

## The Rich Get Richer: The Senate's Medicaid Proposal Gives a Bigger Bailout to Wealthier States

By John R. Graham

### Key Points

- The biggest problem with the Medicaid expansion in the Senate health bill is not the “Cornhusker Kickback,” but that it leverages an already flawed formula to determine federal payments to state Medicaid programs.
- The Senate bill would motivate states to invest more resources in recruiting higher-income residents into Medicaid, rather than traditionally eligible beneficiaries, including the blind and disabled; and increase the risk of fraud, waste, and corruption.
- The Senate bill also gives richer states a bigger Medicaid bailout than lower income ones. New Hampshire, Maryland, and Connecticut get the biggest handouts, while Mississippi, West Virginia, and Arkansas are short-changed.
- The federal government should eliminate entirely the current funding formula in favor of block grants to states.

Imagine that you were inspecting a swimming pool that was cracked and leaking water, such that anyone who dove into it would be at risk of cracking his head on the bottom. You would likely make it a priority to fix the pool. However, if the pool were on a cruise ship, which had a cracked hull and was taking on water, such a priority would obviously be misplaced. Ignoring the ship's hull in favor of the pool would be utterly irresponsible. Nevertheless, this is what the U.S. Senate has proposed in its federalization of Medicaid, the joint federal-state program for low-income Americans.

National Medicaid spending, *per capita*, has increased one-third faster than private medical spending between 1970 and 2008.<sup>1</sup> The current financing mechanism is already burdened with a number of bad incentives such as the Federal Medical Assistance Percentage (FMAP), the federal formula that encourages each state to spend its own taxpayers' money irresponsibly in order to maximize its take from other states. For example, California's FMAP was traditionally the 50 percent minimum: For every dollar California spent, the U.S. Treasury would kick in one dollar. However, the FMAP is supposed to give more federal dollars to states with more poor people. So, Mississippi has had the highest FMAP, 75.67 percent: For every dollar Mississippi spent on Medicare, the U.S. Treasury would kick in \$3.11.<sup>2</sup>

While FMAP is *supposed* to give more dollars to states with a greater proportion of poor people, this has not been the outcome. Instead, states which have the ability to squeeze more tax revenue from their own higher-earning residents have been better able to increase Medicaid dependency. The *U.S. Index of Health Ownership* names this the “Medicaid freeloader” effect and shows that Vermont is the worst offender.<sup>3</sup>

The Senate bill would permanently increase the number of people dependent on Medicaid. The Congressional Budget Office (CBO) reckons that it would draw 15 million more people into the program – just a whisker less than half the 31 million people who would be newly insured by 2019 as a result of the “reform.” That is kind of like the government stating that

it will reduce the number of jobless by putting millions more on welfare and classifying them as “employed.” The number of Medicaid dependents would increase by more than 40 percent versus the number projected under current law: 50 million versus 35 million.<sup>4</sup>

The bill forces states to make almost everyone with an annual income under 133 percent of the Federal Poverty Line (FPL) eligible for Medicaid. Currently, the federal

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mandate only covers pregnant women and small children under this income level, and some other groups, such as the blind and disabled. Higher income and able-bodied people, however, are also enrolled in

Medicaid, because current law also allows states to enroll optionally eligible people. Indeed, Medicaid now covers more optional beneficiaries, and optional services, than mandatory ones.<sup>5</sup>

According to the Senate bill, the federal government would cover the *entire* cost of roping these new people into Medicaid from 2014 to 2016. By 2019, however, the federal government would pay only about 90 percent of the costs of Medicaid expansion, leaving the states to pick up 10 percent, on average. That’s how it was supposed to work, until we learned about elements in the bill such as the “Cornhusker Kickback.”

Senate Majority Leader Harry Reid bought Senator Ben Nelson’s vote in favor of the bill by promising that Nelson’s state of Nebraska would never have to pay for *any* of the Medicaid expansion. The federal government or, more properly, the taxpayers of the 49 other states, would pay for Medicaid expansion in Nebraska. In his State of the State speech earlier this month, California Governor Schwarzenegger angrily declared that Nebraska had got the corn, but California the husk!<sup>6</sup> The governor has also charged that the federal plan levies an unfunded mandate on California that would cost the state \$4 billion to \$5 billion, and begged for a perpetual federal Medicaid bailout.<sup>7</sup>

In fact, the “Cornhusker Kickback,” although unsavory, is a relatively trivial problem for taxpayers. The CBO reckons that the Medicaid expansion would require states to increase spending by \$26 billion for the six years from 2014 through 2019, less than seven percent of the \$395 billion increased federal spending on Medicaid and the State Children’s Health Insurance Program (SCHIP).<sup>8</sup> An independent estimate puts the figure at a lower \$20 billion.<sup>9</sup> However, another scholar has pointed out that the proposed expansion imposes unfunded administrative costs on states, which raises the total additional cost

to states to \$32 billion.<sup>10</sup> Nevertheless, even this figure pales beside the federal spending binge.

The real problem with the Senate’s proposed Medicaid expansion is not the so-called unfunded liability imposed on states. Despite Governor Schwarzenegger’s protests, it’s not really an unfunded liability. There’s no law *requiring* a state to operate a Medicaid program, and other conservative policy analysts have argued that states should quit Medicaid, in order to avoid its crippling effect on states’ deficits.<sup>11</sup>

The real problem is that the Senate bill takes a flawed formula, FMAP, and leverages it into an even worse formula. A key goal of any state is to maximize federal Medicaid matching funds, and Medicaid freeloaders are better able to grab those dollars. That is why fraud, waste, and corruption are endemic to Medicaid. Indeed, New York State and New York City *themselves* settled allegations of fraud with the U.S. Department of Justice by agreeing to pay \$540 million to the federal government last summer.<sup>12</sup>

Another problem is that the higher FMAP would only apply to the relatively higher-income, able-bodied, newly eligible, beneficiaries. People eligible under the current law will still draw the previous FMAP. States with FMAPs of 50 percent would see them increased to 82.3 percent for the newly eligible beneficiaries. Imagine yourself a county public-health bureaucrat who would attract one federal dollar for every dollar spent on a blind or disabled Medicaid beneficiary, or \$4.65 for every dollar spent on an able-bodied young man. Obviously, you would invest your energy in recruiting the able-bodied youth. During the Bush administration, the Centers for Medicare and Medicaid Services had a goal, which they attempted to enforce by regulation, of not giving more Medicaid money to states to enroll higher-income residents until they had enrolled at least 95 percent of the mandatory eligible population.<sup>13</sup> The proposed bill turns that sensible regulation on its head.

Table 1 shows that the Senate bill makes the problem of Medicaid freeloading worse, by giving bigger FMAP increases to richer states. It presents the results of a regression analysis which uses states’ annual per household money income, averaged over 2007 and 2008, to explain each state’s change in FMAP under the Senate bill. Each thousand-dollar increase in money income per household is associated with a one-percent increase in the FMAP under the Senate bill, and this statistically significant regression explains over one-third of the variance in the change in

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FMAP.

For example, New Hampshire’s money income is \$68,175 per household, which is \$16,942 greater than the national average of \$51,233. Its FMAP would increase from 50 percent to 82.3 percent, an increase of 65 percent. This is 18 percent greater than it would have been if higher per household incomes did not explain the Senate’s “generosity.” On the other hand, Mississippi’s FMAP increases by only 20 percent, from the current 74.73 percent to 95 percent. This increase is 15 percent less than it would have been if the state’s low income did not explain its poor outcome in the Senate’s FMAP allocation.

Governor Schwarzenegger, who spends much time demanding more from the federal trough, should rejoice at the new formula, which increases California’s FMAP by 7 percent more than if the state’s per household income were merely the national average. But no state actually wins this race to the bottom of U.S. taxpayers’ pockets. As we noted at the outset, the more serious problem is not with the leaky state pool but the larger federal vessel. Instead of leveraging the FMAP, Medicaid reform should jettison it entirely, in favor of easily understood block grants.

**Table 1: Estimates of Change in Medicaid FMAP in 2019, Per U.S. Senate Bill Passed 12/24/09, As a Function of State Median Money Income (2007-2008)**

State	Normal FMAP	2019 FMAP per Senate Bill	Change in FMAP	State per household median money income, difference from national average (\$51,233) 2007-2008	Change in FMAP explained by state per household median money income, difference from national average	Rank
Alabama	68.40%	95.00%	39%	(\$7,078)	-8%	40
Alaska	50.00%	82.30%	65%	\$13,468	14%	4
Arizona	65.85%	95.00%	44%	(\$3,262)	-3%	34
Arkansas	71.37%	95.00%	33%	(\$10,259)	-11%	48
California	50.00%	82.30%	65%	\$6,212	7%	13
Colorado	50.00%	82.30%	65%	\$10,984	12%	7
Connecticut	50.00%	82.30%	65%	\$14,411	15%	3
Delaware	53.15%	85.45%	61%	\$2,462	3%	17
Florida	55.45%	87.75%	58%	(\$5,028)	-5%	38
Georgia	65.33%	95.00%	45%	(\$2,865)	-3%	33
Hawaii	51.79%	84.09%	62%	\$12,769	14%	6
Idaho	68.85%	95.00%	38%	(\$1,986)	-2%	29
Illinois	50.20%	82.50%	64%	\$2,656	3%	16
Indiana	66.52%	95.00%	43%	(\$3,335)	-4%	35
Iowa	62.63%	94.93%	52%	(\$769)	-1%	25
Kansas	59.05%	91.35%	55%	(\$2,115)	-2%	30
Kentucky	71.49%	95.00%	33%	(\$10,175)	-11%	47
Louisiana	63.61%	95.00%	49%	(\$10,002)	-11%	46
Maine	63.80%	95.00%	49%	(\$2,752)	-3%	32
Maryland	50.00%	82.30%	65%	\$14,699	16%	2
Massachusetts	50.00%	82.30%	65%	\$9,282	10%	9
Michigan	65.79%	95.00%	44%	(\$706)	-1%	24
Minnesota	50.00%	82.30%	65%	\$6,374	7%	12

**Table 1 Continued: Estimates of Change in Medicaid FMAP in 2019, Per U.S. Senate Bill Passed 12/24/09, As a Function of State Median Money Income (2007-2008)**

State	Normal FMAP	2019 FMAP per Senate Bill	Change in FMAP	State per household median money income, difference from national average (\$51,233) 2007-2008	Change in FMAP explained by state per household median money income, difference from national average	Rank
Mississippi	74.73%	95.00%	27%	(\$13,655)	-15%	50
Missouri	63.29%	95.00%	50%	(\$4,328)	-5%	37
Montana	66.81%	95.00%	42%	(\$7,117)	-8%	41
Nebraska	58.44%	100.00%	71%	(\$338)	0%	21
Nevada	51.61%	83.91%	63%	\$4,207	4%	14
New Hampshire	50.00%	82.30%	65%	\$16,942	18%	1
New Jersey	50.00%	82.30%	65%	\$12,837	14%	5
New Mexico	69.78%	95.00%	36%	(\$7,152)	-8%	42
New York	50.00%	82.30%	65%	(\$590)	-1%	23
North Carolina	64.71%	95.00%	47%	(\$7,176)	-8%	43
North Dakota	60.35%	92.65%	54%	(\$1,908)	-2%	28
Ohio	63.69%	95.00%	49%	(\$2,273)	-2%	31
Oklahoma	64.94%	95.00%	46%	(\$5,739)	-6%	39
Oregon	62.85%	95.00%	51%	\$714	1%	20
Pennsylvania	55.64%	87.94%	58%	(\$383)	0%	22
Rhode Island	82.97%	85.27%	3%	\$3,534	4%	15
South Carolina	70.04%	95.00%	36%	(\$7,200)	-8%	44
South Dakota	61.25%	93.55%	53%	(\$1,332)	-1%	27
Tennessee	65.85%	95.00%	44%	(\$9,993)	-11%	45
Texas	60.56%	92.86%	53%	(\$4,077)	-4%	36
Utah	71.13%	95.00%	34%	\$7,829	8%	10
Vermont	58.71%	91.01%	55%	(\$1,275)	-1%	26
Virginia	50.00%	82.30%	65%	\$10,477	11%	8
Washington	50.00%	82.30%	65%	\$7,239	8%	11
West Virginia	73.24%	95.00%	30%	(\$10,382)	-11%	49
Wisconsin	60.16%	92.46%	54%	\$991	1%	18
Wyoming	50.00%	82.30%	65%	\$744	1%	19

Sources: U.S. Census Bureau; Federal Funds Information For States; author's regression analysis.<sup>14</sup>

## Endnotes

- <sup>1</sup> Jeffrey H. Anderson, "Medicaid's Costs, Like Medicare's, Have Risen Far More Than the Costs of Private Health Care," *Health Policy Prescriptions*, vol. 7, no. 7 (July 2009).
- <sup>2</sup> "Federal Participation in State Assistance Expenditures; Federal Matching Shares for Medicaid, the State Children's Health Insurance Program, And Aid to Needy Aged, Blind, or Disabled Persons for October 1, 2009 Through December 30, 2010," 73 *Federal Register* 229 (November 26, 2008), pp. 72051-72053.
- <sup>3</sup> John R. Graham, *U.S. Index of Health Ownership*, third edition (San Francisco: Pacific Research Institute, 2009), p. 18. I adapted "Medicaid freeloader" from work by Pamela Villareal at the National Center for Policy Analysis.
- <sup>4</sup> Congressional Budget Office, *Cost Estimate for the Amendment in the Nature of a Substitute to H.R. 3590, Incorporating the Effects of Changes Proposed in the Manager's Amendment Released on December 19, 2009*, letter to the Honorable Harry Reid, Majority Leader, United States Senate (Washington, DC: Congressional Budget Office, December 19, 2009), enclosure p. 1.
- <sup>5</sup> John R. Graham, "Taming the Medicaid Monster: The President Pushes Progress but States Shirk Solutions," *Health Policy Prescriptions*, vol. 4, no. 8 (August 2006), p. 2.
- <sup>6</sup> Arnold Schwarzenegger, "Governor Schwarzenegger Delivers State of the State Address," (Sacramento, CA: Office of the Governor, January 6, 2010).
- <sup>7</sup> Arnold Schwarzenegger, "Governor Schwarzenegger Sends Letter to California Congressional Delegation on California's Health Care Reform Legislation," press release, (Sacramento: Office of the Governor, December 22, 2009); Arnold Schwarzenegger, "Governor Schwarzenegger Sends Letter to California Congressional Delegation on California's Fair Share from the Federal Government," press release (Sacramento: Office of the Governor, January 13, 2010).
- <sup>8</sup> Congressional Budget Office, *Cost Estimate for the Amendment in the Nature of a Substitute to H.R. 3590, Incorporating the Effects of Changes Proposed in the Manager's Amendment Released on December 19, 2009*, letter to the Honorable Harry Reid, Majority Leader, United States Senate (Washington, DC: Congressional Budget Office, December 19, 2009), p. 8, fn 3.
- <sup>9</sup> Federal Funds Information for States, *Health Care Reform Moves Forward, Includes Big Changes to Medicaid*. Issue Brief 10-01 (Washington, DC: Federal Funds Information For States, January 7, 2010), p. 13.
- <sup>10</sup> Edmund F. Haislmaier, *Expanding Medicaid: The Real Costs to the States*, WebMemo No. 2757 (Washington, DC: The Heritage Foundation, January 14, 2010), p. 2.
- <sup>11</sup> Dennis G. Smith and Edmund F. Haislmaier, *Medicaid Meltdown: Dropping Medicaid Could Save States \$1 Trillion*, WebMemo No. 2712 (Washington, DC: The Heritage Foundation, December 1, 2009).
- <sup>12</sup> U.S. Department of Justice, "New York State and New York City to Pay Record \$540 Million to Settle Allegations of False Claims for Medicaid Funds," press release (Washington DC: U.S. Department of Justice, July 21, 2009).
- <sup>13</sup> "Democratic Lawmakers Say CMS Has No Authority to Limit State Efforts to Expand Medicaid Eligibility" *Kaiser Daily Health Policy Report* (January, 16, 2008). [http://www.kaisernetwork.org/daily\\_reports/rep\\_index.cfm?DR\\_ID=49858](http://www.kaisernetwork.org/daily_reports/rep_index.cfm?DR_ID=49858)
- <sup>14</sup> U.S. Census Bureau, *Current Population Survey: 2006 to 2009 Annual Social and Economic Supplements* (Washington, DC: U.S. Census Bureau, October 21, 2009); Federal Funds Information for States, *Health Care Reform Moves Forward, Includes Big Changes to Medicaid*, Issue Brief 10-01 (Washington, DC: Federal Funds Information for States, January 7, 2010), p. 10.