



An Increase in the Medicaid FMAP: A Proposal to Both Stimulate the Economy and Provide Health Care for Low-Income Individuals

Nearly all states are required to balance their budgets under state laws or constitutions, even during recessions. Yet because of the economic downturn, state revenues are declining significantly and demand for state social services is rising as people lose their jobs. As a result, states will have no choice but to cut spending or raise taxes when such actions would further dampen economic activity and undercut efforts to stimulate the economy.

An increase in the federal medical assistance percentage (FMAP) for states would address this problem. It would provide immediate fiscal relief to states, lessening the scope and depth of such budget cuts and tax increases and minimizing the negative impact on the economy. State fiscal relief is one of the best ways to stimulate the economy because federal dollars used for this purpose avert state budget cuts and tax increases that would be injurious to the economy. It also would ensure that states receive funds to help compensate for the more than 4 million increase in the Medicaid rolls as unemployment continues to increase.

Current Fiscal Condition of States

Prior to the September 11 attacks, state revenues were already declining due to the slowdown of the economy. During the summer, a number of states had already cut budgets by 2-3 percent in order to maintain their balanced budgets. After September 11, state revenues declined sharply. Most states will witness no positive revenue growth and many are witnessing actual month-to-month declines relative to last year. Since most states had assumed a 5 percent to 6 percent revenue growth when their budgets were enacted, many are facing second—even third—rounds of cuts. Conditions in the U.S. Territories are even worse as their economies are heavily dependent on tourism. Not only have revenues declined, but Medicaid growth, which represents 20 percent of state budgets, is approaching 12 percent per year. The decline in revenues, coupled with the explosion in Medicaid, is forcing drastic cuts in state budgets.

- Forty-four states have reported revenues below forecasts for the first several months of their 2002 fiscal years.
- Seven states will convene or have convened special sessions to address budget problems.

The current shortfall that states are facing is currently estimated to be \$15 billion, but as unemployment increases to 6.0 percent to 6.5 percent, it will grow to \$20 billion to 30 billion. Because state tax laws are based in part on federal tax policies, the accelerated depreciation provisions in the House stimulus bill will reduce state revenues by another \$5 billion, thus requiring further cuts.

Given that states are unable to deficit-finance, they have no option but to cut spending or increase taxes. Either option is pro-cyclical, meaning that it will make the recession worse and in fact offset some of the benefits of the federal stimulus.

Increasing Needs

Not only are revenues declining but states are facing increased costs for social programs such as Medicaid and welfare because of greater need during the economic downturn, as well as increased costs for homeland security.

Medicaid -- The National Governors Association (NGA) recently contracted with Economy.com to run a number of economic scenarios to gauge the September 11 impact on state revenues. If the economy rebounds relatively quickly, unemployment will still likely increase to 6.0 percent to 6.5 percent during the next year. If the economy does not turn around quickly, it is possible that the unemployment rate will move up to 7.0 percent or even 8.0 percent. Under all three scenarios, state budgets will be further stretched as these previously employed individuals come back on the Medicaid and welfare rolls and require additional job training. In their current financial situation, states will not be able to provide services for these populations.

States are already experiencing an expansion of the Medicaid rolls. A recent Urban Institute study estimated that an increase in unemployment from 4.5 percent to 6.5 percent would increase Medicaid rolls by 800,000 adults, 2,090,000 children, and 260,000 disabled. This is consistent with the best estimates of unemployment as provided by Economy.com. In this scenario, states will not have revenue to support their share of these costs and are certain to reduce their programs by cutting optional benefits or eligibility.

If unemployment were to increase to 7.0 percent, a slightly more pessimistic scenario, the Medicaid rolls would increase by 1,000,000 adults (10.3 percent increase), 2,610,000 children (11.3 percent increase), and 330,000 disabled (4.3 percent increase). This would mean an additional \$3 billion in federal spending and \$2.3 billion in state spending as unemployment grows from 4.5 percent to 5.5 percent and another \$4.5 billion for federal and \$3.5 billion for states if unemployment grows to 7.0 percent. For states, this would mean an additional \$6 billion in Medicaid expenses as unemployment grows from 4.5 percent to 7.0 percent. Under a more pessimistic scenario, i.e., 8 percent unemployment, total state spending could increase by another \$2.3 billion for a total of \$8 billion. Also, federal Medicaid expenditures for the territories are capped, and therefore, the unique needs of the U.S. Territories should be taken into consideration in any discussion of an economic stimulus package.

Welfare -- Temporary Assistance for Needy Families (TANF) caseloads also are likely to rise during the downturn. Both historical trends and current experience strongly suggest that caseloads are likely to rise significantly as unemployment grows. Welfare caseloads rose in previous recessions, and there is early evidence that caseloads are starting to rise around the country. In West Virginia, TANF caseloads have increased by 18.9 percent over the last year; Tennessee and Michigan have witnessed more than 7 percent increases during the last year. More current national data are available on food stamp caseloads than on TANF caseloads. These data show significant food stamp caseload increases, which suggest states can expect sizable increases in TANF caseloads as well.

Homeland Security -- Since the attacks of September 11, some 5,000 members of the National Guard have been called into state service to provide security around nuclear power plants and additional airport security. (This is above the more than 6,000 National Guard on duty at the 425 airports in the nation.) Governors are providing additional security above that requested by the President at many of the nation's airports, which, in turn, becomes a cost to the states. These security measures include guarding the perimeters of airports and guarding passenger aircraft (usually overnight) that cannot be placed in secure hangars. In addition, Governors were recently requested by the Director of Homeland Security to provide security for the nuclear power plants in their states, which many Governors were already doing prior to the Director's request. No funding was provided with this request. States with major ports or border states (especially the Canadian border, where for example the port of Detroit is critical to auto manufacturing and other trade) are providing inspectors for materials crossing the borders or entering the ports. For example, Maine's ports have been getting extra traffic due to the temporary closing of ports in

New York City. Other security missions or assignments for the National Guard and other security personnel have included water treatment plants; national parks, such as the Hoover Dam in Nevada; and various infrastructures, such as the chemical industry in West Virginia. In addition, there are costs associated with bioterrorism and the anthrax attacks. State police must investigate and state labs must process every case reported.

The Policy Response: Increase the FMAP

The Medicaid Program -- Medicaid is the health care safety net for low-income children, families, the elderly, and the disabled. Medicaid is administered by the states and jointly financed by the states and the federal government. The federal share of the Medicaid program, or the federal medical assistance percentage (FMAP), is based on the relationship between each state's per capita personal income and the national average per capita personal income over three calendar years. The FMAP is recalculated each year and varies from state to state, averaging about 57 percent federal and 43 percent state. Higher-income states have a 50-50 share of Medicaid financing, while states with relatively low per capita incomes may have federal shares as high as 83 percent.

Medicaid financing is designed to respond to changes in state well-being; any given year's FMAP is based on prior-year state per capita income data. This means that in this year's fiscal 2002 recession, the federal share of the program is based on state income in the 1997-1999 boom period. Thus, at a time when many states need the most federal assistance, their federal matching rates may actually decrease. In fiscal 2002, the federal Medicaid matching rate decreased in 29 states.

The Policy -- A temporary increase in the federal share of the Medicaid program will help compensate states for these projected losses in tax revenue. In addition, immediate financial assistance will alleviate the pressures that are growing in many states to make drastic cuts to benefits and eligibility in the program. Finally, an increase in the federal share will help states absorb the enormous burden that the recession will place on the Medicaid program.

- **Temporary FMAP Increase.** A temporary increase in the FMAP of just a few percentage points would benefit all states. This benefit—which could cost as little as \$2.5 billion per percentage point increase in fiscal 2002—will decrease pressure on states to cut spending and raise taxes. It would have the additional benefit of reducing the need to cut Medicaid eligibility and benefits at a time of greater need. Any increase should provide enough fiscal relief to states to hold them harmless from the effects of both declining Medicaid matching rates and revenue losses. Relief also should provide sufficient additional assistance to states to reduce the magnitude of state budget cuts and tax increases and thereby stimulate the economy.

- **Immediate Benefits of FMAP Increase**

- Would not require any new state spending, which is simply not available in most states.
- Would allow states that are able to spend more money to leverage greater amounts of total dollars.
- Would result in an immediate influx of cash into states reeling from recession-driven budget crises.
- Would help states meet their current commitments to the Medicaid program and also be able to withstand future enrollment increases that will occur with the recession.

- Would provide immediate benefits to states and individuals. Proposals that would create new programs or new mechanisms for distributing benefits would take time to create, involving state legislatures that may have gone home or the promulgation of federal regulations with the ensuing lengthy comment periods.

In summary, an increase in the Medicaid FMAP would be a very effective policy to stimulate the economy since all of the funds would be immediately spent. More importantly, an increase will provide health care for the approximately 4 million low-income individuals—including 2 million children and more than 300,000 disabled people—who are expected to become eligible because of the economic downturn.

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