will make more people eligible for Medicaid — and lower state revenues.

A new analysis by the Urban Institute — based on state trends during the 1990s, including the recession that occurred in the early 1990s — indicates how much Medicaid caseload and expenditures might rise in 2002.[4] The study estimates that if the average

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[1] Office of the Secretary of Health and Human Services, "Federal Financial Participation in State Assistance Expenditures for October 1, 2001 through September 30, 2002", *Federal Register*: November 17, 2000. Rates for Alaska were subsequently changed by legislation in December 2000.

[2] The Medicaid matching rate is unchanged in 2002 in 11 states (including the District of Columbia) and has increased in 11 states. States with increased match rates will earn about $230 million more using the newer rates than they would have earned using the 2001 matching rates.

[3] Letter to President Bush from Stephen Saland, President of the National Conference of State Legislatures, and Angela Monson, President-elect of the National Conference of State Legislatures, Oct. 9, 2001.

[4] John Holahan and Bowen Garrett, "Rising Unemployment and Medicaid," The Urban Institute, Oct. 16, 2001, available at http://www.urban.org/pdfs/HPOnline_1.PDF.

Table 1 States with Federal Medicaid Matching Rate Reductions in FY 2002				
State	**FY 2001 Matching Rate**	**FY 2002 Matching Rate**	**Difference FY 01 - FY 02**	**Projected Reduction in Federal Funds in FY 2002**
				(millions of $)
Alaska	60.13%	57.38%	-2.75%	-$13.2
Arizona	65.77%	64.98%	-0.79%	-$26.3
Arkansas	73.02%	72.64%	-0.38%	-$7.6
Florida	56.62%	56.43%	-0.19%	-$18.0
Georgia	59.67%	59.00%	-0.67%	-$36.2
Kentucky	70.39%	69.94%	-0.45%	-$15.3
Louisiana	70.53%	70.30%	-0.23%	-$10.0
Minnesota	51.11%	50.00%	-1.11%	-$48.9
Mississippi	76.82%	76.09%	-0.74%	-$19.1
Montana	73.04%	72.83%	-0.21%	-$1.3
Nebraska	60.38%	59.55%	-0.83%	-$10.7
Nevada	50.36%	50.00%	-0.36%	-$2.8
New Mexico	73.80%	73.04%	-0.76%	-$12.8
North Carolina	62.47%	61.46%	-1.01%	-$65.7
North Dakota	69.99%	69.87%	-0.12%	-$0.6
Ohio	59.03%	58.78%	-0.25%	-$23.3
Oklahoma	71.24%	70.43%	-0.81%	-$18.8
Oregon	60.00%	59.20%	-0.80%	-$20.7
Rhode Island	53.79%	52.45%	-1.34%	-$17.8
South Carolina	70.44%	69.34%	-1.10%	-$37.0
South Dakota	68.31%	65.93%	-2.38%	-$12.4
Tennessee	63.79%	63.64%	-0.15%	-$8.7
Texas	60.57%	60.17%	-0.40%	-$52.7
Utah	71.44%	70.00%	-1.44%	-$13.4
Virginia	51.85%	51.45%	-0.40%	-$16.1
Washington	50.70%	50.37%	-0.33%	-$18.5
West Virginia	75.34%	75.27%	-0.07%	-$1.1
Wisconsin	59.29%	58.57%	-0.72%	-$25.5
Wyoming	64.60%	61.97%	-2.63%	-$6.8
Total for 29 States				**-$565.1**

Note: Federal matching rates are based on data published in the *Federal Register*. Projected state spending is based on states' projected Medicaid benefit spending, as submitted to HHS by August 2001. Since Medicaid expenditures will probably be higher than projected in August because the economic downturn will make more people eligible for Medicaid, the actual reductions in federal funds resulting from the decline in these states' matching rates are likely to be somewhat larger than the figures shown here.

unemployment rate for fiscal year 2002 rose to 5.5 percent national Medicaid enrollment would climb 3.6 percent above the level the Congressional Budget Office projected earlier and Medicaid expenditures, already projected to rise by 9.3 percent between 2001 and 2002, could increase by 10.5 percent instead. If the unemployment rate averages 6 percent, the caseload increase would be 5.4 percent higher than the CBO forecast indicated and the growth in Medicaid expenditures in 2002 would reach 11.1 percent. The latest "blue chip" economic forecast is that unemployment in 2002 will average between 5.5 percent and 6 percent. If the blue chip forecast turns out to be right — and some economists worry it may understate the depth or duration of the downturn — these estimates will bracket the possible impact on Medicaid programs.

Since 49 states have balanced budget requirements, many states are coming under considerable pressure to scale back their Medicaid budgets. For example, Tennessee's governor has recently proposed modifying the TennCare program, with the result that as many as 180,000 people may lose coverage.[5] State officials in Florida are discussing curtailing eligibility the "medically needy" component of the state's Medicaid program in the special legislative session beginning on October 22.[6] Washington state is planning to seek a federal waiver to trim Medicaid benefits substantially and to increase cost-sharing by low-income beneficiaries. Some states, such as Arizona and Nebraska, may convene special legislative sessions later this year to address the need to pare state budgets. When other states' legislatures convene, starting in January 2002, many will find their budgets are in much worse condition than when the legislatures were last in session and will face a need to cut expenditures or raise taxes. A number of these states are likely to consider reducing Medicaid benefits or eligibility.

To help states during the downturn, the federal Medicaid matching rate could be temporarily increased. States could use the additional funds to help cover the costs of increased Medicaid enrollment that are resulting from the downturn and to avert cutbacks in Medicaid during the coming year. These funds would not only assist Medicaid beneficiaries but also would maintain spending in the health care sector for hospitals, clinics, nursing homes and other health care providers, providing an economic stimulus. Four possible options that have roughly equivalent costs are:

1. *Across-the-board increase.* The federal Medicaid matching rate for each state could be raised by one or more percentage points in 2002. Thus, if the increase were two percentage points, then in a state where the federal government pays 60 percent of Medicaid costs, the federal government would pay 62 percent instead. This approach would disburse the added federal funds evenly across states. Providing additional support to each state — rather than just to those states in which Medicaid matching rates are declining — is appropriate because the effects of the economic downturn are expected to be broad and are likely to affect most states.

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[5] Gov. Don Sundquist, "Remarks on the New TennCare," Sept. 28, 2001, available at www.state.tn.us/tenncare/govspeech.html

[6] Alisa Ulferts, "Budget Cuts Could Nick Elderly, Poor, Education," *St. Petersburg Times* Oct 2, 2001

2. *Targeted increase to states with high unemployment.* This alternative would provide a general increase in the federal Medicaid matching rate but target larger increases to states with higher unemployment rates. For example, all states could receive a one percentage point increase, and those with unemployment rates exceeding the national average could get an additional two percentage point increase (for a total increase of three percentage points). This approach would use current economic data to target support to states with serious economic problems. A determination of which states have high unemployment rates would be made using the most recent three months of data from the Bureau of Labor Statistics. States meeting this standard during any quarter in fiscal year 2002 would be eligible for the increased match for the remainder of the fiscal year.

   September state unemployment data just released by the Bureau of Labor Statistics show that, based on the July to September 2001 quarter,16 states would qualify for the high unemployment bonus from the start of the year because their unemployment rates exceed the national average — Alaska, California, the District of Columbia, Idaho, Illinois, Kentucky, Louisiana, Michigan, Mississippi, New Mexico, North Carolina, Oregon, South Carolina, Texas, Washington, and West Virginia. The September unemployment data were collected in early September, however, and do not fully reflect the loss of jobs that occurred after September 11th. Another eight states have unemployment rates just below the national average and might rise above that threshold and thereby qualify for the unemployment bonus later in the year. These states are Arkansas, Hawaii, Nevada, New Jersey, New York, Ohio, Pennsylvania and Rhode Island. Several other states that were further below the national average in the July to September period are likely to rise above the national average as the downturn deepens. In recessions, unemployment always rises more steeply in some states that in others.

3. *Hold harmless and targeted increase based on high unemployment.* This variant includes three steps. First it would maintain the use of the 2001 matching rates in states in which the previously announced rates for 2002 have fallen. Next, all states would receive a one percentage point increase above the rate described in the first step in this approach. Finally, states with higher-than-average unemployment rates, as described above, would get an additional one percentage point increase in their matching rate. This approach ensures no state's Medicaid matching rate falls between 2001 and 2002, that all states gain some additional federal support, and that states with the most serious unemployment problems are provided additional relief.

4. *Targeted increase to non-elderly, non-disabled adults and children.* A final approach would target higher matching rate percentages to non-elderly, non-disabled adults and children, since these are the groups among which enrollment is most likely to increase as a result of higher unemployment. For example, the Medicaid matching rate for these groups could be elevated by eight percentage

points, bringing them closer to matching rates used in the State Children's Health Insurance Program. (This approach would be somewhat harder to implement because state Medicaid expenditures are not reported by eligibility group, but it probably could be worked out.)

The higher matching rates need not be applied to all components of Medicaid expenditures. There is less of a rationale for higher matching rates for Medicaid disproportionate share hospital payments or program administration. Also, to ensure that at least some of the funds are used to avoid harmful reductions in state Medicaid programs, the federal government could stipulate that states receiving a greater Medicaid match not reduce eligibility or benefits.

A temporary increase in the Medicaid matching rate could be an important component of the nation's economic stimulus policy.[7] The impact at the state level would be rapid; little start-up time would be needed since no state legislative action would be necessary. No additional federal or state bureaucracy or infrastructure would be required. The federal government has a broader and more elastic fiscal base than most states and has — if needed — the ability to run deficits, which most states lack, so this could be an appropriate element of countercyclical fiscal policy in a period of economic stress.

Since Medicaid is by far the largest federal grant-in-aid to states, temporarily elevating the federal matching rate could have broad positive ramifications for ailing state budgets. In addition to bolstering states' health insurance programs, the influx of federal funds would free up state funds otherwise needed for Medicaid to help states avoid tax increases or cuts in other areas of state budgets, like economic development or education. Such a policy could help states avoid taking actions that would work at cross-purposes to a federal economic stimulus designed to lessen the severity of the recession and support those who will be adversely affected.

[7] Iris Lav, "State Fiscal Problems Could Weaken Federal Stimulus Efforts: Low-income Households Most Likely to Be Hurt by State Fiscal Actions," Center on Budget and Policy Priorities, Oct. 4, 2001.