



CENTER ON BUDGET AND POLICY PRIORITIES

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Many States Are Considering Medicaid Cutbacks In The Midst of The Economic Downturn

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A growing number of states are considering large budget reductions in their Medicaid programs because of the budget shortfalls they are experiencing as a result of the economic slowdown. Since all states except Vermont are required to balance their budgets each year, states in fiscal distress generally must contemplate raising taxes, lowering expenditures or adopting some combination of such policies. Medicaid — a large and growing component of most state budgets — is a prime target for budget reductions. This analysis examines Medicaid reductions being actively considered in more than a dozen states.

In August, before the terrorist attacks of September 11, states projected their revenues would grow just 2.4 percent in the coming year, while the Congressional Budget Office (CBO) projected that Medicaid expenditures would grow at the much faster pace of 9 percent. (The CBO projection reflected, in particular, CBO's estimate of the impacts of general health care inflation, rapidly increasing prescription drug costs, and the increasing costs of services for elderly and disabled beneficiaries. It may be noted that private health insurance premiums have been rising at an even faster clip in recent years than Medicaid expenditures.) The subsequent economic downturn has led most analysts to expect that the increase in Medicaid expenditures will be larger than had previously been expected, since some workers who lose their jobs will become eligible for Medicaid, while state revenues will be lower than had been anticipated. These developments are leading a number of states to consider budget cuts of considerable magnitude, and many are planning to scale back their Medicaid programs.

The magnitude of the Medicaid funding reductions being considered by states poses a strong risk that Medicaid eligibility will be scaled back in some states, which could result in substantial numbers of low-income beneficiaries losing health insurance coverage. Other policy changes that states may consider could make it more difficult for eligible families and individuals to enroll in Medicaid, with the result that fewer eligible people would participate and more would be uninsured. In addition, the range of health care services that Medicaid covers is likely to be pared back in some states, and other states may increase cost-sharing by low-income beneficiaries; this risk is heightened by a recent Administration policy on Medicaid waivers that makes it easier for states to institute such benefit reductions.

While cutbacks in Medicaid can help states balance their budgets, such actions also have significant downsides for states. Every state dollar saved when a state reduces Medicaid expenditures causes the state to lose one to three dollars in federal Medicaid matching payments.

Medicaid reductions consequently result in a loss of federal dollars for the state's economy at a time when state economies need more spending to help them recover. Moreover, a portion of the health care services that Medicaid ceases to cover when program cutbacks are instituted are still provided — such as through emergency rooms or uncompensated care — and are paid for in significant part by state and local governments, without any federal funds to help defray the costs. Finally, to the degree that reductions in Medicaid result in health care services being foregone and lower health care expenditures, that can be problematic for the health care sector, which has been one of the most vibrant sectors of the economy in the past year and a major creator of jobs.

As part of its economic stimulus policy, the federal government could help backstop states by temporarily increasing the federal Medicaid matching rate. The federal Medicaid matching rate has been reduced in 29 states, effective October 1, 2001, exacerbating budget difficulties in the affected states. The fiscal year 2002 federal matching rates could instead be increased temporarily to help states weather their current budget crises. Such a temporary increase would not only help states avoid harmful Medicaid cuts but would also free up funds to help states balance their budgets without instituting economically damaging measures to raise taxes or cut programs during an economic downturn.

What Kinds of Medicaid or Other Health Care Cutbacks Are on the Table?

Preliminary information from a number of states suggests many of them are considering ways to reduce Medicaid costs. The information that follows is not the result of a comprehensive survey of all states, but rather information that has been compiled from various sources about actions that certain states are contemplating. Undoubtedly, other states not listed here also are considering scaling back their Medicaid programs. A new survey of 20 state Medicaid agencies, conducted for the Kaiser Commission on Medicaid and the Uninsured, found that more than half of the agencies have been asked by their governors to prepare proposals to trim Medicaid spending in this state fiscal year and agencies in some other states are considering budget reductions in the coming year.¹

Both the Medicaid policies and the budget targets of many of the states discussed here remain in flux and are likely to change as more information is compiled about how the events of September 11 are affecting state economies. At this point in most states' budgeting cycles, budget options are still being developed for the state fiscal year that begins July 1, 2002, and governors have yet to issue their budget proposals for that year. Some states, however, are convening special legislative sessions during October or November of this year in efforts to restore budget balance for the state fiscal year that, in most states, ends on June 30, 2002. These states are expected to act in coming weeks to institute budget cuts for the current state fiscal year, and in some cases, for the succeeding year as well. A larger number of states are not convening

¹ Vern Smith, *Medicaid and State Budgets: An October 2001 Update*, Kaiser Commission on Medicaid and the Uninsured, Oct. 16, 2001.

special sessions but are expected to adopt mid-year budget cuts when their legislatures convene in January or February. Some states also are planning to institute cuts through executive action.

Florida. A special session of the Florida legislature convened on October 22. Governor Jeb Bush has proposed that the state reduce spending by about \$1.5 billion for the rest of this fiscal year. The state's Agency for Health Care Administration, which administers the Florida Medicaid program, has prepared a lengthy list of budget options for consideration by the legislature, including:

- Eliminating the medically needy eligibility category of Medicaid, which primarily serves elderly and disabled people with high medical expenses. About 24,000 people could lose coverage.
- Reducing the Medicaid eligibility limit for pregnant women from 185 percent to 150 percent of the poverty line, which would eliminate prenatal and postpartum care for more than 5,000 low-income pregnant women. Prior research indicates that such a change may increase medical spending over time if newborns' health is compromised because their mothers did not get adequate prenatal care.
- Lowering eligibility for senior citizens from 90 percent to 83 percent of the poverty line, which would cause about 4,000 poor elderly individuals to lose Medicaid coverage.
- Moving about 300,000 Medicaid beneficiaries who are now part of a primary care case management program to more restrictive forms of capitated managed care, such as health maintenance organizations.
- In addition, a variety of public and community health programs that the state's Department of Health administers could face budget reductions of as much as \$100 million.

Tennessee. Governor Don Sundquist has recently proposed a major change in the state's Medicaid program, called TennCare, that would result in 180,000 people losing their health insurance and substantially reduce benefits for many who remain covered. The governor's proposal would essentially terminate coverage now being provided to adults with incomes above the poverty line and children with incomes above twice the poverty line. (TennCare currently serves a significant number of uninsured people with incomes above these levels.) In addition, the health care services for which adults with incomes between 76 percent of the poverty line² and 100 percent of poverty are covered would be pared back significantly, and cost-sharing for covered services would be increased. Health services also would be pared back, and cost-sharing increased, for children with family incomes between 100 percent of the poverty line and 200

² The 76 percent of poverty level figure would apply to a family of three. The cut-offs for other family sizes may be slightly different.

percent of the poverty line (between 133 percent and 200 percent of the poverty line for children under age six).

Arizona. A special legislative session will be convened in November. The reductions in health spending could exceed \$80 million. The state legislature has compiled a series of budget options. The largest savings proposal would transfer money from a trust fund that is intended to help finance a recently enacted Medicaid expansion for impoverished individuals, using funds from the state's tobacco lawsuit settlement, to the state's general fund. (Last November, the state passed a referendum to use most of its tobacco settlement funds to extend Medicaid to all people below the poverty line.) The transfer would enable the money to be used for other purposes and could ultimately place the planned Medicaid expansion in jeopardy. The legislature also has raised the possibility of reducing the number of Medicaid eligibility workers, which may make it harder to enroll people in Medicaid in a timely manner. Another proposal on the options list would eliminate Medicaid coverage to foster children who have turned 18. Additional proposals under consideration would reduce funding for other health services programs, including funding for children's vaccines and funds set aside to upgrade children's mental health services under a court-ordered settlement.

Government-wide Budget Cuts

In a number of states, governors have directed all state agencies to prepare options for broad-based budget reductions. In some states, these options are intended for use in crafting specific proposals that would be presented to state legislatures. In other states, these budget cuts could be implemented on an administrative basis, with little or no legislative review or approval. In most of these cases, it is too early to determine the specific scope or nature of the Medicaid budget reductions being considered. However, the magnitude of the cutbacks that agencies have been directed to develop suggests that significant reductions in Medicaid are likely in a number of these states.

Washington. The state of Washington has suffered economic setbacks as workers have been laid off from the high-tech sector and, more recently, from airplane manufacturing. Governor Gary Locke has asked all state agencies to submit budget options to reduce costs by 15 percent in the next fiscal year. In addition, the state is now developing a request for a controversial Medicaid waiver that would let the state pare back benefits or increase cost-sharing for those now participating in the program.

California. The Golden State is facing a large budget deficit for this year and a larger one for next year. There is a distinct possibility a special legislative session will be convened to address this problem. As part of its budget planning process, Governor Gray Davis has asked all agencies to prepare options to reduce their expenditures by up to 15 percent. Medi-Cal budget reductions of as much as \$1 billion are under discussion.

Michigan. The state budget director has asked all state agencies to devise budget options that would reduce expenditures by 10 percent.

Oregon. Governor John Kitzhaber has asked all state agencies to prepare options to reduce spending for the next fiscal year by 10 percent and is also seeking smaller administrative savings in the current year. The state is now preparing a Medicaid waiver that could reduce benefits or increase cost-sharing for a large number of beneficiaries.

Georgia. Governor Roy Barnes has asked all state agencies to prepare budget options to reduce spending in the current fiscal year by 2.5 percent and to trim expenditures by 5 percent in the next fiscal year. For the state's Medicaid program, this amounts to an \$80 million to \$90 million reduction this year and twice as much next year.

South Carolina. State legislators are considering budget reductions of 1.5 percent in the current fiscal year.

New Hampshire. Governor Jeanne Shaheen has asked all agencies to prepare for a one percent budget reduction.

In two other states, there is a substantial risk of a Medicaid shortfall in the current fiscal year because the amounts appropriated for Medicaid earlier this year by the state legislatures were deliberately set below more reasonable estimates of the amount that would be needed.

Indiana. To balance its budget earlier this year, the legislature appropriated \$140 million less for Medicaid for the budget period from July 2001 to June 2003 than the state agency projected would be needed. Moreover, the state's budget assumed a \$21 million reduction in fees paid to pharmacists, but this has been blocked — at least temporarily — by a state court decision. As a result, even without considering the consequences of the recent economic downturn, the state's Medicaid budget has a serious shortfall that will probably lead to changes in the Medicaid program.

Texas. Similarly, the Texas legislature short-changed Medicaid funding for the biennium that spans July 2001 to June 2003 by \$153 million; the state assumed payments to nursing homes would be delayed by one-month into the next budget period. This means the Medicaid budget began with a shortfall; subsequent changes due to the economic downturn will exacerbate this problem. (This accounting gimmick was employed because the state used a similar gimmick — and assumed a similar payment delay — in its budget for the 1999 to 2001 period and had to pay for that delayed month's worth of nursing home payments out of this year's budget.)

Finally, **Idaho's** budget for its State Children's Health Insurance Program (SCHIP) this year includes a budget cap. State legislators required the state agency to lower eligibility or limit enrollment if it looks like SCHIP expenditures will reach the cap. The state already has curtailed outreach advertisements to slow children's enrollment in the program.

Medicaid Cutbacks Can Make States' Economic Recovery More Difficult

Because Medicaid is such a large component of state budgets and has been growing rapidly, it is a prime target when state officials consider budget cutbacks. There are sound reasons, however, why state officials should seek to spare Medicaid from significant reductions.

Every dollar cut from a state's Medicaid expenditures results in loss of one to three dollars in federal matching payments. (For the SCHIP program, the federal matching ratio is even more favorable. Every dollar in state savings reduces federal payments to the state by two to five dollars.) Thus, while states can reduce their general fund budget deficits by lowering Medicaid expenditures, such actions result in a disproportionate loss of money flowing into the state's economy as a consequence of the loss of federal matching funds.

Medicaid is designed as a countercyclical program, which provides more aid and brings more federal funds into state economies when there is an economic downturn and poverty rises. In this sense, Medicaid helps hasten economic recovery, since health care providers gain income and, in turn, purchase more goods from the local economy. In recent years, the health care sector has been one of the most vibrant components of the national economy. A recent analysis in *Business Week* magazine noted that the health care sector has been responsible for 30 percent of the real growth in the gross domestic product and 45 percent of the net increase in jobs in the past year.³ Large cutbacks in state Medicaid programs might weaken state economic recoveries and adversely affect employment.

Indeed, in addition to supporting hospitals, physicians, clinics and the broad range of health care providers, Medicaid funding helps support the employment in the health sector of numerous low-skill, low-wage workers, including nurses' aides, orderlies and home health aides. If such low-skill workers lose their jobs because of reductions in Medicaid expenditures, many of them will require government assistance, including unemployment compensation, welfare, food stamp benefits and perhaps even Medicaid.

Finally, Medicaid helps to address the needs of low-income families and individuals who lose their jobs and private health insurance because of the downturn. While it is not possible to replace all of the income lost by workers during a recession, the availability of Medicaid benefits helps ensure that many of the neediest low-income populations still have access to medical care.

Federal Efforts to Aid Health Coverage and Support States

Even before the events of September 11, there was an imbalance between state revenues and Medicaid expenditure growth. In August, states projected their revenues would grow 2.4 percent in the coming year, while the Congressional Budget Office (CBO) projected that Medicaid expenditures would rise about 9 percent. The downturn trend in the economy since

³ Michael Mandel, "Health Care May Be Just What the Economy Ordered," *Business Week*, Sept. 17, 2001.

then means that state revenues will be lower than was projected in August, while unemployment (and hence Medicaid expenditures) will be higher. A recent analysis by the Urban Institute finds that higher unemployment will lead to higher Medicaid enrollment levels and expenditures than anticipated earlier. If, for example, the unemployment level for the nation averages 6 percent in fiscal year 2002, Medicaid enrollment could rise by 2.4 million people and total Medicaid costs could increase by \$4 billion above the levels CBO previously projected.⁴

The federal economic stimulus package could significantly reduce these problems by addressing three key issues on a temporary basis:⁵

- *Stem the loss of private health insurance by those who lose their jobs.* The National Governors Association (NGA) and National Conference of State Legislatures (NCSL) have recommended that the federal government provide temporary subsidies to help recently unemployed workers purchase COBRA health insurance so they can maintain their private health insurance. Senators Max Baucus and Edward Kennedy have set forth a proposal along these lines in which the federal government would subsidize half of the cost of COBRA coverage by unemployed workers on a temporary basis.
- *Offer health insurance to low-income people who are not eligible for COBRA or who can not afford to buy COBRA coverage.* The Baucus-Kennedy proposal also would give states the option to expand Medicaid eligibility to serve as a “wraparound” to help those who would not be helped by a COBRA subsidy. NGA recommended a similar temporary Medicaid option. To ensure that hard-pressed states can afford to offer such a Medicaid option, the federal government would need to offer a matching rate much higher than the standard Medicaid matching rate and probably higher than the enhanced matching rate used in the State Children’s Health Insurance Program. The NGA has recommended that the federal government provide 100 percent funding for this temporary effort, in a fashion akin to other proposals that would offer 100 percent federal funding to extend unemployment benefits.

Policies to help establish additional Medicaid coverage are especially important in light of recent data showing that fewer than one-third of low-income workers and their spouses or other adult dependents would be eligible for COBRA if the workers lost their jobs.⁶ (Low-income is defined here as having income below

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

⁵ Edwin Park and Leighton Ku, "Temporary Medicaid Improvements as Part of an Economic Stimulus Package," Center on Budget and Policy Priorities, Oct. 9, 2001.

⁶ Steve Zuckerman, Jennifer Haley, and Matthew Fragale, "Could Subsidizing COBRA Health Insurance Coverage Help Most Low-income Unemployed?" The Urban Institute, Oct. 17, 2001. Available at

200 percent of the poverty line.) A much smaller proportion actually would be able to afford COBRA insurance, even if a substantial federal subsidy is provided. In 1999, only 5 percent of all low-income unemployed workers had COBRA insurance coverage .

- *Increase the federal Medicaid matching rate to relieve the fiscal pressure on states.* Despite the harsher economic circumstances faced by most states today, the federal Medicaid matching rate was reduced in 29 states as of October 1, 2001. If, instead, the federal matching rates were increased in federal fiscal year 2002, states would better be able to avoid the Medicaid cutbacks now under discussion. Moreover, to the extent that increasing federal support for Medicaid frees up state funds, this policy also would provide broader fiscal support to states so they could avoid cutbacks in other areas such as education. A number of methods exist to increase the federal Medicaid matching rates, whether on an across-the-board basis or targeted to states with high unemployment rates.⁷

To date, the primary economic stimulus package that has been acted upon in Congress is a package the House Ways and Means Committee approved on October 12. Unfortunately, the principal health insurance component of the Ways and Means bill is a half-hearted, underfunded proposal to provide \$3 billion to states through the Social Services Block Grant to help insure workers who have lost their jobs.⁸ In contrast, a temporary health insurance proposal that Senators Baucus and Kennedy have developed, which would offer a 50 percent COBRA subsidy and an option to expand Medicaid for unemployed workers with an enhanced federal matching rate, would cost \$16 billion. The Social Services Block Grant proposal offers only one-fifth as much funding for health insurance coverage as the Baucus-Kennedy proposal. The Ways and Means economic stimulus proposal offers little to meet the needs of unemployed workers or states, in large measure because so many of its budget resources are devoted to tax-reduction measures for corporations and higher-income individuals (many of which would do little to stimulate the economy).⁹ More appropriate federal policies could better meet the needs of states and unemployed workers and help stimulate a stronger economic recovery.

www.urban.org/pdfs/HPOnline_2.PDF

⁷ Leighton Ku and Edwin Park, "Federal Aid to State Medicaid Programs Is Falling as the Economy Weakens," Center on Budget and Policy Priorities, Revised Oct. 19, 2001.

⁸ Edwin Park and Leighton Ku, "Health Care Provisions of House Ways And Means Committee Stimulus Package Offer Little Help for the Health Insurance Needs of Unemployed Workers," Center on Budget and Policy Priorities, Revised Oct. 19, 2001.

⁹ Joel Friedman and Bob Greenstein, "Ways And Means Package Departs From Bipartisan Principles For Effective Stimulus and Offers Little Help to the Unemployed," Center on Budget and Policy Priorities, Revised Oct. 22, 2001