CENTER ON BUDGET AND POLICY PRIORITIES

820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org www.cbpp.org

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STATE FISCAL RELIEF PROVIDES AN OPPORTUNITY TO SAFEGUARD MEDICAID BUDGETS

By Leighton Ku

The recent enactment of the state fiscal relief provisions contained in newly enacted tax-reduction legislation (the Jobs and Growth Tax Relief Reconciliation Act of 2003) will substantially reduce the cost of Medicaid to states in 2003 and 2004 and ease budgetary pressures to cut the program. The new legislation temporarily raises the federal matching rate for Medicaid — the Federal Medical Assistance Percentage or FMAP — and thus directly lowers states' share of Medicaid expenses by about $10 billion during the period April 1, 2003 through June 30, 2004. In addition, the legislation provides grants worth $5 billion in federal fiscal year (FFY) 2003 and another $5 billion in FFY 2004 that states can use for broader budgetary relief. States can use this opportunity to safeguard Medicaid budgets; they can avert unnecessary and harmful proposed cuts and/or restore some cuts that have already been made.

One of the chief reasons that many states have recently considered reductions in Medicaid is the program's rapid expenditure growth. The new law immediately and substantially reduces state Medicaid expenditure growth for all states in the state fiscal year that starts July 1 in most states, reducing the need to scale back Medicaid. Because the new legislation lowers the percentage of total Medicaid costs that a state must pay, the cost of Medicaid to states will be at least 5.9 percent — and as much as 12.8 percent — lower than previously estimated under the old federal matching rates for the state fiscal year that begins in July 2003.

Recent federal data show that states have already been successful in slowing Medicaid spending growth. During the period October 2002 to April 2003, Medicaid expenditures were 7.3 percent higher than in the same period of the prior year, a rate of growth that is about half that experienced in the previous year. The combination of slower Medicaid expenditure growth and increased federal aid should greatly ease growth in state Medicaid expenditures in the year ahead. This should make deep Medicaid cutbacks for the coming year much less necessary.

In addition, the new legislation alters the fiscal incentives for states to scale back their Medicaid programs. Because of the higher federal matching rates, a proposed or already planned cutback will save a state *5.9 to 12.8 percent less* than the amounts estimated before the matching rates changed. A cut also will lead to a greater loss of federal matching revenue than previously estimated. To take advantage of these new fiscal opportunities, states should consider canceling or scaling back Medicaid budget cuts.

States that cut their Medicaid programs will receive less federal aid, while those that cancel or postpone cuts will gain more aid. Some state policy officials may mistakenly believe that the amounts of federal Medicaid relief are fixed in size. The amount of relief will be a

percentage of the amount that a state actually spends on Medicaid. Medicaid cuts will thus reduce the amount of federal Medicaid relief that a state receives.

Many states are still working on their budgets for state fiscal year (SFY) 2004, the year that begins on July 1, 2003 in most states. These states could immediately reassess state budget estimates for Medicaid and examine whether it is still necessary or appropriate to cut their Medicaid programs. Other states have already completed action on SFY 2004 budgets but could reassess their budgets and take legislative or administrative actions to cancel, delay or lessen the severity of cutbacks planned for 2004. It is particularly important that states that plan to institute restrictions in Medicaid eligibility reconsider these plans; such policies are likely to violate one of the requirements of the new law and trigger the loss of most of the federal Medicaid aid that otherwise would be provided to a state under the new legislation.

Summary of the New Federal Legislation

Under the legislation, each state's federal Medicaid matching rate (or FMAP) is modified during the last two quarters of FFY 2003 (April 1 to September 30, 2003) and the first three quarters of FFY 2004 (October 1, 2003 to June 30, 2004). Medicaid matching rates will be recalculated as follows:

(a) Hold Harmless. First, for the period April to September 2003, the state's federal matching rate will be the *higher* of the regular FMAP for FFY 2002 or its regular FMAP for FFY 2003. From October 2003 to June 2004, the matching rate will be the higher of the regular FMAP for either FFY 2003 or FFY 2004.

(b) Across the Board 2.95 Percentage Point Increase. Second, during the period April 1, 2003 to June 30, 2004, each state's revised FMAP will be increased by *2.95 percentage points* (above the "hold harmless" rate just described).

(c) Eligibility Maintenance of Effort. If a state restricts Medicaid eligibility below the levels in effect in its state plan as of September 2, 2003, the state will *not* receive the 2.95 percentage point increase in FMAP. If a state restricts eligibility but subsequently reinstates it, however, the state can begin to collect the higher FMAP in the quarter the reinstatement begins.

(d) Applicability. The FMAP increase applies to the main portion of Medicaid benefits and does not affect the matching rates for Medicaid disproportionate share hospital (DSH) payments, administrative expenses, other Medicaid matching rates above the regular FMAP rate (e.g., the 90 percent rate for family planning services or the 100 percent rate for Indian Health Service-related expenditures) or the State Children's Health Insurance Program.

(e) Local Contributions. If a state requires local contributions to meet the state share of Medicaid costs, the state may not require that local governments pay a greater percentage of the state share of costs than the local governments paid prior to April 1, 2003.

There Is Less Need to Cut Medicaid in State Fiscal Year 2004

The main reason many states have been interested in cutting Medicaid in the coming state fiscal year is because state Medicaid expenditures have grown rapidly. It is important to realize, however, that Medicaid costs have grown because they are affected by the same underlying increases in health care costs that also escalate private health insurance premiums, state employee health costs and all other health spending. Indeed, states have generally been able to hold down increases in the per capita costs of Medicaid to rates well below those experienced for private sector health insurance premiums.[1] But since Medicaid is the largest health expenditure in state budgets, rising Medicaid costs are particularly visible in state budgets.

The higher federal matching rates during the April 2003 to June 2004 period mean that states' Medicaid costs will automatically be significantly lower than previously anticipated. As a result, growth in states' share of Medicaid costs will be substantially reduced in the coming state fiscal year, and there should be much less need to adopt Medicaid cutbacks that adversely affect low-income families, children, elderly people and people with disabilities.

Table 1 presents the current, regular FMAP rates for each state, as well as the rates that will apply under the new fiscal relief legislation.[2] Also shown in the table is the percentage reduction in state Medicaid costs that will result from the increase in Medicaid matching rates. For example, if a state's federal matching rate was originally 50 percent and now will be elevated to 52.95 percent, the state share of Medicaid costs will fall from 50 percent to 47.05 percent. This is equal to a 5.9 percent reduction in the state's Medicaid expenditures.[3] As seen in the table, all states will have reductions in the state-level Medicaid expenditures ranging from 5.9 percent to 12.8 percent; the majority have reductions greater than 5.9 percent.

- Consider, for example, a hypothetical state that projected Medicaid expenditures would grow 10 percent in state fiscal year 2004 and planned to adopt a 6 percent cutback in Medicaid benefits to limit expenditure growth to just 4 percent. If the data in Table 1 showed that this state's Medicaid expenditures would fall by 7 percent in SFY 2004 solely because of the higher federal matching rate, then the state would have already met — actually exceeded — its budget target and there would be no need to adopt any additional cuts.

Furthermore, state worries about double-digit growth in Medicaid expenditures already appear to be easing. Data from the U.S. Treasury Department show that Medicaid spending growth already has slowed considerably. From October 2002 to April 2003, Medicaid

[1] Leighton Ku and Matt Broaddus, *Why Are States' Medicaid Expenditures Rising?,* Center on Budget and Policy Priorities, Jan. 13, 2003.

[2] HHS has already published the regular FMAPs for FFYs 2003 and 2004. Our calculations of the revised FMAPs adjust the regular FMAPs to account for the recently enacted changes.

[3] The 2.95 percentage point reduction in the state share divided by the state's earlier 50 percentage point state share equals a 5.9 percent reduction.

Table 1.
Changes in Federal Matching Rates and Reductions in States' Share of Medicaid Costs

	"Regular" FFY 2003 FMAP	"Regular" FFY 2004 FMAP	Revised FMAPs for April 2003 to September 2003*	Revised FMAPs for October 2003 to June 2004*	% Reduction in State Costs Due to New Law, April 2003 to September 2003	% Reduction in State Costs Due to New Law, October 2003 to June 2004	Blended % Reduction in State Costs, SFY 2004 (July 2003 to June 2004)**
	(federal matching rates, percentage points)						
Alabama	70.60	70.75	73.55	73.70	-10.0%	-10.1%	-10.1%
Alaska	58.27	58.39	61.22	61.34	-7.1%	-7.1%	-7.1%
Arizona	67.25	67.26	70.20	70.21	-9.0%	-9.0%	-9.0%
Arkansas	74.28	74.67	77.23	77.62	-11.5%	-11.6%	-11.6%
California	50.00	50.00	54.35	52.95	-8.7%	-5.9%	-6.6%
Colorado	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
Connecticut	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
Delaware	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
Dist Columbia	70.00	70.00	72.95	72.95	-9.8%	-9.8%	-9.8%
Florida	58.83	58.93	61.78	61.88	-7.2%	-7.2%	-7.2%
Georgia	59.60	59.58	62.55	62.55	-7.3%	-7.3%	-7.3%
Hawaii	58.77	58.90	61.72	61.85	-7.2%	-7.2%	-7.2%
Idaho	70.96	70.46	73.97	73.91	-10.4%	-11.7%	-11.4%
Illinois	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
Indiana	61.97	62.32	64.99	65.27	-7.9%	-7.8%	-7.9%
Iowa	63.50	63.93	66.45	66.88	-8.1%	-8.2%	-8.2%
Kansas	60.15	60.82	63.15	63.77	-7.5%	-7.5%	-7.5%
Kentucky	69.89	70.09	72.89	73.04	-10.0%	-9.9%	-9.9%
Louisiana	71.28	71.63	74.23	74.58	-10.3%	-10.4%	-10.4%
Maine	66.22	66.01	69.53	69.17	-9.8%	-9.3%	-9.4%
Maryland	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
Massachusetts	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
Michigan	55.42	55.89	59.31	58.84	-8.7%	-6.7%	-7.2%
Minnesota	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
Mississippi	76.62	77.08	79.57	80.03	-12.6%	-12.9%	-12.8%
Missouri	61.23	61.47	64.18	64.42	-7.6%	-7.7%	-7.6%
Montana	72.96	72.85	75.91	75.91	-10.9%	-11.3%	-11.2%
Nebraska	59.52	59.89	62.50	62.84	-7.4%	-7.4%	-7.4%
Nevada	52.39	54.93	55.34	57.88	-6.2%	-6.5%	-6.5%
New Hampshire	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
New Jersey	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
New Mexico	74.56	74.85	77.51	77.80	-11.6%	-11.7%	-11.7%
New York	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%
North Carolina	62.56	62.85	65.51	65.80	-7.9%	-7.9%	-7.9%
North Dakota	68.36	68.31	72.82	71.31	-14.1%	-9.5%	-10.6%
Ohio	58.83	59.23	61.78	62.18	-7.2%	-7.2%	-7.2%
Oklahoma	70.56	70.24	73.51	73.51	-10.0%	-11.0%	-10.7%
Oregon	60.16	60.81	63.11	63.76	-7.4%	-7.5%	-7.5%
Pennsylvania	54.69	54.76	57.64	57.71	-6.5%	-6.5%	-6.5%
Rhode Island	55.40	56.03	58.35	58.98	-6.6%	-6.7%	-6.7%
South Carolina	69.81	69.86	72.76	72.81	-9.8%	-9.8%	-9.8%
South Dakota	65.29	65.67	68.88	68.62	-10.3%	-8.6%	-9.0%
Tennessee	64.59	64.40	67.54	67.54	-8.3%	-8.8%	-8.7%
Texas	59.99	60.22	63.12	63.17	-7.8%	-7.4%	-7.5%
Utah	71.24	71.72	74.19	74.67	-10.3%	-10.4%	-10.4%
Vermont	62.41	61.34	66.01	65.36	-9.6%	-10.4%	-10.2%
Virginia	50.53	50.00	54.40	53.48	-7.8%	-7.0%	-7.2%
Washington	50.00	50.00	53.32	52.95	-6.6%	-5.9%	-6.1%
West Virginia	75.04	75.19	78.22	78.14	-12.7%	-11.9%	-12.1%
Wisconsin	58.43	58.41	61.52	61.38	-7.4%	-7.1%	-7.2%
Wyoming	61.32	59.77	64.92	64.27	-9.3%	-11.2%	-10.7%
Puerto Rico & territories	50.00	50.00	52.95	52.95	-5.9%	-5.9%	-5.9%

* Revised FMAP rates account for both hold the harmless provisions and the 2.95 percentage point FMAP increase.
** Blended rate for SFY 2004 assumes one-fourth of costs are at revised FFY 2003 rate and three-fourths at revised FFY 2004 rate.

draw downs were 7.3 percent higher than in the same period last year. This is about half the 15.8 percent growth rate measured in the same time period the year before.[4] The combination of already slower Medicaid spending growth and the enhanced federal matching rates means that most states will experience only modest growth in Medicaid expenditures in the coming fiscal year, even without adopting budget reductions.

Proposed or Planned Medicaid Reductions Will Save Less Money

Medicaid cutbacks proposed or planned for the coming year will save less for the states than the amounts such reductions were estimated to save before the matching rates changed. The increase in Medicaid matching rates reduces the marginal cost of Medicaid to states and thereby reduces fiscal incentives for states to cut the program.

State cuts also now will lead to a greater loss in federal Medicaid revenue than the amounts estimated earlier. A number of recent studies have found that state Medicaid expenditures help spur state economic activity and employment, particularly because federal matching funds help magnify state funding.[5] The higher federal matching rates just enacted means that the economic and employment impacts of Medicaid per dollar of state expenditure will be even larger than these studies have found, because the studies were based on the regular federal matching rates.

Finally, states that institute restrictions on Medicaid eligibility after September 2, 2003 will not be eligible for the 2.95 percentage point increase in federal matching rates. States that trim Medicaid eligibility could consequently experience a substantial loss of federal matching funds. States should take particular care in considering actions that would reduce Medicaid eligibility.

If Medicaid Is Cut, States Will Get Less Federal Relief

The Center on Budget and Policy Priorities and the Federal Funds Information Service (FFIS) have disseminated preliminary estimates of the amount that states will collect under both

[4] In contrast, *Medicare* expenditures during same seven months in FFY 2003 were 9.6 percent higher than the equivalent period in FFY 2002. While Medicaid has grown more slowly this fiscal year, Medicare growth has accelerated slightly. Medicare expenditures grew 8.5 percent during the same seven months in 2002 and 2001.

[5] Seven states have produced reports about the economic impact of Medicaid, including Alaska, North Carolina, Ohio, South Carolina, Texas, Wisconsin and Utah. See, for example, the Perryman Group, *Medicaid and the CHIP Program, An Assessment of Their Impacts on Business Activity and the Consequences of Potential Funding Reductions,* April 2003; Kerrey E. Kilpatrick et. al. *The Economic Impact of Proposed Reductions in Medicaid Spending in North Carolina* University of North Carolina Institute for Public Health, April 11, 2002; Moore Business School of the University of South Carolina*: Economic Impact of Medicaid on South Carolina*, January, 2002. See also Families USA, *Medicaid: Good Medicine for State Economies*, Jan. 2003.

the FMAP and the grant components of the fiscal relief legislation. The two organizations' estimates are very similar.[6]

Initial feedback suggests that some state policy makers may erroneously believe that the Medicaid aid levels are fixed. While the fiscal relief grants are fixed in size, the amount of additional federal Medicaid revenue that states receive is not fixed; it will depend on how much states actually spend in Medicaid from April 2003 to June 2004, since the amounts are based on the increase in the federal matching rate times the level of total Medicaid expenditures. A state that scales back Medicaid, therefore, will receive less federal aid than it would without such reductions. (Similarly, a state whose expenditures are higher than projected will receive more aid.)

Quick Action Is Needed

The higher Medicaid matching rates are in effect back to April 1, 2003. In some cases, states may be able to modify policies during the final weeks of the April to June 2003 quarter to take advantage of the new fiscal incentives. In most states, the main period for which states are setting policies is the coming state fiscal year.

A necessary first step is for states to revise their Medicaid budget estimates in light of the changes in Medicaid matching rates. This will lower estimates of the state share of the cost of Medicaid operations in all states and also lower the savings attributed to proposed Medicaid reductions.

Many states are still considering their budgets for state fiscal year 2004 and can take this opportunity to reconsider their Medicaid budget plans. A number of other states have already completed regular legislative sessions and passed serious Medicaid cuts but may convene special sessions this summer to reconsider their budgets. These states, as well, should take the opportunity to reconsider their Medicaid budgets and reverse or reduce the cuts adopted. Some states have other administrative or legislative mechanisms to revise Medicaid policies in light of the new federal relief. For example, many states grant the state Medicaid agency discretion to make operational or policy changes to keep expenditures within a given appropriations level; the revised matching rates will make it easier for such states to keep within their current Medicaid appropriations without cuts and may let some agencies scale back planned cuts or restore reductions already made. If states are planning to expand Medicaid services in the coming fiscal year, the new federal policies make these changes more affordable.

Medicaid cuts can have adverse effects on the health care of low-income children, families, seniors and people with disabilities. They may also harm the financial status of health care providers and reduce economic activity and employment in states. States can take prompt action to use the opportunities that the new state fiscal relief legislation provides to avert or restore potentially harmful Medicaid cuts that may no longer be necessary.

[6] Both the Center and FFIS computed estimates of how much states will get in additional federal Medicaid funding, based on February 2003 state projections of Medicaid expenditures. Some states are projecting different levels of federal relief because they are using different projections of Medicaid expenditures.