Issue BRIEF

July 2008

Precarious Position:
States Must Balance Declining Revenues With a Growing Need for Medicaid

"The states are now in a precarious position. The economy is slowing down. Tax revenues are falling. And demand for expensive services–health care, food assistance and the like–is growing. …Rest assured, states will manage their economic challenges and balance their budgets as they have before. But Washington's failure to meet its obligations is forcing states to cut education, health care and other vital services. The federal government should accept its responsibility, do no harm and pay its bills"

– Arizona Governor Janet Napolitano, *The Wall Street Journal*, April 24, 2008

Introduction

As the economy heads into a recession, states are finding themselves in the difficult position of trying to make up for deficits in the current fiscal year and balance their budgets for the next year. As of April 2008, 16 states and Puerto Rico faced budget shortfalls for fiscal year 2008 totaling $11.7 billion.[1] And this problem is only expected to grow. Next fiscal year, at least 29 states and the District of Columbia expect to face shortfalls totaling some $48 billion, and at least two more states will face budget gaps of unknown amounts over the next two years.[2] Unlike the federal government, however, most states cannot run a budget deficit.[3] States are therefore forced to reduce spending or eliminate programs to address these budget shortfalls. Such shortfalls tend to grow worse over time and have lasting effects, even after the economy begins to recover, leaving important safety net programs at risk over multiple years.

As governors and state legislators examine their budgets, they often find that Medicaid—one of the largest components of any state's budget—is growing at the same time that states are trying to cut expenditures.[4] That's because Medicaid is the safety net program that low-income working families often need when they lose their jobs or their health coverage. In the past 12 months, the number of unemployed individuals rose by approximately 800,000.[5] A recent study found that a one percentage point rise in the national unemployment rate would increase enrollment in Medicaid and the State Children's Health Insurance Program (CHIP) by 1 million, which would, in turn, increase costs for those programs by $3.4 billion, including $1.4 billion in state spending.[6]

In a time of economic distress, safety net programs such as Medicaid become even more important. Thus, even though many states are finding themselves in a financial crunch, they should be moving to protect their Medicaid programs rather than cutting them. But with Medicaid programs in a number of states already in jeopardy, states need federal help. If Congress acts now to bring fiscal relief to the states, many of the harmful cuts that states are considering can be minimized or averted altogether.

FamiliesUSA
The Voice for Health Care Consumers

Cutting Medicaid Harms the Most Vulnerable

Medicaid provides life-saving health care to our nation's most vulnerable groups: children, pregnant women, and elderly and disabled individuals with very low incomes. Several states also cover some uninsured childless adults with very low incomes in their Medicaid programs, thus providing much needed care to an often forgotten population. Without Medicaid, these individuals would not have access to primary or specialty care, prescription drugs, or prenatal care. Multiple studies have shown that uninsured Americans die prematurely because they delay or forgo needed care that they simply cannot afford.[7] Thus, a strong Medicaid program can mean the difference between life and death for millions of low-income Americans.

Cutting Medicaid Hurts States' Bottom Lines

Medicaid cuts not only take a toll in human lives, they also have a negative impact on states' budgets. States may decide to cut their Medicaid programs to fill impending budget gaps, but such short-sighted solutions raise more problems in the long run for states and for their residents' wallets.

- ### Cutting Medicaid Causes States to Lose Federal Funding

  When states cut Medicaid, they also lose significant federal dollars. This is because Medicaid is jointly funded by the states and the federal government. Each state receives matching dollars from the federal government, and those matching rates vary across the states from 50 to 76 percent. This means that, for every dollar a state spends on Medicaid, the federal government contributes between $1.00 and $3.17.

  Because state and federal Medicaid funding are intertwined, cutting Medicaid is a very inefficient way to save state dollars: For every dollar a state cuts from its Medicaid program, it saves only 24 to 50 cents. As a result, cutting Medicaid hurts the people who rely on Medicaid while providing little in the way of financial savings.

- ### Cutting Medicaid Hurts State Economies in Other Ways

  While Medicaid's role in providing critical health care services is clear, what is often overlooked is the unique role that Medicaid plays in stimulating state business activity and state economies. Every dollar a state spends on Medicaid pulls new federal dollars into the state—dollars that would not otherwise flow into the state. These new dollars pass from one person to another in successive rounds of spending. For example, health care employees spend part of their salaries on new cars, which adds to the income of auto dealership employees, enabling them to spend part of their salaries on washing machines, which enables appliance store employees to spend additional money on groceries, and so on. Economists call this the "multiplier effect." The magnitude of the multiplier effect varies from state to state, depending on how the dollars are spent and on the economic structure of, and conditions in, the state.

Because of the multiplier effect, the overall impact of Medicaid spending—and conversely, of Medicaid cuts—on a state's economy is much greater than the value of services purchased directly by the Medicaid program. So, although Medicaid is a significant state expenditure, and maintaining its funding can be challenging during an economic downturn, cutting Medicaid will actually increase the damage to state economies by reducing business activity, jobs, and wages—exactly the opposite of what governors and state legislators should be doing.

For example, in the face of a serious shortfall in the state's budget, California Governor Schwarzenegger has proposed cutting the state's Medicaid program by $1.1 billion. Such a cut would cause a loss of approximately $2.7 billion in business activity, almost 22,000 jobs, and $9.9 million in associated salaries and wages.[8]

■ A Perfect Storm

State revenues also decline significantly during a national recession. Income tax receipts fall as unemployment rises, a drop in consumer activity leads to a reduction in sales tax revenue, and the declining housing market greatly diminishes real estate taxes. And at the same time as unemployment increases the demand for Medicaid, a one percentage point increase in the unemployment rate causes state general fund revenues to drop by 3 to 4 percent.[9]

All of these factors are coming together to make a perfect storm for states: falling revenues, spikes in unemployment, increased demand for Medicaid and other safety net programs, and the need to balance state budgets. Unfortunately, policymakers often respond to such circumstances by stripping their Medicaid programs, which then no longer meet the needs of enrollees—or of the additional Americans who need Medicaid but who are forced to join the ranks of the uninsured. What's more, these Medicaid cuts harm state economies, compounding the underlying economic problems that led to their budget shortfalls in the first place.

Cutting Medicaid: People Get Hurt, States Don't Save Money
The Oregon Example

Cutting Medicaid is a short-term fix with long-term negative effects on state and local budgets, on the health care system, and on people who need Medicaid. A recent study examined the 2003 cuts to the Oregon Health Plan, the state's Medicaid program, and the effects of those cuts on emergency department use and hospitalizations. In 2003, in the midst of a recession-spurred budget crisis, Oregon made massive cuts to its Medicaid program, increasing premiums; raising copayments; eliminating essential benefits such as diabetes supplies and dental, vision, mental health, and substance abuse services; and disenrolling people who could not pay their monthly premiums. More than 50,000 low-income adults were kicked off the Oregon Health Plan due to these cuts. The study found that the Medicaid cuts led to increases in emergency department use and hospitalizations, which in turn led to an increase in uncompensated care for Oregon hospitals. From 2002 to 2004, the state's hospital uncompensated care costs rose by $253 million. These cost increases were especially steep for care related to substance abuse and mental health, which rose by 173 percent and 106 percent, respectively.[10]

Federal Relief Is Needed

This year, Congress has an opportunity to provide fiscal relief to states before the worst of their budget problems arise, thus preventing significant Medicaid cuts. A temporary increase in states' Medicaid matching rates, known as the Federal Medical Assistance Percentage (FMAP), (similar to the one enacted in the Jobs, Growth, and Tax Relief Reconciliation Act of 2003) would increase federal funding for Medicaid and take some of the burden off of states.

Temporarily raising the FMAP has proven to be a useful tool that helps states avoid Medicaid cuts and helps them meet the increasing enrollment demands that arise during an economic downturn. (Medicaid enrollment rose by 8.6 percent between 2001 and 2002 because of the recession.[11]) When the FMAP was temporarily increased in 2003, states received $10 billion in federal funding, which was instrumental in helping states such as Minnesota, Missouri, and Ohio avoid or postpone cutbacks in eligibility and benefits.[12] By taking action this year, Congress can help states avoid making the difficult decision to cut Medicaid next year.

Congressional Legislation Would Provide Relief to States

Congress has begun exploring ways to bring fiscal relief to the states. Bipartisan legislation has been introduced in both the House and the Senate. In the House, legislation introduced in February by Representatives Frank Pallone (D-NJ), Peter King (R-NY), John Dingell (D-NY) and Thomas Reynolds (R-NY) (HR. 5268) would temporarily increase the federal matching rate for Medicaid (FMAP) by 2.95 percentage points over five quarters in fiscal years 2008 and 2009. In the Senate, the Economic Recovery in Health Care Act of 2008 (S. 2819), introduced in April by Senators Jay Rockefeller (D-WV), Olympia Snowe (R-ME), and Ted Kennedy (D-MA), would help many states preserve their Medicaid programs by increasing the FMAP by 1.667 percentage points for at least 38 states over two rounds. In Round 1, 28 states (including the District of Columbia and five U.S. territories) that are currently experiencing the greatest economic hardship would receive an FMAP increase for the last two calendar quarters of FY 2008 and the first three calendar quarters of FY 2009. In Round 2, based on the economic conditions that are prevalent in late 2008, at least 10 more states would receive an FMAP increase for the first three calendar quarters of FY 2009. Although neither bill has passed, Congressional leaders may still take action this year to help bring relief to the states.

Cutting Medicaid: State Examples from across the U.S.

The need for federal fiscal relief for states is clear: A number of states have already begun cutting their Medicaid budgets or are proposing Medicaid cuts in order to fill budget gaps in both the current and the next fiscal year. The Medicaid cuts discussed in the states listed below will greatly affect the health and well-being of thousands of Americans, and unfortunately, it is likely that the worst is yet to come. A few of these states had proposed even deeper Medicaid cuts, but they were

able to find revenue to fill in some of their budget gaps. There were also a number of states that we did not include in this report that proposed Medicaid cuts that were never enacted. However, the effects of a recession are generally felt over a number years even after the economy begins to bounce back. Thus, regardless of whether states have been or will be able to stave off or minimize proposed cuts this year, they will most certainly be faced with these difficult decisions again next year—unless the federal government acts to provide relie.

California

California, which is proposing major cuts to its Medicaid program, is something of a bellwether state, projecting economic trends that are likely to be experienced by other states across the country. Faced with a $17.2 billion shortfall for fiscal year 2009, Governor Schwarzenegger has proposed $1.1 billion in cuts to Medi-Cal (the state's Medicaid program) and Healthy Families (the state's CHIP program). His proposal would dramatically cut enrollment in Medi-Cal and Healthy Families, limit the benefit packages for these programs, reduce payments to doctors and hospitals, and cut the number of workers who process applications and enrollment paperwork. Specifically, the proposal would:

- Reduce the income limit for parents on Medi-Cal from 106 percent of the federal poverty level ($18,656 for a family of three in 2008) to 61 percent of poverty ($10,736 for a family of three in 2008) and reinstate the requirement that the principal earner in a two-parent household would have to work fewer than 100 hours in a month;
- Require all enrollees to prove that they are still eligible every three months rather than annually;
- Delay implementation of a new streamlined enrollment process for children in Medi-Cal or Healthy Families;
- Cut dental, chiropractic, optometry, podiatry, speech therapy, and psychological services for adults in Medi-Cal;
- Increase premiums and copayments for children in Healthy Families;
- Limit dental care for children in Healthy Families;
- Cut services for immigrants who are covered in either the regular Medi-Cal program or in Emergency Medi-Cal; and
- Reduce payments to doctors and hospitals that serve a large number of Medicaid enrollees.

The state's Department of Health Care Services estimates that 430,000 parents will lose coverage by 2011 due to the lowered income limit and that the new paperwork requirement will cause almost 500,000 children and 35,000 adults to lose coverage over the next five years. In addition, because many families will be unable to afford the proposed cost-sharing requirements, many will drop out of Healthy Families or forgo needed care. Overall, the savings produced by these cuts will be offset by a loss of $1.2 billion in federal matching funds.

The Senate and the Assembly Budget Committees voted to reject some of these cuts while approving others. The budget must still go before the full Senate and Assembly, which will determine which cuts will end up in the final budget.

Florida

The state was able to avert cutting thousands of beneficiaries from its Medicaid rolls by tapping into its tobacco settlement trust fund. However, in their final 2009 budget bill, state legislators still had to make a number of harmful cuts that will affect the state's poorest and sickest residents, including the following:

- Major cuts in reimbursement rates to nursing homes, which will likely lead to staff layoffs and delays in maintenance on aging facilities, both of which will affect the quality of patient care.
- A $9 million reduction in funding for mental health and substance abuse services provided under Medicaid managed care.
- Thousands of Medicaid recipients who rely on the MediPass program will be moved into managed care. MediPass is a primary care case management program that allows beneficiaries to rely on their primary care physician to manage their medical care. This new requirement is expected to move 27,000 Medicaid recipients out of MediPass, leaving them to fend for themselves and coordinate their own medical care, which is often difficult for this population.
- In addition, administrative fees for doctors participating in MediPass will be cut by one-third, which may lead many providers to drop out of the program.

Maine

Faced with a $190 million budget shortfall, the Maine state legislature struggled with how to fill its budget gap. Governor Baldacci proposed significant Medicaid cuts, including the following:

- Making major cuts to the childless adult program by lowering the enrollment cap and eliminating drug coverage;
- Eliminating podiatry services for everyone covered under MainCare, the state's Medicaid program;
- Increasing copayments for childless adults; and
- Eliminating coverage of some durable medical equipment, such as bathing aids, speech communication devices, and orthopedic shoes.

While the legislature rejected many of the governor's proposals, it did enact an annual $25 enrollment fee for each parent in families with incomes above 150 percent of the federal poverty level ($26,200 for a family of three). This seemingly modest fee will likely be too high for many families with such low incomes, leaving them without health coverage. The legislature also implemented new prior authorization requirements for brand-name drugs, durable medical equipment, and podiatry care, which could restrict access to these needed services.

Mississippi

The state is facing a $90 million shortfall in its Medicaid budget, and the governor convened a special session of the legislature to address how to reduce costs or fill the shortfall. Legislators have been debating whether to institute a cigarette tax increase, a new tax on hospitals, or use money from the state's rainy day fund. The legislature was not able to come to a consensus on Medicaid funding during the special session, so they will reconvene at a later date. In the meantime, the legislature did decide to reduce Medicaid reimbursement to pharmacies as of May 1, which could affect beneficiaries' access to prescription drugs. This reduction will eliminate approximately one-third of the estimated shortfall in the state's fiscal year 2009 Medicaid budget.

New Jersey

Dealing with a $3.2 billion deficit, Governor Corzine has proposed several changes to the state's Medicaid program, including adding copayments for prescription drugs and "unnecessary" emergency room visits and decreasing by 15 percent funds for hospitals to cover the charity care they provide. The governor's budget recommends a $2 copayment for prescription drugs (with a $10 cap per recipient) and a $6 copayment for all emergency room visits that are not "true" emergencies, which would save the state $7.5 million in fiscal year 2009. These increased cost-sharing amounts could lead individuals to opt to go without needed medication or critical health care services.

Rhode Island

The state supplemental fiscal year 2008 budget eliminated RIte Care coverage for 2,800 non-citizen children and for an estimated 225 self-employed home-based child care providers and their children, effective July 1, 2008 (RIte Care is the state's Medicaid managed care program for families.).

The budget for fiscal year 2009, which begins on July 1, 2008, reduced state spending by $85 million. Though the Rhode Island Assembly voted against a number of the Medicaid cuts proposed by Governor Carcieri, some RIte Care cuts were in the final budget, including the following:

- The income eligibility limit for parents was reduced from 185 percent of poverty to 175 percent of poverty (from $32,560 to $30,800 for a family of three in 2008). This reduction will cut an estimated 1,000 parents from the program.[14]
- A new monthly family premium of $45 will be implemented for families in RIte Care with incomes between 133 percent and 150 percent of the federal poverty level ($23,408 to $26,400 for a family of three in 2008). Premiums for families between 150 percent and 250 percent of poverty ($44,000 for a family of three in 2008) will increase from 3 percent of family income to 5 percent.
- Medicaid beneficiaries are required to use generic prescriptions when available.

Tennessee

In a revised budget for fiscal year 2009 released on May 12, Governor Bredesen announced cuts totaling $468 million to adjust for a decline in revenues since his January budget proposal. The governor had promised to include $100 million in the budget for TennCare (Tennessee's Medicaid program) to reopen the Medically Needy program, which would have allowed 100,000 individuals to be covered. Instead, he included only $20 million.

The Medically Needy program covers people with high unpaid medical bills whose income would otherwise be too high to qualify for TennCare. The program has been capped for the past three years. There are currently about 50,000 people qualified as "medically needy," but everyone in the program must go through a re-verification process to confirm their eligibility. This process is expected to eliminate almost all current enrollees from the program.

The $20 million that the governor included in his revised budget can cover a total of only 20,000 beneficiaries. This means that thousands of individuals with serious medical conditions (including cancer, kidney disease, and diabetes) who currently have or who would have been eligible for TennCare will be left without health coverage.

To make matters even worse, about 100,000 Tennesseans who have TennCare because of a qualifying disability will most likely be dropped from the program this year. These individuals are at risk of losing all access to health care because the governor did not include in his budget funds for a safety net program that would have provided limited services for this group. This despite the fact that TennCare currently has reserve funds, which the Governor refused to tap.

The end result is another devastating blow to the state's poorest and sickest residents.

States Cannot Solve This Problem on Their Own

State leaders often have a knee-jerk tendency to cut Medicaid and other safety net programs when their state is in a fiscal crisis. As mentioned above, states often have no choice but to balance their budgets, so they must either make cuts or increase taxes, neither of which is popular or even politically feasible.

States do have a few other options to avoid making drastic cuts in Medicaid and other important programs, such as tapping tobacco settlement or rainy day funds (see "Sin Taxes and Other Funding Sources" on page 9), but these measures are short-term solutions that do not boost a state's economy. These measures are not long-term solutions, and they should not be seen as a substitute for federal action. During a national recession, only federal relief can help states protect and sustain Medicaid.

Sin Taxes and Other Funding Sources

As mentioned above, because more people are unemployed and consumer spending has slowed, states are seeing less revenue from sales and income taxes. Most governors and legislators are reluctant to raise taxes, but there are some taxes that are more "voter friendly." Many states have been looking to so-called "sin taxes" to fill gaps in their budgets. These are taxes on such things as alcohol and cigarettes. Increases in cigarette and other sin taxes have been proposed in numerous states, and, in states where such taxes have been enacted, they have helped stave off cuts. For example:

- New York balanced its books this year by raising the cigarette tax by $1.25 to a total of $2.75;
- Maine implemented a new tax on beer, wine, and soda to stabilize funding for Dirigo Health; and
- Mississippi is looking at the possibility of instituting a cigarette tax to fill the $90 million gap in the state's Medicaid budget.

Overall, 22 state legislatures have active bills this year to raise tobacco taxes, and 11 states enacted such increases in 2007.[15]

Another tobacco-related funding source that states have turned to is tobacco settlement funds. In 1998, states signed a multistate settlement agreement with the country's four largest tobacco companies. This agreement gave the states billions of dollars to offset the costs associated with treating tobacco-related illnesses.

A number of states have tapped these tobacco settlement funds for health-care-related initiatives, including Medicaid. Just this month, Florida was able to avoid cutting 40,000 from its Medically Needy and Aged and Disabled Medicaid programs by taking $300 million from the state's tobacco settlement fund for fiscal year 2009. However, the same budget also includes language that sunsets these two Medicaid programs next year, so this was only a temporary fix, and individuals covered under these programs will be at risk of losing coverage again next year.

Conclusion

As the nation's economy continues its downward spiral, Medicaid programs in a number of states are in jeopardy. Several states are proposing to balance their budgets by making cuts to Medicaid in the form of raising cost-sharing amounts, shrinking eligibility, or reducing benefits. Many of these cuts can be minimized or averted if Congress acts now to bring fiscal relief to the states.

Endnotes

[1] National Conference of State Legislatures, *State Budget Update: April 2008* (Washington: National Conference of State Legislatures, April 25, 2008).

[2] Elizabeth McNichol and Iris Lav, *29 States Face Total Budget Shortfall of at Least $48 Billion in 2009; 2 Others Expect Budget Problems* (Washington: Center on Budget and Policy Priorities, June 9, 2008).

[3] Vermont is the only state that allows itself to run a budget deficit. National Conference of State Legislatures, *State Balanced Budget Requirements* (Washington: National Conference of State Legislatures, April 12, 1999).

[4] Medicaid makes up approximately 22 percent of all state spending, including federal matching funds. National Governors Association and the National Association of State Budget Officers, *Fiscal Survey of States* (Washington: National Governors Association, December 2007).

[5] Keith Hall, Commissioner, Bureau of Labor Statistics, *Statement before the Joint Economic Committee, United States Congress*, May 2, 2008.

[6] Stan Dorn, Bowen Garrett, John Holahan, and Aimee Williams, *Medicaid, SCHIP and Economic Downturn: Policy Challenges and Policy Responses* (Washington: Kaiser Family Foundation, April 2008).

[7] Families USA, *Dying for Coverage* (Washington: Families USA, April 2008).

[8] Families USA's Medicaid Calculator. The Medicaid Calculator is based on a Families USA analysis using an economic model from the U.S. Department of Commerce. It is available online at http://www.familiesusa.org/issues/medicaid/other/medicaid-calculator/medicaid-calculator-states-map.html.

[9] Stan Dorn, Bowen Garrett, John Holahan, and Aimee Williams, op. cit.

[10] Robert Lowe et al, "Impact of Medicaid Cuts on Emergency Department Use: The Oregon Experience," *Annals of Emergency Medicine*, April 17, 2008, available online at http://www.annemergmed.com/webfiles/images/journals/ymem/ralowe.pdf.

[11] National Governors Association, *Economic Stimulus, State Budget Shortfalls, and State Countercyclical Funding* (Washington: National Governors Association, January 2008).

[12] Donna Cohen Ross and Laura Cox, *Preserving Recent Progress on Health Coverage for Children and Families: New Tensions Emerge, A 50 State Update on Eligibility, Enrollment, Renewal and Cost-Sharing Practices in Medicaid and SCHIP* (Washington: Kaiser Family Foundation, July 2003).

[13] Economic hardship is calculated using unemployment rates, food stamp participation, and foreclosure rates. These criteria would be used in both rounds 1 and 2.

[14] *Assembly Approves 2009 State Budget Bill*, Rhode Island Press and Information Bureau, June 19, 2008.

[15] "States Look to Tobacco Tax for Budget Holes," *The New York Times*, April 21, 2008.

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