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THE HENRY J. KAISER FAMILY FOUNDATION

POLICY BRIEF

JANUARY 2009

Medicaid in a Crunch:
A Mid-FY 2009 Update on State Medicaid Issues in a Recession

Executive Summary

As economic conditions across the country continue to worsen, Medicaid programs are feeling the strain of increased demand, while states have fewer resources available to support the program as revenues come in lower than projected. When state legislatures finalized state budgets for FY 2009, they authorized total Medicaid spending growth that averaged 5.8 percent for FY 2009, up from 5.3 percent the previous year. Growth was primarily driven by increased Medicaid enrollment and increased costs of Medicaid services. Even at that time, two-thirds of Medicaid officials anticipated that this level of spending might not be adequate.

This report provides a mid fiscal-year 2009 update on key state Medicaid issues, including the impacts of the economic downturn, based on the perspectives of leading Medicaid directors. This report augments the most recent Medicaid budget survey report which was based on a survey and interviews with all state Medicaid directors in July and August 2008, at the beginning of state fiscal year 2009.[1] Now, approaching the mid-point of state fiscal year 2009, Medicaid directors reported that:

- Although the impact varies, the economic downturn is affecting every state budget and Medicaid program, in some cases causing severe distress.
- Four months into state FY 2009, well over half of Medicaid directors report that program enrollment and spending trends are above the levels projected at the beginning of the state fiscal year. Most states are facing the prospect of mid-fiscal year 2009 program cutbacks necessitated by states requirements for an annually balanced budget. Many directors say they cannot identify additional reasonable options for making further spending cuts after having undertaken aggressive cost containment actions only a few years ago in the last downturn.
- Looking ahead to next fiscal year, the outlook for FY 2010 is that it will be a very difficult year, with the potential for widespread program cutbacks and rate cuts that will affect millions of Medicaid beneficiaries and the hospitals, doctors and other providers who serve them.
- Medicaid directors believe the highest priority for federal action should be a substantial temporary adjustment in the federal Medicaid matching rate (FMAP), along with reauthorization of SCHIP. Medicaid directors believe the second highest priority for federal action should be rescission of the federal regulations that are now subject to Congressional moratoria. These regulations could have significant negative fiscal implications for states.
- Despite fiscal challenges, Medicaid directors anticipate a positive relationship with the federal government under the new administration.

[1] State fiscal years begin on July 1, with the following exceptions: New York on April 1, Texas on September 1, Alabama, Michigan and the District of Columbia on October 1.

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Introduction

The purpose of this report is to provide a mid fiscal-year 2009 update on Medicaid key issues from the perspectives of leading Medicaid directors who administer the program. This report augments the most recent Medicaid budget survey report which was based on a survey and interviews with all state Medicaid directors in July and August 2008 at the beginning of state fiscal year 2009.[2]

Medicaid is a federal entitlement program that covers health and long-term care services for nearly 60 million low-income Americans. Medicaid is administered by the states under rules established in federal law. Each state has a great deal of flexibility to shape its own program in terms of eligibility, benefits, provider payment rates and delivery systems. Total Medicaid expenditures were estimated to exceed $350 billion in federal fiscal year 2008[3], but the program is jointly financed by the states and federal government. The federal matching rate averages 57 percent but varies from state to state from a floor of 50 percent to a high of 76 percent, depending on the state average personal income compared with the national average.

When state legislatures finalized state budgets for FY 2009, the economic downturn was already having an impact on Medicaid spending. Legislatures authorized total spending growth that averaged 5.8 percent for FY 2009, up from 5.3 percent the previous year. Two primary factors contributing to this increased rate of Medicaid spending were expected increases in Medicaid enrollment and increased costs of Medicaid services. Initial Medicaid budgets were based on enrollment growth that averaged 3.6 percent, compared to only 2.2 percent actual average growth in the previous year. The primary factor contributing to increased enrollment growth for FY 2009 was the slowing economy which results in increased demand for Medicaid as individuals lose jobs and employer sponsored coverage and incomes decline. State policy changes to expand eligibility or enrollment were a secondary factor contributing to enrollment growth with 34 states adopting positive (but modest) eligibility changes for FY 2009. Changes in provider payments also contributed to Medicaid spending growth for FY 2009. A total of 47 states adopted budgets that would increase provider payment rates for at least one provider group in FY 2009. Many of these rate increases were restorations or catch-up increases for years of cuts or freezes during the last economic downturn from 2001 to 2004.

The general direction of Medicaid policy change as initially adopted across all states for FY 2009 was positive; however, even as the fiscal year 2009 began in July of 2008, Medicaid directors in many states expressed concern that the budget enacted by the legislature would not be fully sufficient to finance the program for the fiscal year. When surveyed in the first weeks of FY 2009, almost two-thirds of Medicaid directors indicated the likelihood of a Medicaid budget shortfall for FY 2009 was at least 50-50.

Several states, including California, New York, Nevada, Rhode Island and South Carolina experienced state-wide budget crises that extended to their Medicaid programs. All of these states adopted Medicaid provider payment cuts for FY 2009. These changes preceded the

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[2] State fiscal years begin on July 1, with the following exceptions: New York on April 1, Texas on September 1, Alabama, Michigan and the District of Columbia on October 1.
[3] FY 2008 total Medicaid spending estimated based on federal spending of $201 billion and an average federal Medicaid matching rate (FMAP) of 57 percent. Federal Medicaid spending for federal fiscal year 2008 reported by Congressional Budget Office, Monthly Budget Review, November 2008.

dramatic drop in world-wide stock markets that began in October 2008, the worsening crises in the credit and housing markets, and the drop in employment and overall economic activity that translated directly to drops in state revenues. By October and November 2008 the effects of the economic downturn were seen in unanticipated declines in state revenues and growth in Medicaid enrollment and spending in almost all states. Suddenly, many states were forced to consider actions to slow overall state spending in light of an economic and revenue outlook that had become much more dismal than it had been in the spring of 2008 when state budgets were adopted for FY 2009.

It was in this context in November 2008 that leading Medicaid directors gathered to discuss the impact of the economic downturn on FY 2009 Medicaid enrollment and spending trends, the implications for Medicaid policies for the balance of the current fiscal year and the potential implications for FY 2010.

Methodology

This report is based on focused discussions with leading Medicaid directors in November 2008. Medicaid directors who serve on the Executive Committee of the National Association of State Medicaid Directors (NASMD) were invited by the Kaiser Commission on Medicaid and the Uninsured to participate in a special discussion on the impact of the current economic downturn on their state Medicaid program. Specifically, the discussion focused on the impacts of the economic downturn on Medicaid enrollment, spending and policy directions, including the impacts on proposed coverage expansions and health reforms. The discussion took place on the evening before the NASMD annual meeting in Washington, DC, and followed a structured agenda to be sure each topic was addressed.

Participating in the roundtable discussion were Medicaid directors from the following eight states: Alabama, California, Michigan, Nevada, Oklahoma, Vermont, Pennsylvania and Vermont. Also participating were the Executive Director of NASMD and the director of the New Jersey Department of Human Services. Members of the NASMD Executive Committee unable to participate in person included Medicaid directors from Connecticut, Minnesota, Tennessee and Washington; these Medicaid directors were contacted individually and their input is reflected in this report. Medicaid directors from all other states were contacted by email or interviewed by phone. Altogether, this report is based on input from all 50 states and the District of Columbia.

Key Findings

Although the impact varies, the economic downturn is affecting every state budget and Medicaid program, causing severe distress in some cases.

In state after state, Medicaid directors described a state budget situation in which state revenues were coming in below projections and below the levels on which states had premised their budgets for FY 2009. By December 2008, at total of 41 states and the District of Columbia reported they were facing mid-year budget gaps of $42 billion. More than one-third of these states faced a gap of five percent of more of their total general fund budget.[4] This gap combined with the $48 billion in shortfalls states had to address heading into FY 2009 resulted in FY 2009 shortfalls of $89 billion to date. The clear message from Medicaid directors in most states was that the economy has had a profound impact of state budgets in the early months of FY 2009 and that Medicaid will be expected to bear a share of the burden of addressing the overall state budget problem.

As in previous economic downturns, most states have implemented across the board spending restrictions such as hiring freezes or travel bans as a first step to address budget shortfalls. However, in most cases these restrictions do not come close to addressing serious budget gaps. Among the most dire state economic crises are those in California and Nevada. California is dealing with a budget gap of nearly $14 billion (or 13.6 percent of its total budget). A special session of the legislature in November called by the governor was unable to reach agreement on how to resolve the crisis. Nevada has seen state revenues plummet as a result of the economic impacts on gaming, housing and overall economic activity. Nevada has already gone through two rounds of budget cutting in FY 2009, including Medicaid payment and benefit cuts and is facing a third round of budget cuts to achieve a further ten percent reduction in current year spending. Other states including Pennsylvania and Michigan reported that revenues were short of expectations causing overall budget shortfalls.

No state reported that it was immune from the effects of the economic downturn, although a limited number of states indicated that the effects so far had not caused the state to consider actions to curtail spending in the current year Medicaid budget. For example, Oklahoma and Texas, both energy rich states reported that they were not facing overall or Medicaid state budget issues at this time. A few other states such as Indiana reported that revenues had dropped below original projections but they were not facing overall general fund budget shortfall, and budget authorization for Medicaid was expected to be adequate.

Four months into state FY 2009, Medicaid enrollment and spending trends are above the levels projected at the beginning of the state fiscal year.

The same forces that cause state revenues to slow also cause increases in Medicaid enrollment and spending. Across the states, Medicaid directors reported growth in the numbers of persons enrolling in Medicaid, and growth in Medicaid spending. Based on updated enrollment information provided by state Medicaid officials for this report, growth in enrollment was above the levels projected at the beginning of the fiscal year in over half of reporting states (30 states and the District of Columbia). In only one state (Rhode Island) was enrollment now projected to

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[4] Elizabeth McNichol and Iris J. Lav, *State Budget Troubles Worsen*, Center on Budget and Policy Priorities, December 23, 2008.

be below projections made at the beginning of the fiscal year, due to budget-driven policies already implemented to restrict eligibility and add cost sharing. In some states, current enrollment growth is substantially above levels assumed when the FY 2009 budget was prepared.

When the fiscal year began, Medicaid budgets were based on projected growth in the numbers of persons enrolled in Medicaid that averaged 3.6 percent across all states in FY 2009. It is now virtually certain that initial projections will prove to be low, in some cases by a substantial margin, with the largest growth often in states with the most significant budget shortfalls. For example:

- Arizona, is now expecting enrollment growth of nine to eleven percent over last six months of the fiscal year.
- In California, families and children on Medicaid are growing at an annual rate of six to seven percent, significantly above initial estimates.
- Florida is experiencing what was described as "the biggest increase in caseload in a decade," with enrollment expected to be perhaps 100,000 above initial projections.
- Kentucky Medicaid enrollment is growing by 3,000 per month, well above the 1,000 per month projected.
- Michigan expected FY 2009 growth of less than two percent, but now expects growth at least twice that amount.
- Nevada is also seeing double-digit rates of growth as unemployment is among the highest in the country.
- In Tennessee, enrollment is up about five percent, whereas the budget was based on growth of less than one percent.
- Utah is seeing a double-digit rate of enrollment growth, with a five percent growth already realized in the first four months of this fiscal year.

Enrollment growth is a primary determinant of Medicaid spending growth, but it is not the only factor. Among states with enrollment growth close to original projections, several indicated that spending was still coming in above expected levels. Alabama, for example, indicated that enrollment was nearly stable, as expected, but that spending was up due to increases in utilization as they moved to a medical home model of service delivery. Higher spending was evident for laboratory and X-ray services, and for mental health related prescription drugs. Similarly, Pennsylvania and Vermont reported that the enrollment trend was on target, but that Medicaid spending growth was contributing to the overall state budget shortfalls.

Most states are facing the prospect of program cutbacks or provider rate cuts during FY 2009.

Medicaid directors indicated that mid-year budget-driven Medicaid cutbacks were now a certainty in over half of states. States are required by law to balance their budgets annually.[5] Since Medicaid is such a large program within state budgets, it is difficult for a state to address a statewide budget shortfall without cutting Medicaid spending along with other programs.

Indeed, several states had already enacted and implemented FY 2009 Medicaid cuts, including California, Nevada, New York, Rhode Island and South Carolina. From the discussion with Medicaid directors, it was clear that many other states would soon also be forced to make mid-year cuts in Medicaid, due to the severity of the state fiscal situation. Several states were looking beyond provider rate cuts. One director indicated that due to budget constraints it would not be possible this year to implement some of the pay-for-performance incentives the legislature had adopted to improve quality of health care for Medicaid beneficiaries and improve value for taxpayers. Another discussed adopting a strategy of carving pharmacy benefits out of full-risk managed care plans in order to achieve savings from federal rebates, even though this strategy might be counter-productive to achieving the most effective care management over time. Other states were cutting back on some optional benefits such as personal attendant hours or vision benefits.

As an example of the seriousness of the problem and the difficulty in finding easy or even "reasonable" options, one state director indicated they were considering reducing eligibility levels for persons in long term care settings such as nursing homes. A few states with the most challenging fiscal circumstances anticipate that they will simply run out of cash to pay Medicaid providers during the fiscal year. Legislative action remains pending at this writing in California and Nevada on how to resolve the cash crisis.

In some states, decisions on the size and nature of cuts were awaiting legislative action, while in other states decisions were awaiting the outcome of regularly scheduled revenue and spending estimating conferences. In Michigan, for example, Governor Granholm announced in early November that an Executive Order to reduce spending in FY 2009 would be issued in December 2008, with the amount of mid-year reductions to be determined by the outcome of the December revenue estimates. The December Executive Order required statewide reductions of over $140 million in state general funds, to partially address a current year budget shortfall estimated to be $240 million.

Few easy options for Medicaid cost containment exist since states were so aggressive in controlling costs during the last economic downturn.

Directors indicated that they now faced particular difficulty identifying budget reduction strategies, since they had had to undertake major budget reductions only a few years ago during the last recession (and many of those reductions were not restored). Another director facing a large Medicaid budget shortfall indicated that he had created four categories of potential actions: First, additional utilization management, competitive purchasing for medical supplies and adjustments to pharmacy reimbursement; second, cutbacks in covered benefits, such as adult dental, vision and hearing services, while preserving the core Medicaid services; third, provider

[5] All states except Vermont have a constitutional or statutory requirement for a balanced budget. Vermont adheres to a balanced budget without the statutory requirement to do so.

payment cuts, starting with those less likely to affect access, such as inpatient and outpatient hospital and payment for certain services such as C-sections, and fourth, eligibility restrictions, including postponing scheduled eligibility expansions and instead making actual cuts in eligibility that would remove certain individuals from Medicaid coverage. The budget hole in his state is so large that even adopting every item in all four categories would yield insufficient savings to address the FY 2009 Medicaid budget shortfall.

One long-time director in another state indicated that: “For the first time ever, I don’t know what we will do. The situation is so dire, so out of control. All the logical options have been exhausted.” Even with the difficult budget situation, a few states reported a commitment among political leaders at the state level to minimize cuts to Medicaid that would affect beneficiaries, or to pursue health reform initiatives, even though the fiscal challenges are daunting.

States such as Michigan, Pennsylvania and Oklahoma indicated their leadership remained committed to health reform initiatives even though it was slow going and uphill to achieve. Sometimes this commitment was in the form of seeking a modest coverage expansion for children or sometimes a firm resolve not to cut Medicaid eligibility.

Looking ahead to next fiscal year, the outlook is that FY 2010 almost certainly will be a very difficult year, with the potential for widespread program cutbacks and provider rate cuts that will affect millions of Medicaid beneficiaries.

Medicaid directors see FY 2010 as worse than FY 2009. With 38 states already anticipating significant budget shortfalls next year, state budget officials have already signaled that program managers need to expect budgets for next year that reflect deeper cuts than those required for FY 2009. At the time of the discussion with Medicaid directors in November 2008, governors were already finalizing their FY 2010 budget proposals for presentation to legislatures in January.

In California, for example, the budget shortfall for FY 2010 is already expected to be $25 billion. Other states face FY 2010 deficits that may be less than the one in California, but which nevertheless will force states to make difficult decisions about their program. In Connecticut, for example, the state is facing a significant deficiency for FY 2010, of which $1 billion is attributed to Medicaid. Other states indicated they had already been asked, or expected to be asked to make cuts of ten percent or more.

In a handful of states, directors indicated that expected growth in Medicaid enrollment and spending will be accommodated within the state budget without the need for further budget cuts. However, for most states, the budget prospect for FY 2010 is not positive. Directors indicated they face very difficult choices that almost certainly will result in negative impacts on current beneficiaries and providers. And, with all the focus on program cuts, it will be almost impossible to proceed with decisions already made to pursue health reform or to expand coverage to address the uninsured.

Medicaid directors believe the highest priority for federal action should be a substantial temporary adjustment in the federal Medicaid matching rate (FMAP), along with reauthorization of SCHIP.

Among the Medicaid directors participating in the discussion, there was unanimous agreement that the most urgent present need was for Congressional action to provide an enhanced federal Medicaid matching rate for states for a limited period of time, such as two years. As one director said: "Without the stimulus package, including the FMAP increase, the rest doesn't matter."

These Medicaid directors see the current situation facing Medicaid as a fiscal emergency. Caseloads and expenditures are increasing just when state revenues are dropping. State finances are inherently tied to economic activity, making it nearly impossible for a state to finance a counter-cyclical program the size of Medicaid during an economic downturn. The only alternative for states is to scale back the program just at the time the need is greatest.

Of equal priority for Medicaid directors is the timely reauthorization of Medicaid's partner program, the State Children's Health Insurance Program (SCHIP). A year ago SCHIP was temporarily funded through March 2009. The temporary nature of last year's action created uncertainty that made policy making for SCHIP difficult. Because the program is set to expire, of necessity SCHIP reauthorization must be a priority for the new Congress and administration. States officials indicated that an adequately funded SCHIP program will greatly assist state health policy making.

Medicaid directors believe the second highest priority for federal action should be rescission of the federal regulations now subject to Congressional moratoria.

Medicaid directors continue to be concerned about what they have come to call the "Six Deadly Regulations." The Congress adopted moratoria on these regulations, but the moratoria extend only through April 2009. For most states, these regulations will have a significant fiscal impact as these regulations are expected to shift federal Medicaid costs to the states. For the same reasons that states describe urgency about the need for an economic stimulus package and a temporary enhanced FMAP, state officials indicate urgency that these regulations be rescinded.

Despite fiscal challenges, Medicaid directors anticipate a positive relationship with the federal government under the new administration.

Medicaid directors hope that the new administration will work in partnership with states to address problems and pursue Medicaid and health reform initiatives. Previous surveys of Medicaid directors have documented the states' frustration with federal initiatives (regulations and audits) perceived to shift Medicaid costs previously borne by the federal government to the states and an arduous process for federal approval of state initiatives and policy proposals. Medicaid directors acknowledged that new administration will face difficult challenges and efforts to improve program integrity will continue to be important. They also expect that the new administration might set new priorities in terms of coverage, access and program management.

Conclusion

Only four months into state fiscal year 2009, a group of leading state Medicaid directors gathered to discuss a dramatically changed economic environment and its impact on Medicaid in their state. The situation they and their Medicaid director colleagues across the U.S. described in November and December 2008 was quite a contrast to the one they reported only a few months earlier when they were surveyed at the beginning of the state fiscal year. Now, state officials in almost all states were focused on how to deal with significant budget shortfalls for FY 2009 and beyond. Medicaid officials expressed concern that they had exhausted available avenues to slow program expenditures only a few years ago in the most recent recession, leaving few reasonable options to use in this economic downturn. State Medicaid officials thought that federal fiscal relief in the form of an enhanced match rate, the reauthorization of SCHIP and a rescission of federal Medicaid regulations currently under moratoria are urgent federal actions that could help bolster Medicaid financing and help avoid the most severe program cutbacks during a time when more individuals will be seeking coverage. Longer term, Medicaid directors were optimistic about an improved partnership to administer Medicaid with a new Congress and Administration.

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