

medicaid
and the uninsured

**Medicaid, SCHIP and Economic Downturn:
Policy Challenges and Policy Responses**
Executive Summary

Prepared by
Stan Dorn, Bowen Garrett, John Holahan, and Aimee Williams
The Urban Institute

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kaiser commission medicaid and the uninsured

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Executive Summary

As the country heads into economic downturn, 28 states (including the District of Columbia) are forecasting budget deficits for the coming fiscal year, which collectively exceed \$39 billion. Because the current downturn is following unusually quickly on the heels of the last economic slowdown, states are less well-positioned than they were in the past to withstand the adverse effects of lost revenue and increased costs. Without federal help, many states may be required to increase taxes or cut spending for Medicaid and other services to meet balanced budget requirements. Already, Medicaid and SCHIP cuts are proposed in 13 states; K-12 education is targeted in 9 states; higher education funding is proposed for reductions in 12 states; and 7 states have either increased taxes or are considering such increases. In light of these economic conditions, this paper examines:

- The effect of an economic downturn on Medicaid and SCHIP enrollment and spending as well as the number of uninsured;
- Whether past federal fiscal relief was effective in preventing Medicaid cuts and providing economic stimulus, and
- Options for structuring federal fiscal relief in the future.

The key findings of the paper are:

Economic Downturns Increase Medicaid Enrollment and Spending - This analysis shows that a 1 percentage point rise in the national unemployment rate would increase Medicaid and SCHIP enrollment by 1 million (600,000 children and 400,000 non-elderly adults) and cause the number of uninsured to grow by 1.1 million. That would increase Medicaid and SCHIP costs by \$3.4 billion, including \$1.4 billion in state spending. This represents a 1 percent increase in total Medicaid and SCHIP expenditures.

Economic Downturns Reduce State Revenues - Medicaid and SCHIP are also affected by state revenue declines. Recent Urban Institute research shows that a 1 percentage point increase in the unemployment rate causes state General Fund revenue to drop by 3 to 4 percent below expected levels. If states must balance their budgets and all state spending is reduced proportionately, a 1 percentage point increase in unemployment would therefore entail a 3 to 4 percent reduction in Medicaid and SCHIP spending. Even if these health programs absorb somewhat less than their proportionate share of state revenue losses, revenue effects clearly exceed enrollment increases as a fiscal problem for Medicaid and SCHIP.

State Policy Responses Can Worsen Cyclical Downturns - Unlike the federal government, almost all states are legally required to balance their budgets. To meet this requirement in times of economic stress, states may take such steps as tapping reserves, borrowing from trust funds, securitizing future revenue streams, delaying spending from one fiscal year to the next, etc. Even after such efforts, states frequently need to increase taxes or cut spending on Medicaid, post-secondary education, aid to localities, or other priorities. All of the latter actions tend to worsen the economic downturn.

Moreover, the need to cut Medicaid during economic decline limits the program's ability to function as an automatic fiscal stabilizer. Such stabilizers are some of the country's most effective buffers that alleviate the harmful effects of the business cycle. They automatically stimulate the economy when it weakens and retract stimulus when it improves. This feature of unemployment insurance, an automatic fiscal stabilizer with many fewer dollars than the portion of Medicaid that responds to economic changes, saves more than 130,000 jobs in the average recession's peak year. Restructuring Medicaid to achieve similar results could improve economic security while preventing cutbacks in health coverage during economic decline.

Federal Fiscal Relief in 2003-2004 Had Positive Effects - In response to the last economic downturn, which took place earlier this decade, the federal government passed the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA), which provided \$20 billion in fiscal relief to states: \$10 billion in the form of block grants and the other \$10 billion in a 2.95 percentage point increase to each state's federal medical assistance percentage, or FMAP (the percentage of Medicaid spending paid by the federal government). As a condition of receiving this enhanced FMAP, states had to agree not to reduce Medicaid eligibility standards below prior levels. The FMAP increase prevented formal Medicaid eligibility cuts and allowed restoration of some previous cutbacks. In addition, reductions of other kinds were limited in scope (though not entirely eliminated), thanks to additional federal resources.

However, delays in reaching federal agreement meant that many states made large reductions before fiscal relief was available. Because states varied in the length and depth as well as the beginning and end points of their economic downturns, a uniform FMAP increase meant that some states got assistance at the wrong time and some obtained less help than they required.

Congress May Consider Options to Better Target Federal Relief - As states enter a new economic downturn, policymakers could consider three basic options for fiscal relief. One approach would, like JGTRRA, provide a uniform increase in Medicaid matching rates to all states, for a specified time.

A second option would be partially targeted. For a Congressionally defined period, states that meet certain criteria would receive a uniform increase in their Medicaid matching rates. Such an approach is proposed in the Economic Recovery in Health Care Act of 2008.

Third, policymakers could consider fully targeted assistance that would use economic conditions to determine whether a state receives help, the amount the state obtains, and the time period when assistance is furnished. Congress could provide fully targeted assistance through a temporary measure that would appropriate a specific amount of money, available for expenditure over multiple years, but only to states that meet specified criteria showing economic distress. Alternatively, policymakers could make an ongoing change to the Medicaid and SCHIP statutes that would provide automatic, countercyclical adjustments to states that experience serious economic downturns (for both the present slowdown and in the future).

For any of these three options, Medicaid federal fiscal relief could be coupled with a broader state fiscal relief package focused on more general budget problems facing the states.

Each approach for Medicaid/SCHIP fiscal relief has its advantages. The uniform approach has been tested and was generally effective, is simple, and all states would gain. A partially targeted approach would focus assistance on states with the greatest need. A fully targeted approach would provide the most money to the states in greatest difficulty, so a given amount of federal funds would go farther to preserve health coverage and provide stimulus in the states that are experiencing the deepest economic decline. It would also prevent federal funds from being spent on states that experience economic recovery.

Fully targeted policies have been proposed by General Accountability Office (GAO) and legislation reauthorizing SCHIP that the Senate passed during the summer of 2007. There are many ways to structure such a policy option, but the key principles to consider include the following:

1. Assistance would vary with the depth and length of each state's economic distress;
2. Assistance would begin and end based on changes to state economic indicators; and
3. Funds would be sufficient to offset state costs associated with increased enrollment and the Medicaid/SCHIP share of projected state revenue losses.

Federal Fiscal Relief Can Prevent Medicaid Cuts During Economic Downturns - As a new economic downturn unfolds, many states appear headed for serious budget shortfalls. Economic hard times reduce state revenues and increase the number of people who qualify for need-based benefit programs. Because of state balanced budget requirements, these trends eventually cause many states to increase taxes and fees or cut Medicaid, SCHIP, and other services precisely when such services and the resulting economic stimulus are most needed. The federal government does not have balanced budget requirements, so it has the flexibility to target supplemental funds to states during an economic downturn, preventing harmful and ill-timed cuts in health coverage. Regardless of how federal policymakers structure assistance, state fiscal problems are emerging that warrant serious consideration as part of an ongoing national strategy to minimize the duration, severity, and consequences of economic downturn.

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