Georgetown University Health Policy Institute
Center for Children and Families

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Medicaid's Impact on State Budgets: Looking at the Facts

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Medicaid's role in state budgets is more complicated than the headlines suggest. The program is financed jointly by federal and state funds. When considering Medicaid's impact on state budgets and priorities, it is therefore important to distinguish between *total* spending on Medicaid and spending with *state funds.* This brief explains the different measures and provides data on how much each state spends on Medicaid.

Key Findings

- It is often reported that states spend, on average, more than 21 percent of their state budgets on Medicaid, but this figure considers *federal* as well as *state* funds. When the question is, "How does Medicaid spending affect states' ability to finance other state priorities?" it is more appropriate to consider the level of *state* funds spent on Medicaid. When *state* general funds are considered, Medicaid accounts for 16.1% of state budgets—still substantial, but far less than the 21.4% commonly cited.
- In some states, the different measures can result in dramatically different stories because in states with higher Medicaid matching rates federal funds account for as much as two-thirds to three-fourths of Medicaid spending. For example, using the measure commonly cited, Medicaid accounts for 25.8 percent of total spending in Mississippi, but when only state general funds are counted, Medicaid's share of the Mississippi budget drops to 5.8 percent.
- Federal funds coming into a state to help that state pay for Medicaid services do not compete with other priorities; these federal funds can only be used for Medicaid services. In fact, these funds actually help states finance other priorities. For example, Medicaid often pays for the medical services associated with child welfare programs or special education services for children; this helps those programs stretch their state dollars. In addition, if a state were not paying for a service through Medicaid it might be financing the same service with state or local funds. By bringing in federal dollars, Medicaid frees up state dollars for other priorities.

Table 1 on page 9 shows state and federal Medicaid spending as a share of state expenditures for all states.

Introduction

Medicaid is now the largest single source of health care coverage in the nation. Most of its 53 million enrollees are children, but the lion's share of the costs are for people with significant health and long term care needs—the elderly and people with disabilities. Nearly half of all nursing home care in the country is financed by Medicaid.

Medicaid is a large program and, particularly in the past several years, costs have been growing, although on a per person basis more slowly than in the private sector. The increase in costs is largely a reflection of three factors: generally rising health care costs, the recent downturn in the economy that caused more people to need and qualify for Medicaid, and Medicaid's growing responsibility filling in the gaps in Medicare. (See box on page 7.) Rising Medicaid costs have created considerable stress for states, which finance an average of 43 percent of program spending.[1] The stress on state budgets is real, but some of the characterizations of Medicaid as the "budget monster" or "Pac man" have obscured or mischaracterized important points about Medicaid's role and can lead to ill-advised policies. For example, based in part on a misleading analysis of Medicaid spending in Florida, Governor Jeb Bush has proposed a radical plan that would essentially convert the program into capped premium payments to private plans, letting those plans largely determine Medicaid benefit guarantees and cost sharing.[2]

Measuring the Squeeze: Different Numbers, Different Story

Data collected by the National Association of State Budget Officers (NASBO) show how states spend their funds and provide insight into the different ways that Medicaid affects state budgets. A number that has captured attention is that in fiscal year 2003 Medicaid consumed 21.4 percent of state budgets, a close second to K-12 education (21.7 percent).[3] This number has been cited widely in newspaper articles, as well as by some policymakers calling for sweeping Medicaid reform.

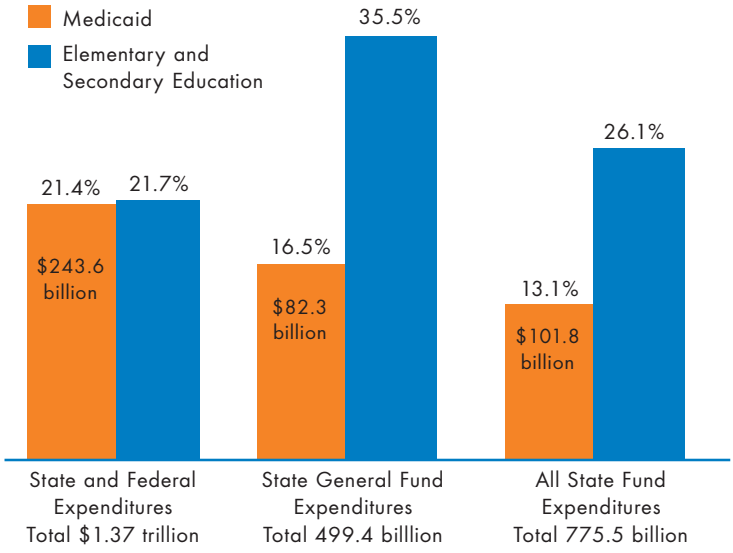
These numbers can be informative or misleading, depending on the context in which they are used. They reflect Medicaid's share of *total* expenditures—including spending that is financed with *federal* dollars. When the question is, "How does Medicaid spending affect states' ability to finance other state priorities or to balance its budget?" it is more appropriate to consider the level and percent of *state* funds that are spent on Medicaid.[4] Payments that a state receives from the federal government to help finance Medicaid-covered health care do not squeeze out state spending for education, corrections or other state priorities. Federal Medicaid funds must be spent on Medicaid services.Indeed, federal Medicaid funds often relieve state financing pressures by freeing up state and local funds that would otherwise be spent on health care, allowing those freed-up funds to be spent on other programs and services.

The story changes considerably when federal funds are excluded from the calculations. NASBO data divides state funds into two broad categories: "state general funds" and "other state funds." (See text box below for an explanation of these terms.) When state general funds are considered, Medicaid's share of spending drops to 16.1 percent, still considerable, but much less than the 21.4 percent commonly cited. If all state spending is considered (excluding federal funds but considering state general funds and other state funds), Medicaid's share of state spending drops to 13.1 percent. As Figure 1 shows, the comparison between Medicaid and education spending changes markedly when federal funds are excluded for both.[5]

Figure 1

Different Measures, Different Stories

Medicaid as a Share of Expenditures 2003



Source: **Georgetown Health Policy Institute analysis based on National Association of State Budget Officers, 2002 State Expenditure Report, November 2003. Total State Fund Expenditures include expenditures from the State General Fund and Other State Funds. For most states, K-12 and Medicaid are the two largest spending items.**

State Funds—Explaining the Terms

The "General Fund," according to NASBO, is the "predominant fund for financing a state's operations." It is where broad-based state taxes (e.g., income and sales taxes) are deposited. By contrast, "Other State Funds" are from restricted revenue sources, such as gas taxes earmarked for highway construction and tobacco settlement funds used for health care and public health initiatives.

All states rely on their General Fund to finance Medicaid, but some use special fund dollars as well. Nationwide, 7.1 percent of "Other State Funds" were used for Medicaid in 2003, but the pattern varies widely; nine states spent no "Other State Funds" on Medicaid in 2003. The sources for each state's spending should be examined to determine whether it is more appropriate for that state to look only at state general funds or at all state sources of funds. In some states, if only general fund spending is considered, a significant amount of other state funds spent on Medicaid might be overlooked. That could understate Medicaid's impact on state finances. However, in states that do not spend much or any of their "other state funds" on Medicaid, counting these fund sources might skew the analysis in the other direction by considering sources (like gas tax revenues) which may be earmarked for specific purposes.

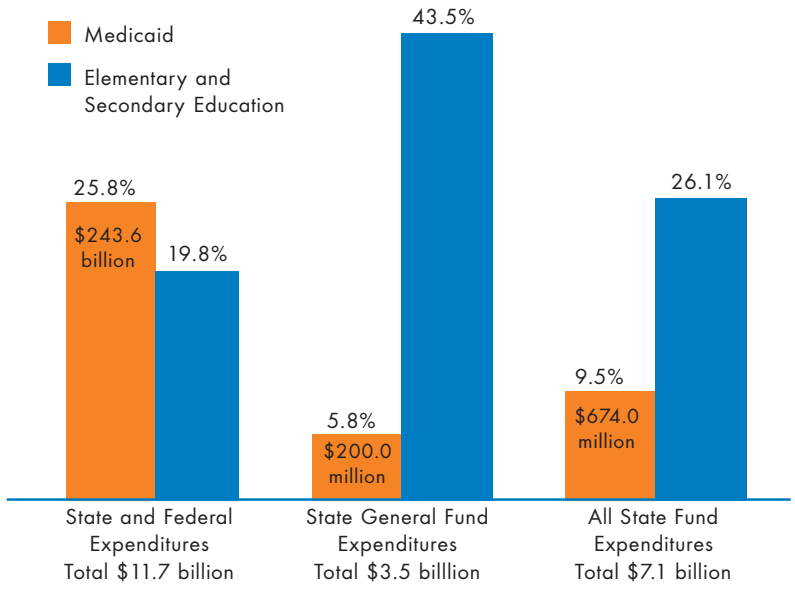
Different States, Different Story

The figures discussed on the previous page are for the nation as a whole. The different measures will produce even more dramatically different results in some states, particularly those with higher-than-average federal Medicaid matching rates. For example, in Mississippi, Medicaid accounts for 25.8 percent of total spending (federal funds, state general funds and other state funds), but when federal funds are excluded, Medicaid's share of state spending drops to 5.8 percent (considering state general funds only) or 9.5 percent (considering state general funds and other state funds). (Figure 2)

In Florida, Governor Bush has described Medicaid's impact on state finances by looking at total spending (state and federal). In 2003, Medicaid accounted for 22.3 percent of Florida's total spending, but well over half (59%) was financed with federal Medicaid funds. When only Florida state funds are considered, Medicaid accounted for 17.8 percent of Florida's general fund spending and 13.5 percent of all state funds. (Figure 3) See Table 1 on page 9 for data for all 50 states.

Figure 2

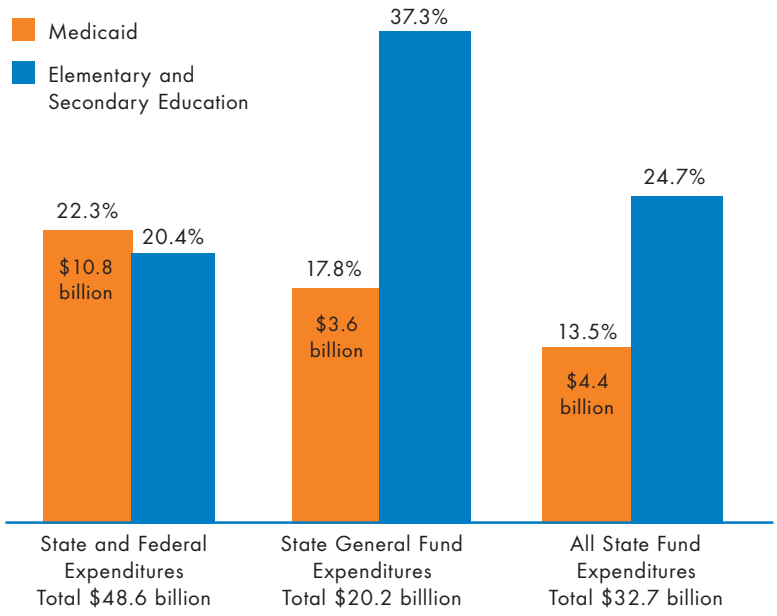
Medicaid as a Share of Mississippi's Expenditures 2003



Source: Georgetown Health Policy Institute analysis based on National Association of State Budget Officers, 2002 State Expenditure Report, November 2003. Total State Fund Expenditures include expenditures from the State General Fund and Other State Funds. For most states, K-12 and Medicaid are the two largest spending items.

Figure 3

Medicaid as a share of Florida's Expenditures 2003



Source: Georgetown Health Policy Institute analysis based on National Association of State Budget Officers, 2002 State Expenditure Report, November 2003. Total State Fund Expenditures include expenditures from the State General Fund and Other State Funds. For most states, K-12 and Medicaid are the two largest spending items.

The Value of Federal Funds

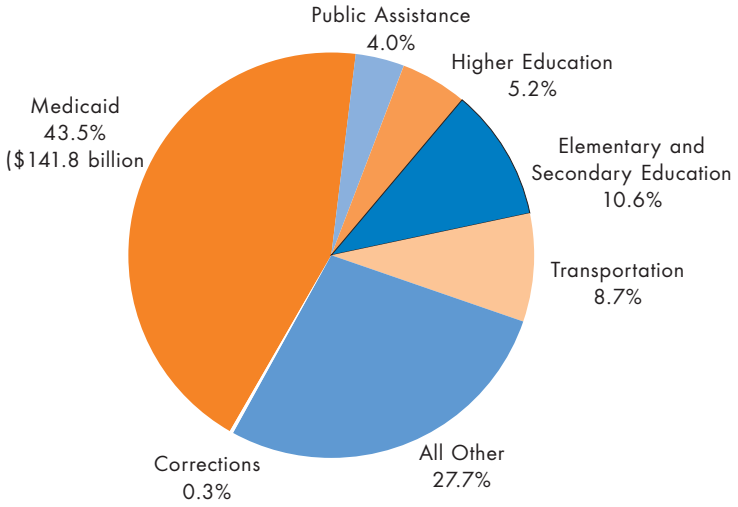
Rather than being a drain on state budgets, the federal Medicaid funds spent by each state make a significant contribution to that state's ability to provide its residents access to health care. In 2003, federal Medicaid payments to states totaled $141.8 billion; Medicaid was the single largest source of federal grants to states. (See Figure 4.)

In addition to helping states provide coverage and long term care services to their residents, federal Medicaid funds provide direct and indirect help to states in a number of ways:

- ***Federal Medicaid funds directly support priorities often cited as competing with Medicaid.*** For example, Medicaid strengthens and supports education opportunities for children by funding the health care components of early intervention services, Head Start and special education. Medicaid also helps finance child welfare services and an array of public health initiatives in many states.

Figure 4

Federal Medicaid Payments as a Share of Total Federal Funds to States, FY 2003



Total Federal Funds to States = $326 billion

Source: Georgetown Health Policy Institute analysis based on National Association of State Budget Officers, 2003 State Expenditure Report, Fall 2004..

- ***Federal Medicaid payments indirectly help states finance other priorities by freeing up state dollars that otherwise would have been spent on health care.*** One reason why Medicaid has grown is that over the years most states have (appropriately) paid for medical services that had been financed with state or local dollars through Medicaid in order to leverage federal funding. For example, a range of community mental health services that most states finance through Medicaid would likely be provided, but paid for with state or local dollars if federal Medicaid funds were not available. The state (and local) funds not spent on health care thanks to Medicaid are potentially available for other priorities, such as education.
- ***Federal Medicaid funding flows to local communities and contributes to local economies*** by creating jobs, financing the purchase of medical supplies and other goods and services, and thereby generating additional state and local tax revenues. A range of studies examining the effect of federal Medicaid payments on state and local economies have found a strong, positive impact.[6]

Why Are Medicaid Costs Growing?

After a period of relatively slow growth, Medicaid spending has been rising in recent years. Several factors explain these trends:

- The cost of health care has been rising in both private and public sectors, with prescription drug costs skyrocketing at an average annual rate of 15.5 percent from 1998 to 2003. Medicaid prescription costs grew at an average annual rate of 19.3 percent between 1998 and 2003.
- While health costs have been growing in both the private and public sectors, *on a per person basis, Medicaid costs are lower than private insurance.* An Urban Institute study showed that Medicaid costs 30 percent less for adults and 10 percent less for children than private insurance. *Medicaid costs have also been growing considerably more slowly than private insurance*. Between 2000 and 2003, acute care Medicaid costs per enrollee grew by 6.9 percent, compared to private insurance premium increases of 11 to 13 percent.
- Over the past few years, enrollment gains have contributed to higher costs. Medicaid is designed to be countercyclical—when other sources of coverage contract, Medicaid expands. The recent downturn led to increases in Medicaid enrollment as coverage from employer-based insurance declined.
- A key driver and source of concern for state Medicaid programs is the rising cost of covering so-called "dual eligibles"—Medicare beneficiaries who rely on Medicaid for supplemental coverage and help with cost sharing. Medicaid—not Medicare—is primarily responsible for providing long term care for Medicare beneficiaries. The cost shift from Medicare to Medicaid is substantial (nationwide, about 42% of all Medicaid expenditures were for dual eligibles in 2002) and will grow over time as the baby boomers retire.

Sources: National Health Care Expenditures from Centers on Medicare and Medicaid Services. Data available online: http://www.cms.hhs.gov/statistics/nhe/historical/nhe03.zip. Hadley J, Holahan J. "Is Health Care Spending Higher under Medicaid or Private Insurance?" *Inquiry*, Vol. 40, No. 4, Winter 2003/2004.*Inquiry* 2004. Holahan J, Bruen B, Urban Institute. "Medicaid Spending: What Factors Contributed to the Growth between 2000 and 2003?" Kaiser Commission on Medicaid and the Uninsured, September, 2003. Strunk BC, Reschovksy JD. "Trends in US Health Insurance Coverage, 2001-2003." Center for Studying Health System Change, August 2004. Cohen RA, et. al. "Health Insurance Coverage: Estimates from the National Health Interview Survey, January-September 2003." Centers for Disease Control and Prevention, March 2004.

Conclusion

Medicaid is at a crossroads. Changes are needed to provide states with more resources and tools to deal with rising health care costs, an aging population, and the increasing demand for long term care. Misunderstandings and mischaracterizations of Medicaid's impact on state budgets and budget priorities cloud, rather than illuminate, these important issues. Instead of helping to move the public debate toward workable solutions, they may lead to results that are harmful not only to the program's ability to do its job but also to the longer term health of state and local finances.

Endnotes

[1] State funds spent on Medicaid are matched by the federal government, with the federal match rate (known as "FMAP") ranging from a minimum of 50 percent up to 77 percent. (Medicaid expenditures for some selected services and supports are matched at a higher rate for all states.) As such, at least half, and in some cases, over three-quarters, of total state Medicaid expenditures are paid for with federal, and not state, dollars. See Table 2 for the federal matching rates for the 50 states and the District of Columbia.

[2] "Florida Medicaid Modernization Proposal," Jeb Bush, Governor, State of Florida, January 11, 2005, page 1; Alker, J., *Issues to Consider in Governor Bush's "Florida Medicaid Modernization Proposal:*, Winter Park Health Foundation Policy Brief, March 2005, http://www.wphf.org/access/pubs/Medicaid3.pdf

[3] National Governors Association, National Association of State Budget Officers, Press Release, *Medicaid Squeezes State Budgets*, October 12, 2004.

[4] This is the approach adopted by the Congressional Research Services in its recent analysis of Medicaid's impact on the state fiscal crisis C.Scott, Congressional Research Services, CRS Report for Congress, "Medicaid and the Current State fiscal Crises," Updated February 17, 2004.

[5] National and state data are from the National Association of State Budget Officers, *2003 State Expenditure Report*, Fall, 2004, available at www.nasbo.org. This analysis does not consider local spending which is far more significant for K-12 education than for Medicaid. According to the Department of Education, 37 percent of funding for education comes from local funds. National Association of State Budget Officers, *2003 State Expenditure Report*, November 2003, page 14.

[6] Carbaugh A. "The Role of Medicaid in State Economies: A Look at the Research." Kaiser Commission on Medicaid and the Uninsured, April 2004.

Table 1: Medicaid as a Percent of State Expenditures, FY 2003

State	State Medicaid Expenditures as a Share of State General Fund Expenditures	State Medicaid Expenditures as a Share of State General Fund and Other State Fund Expenditures	State and Federal Medicaid Expenditures as a Share of Total State and Federal Expenditures
Alabama	5.3%	10.2%	22.3%
Alaska	8.3%	6.0%	12.1%
Arizona	14.1%	9.0%	20.7%
Arkansas	11.4%	7.3%	19.5%
California	13.6%	12.9%	18.5%
Colorado	18.3%	11.7%	17.8%
Connecticut	22.8%	22.4%	25.3%
Delaware	12.9%	7.4%	11.5%
Florida	17.8%	13.5%	22.3%
Georgia	11.0%	10.4%	17.6%
Hawaii	8.0%	5.2%	9.7%
Idaho	11.6%	10.1%	19.6%
Illinois	18.9%	18.3%	25.4%
Indiana	14.6%	11.3%	20.5%
Iowa	9.5%	9.8%	18.1%
Kansas	11.8%	8.7%	16.0%
Kentucky	10.4%	9.1%	20.8%
Louisiana	12.2%	10.6%	26.2%
Maine	20.3%	13.5%	28.2%
Maryland	19.1%	11.6%	17.7%
Massachusetts	14.0%	13.5%	20.8%
Michigan	18.5%	11.6%	20.0%
Minnesota	17.3%	13.3%	20.8%
Mississippi	5.8%	9.5%	25.8%
Missouri	18.7%	18.7%	32.6%
Montana	9.8%	6.1%	15.6%
Nebraska	17.3%	9.8%	18.9%
Nevada	25.1%	14.4%	20.2%
New Hampshire	25.1%	19.5%	26.4%
New Jersey	15.8%	13.5%	20.6%
New Mexico	11.1%	6.9%	17.8%
New York	15.8%	15.6%	28.4%
North Carolina	14.7%	12.0%	23.4%
North Dakota	12.9%	9.1%	19.0%
Ohio	37.0%	23.8%	23.1%
Oklahoma	12.3%	8.1%	18.4%
Oregon	17.1%	9.6%	18.7%
Pennsylvania	19.4%	19.8%	28.8%
Rhode Island	23.5%	16.6%	26.3%
South Carolina	9.1%	10.1%	22.0%
South Dakota	17.7%	9.1%	14.9%
Tennessee	25.2%	19.9%	33.9%
Texas	16.4%	13.2%	23.0%
Utah	5.6%	6.3%	14.5%
Vermont	14.8%	14.2%	25.8%
Virginia	15.8%	8.5%	13.5%
Washington	23.8%	14.4%	22.2%
West Virginia	6.1%	3.4%	11.1%
Wisconsin	13.2%	6.0%	12.6%
Wyoming	9.6%	3.7%	7.9%
ALL STATES	**16.5%**	**13.1%**	**21.4%**

Source: Georgetown Health Policy Institute analysis based on "2003 State Expenditure Report." National Association of State Budget Officers, Fall 2004. Notes: See "Medicaid Notes" in NASBO report, page 52, regarding how federal and state funds are deposited and/or reported in Connecticut, Massachusetts, Missouri, and Ohio. Comparisons across states should be avoided as the data is not always reported consistently across states; for example, Iowa, Michigan, and Nevada, include local funds, but New York and Ohio do not.

Table 2: Medicaid Federal Match Rate (FMAP), FY 2005

State	Federal Medical Assistance Percentages, FY 2005	State	Federal Medical Assistance Percentages, FY 2005
Alabama	70.83%	Nebraska	59.64%
Alaska	57.58%	Nevada	55.90%
Arizona	67.45%	New Hampshire	50.00%
Arkansas	74.75%	New Jersey	50.00%
California	50.00%	New Mexico	74.30%
Colorado	50.00%	New York	50.00%
Connecticut	50.00%	North Carolina	63.63%
Delaware	50.38%	North Dakota	67.49%
District of Columbia	70.00%	Ohio	59.68%
Florida	58.90%	Oklahoma	70.18%
Georgia	60.44%	Oregon	61.12%
Hawaii	58.47%	Pennsylvania	53.84%
Idaho	70.62%	Rhode Island	55.38%
Illinois	50.00%	South Carolina	69.89%
Indiana	62.78%	South Dakota	66.03%
Iowa	63.55%	Tennessee	64.81%
Kansas	61.01%	Texas	60.87%
Kentucky	69.60%	Utah	72.14%
Louisiana	71.04%	Vermont	60.11%
Maine	64.89%	Virginia	50.00%
Maryland	50.00%	Washington	50.00%
Massachusetts	50.00%	West Virginia	74.65%
Michigan	56.71%	Wisconsin	58.32%
Minnesota	50.00%	Wyoming	57.90%
Mississippi	77.08%		
Missouri	61.15%	**Average FMAP**	**64.01%**
Montana	71.90%	**Median FMAP**	**63.76%**

Source: Federal Register, December 3, 2003 (Vol. 68, No. 232), pp. 67676-67678. Available online: http://aspe.os.dhhs.gov/health/fmap05.htm.

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