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Georgetown UNIVERSITY Health Policy Institute

State Budget Woes: Revenue Declines, Not Medicaid Spending, are to Blame

By Martha Heberlein and Joan Alker

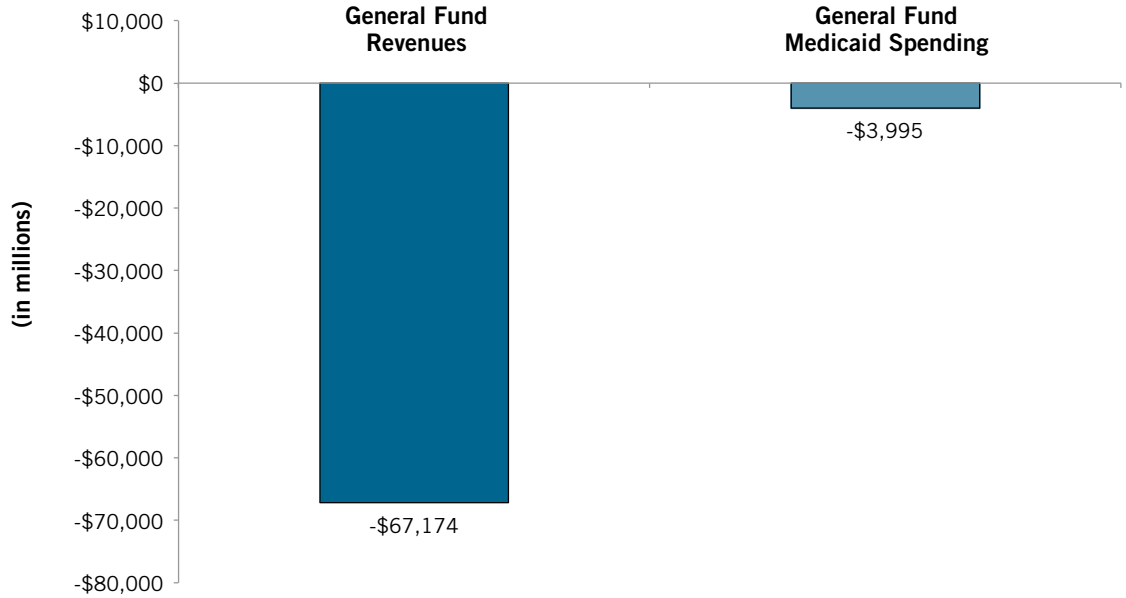
Introduction

The worst recession since the Great Depression left states and families struggling to make ends meet. Unemployment remained above nine percent for much of the last three years,[1] increasing the need for state services at the same time that revenues were declining. As states have faced large budget deficits, some politicians have laid the blame at Medicaid's doorstep, saying that the program's costs are growing "out of control" and that it is "crowding out" other priorities. While spending in Medicaid has grown as a result of increased enrollment due to the recession, most of this added spending has been born by the federal government. Although less frequently discussed, a greater challenge to state budgets during these difficult economic times has been the steep declines in revenues. In fact, state Medicaid spending and general revenues both declined during the last recession (see Figure 1). This report examines the decline in state revenues and changes in Medicaid spending during the last two recessions to look more closely at what has been driving state budget deficits.

State Revenue Response to Recessions

Revenues that go into the state general fund, the largest source of state expenditures and the part of the budget over which policymakers have the most control, arise from three main sources – personal income taxes (39.4 percent in fiscal year 2010),[2] sales taxes (32.6 percent), and corporate income taxes (6.4 percent). While these are the most significant contributors to revenues, states also employ other taxes, such as those on alcohol, cigarettes, or insurance premiums, and licenses and fees to finance their general fund spending. In addition, states may have special funds – for example lottery proceeds or

Figure 1. Change in General Fund Revenue and Medicaid Spending, FY 2008 to FY 2009



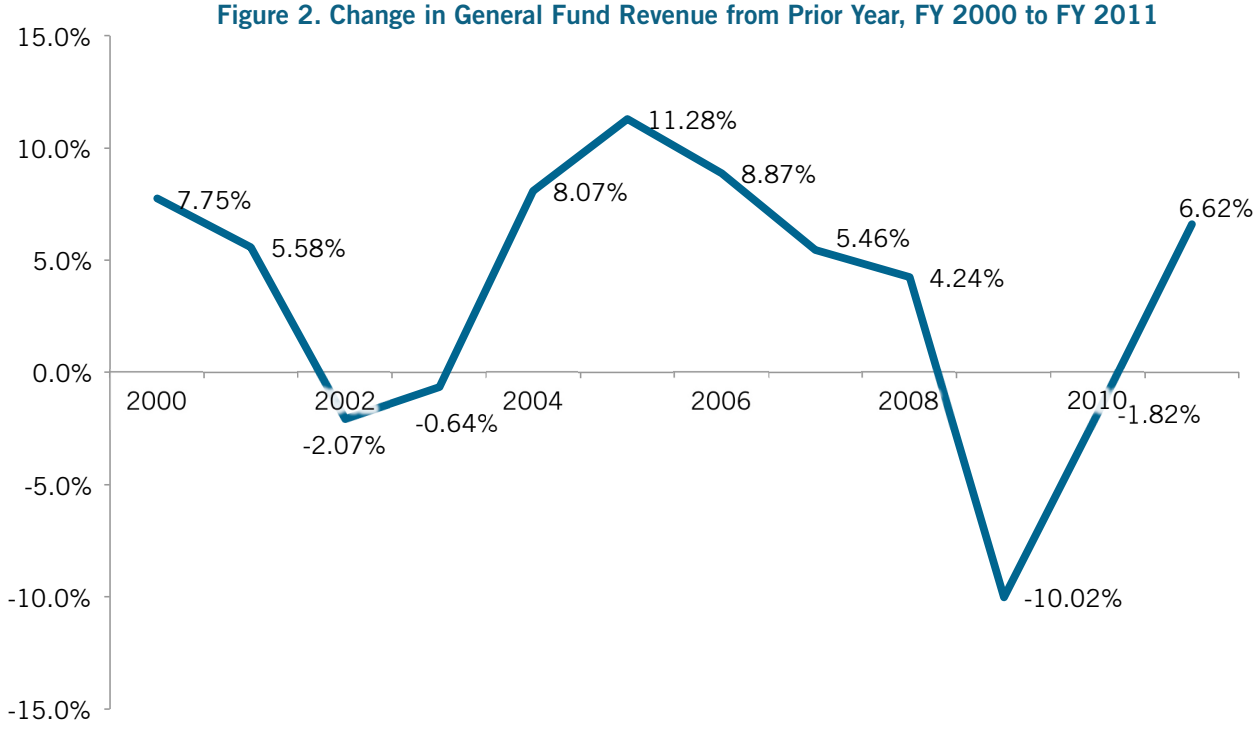
settlement funds from tobacco litigation – that are often earmarked for particular purposes and are not reflected in the general fund.

Most sources of state revenue are shaped by the health of the economy as a whole – as additional people join the ranks of the unemployed, state income taxes fall; as consumers cut back on purchases to make ends meet, revenues from sales taxes decline. Corporate tax revenues are even more variable as a result of the volatility in earnings associated with the economy, as well as the timing of tax payments.[3] These ties to the broader economy result in a decline in revenues coming into state coffers as seen during the last two recessions (see Figure 2).

The 2001 recession, which lasted from March 2001 to November 2001,[4] saw a decline in general fund revenues in just two fiscal years (FY 2002 and FY 2003). Nationally, total state general revenues declined 2.1 percent between FY 2001 and FY 2002, with 35 states experiencing declines. The 14 states that did not see revenue declines experienced only modest growth, averaging just 2.6 percent.[5] Between FY 2002 and FY 2003, revenues began to rebound as 31 states saw increases in general tax revenues. By FY 2004, state general fund revenues were growing again at a healthy rate of just over 8.1 percent nationally, with only two states showing declines.

Stretching from December 2007 to June 2009, the recent recession was far more severe, hitting virtually every state, all sources of revenue, and resulting in far greater declines in the amount of money flowing into state coffers. Between FY 2008 and FY 2009, state general fund revenues decreased by 10 percent nationally, with 49 states experiencing a decline. Only Ohio did not see revenues decrease, but growth was very modest at just 0.1 percent and the state saw a decline in the following fiscal year. Between FY 2009 and FY 2010, 35 states again saw drops in revenue although the decline nationally (1.8 percent) was not as marked as in the prior fiscal year. By FY 2011, the vast majority of states (45) saw growth in general tax revenues, as they rose nationally by 6.6 percent. Despite the growth seen in most states, general revenues still remain below the pre-recessionary FY 2007 levels.

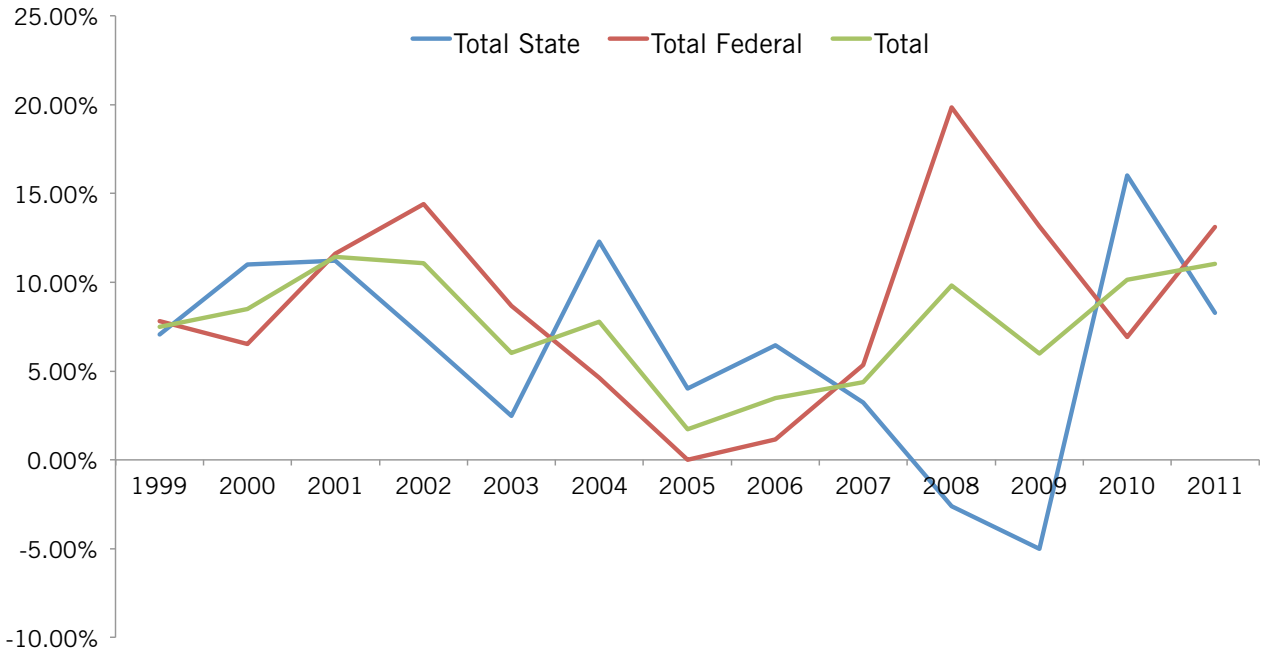
Figure 2. Change in General Fund Revenue from Prior Year, FY 2000 to FY 2011



Changes in Medicaid Spending Fluctuate with Economy

When economic conditions weaken, people lose jobs, income, and access to employer-based coverage. More families then turn to Medicaid, and enrollment and spending increases at the same time state revenues decline, as described above. As a result, financing Medicaid coverage during recessions can be challenging especially as almost all states, with the exception of Vermont, are required to balance their budgets unlike the federal government. While financing for Medicaid is

Figure 3. Change in Medicaid Spending by Funding Source, FY 1999 to FY 2011



shared between the states and the federal government,[6] with the federal government covering, on average, 57 percent of the costs, during both of the recent recessions the federal government temporarily increased its share of Medicaid spending to help states cover the rising cost of the program.

As the last recession hit, state spending in Medicaid rose 11.3 percent nationally between FY 2001 and FY 2002. Medicaid spending growth slowed slightly between FY 2002 and FY 2003, as federal fiscal relief under the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) started flowing to the states.[7] As a result of the additional federal dollars, between FY 2003 and FY 2004, growth in state Medicaid spending nationally was 2.5 percent, with 16 states actually seeing declines in Medicaid spending. As the fiscal relief expired, state spending on Medicaid increased dramatically between FY 2004 and FY 2005, but then moderated during the years that followed (see Figure 3).

In response to the recent recession, the federal fiscal relief provided through the American Recovery and Reinvestment Act (ARRA), was much larger, lasted longer, and began earlier in the downturn than the relief under JGTRRA.[8] As a result, the impact on state spending was far more substantial. Between FY 2007 and FY 2008, the beginning of the recession, state Medicaid spending increased nationally by just 3.2 percent with 42 states experiencing growth. But from FY 2008 through FY 2010 state spending on Medicaid declined nationally, despite overall growth in Medicaid costs, due to the influx of ARRA funds. State spending actually declined by 2.6 percent in FY 2009 and by 5.0 percent in FY 2010. When the federal fiscal relief ended, state spending in Medicaid began to rise.

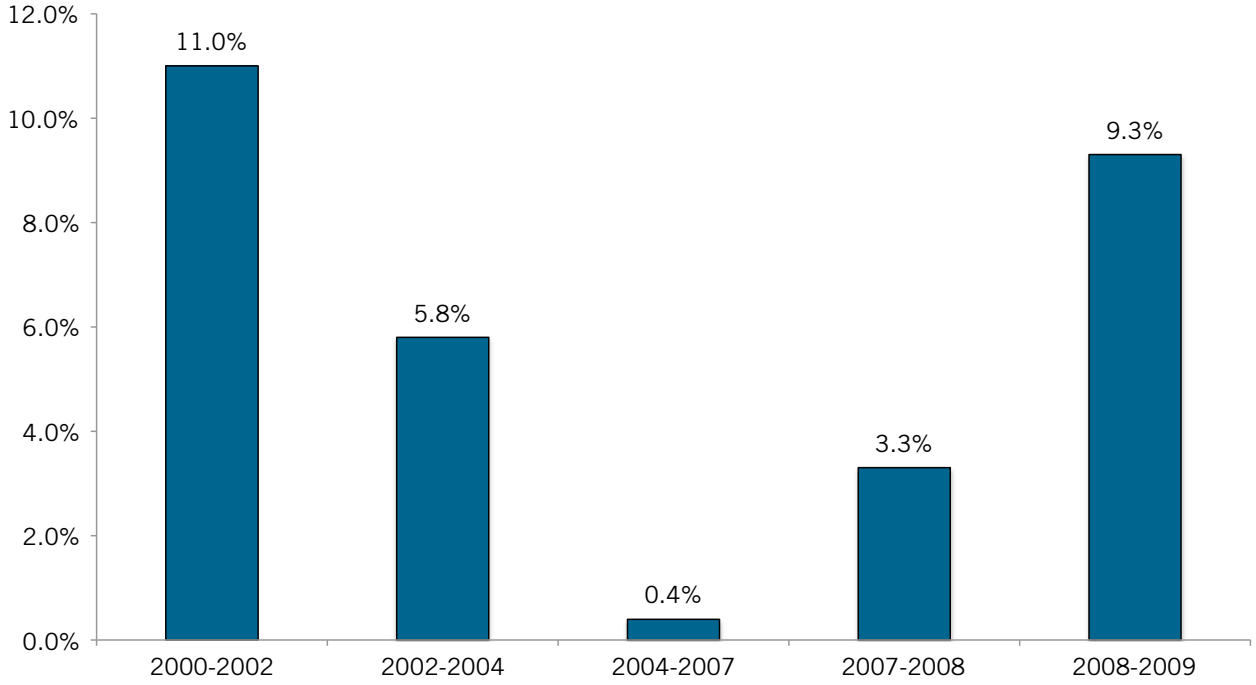
A Look Behind the Rising Costs in Medicaid

The latest recession has resulted in high rates of unemployment, peaking at 10 percent in October 2009.[9] However, as intended, Medicaid stepped in to fill the gap for low- and moderate-income children and families as they lost coverage when they became unemployed. While throughout the program's history growth in spending has followed increases in enrollment, the influx of nearly six million people between December 2007 and December 2009, was the largest seen since the early days of Medicaid implementation.[10]

During the earlier recession, enrollment among families increased by 11 percent per year between 2000 and 2002. Enrollment growth slowed as the economy began to improve, growing at a rate of 5.8 percent for the next two years; and as the recession ended and the unemployment rate declined, enrollment among families remained fairly constant, expanding at a rate of just 0.4 percent between 2004 and 2007. Once again as the economy deteriorated, enrollment began to increase, by 3.3 percent in 2008 and by 9.3 percent in 2009 (see Figure 4 on next page).[11]

This enrollment growth explains much of the increase in

Figure 4. Medicaid Enrollment Growth, 2000 to 2009



Medicaid spending seen over the last decade. Between 2000 and 2009, overall Medicaid spending per person increased on average by 4.6 percent annually. During this same time period, per capita national health expenditures increased by 5.9 percent annually and monthly premiums for employer-sponsored insurance rose 7.7 percent on an annual basis. Growth in per capita Medicaid spending tracks very closely with growth in the consumer price index for Medical care, illustrating that while Medicaid costs have grown, the program has done a better job in controlling costs than private coverage.[12]

In fact, Medicaid programs across the country have instituted a variety of cost-containment strategies over the years, such as reducing provider payment rates, implementing preferred drug lists, and moving long-term care services to community-based models.[13] A number of states are also considering expanding mandatory managed care to include beneficiaries that have greater health care needs, such as children with special health care needs, dual eligibles, and those with disabilities,[14] although it is not clear that such an approach will save states money.[15] While states continue to look to other means to control Medicaid spending, such as better care coordination of those eligible for both Medicaid and Medicare, the slower cost growth in Medicaid compared to cost growth in private coverage suggests that further cost containment will likely need to be found on a health system-wide basis, such as slowing the cost growth of prescription drugs or new medical technologies.

Conclusion

The enhanced federal match helped states fill the gap between decreased revenue and increased demand for Medicaid and CHIP during the last two recessions. As states progress through the first full budget year after the enhanced federal funding expired, economic conditions are continuing to improve. In January 2012, unemployment hit a three-year low of 8.3 percent, down from 9.4 percent a year earlier[16] and state coffers are seeing signs of recovery with total tax revenues growing for two years.[17] At the same time, in FY 2012, enrollment gains in Medicaid have eased and expected overall growth in Medicaid spending slowed to 2.2 percent – one of the lowest rates on record.[18]

Despite these positive signs, however, 30 states have either projected or addressed shortfalls for FY 2013.[19] As states enact their budgets for the year, the choices they make will have serious consequences in the years ahead, especially as many of the easy options to reduce Medicaid spending have already been implemented. The data reported here make apparent that state budgets have faced shortfalls in large part due to the decline in revenues and that spending growth in Medicaid has largely been offset by federal funds. Thus to address their budget problems, states need to continue to find a balanced approach that looks at the revenue side of the equation as well. As revenues continue to rebound and

Medicaid enrollment and spending growth slows, a balanced approach should protect the security that Medicaid coverage provides for families who have also been hit hard by the recession.

Data Source

This report is based on data published in the series of State Expenditure Reports from the National Association of State Budget Officers. Data on state tax collections and Medicaid spending are pulled from the 2010, 2008, 2006, 2004, 2002, and 2000 reports. "Actual" figures (as opposed to "estimated" figures) are reported in all years except for FY 2011, as actual figures are not yet available. Unless noted, state Medicaid spending includes spending from the general fund and "other" funds. Data are not collected for the District of Columbia.

Endnotes

1. Bureau of Labor Statistics, "Labor Force Statistics from the Current Population Survey" (accessed March 7, 2012).
2. Fiscal year refers to state fiscal year, which in almost all states runs from July to June. Exceptions are Alabama, Michigan, New York, and Texas. The fiscal year begins in October in Alabama and Michigan, in April in New York, and in September in Texas. National Association of State Budget Officers, "Budget Processes in the States" (Summer 2008).
3. L. Dadayan, "Tax Revenue Keeps Rising, But Growth Again Ticks Downward," Rockefeller Institute of Government (January 26, 2012).
4. National Bureau of Economic Research, "US Business Cycle Expansions and Contractions" (September 20, 2010).
5. Data were not reported for Alaska for FY 2001 and FY 2002.
6. For more on the role Medicaid plays in state budgets, see M. Heberlein, J. Alker, & Q. Qasim, "Medicaid and State Budgets: Looking at the Facts," Georgetown University Center for Children and Families (March 15, 2011).
7. Under JGTRRA, $10 billion was set aside for state fiscal relief through a temporary increase in the federal matching rate. For the last two quarters of federal fiscal year (FFY) 2003 and for the first three quarters of FFY 2004 (April 1, 2003 through July 1, 2004), the states' matching rate was "held harmless" (meaning it could not fall below FFY 2002 levels) and was increased by 2.95 percentage points.
8. Originally available to states from December 2008 through December 2010, the temporary increase in the Medicaid matching rate was extended at a reduced level through June 30, 2011. Under the original ARRA provisions, states FMAP rates were held harmless, before receiving an extra 6.2 percentage points, plus an additional increase based on the state's unemployment rate. Under the extension, the size of the enhancement declines to 3.2 percentage points in January 2011 and 1.2 percentage points in April, again with an additional increase based on the state's unemployment rate.
9. op. cit. (1).
10. J. Holahan, et al., "Medicaid Spending Growth Over the Last Decade and the Great Recession, 2000-2009," Kaiser Commission on Medicaid and the Uninsured (February 2011).
11. Ibid.
12. Ibid.
13. V. Smith, et al., "Moving Ahead Amid Fiscal Challenges: A Look at Medicaid Spending, Coverage and Policy Trends," Kaiser Commission on Medicaid and the Uninsured (October 2011).
14. K. Gifford, et al., "A Profile of Medicaid Managed Care Programs in 2010: Findings from a 50-State Survey," Kaiser Commission on Medicaid and the Uninsured (September 2011).
15. M. Duggan & T. Hayford, "Has the Shift to Managed Care Reduced Medicaid Expenditures? Evidence from State and Local-Level Mandates," National Bureau of Economic Research, Working Paper No. 17236 (July 2011).
16. This rate remained constant in February 2012. Bureau of Labor Statistics, "The Employment Situation – January 2012" (February 3, 2012).
17. L. Dadayan, "State Tax Revenues Softened in the Fourth Quarter of 2011," Rockefeller Institute of Government (March 19, 2012).
18. V. Smith, et al., "A Mid-Year State Medicaid Budget Update for FY 2012 and a Look Forward to FY 2013," Kaiser Commission on Medicaid and the Uninsured (February 2012).

19. E. McNichol, P. Oliff, & N. Johnson, "States Continue to Feel Recession's Impact," Center on Budget and Policy Priorities (Updated March 21, 2012).

This brief was prepared by Martha Heberlein and Joan Alker of the Georgetown Center for Children and Families.

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