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Medicaid and State Budgets: An October 2001 Update

State Medicaid programs serve as an important safety net for Americans by providing health and long-term care coverage. Reduced state revenues are placing severe strains on many state budgets and could limit Medicaid at a time when additional coverage and spending is most needed. After strong economic growth during the mid- to late-1990's that allowed states to build up significant general fund balances, states began at the end of 2000 to see their tax collections fall and their spending exceed expectations. As a result, many states had to dip deeply into their year-end balances to cope with budget pressures. According to the National Association of State Budget Officers, by August 2001, more than half the states were either in recession or near recession. A review of state spending projections, prior to September 11, revealed relatively low growth projections for overall state budgets (2.4%) but substantially higher projections for Medicaid (8.9%), leaving limited room for growth in other state programs and putting renewed fiscal pressure on Medicaid.*

Since the terrorist attacks of September 11, 2001, the rate at which states' fiscal conditions are deteriorating has accelerated, and many states have either made budget cuts or announced plans to do so. In many cases, states are looking to cut Medicaid as part of their efforts to address budget shortfalls. State spending for Medicaid represents a large share, on average 15%, of state general fund budgets and at least 20 states began FY 2002 anticipating Medicaid budget shortfalls. Several Governors are now calling for special legislative sessions to address budget shortfalls, often citing precipitous declines in revenues since the September 11, 2001 attacks as a reason for the problem.

Last spring, the Kaiser Commission on Medicaid and the Uninsured sponsored a survey of state officials to assess the state budget situation and the implications for Medicaid. This information is presented in the report, *Medicaid Budgets Under Stress: Survey Findings for State Fiscal Years 2000, 2001, and 2002,* and is based on interviews with Medicaid officials in all 50 States during the months of May and June 2001. As the report was finalized in October 2001, it became clear that the State budget and Medicaid budget situations had changed in significant ways in many States. To reflect the most current information, follow-up interviews were conducted by Health Management Associates for the Commission in 20 States in October 2001.

The follow-up interviews focused on four specific questions:

1. How would you describe the current budget situation in your State? How has it changed in the past month or two? How have revenues / revenue projections changed?

*National Association of State Budget Officers, "Fiscal Update: State Budgets Post-Attack," September 25, 2001, citing Mark Zandi of Economy.com. See www.nasbo.orgs.

1450 G Street NW, Suite 250, Washington, DC 20005
Phone: 202-347-5270, *Fax:* 202-347-5274, Publications: 1-800-665-4533
Web Site: www.kff.org

2. Are there any specific actions being taken to contain or reduce expenditures across all State agencies because of the State FY2002 budget situation?

3. Have you been asked to reduce Medicaid spending in FY2002? What specific actions are you doing or considering?

4. What is the outlook for the 2003 budget?

These interviews confirmed that in most States, but not all, the budget situation had deteriorated over the summer of 2001. In several cases, a marked deterioration had occurred in State revenues and revenue forecasts since the events of September 11, 2001. That deterioration was just becoming known as these follow-up interviews were conducted. Reflecting new evidence of an economic downturn, State forecasts of revenues from sales and income tax sources are being lowered, forcing States to make mid-year adjustments in their budgets. All State services are affected, but Medicaid is such a large portion of State expenditures that the impact on Medicaid is substantial.

Interviews were conducted with Medicaid officials in mid-October in the following States: AR, CA. DE, FL, GA, IL, IN, IA, KS, MI, NC, ND, OR, SD, TX, UT, WA, WI and WV. In addition, interviews were conducted with State budget officials in five states: IL, IN, MI, OH and NC. The following summarizes the results of the follow-up interviews:

1. The budget situation in many States worsened significantly in September and October, 2001

In about two-thirds of the 20 States interviewed, the budget situation was described as having taken a noticeable turn for the worse in September and October 2001. Representative comments from State officials illustrate the economic significance of the changes:

> "The September 11 attacks appear to have sent an already weak economy into a tailspin." [MI]
>
> As of last week collections took a big drop. The papers are saying we will have to cut the State budget by up to $130 million. [AR]
>
> All the most recent revenue numbers show drastic drops. The corporate income tax is down; the sales tax is down. [CA]
>
> Definitely things went south in Florida. [FL]
>
> Revenue for the month of September 2001 was $74 million less than September 2000. That has been the trend for several months. [GA]

> The revenue collection estimates for the first quarter of '02 are already $140 million behind the April estimate. [IN]
>
> We are being battered by the economy. [IL]
>
> Actual revenue collections were 3% below the prior year or 5% below the estimate for the first quarter (of FY2002). [NC]
>
> On September 19 Boeing announced 20,000 to 30,000 layoffs in the commercial aircraft division…The latest estimates are budget cuts necessary in the range of $200 million to $1 billion. Most folks are focusing more on the high end of that estimate." [WA]

On the other hand, in about one of three States interviewed, officials indicated that the most recent information available to them was that their budget situation was close to what was anticipated when the State budget was adopted. Several of these officials were careful to indicate that their information was based on published revenue and expenditure reports that did not reflect events in September, and new reports for the first quarter of the State fiscal year might show different results. In some States formal revenue and expenditure estimating committees were scheduled within a few days. No State expected that any new information would be more favorable.

2. A number of States are instituting mid-year reductions in FY 2002 spending.

In over half of the interviewed States, the Governor had recently initiated actions to constrain FY2002 State expenditures across all State programs and agencies. In some cases state agencies had just begun developing proposals for budget and program cuts. This process might take weeks or months before decisions are made. Actions already undertaken ranged from administrative controls such as freezes on hiring and restrictions on travel to reductions in Medicaid and other programs. In many States a budget reduction process initiated by the Governor requires action by the Legislature before it is implemented.

Examples of statewide budget reduction actions are described below in the words of State officials:

> The department took a 3.4% cut on the staff budget. There are no cuts in the program now, but we are looking at options. [CA]
>
> We have been asked to reduce expenditures this year by 5%. [DE]
>
> We got a directive last week to cut 2½% this year and 5% next year."
> The Governor has said he does not intend to reduce the workforce, except through attrition. We are already under a restrictive hiring process, where we have to go to the Governor's office to get approval for any hiring. [GA]

Three weeks ago the Governor announced a hiring freeze and other administrative restrictions to save $50 million. [IL]

In the summer all agencies were cut 7%. The State has a hold on all hiring and travel and a moratorium on capital spending. Medicaid did not share equally in the first round of cuts. [IN]

The Governor yesterday ordered across the board cuts of 4.3% without any exceptions. Nothing is exempt. [IA]

Last week the State budget director asked all state agencies to develop contingency plans to cut their general fund budgets by 10%. [MI]

All agencies were asked to take 4% out of their budgets. So far Medicaid is carved out of this requirement, because Medicaid is already forecast to be $60 million GF over budget. [NC]

The Governor asked every State agency to come up with proposals that reduce spending by 10% in this biennium, in two- percent increments. That is 10% from the legislatively approved budget. At this point he is anticipating only the equivalent of across the board 2% reductions. He is not going to make across the board changes in programs. That is why he has asked everybody for 10% plans. We are putting these proposals together now. [OR]

We have been directed to begin development of a number of proposed cuts in our programs. [WA]

3. In most States, Medicaid has been directed to develop proposals for reducing the Medicaid expenditures, or to implement them.

In over half the States Medicaid officials have been directed by the Governor to prepare proposals to reduce current year spending below the level authorized by the legislature. Reflecting the urgency of the budget problem, States are considering every possible action that might reduce expenditures. Referring to a proposal for a small policy change, one Medicaid official said: “It doesn’t save much, but every penny is beginning to count.”

Medicaid and budget officials described the specific actions they had been directed to undertake to reduce Medicaid spending for FY 2002:

> We are putting together a contingency list. Nothing specific, just anticipating. There is such a lead time needed for Medicaid you’ve got to think ahead. It takes at least six months to see any impact. [AR]
>
> We need to come up with proposals for $20 million in general revenues. We are trying not to cut services, but we will need to look at some. [DE]

We are costing out several options. At this point we do not know which ones will be accepted. [FL]

We need to cut $88 million ($33 million general funds) out of Medicaid this year, and $64 million ($66 million GF) next year. We need to submit proposals by the end of October and be able to implement them in November or December. [GA]

The Indiana Medicaid program has a $150 million shortfall. The $150 million shortfall is after we had $110 million in budget reductions. We are not hitting all those targets, and every delay is adding to the amount we have to save. [IN]

The proposed cut is more than $18 million general fund for Medicaid. We will have a proposal for the Governor next week. [IA]

We are looking at several options (for cuts.) We are also looking at some new ways to manage pharmacy that will help in 2003. Even with these actions we will still be about $100 million (total funds) over budget. [KS]

Proposals are under development for options to cut 10%. [MI]

Medicaid has lots of cuts to make. Total reduction of $44.4 million GF, including $21 million in Rx. There are some expansions for dental services and breast and cervical cancer coverage, so the net reduction is $27.5 million. [NC]

Our [Medicaid] caseload is up 4 to 5 percent from where we were at the end of the legislative session. We are trying to figure out how we deal with that in addition to the proposals to reduce funding [10%] below legislatively approved levels. [OR]

Actions are those included in the budget adopted by the legislature earlier this year. They include cost reducing actions totaling $205 million general funds. The actions are in pharmacy, hospitals, managed care, copays and competitively bidding certain services. [TX]

We reduced the rate increases to hospitals, HMOs, nursing homes and physicians. We also instituted a $2 copay on physician and outpatient hospital services that will be effective November 1, and on the eligibility side there was a reduction in the retroactive period to 90 days instead of to the 1st of the month. [UT]

We do our first quarterly review next week. The actions being taken now by Medicaid are those directed in the 2002 budget. These are primarily in the pharmacy area. We are also seeing enrollment pressure. Current enrollment is 9,000 over the average for the year in the budget. The

> increase is almost entirely in family Medicaid, who are lower cost recipients, so we may be okay in the budget. [WI]

4. The outlook for 2003 is for continued budget pressure on Medicaid.

In the fall of the year State officials are preparing their budget requests for the next fiscal year. These budget proposals are being developed now in a climate of extreme fiscal restraint. The prevalent expectation is that difficult economic times will continue well into the next fiscal year. Comments from Medicaid and budget officials include these:

> We are now proposing the 2003 budget. We were asked to look at 3%, 5% and 10% cut proposal options. We of course don't know what will be proposed. [CA]
>
> No expansions. We can't even use the word expansion.
>
> 2003 will be worse than 2002. We are anticipating further slides in state revenues. [DE]
>
> We are still getting a feel for life after September 11. The economy is the key. We look at the budget being flat in '03 compared to '02. [IL]
>
> For Medicaid, we are projecting a shortfall of about $60 to $70 million in general funds for '03. The Governor has asked the legislature to participate in a "Medicaid Summit" for the purpose of considering how Medicaid costs can be controlled. [IA]
>
> The Governor has requested agencies to do 2% and 4% cuts for their budget submissions for 2003. [KS]
>
> These reductions [in 01-03] will be part of the budget process for 03-05. [OR]
>
> We are now doing the '03 budget, with the base reduced by the amount of savings [from '02 budget reductions.] The next revenue projection is in November. The expectation is few program expansions for the next several years, unless you can take it out of your base, and it is questionable that we can maintain the base. [UT]
>
> There is a cloud over 2003. [WI]
>
> We will struggle with how to expand the program when revenues are not expanding. [WV]

Conclusion

The fiscal condition of States has worsened substantially over the past few months. A slower economy is now reflected in revenue growth below the level on which State budgets were based when they were adopted by legislatures only months ago. As a result, States are initiating cost reduction measures to keep expenditures within available revenues.

During economic downturns, Medicaid programs get caught in the crossfire between the need for increased coverage and spending and the erosion of state revenues and constraints on state budgets. Medicaid is designed to be counter-cyclical: as unemployment rises and incomes drop, more people become eligible for Medicaid. If the program operates as intended, states and the federal government spend more on Medicaid as a result, easing the negative effects of the economic downturn. On average, the federal government pays 57% of Medicaid spending, ranging from 50 percent in 11 states to over 70% in the ten poorest states and DC, and contributes to spending for all people who are eligible. Open-ended federal matching funds through Medicaid allow spending to increase automatically in response to higher enrollment levels, but states must provide matching funds to avail themselves of the federal assistance.

The current State budget situation serves to highlight a key feature of Medicaid, one that is simultaneously one of its great strengths and an Achilles heel. That feature is that Medicaid is fundamentally a State program, in that the policymaking responsibility lies with the States, within some federal guidelines. As a State program, Medicaid is able to reflect the values, culture and priorities of each State. States are able to develop their own unique Medicaid program, and do so with the support of Federal funds. That is a strength. However, in times of economic distress the funding of Medicaid is something of an Achilles heel. Even though a majority of Medicaid's funding comes from Federal grants, the availability of Federal funds is meaningless when the State cannot afford its share. If State funds are not available a State may be forced by economic circumstances to cut the program at a time when the need for it may be greatest.

The extent of the current budget shortfalls may require difficult policy decisions. However, if states respond to their difficult fiscal situations by cutting Medicaid in the months ahead, it not only will make it more difficult for newly unemployed workers to secure coverage, but it also could deepen the negative effects of the economic downturn. On average for each $1 that states cut from their Medicaid general fund budgets, the total amount of spending on the program drops by $2.33 because of the even greater loss of federal Medicaid matching funds. In states with higher than average federal matching rates, however, the economic consequences of cutting Medicaid can be even more severe since each $1 cut in state funds causes a total of more than $3 to $4 to be withdrawn from the state's economy.

Budget cuts are never easy, but they are especially difficult when they affect the ability of a State to provide health care to low-income uninsured families and children, the elderly and persons with disabilities and chronic medical conditions. Recognizing the importance of health care coverage, over the last several years states have taken advantage of opportunities to expand eligibility and enrollment of their low-income populations. The responses from state officials suggest that we may be entering a time of serious fiscal distress that will affect all State programs, and that Medicaid and the health coverage it finances may be at particular risk.

During this period of fiscal stress State and Federal policy-makers can be expected to consider a number of strategies to mitigate the negative consequences of budget-driven program cuts and to preserve the investments that have been made through the Medicaid program. Specific strategies likely to be considered as states move closer to FY 2003 include: drawing on any available reserve funds that states built up during the strong economic period of the 1990s; using tobacco settlement funds to shore up state spending on Medicaid; working with the federal government to increase its investment in Medicaid; taking steps to strengthen the state's revenue stream; and implementing a variety of strategies to contain costs. Most likely, given the scope of the currently anticipated fiscal situation a combination of these strategies will be necessary.

Vern Smith, Ph.D. and Mary Lanoye of Health Management Associates prepared this survey update for the Kaiser Commission on Medicaid and the Uninsured.

1450 G Street NW, Suite 250, Washington, DC 20005
Phone: 202-347-5270, *Fax:* 202-347-5274,
Web Site: www.kff.org

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