Massachusetts Medicaid Policy Institute

MassBudget
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Massachusetts Medicaid in Perspective: An Analysis of Spending Growth and Economic Growth, 1996-2007

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> Let us take first the question of the size and shape of government. The myth here is that government is big and bad — and steadily getting bigger and worse. Obviously this myth has some excuse for existence. It is true that in recent history each new administration has spent much more money than its predecessor. Thus President Roosevelt outspent President Hoover, and with allowances for the special case of the Second World War, President Truman outspent President Roosevelt. Just to prove that this was not a partisan matter, President Eisenhower than outspent President Truman by the handsome figure of $182 billion. It is even possible, some think, that this trend may continue.
>
> But does it follow from this that big government is growing relatively bigger? It does not — for the fact is for the last fifteen years, the federal government [has] grown less rapidly than the economy as a whole. If we leave defense and space exploration aside, the federal government since the Second World War has expanded less than any other major sector of our national life — less than industry, less than commerce, less than agriculture, less than higher education, and very much less than the noise about big government.
>
> *President John F. Kennedy, Yale University, June 11, 1962*

Medicaid in perspective

Medicaid cost growth in Massachusetts has exceeded growth in the economy only modestly since the mid-1990s, contrary to common perception. This paper examines growth in Medicaid spending in Massachusetts from Fiscal Year 1996 through Fiscal Year 2007 — a complete business cycle — and compares that growth to benchmarks of overall economic growth in the state. The paper also examines how the rate of growth in Medicaid has varied, and how that variation relates to larger cycles of expansion and contraction in the state's economy.

This analysis updates *MassHealth and State Fiscal Health: A New Look at the Effects of Medicaid Spending on State Finances*, produced by the Massachusetts Budget and Policy Center (MBPC) and the Massachusetts Medicaid Policy Institute (MMPI) in 2006, and extends the analysis through two additional state fiscal years. It also includes new benchmarks for comparing Medicaid expenditure growth with overall growth in the state's economic capacity.

Major conclusions are:

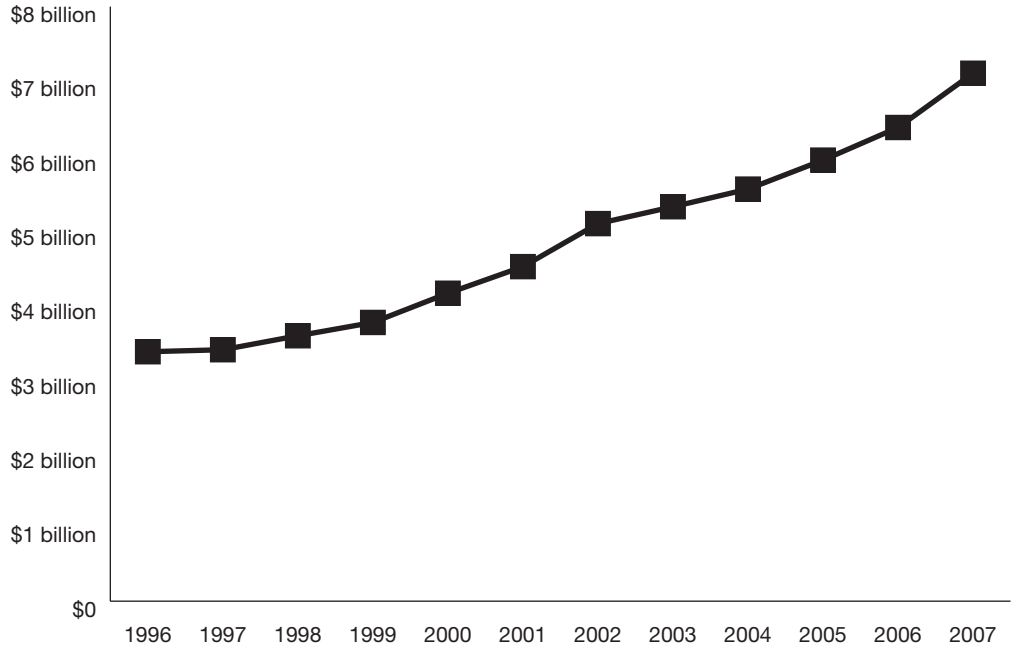
- Medicaid's overall rate of growth has been only slightly faster than the rate of growth in the state's economy;
- Medicaid spending is counter-cyclical: during periods of economic expansion, the rate of growth in Medicaid spending has been lower than growth in the economy, while in periods of economic downturn Medicaid cost growth has exceeded growth in the economy; and
- The fiscal effect of growth in Medicaid expenditures has been $315 million between Fiscal Years 1996 and 2007, far less significant than the $3.4 billion associated with the reduction in available state tax revenues due primarily to state tax cuts.

The Medicaid program since the mid-1990s

Medicaid is a program of health care financing that is jointly administered by states and the federal government. The program pays directly for health care services or health insurance for eligible state residents. The state of Massachusetts operates Medicaid within broad federal rules, and the federal government pays about half the cost of the program. The federal government sets minimum standards for the program in terms of the population covered and the benefits provided, and states can exceed those minimum standards within some limits. In Massachusetts, the program is called "MassHealth." MassHealth ensures that the most vulnerable residents of the Commonwealth — those with low incomes or disabilities — have access to decent and affordable health care.

A first look at Medicaid spending shows that it has grown 7.1 percent annually since FY 1996 (see figure 1). In nominal terms, total program spending has gone from $3.36 billion in FY 1996 to $7.10 billion in FY 2007.[1] This growth encompasses significant health care cost inflation, as well as certain important programmatic expansions.

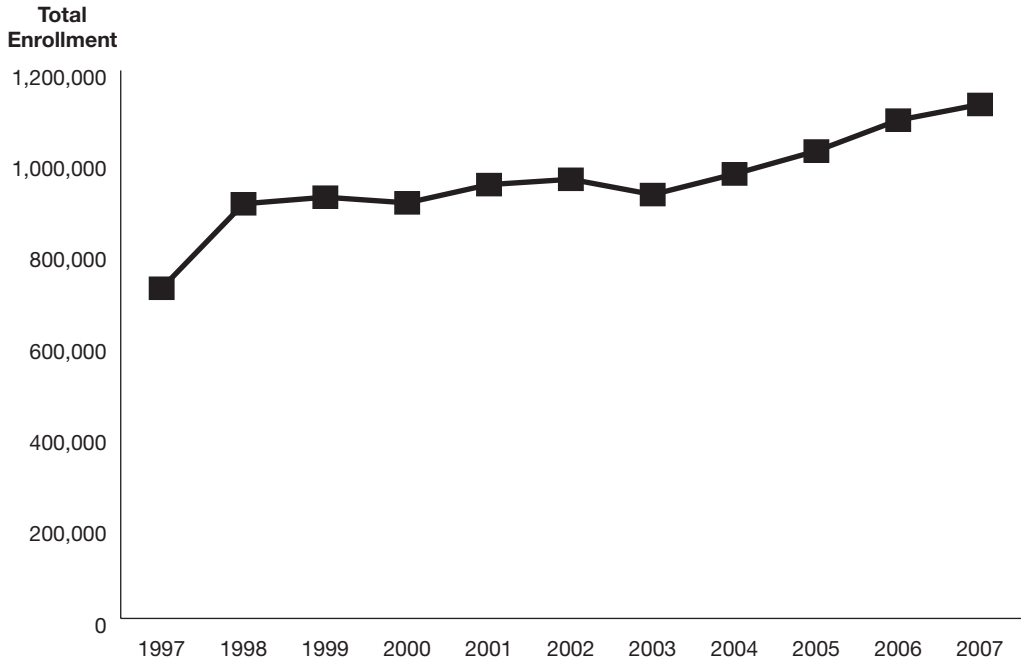
Figure 1: A first look at Medicaid spending shows a 7.1% average annual growth rate



1 This number takes Medicaid spending as recorded in the Massachusetts Office of the Comptroller's *Statutory Basis Financial Report*, and then makes certain adjustments to ensure that the numbers are comparable from year to year. The figures also exclude the amounts associated with drug rebates.

Some portion of the increase in MassHealth expenditures over this time period is attributable to increases in the number of people covered by the program. During the 1990s, the federal government enacted several laws (including the State Children's Health Insurance Program, or SCHIP) that allowed for expansions of Medicaid at the state level. Over the past two decades the federal government also provided increased flexibility for states to expand Medicaid coverage through Medicaid "demonstration waivers," which provide funding for experimental policy innovations designed to further the objectives of the Medicaid program. Massachusetts, like many states, took advantage of these new federal funding opportunities and expanded the program incrementally to cover additional populations. The most recent of these policies is the 2006 health reform law, Chapter 58, which has expanded enrollment in Medicaid by more than 70,000 individuals since June 2006 . The overall impact of these expansions on total Medicaid enrollment has been dramatic: 751,000 in 1996 to 1.1 million in 2007 (see figure 2)[2]. The reform law also increased some provider payments under Medicaid.

Figure 2: Massachusetts Medicaid Enrollment: 1997-2007

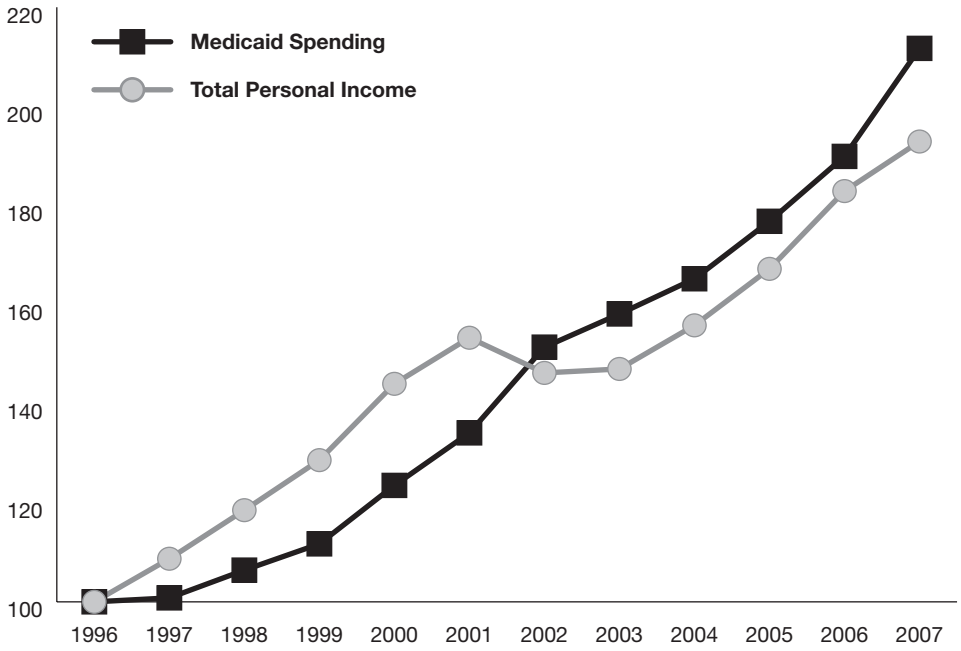


2 Source for 1996 enrollment is the United States Bureau of the Census, Statistical Abstract of the United States: 1998. Source for 2007 enrollment is the Massachusetts Executive Office of Health and Human Services, monthly MassHealth "Snapshot."

Medicaid expenditures grew only slightly more than the economy from FY 1996-FY 2007

While Medicaid spending grew 7.1 percent on average annually from FY 1996 to FY 2007, the state economy as measured by total personal income grew on average 6.2 percent over the same period (see figure 3).[3]

Figure 3: Medicaid spending has grown only slightly faster than the economy



We use an analysis of growth in total personal income to measure growth in the economy. To calculate changes in personal income in Massachusetts we begin with the Bureau of Economic Analysis (BEA) measure of state personal income.[4] We then add capital gains income (which the BEA measure does not include), as well as an adjustment for income earned in

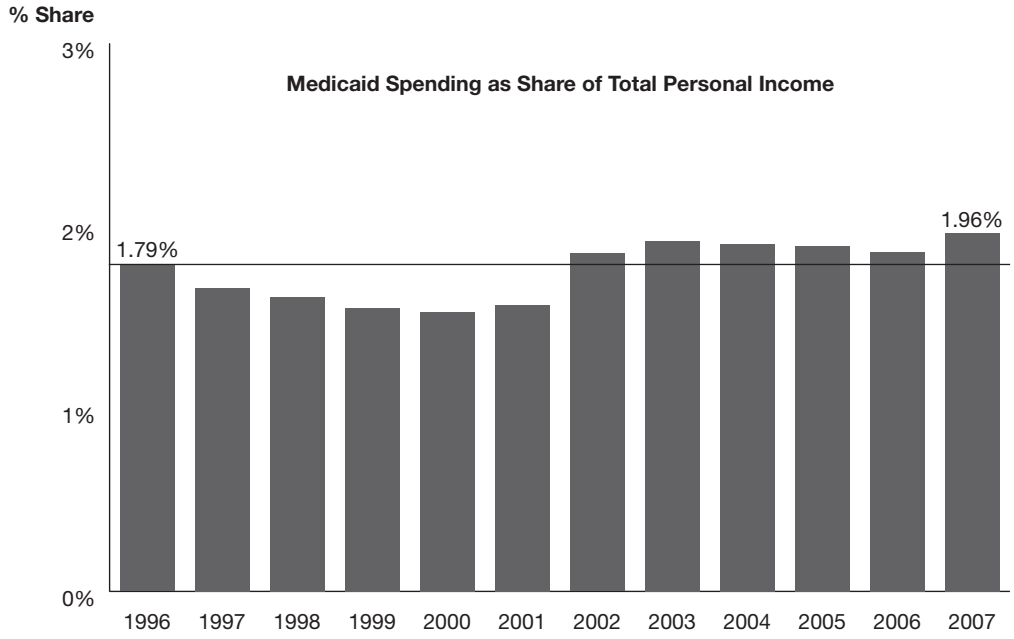
3 This chart creates an index for Medicaid spending and total personal income, in order to compare growth rates for the period FY 1996-FY 2007. We set the value of Medicaid spending and total personal income to 100 for FY 1996, and then calculate the annual growth rate for each year of the period under analysis.

4 The standard measure of personal income includes wage and salary disbursements, supplements to wages and salaries, proprietors' income with inventory valuation and capital consumption adjustments, rental income of persons with capital consumption adjustment, personal dividend income, personal interest income, and personal current transfer receipts, less contributions for government social insurance. See U.S. Department of Commerce, Bureau of Economic Analysis, Regional Economic Accounts, http://www.bea.gov/bea/regional/definitions/nextpage.cfm?key=Personal%20income

Massachusetts by non-resident workers.[5] We refer to this adjusted personal income measure as "total personal income." In our 2006 report, we used BEA personal income alone; we use total personal income here because it is a more accurate measure of the level of economic activity and capacity in a state.

Between FY 1996 and FY 2007, Medicaid spending has grown modestly as a percentage of total personal income (see figure 4). The impact of that growth has not been dramatic, however — Medicaid amounted to 1.79 percent of Massachusetts total personal income in FY 1996 and 1.96 percent in FY 2007. The fiscal impact of this increase over the entire eleven year period is approximately $630 million in FY 2007. However, since federal Medicaid revenue reimburses the Commonwealth for roughly half of all Medicaid spending, this increase translates to approximately $315 million in state dollars, or slightly less than $30 million each year over the full eleven years.

Figure 4: Medicaid spending has grown slightly as a share of the economy

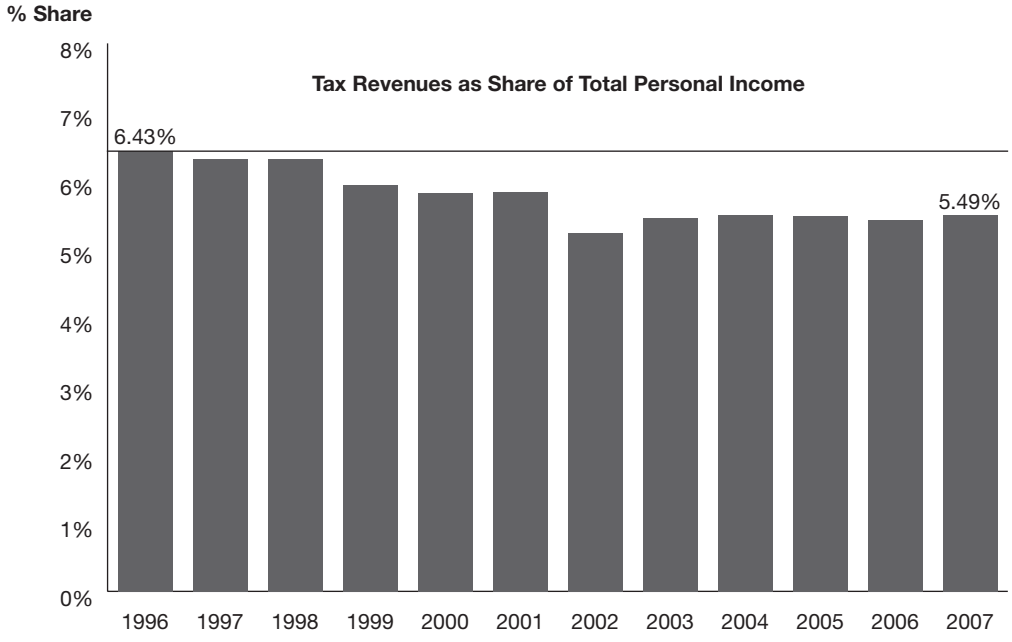


5 Capital gains estimates combine non-taxable capital gains data from annual Tax Expenditure Budgets published by the Massachusetts Department of Revenue, and add an estimate for taxable capital gains income, also from the Massachusetts Department of Revenue. For income earned by non-resident workers, and a discussion of adjusting personal income to better reflect growth in the economy, see New England Public Policy Center of the Federal Reserve Bank of Boston, "Assessing Alternative Measures of State Income," (memorandum), July 30, 2008, available at http://www.bos.frb.org/economic/neppc/memos/2008/weinerpopov073008.pdf. For the analysis in this brief, we follow the methodology recommended by the Federal Reserve Bank. However, rather than using the capital gains data from the U.S. Internal Revenue Service, we use more recent capital gains estimates from the Massachusetts Department of Revenue.

Changes in tax policy have caused the growth in Medicaid expenditures to appear larger than it actually is

It is important to note, as we did in our 2006 report, that, while Medicaid spending growth was roughly in line with growth in the economy, revenues coming into the state treasury from FY 1996 to FY 2007 declined significantly as a share of the economy. During the 1990s, the Commonwealth enacted a series of tax cuts that reduced the revenue available for the state budget. Between FY 1996 and FY 2007, tax revenues dropped from 6.4 percent of total personal income to 5.5 percent of total personal income. This 0.9 percentage point drop is worth about $3.4 billion dollars in FY 2007 alone (see figure 5).

Figure 5: Tax revenues have dropped as a share of the economy



Comparing the $315 million in additional fiscal pressures caused by Medicaid costs increasing more rapidly than the economy with the $3.4 billion cost of tax cuts over the same period provides some context for understanding the relative magnitude of two factors contributing to the state's fiscal challenges (see figure 6). Medicaid is a growing share of the state budget, but that is largely because tax cuts have reduced the size of the state budget as a share of the overall economy.

Figure 6: Personal Income, Capital Gains, Medicaid Spending, Tax Revenues Fiscal Years 1996 and 2007

	Fiscal Year 1996	Fiscal Year 2007	Value of Difference
Personal Income (from Bureau of Economic Analysis)	$173,323,250,000	$307,197,000,000	
Total Personal Income (includes capital gains)	$187,563,863,296	$361,777,142,377	
Medicaid Spending	$3,355,778,000	$7,103,091,000	
Medicaid Spending as a Share of Total Personal Income	*1.79%*	*1.96%*	
Difference between FY 2007 and FY 1996		*0.17%*	$630,395,000
Impact on state fiscal health (assuming 50% federal reimbursement)			$315,198,000
Tax Revenues	$12,057,848,000	$19,849,187,000	
Tax Revenues as a Share of Total Personal Income	*6.43%*	*5.49%*	
Difference between FY 2007 and FY 1996		*-0.94%*	-$3,408,245,000
Impact on state fiscal health			-$3,408,245,000

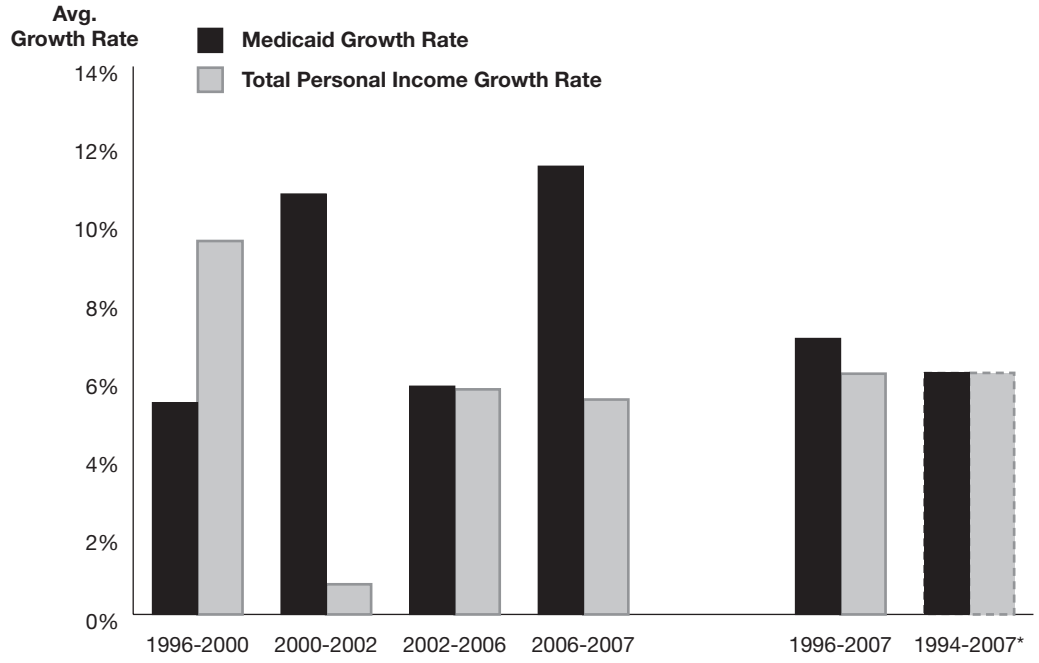
Medicaid is counter-cyclical, and shorter-term trends are important

While an examination of Medicaid expenditures over the business cycle from FY 1996-2007 provides an important comparison with long-term growth in the state's economy, it is essential to also look at shorter-term trends within that period. These shorter-term trends reveal the often cyclical nature of the program. When the economy is contracting, Medicaid often expands, and vice-versa. This phenomenon is due to two factors. First, demand on the program is at its highest when the economy is at its lowest point. In difficult economic times, if unemployment increases and incomes drop, fewer people receive health insurance from their places of employment and more individuals meet the eligibility requirements

for Medicaid coverage. Second, because Medicaid is an entitlement program, under federal law many of those eligible for Medicaid have a legal right to the care they receive, making it difficult to reduce program services and costs during times of fiscal stress.

In order to compare cycles in the rate of growth in Medicaid expenditures relative to the rate of growth in the economy for portions of the time period FY 1996-2007 we have broken the time period into four segments (see figure 7).

Figure 7: Medicaid growth is often cyclical, causing stress when the economy falters



* 1994-2007 added for reference; Medicaid growth rate and total personal income growth rate during this period almost identical

During the period FY 1996-2000, the Commonwealth experienced a significant economic expansion, with annual growth in total personal income at 9.5 percent. Average annual growth in Medicaid spending during this period was low, at 5.4 percent, therefore Medicaid declined as a share of income. During the period FY 2000-2002, the Commonwealth experienced a recession, and then the start of a slow economic recovery. Total personal income growth was negligible during this period. Meanwhile, the average annual growth in Medicaid expenditures was 10.7 percent, reflecting in part increased demand on the program due to the slowing economy. In the period FY 2002-2006, growth in the Massachusetts economy was 5.8 percent, and Medicaid also grew at 5.8 percent. More recently, during the period FY 2006-2007, growth in total personal income dropped to 5.5 percent, but Medicaid spending grew at an annual rate of 11.5 percent. This reflects both the growth in the program due

to the state's health reform law and the impact on Medicaid of the potential slowing of the economy. We have also included as a reference a comparison of Medicaid spending growth and total personal income growth between FY 1994 and FY 2007. Although these additional years expand the analysis beyond one business cycle, because these two additional years were a period of slow Medicaid spending, we see that Medicaid spending growth and growth in the economy were almost identical.

Conclusions

In order to understand the impact of Medicaid spending growth on the Commonwealth's budget, it is important to look at trends over the longer term, compare spending trends to state revenue trends, and place any changes in spending in the context of the state's economic growth. When Medicaid spending and overall economic growth are examined together, the long term trends do not suggest that Medicaid has been as large a source of fiscal strain as is often assumed. Further, the impact of the growth in spending on Medicaid did not have the same fiscal impact as did the impact of tax revenue reductions enacted over the past decade. The fiscal impact of increases in state spending on Medicaid since FY 1996 amount to about $315 million in FY 2007, while the impact of total reductions in state tax revenue, due primarily to tax cuts, amount to about $3.4 billion.

There is no question that Medicaid is a much larger program today than it was in FY 1996. That is largely thanks to the increased demands we have placed on the program by expanding the populations eligible for Medicaid and improving the benefits available to Medicaid members. Even so, growth in spending on Medicaid has only modestly exceeded growth in total personal income in Massachusetts. Nevertheless, the nature of the program and its growth as a central component of the state's health care reform efforts suggest that we should focus even greater efforts on cost control and plan carefully for economic downturns to assure that the program is sustainable into the future.

About the Massachusetts Budget and Policy Center

The Massachusetts Budget and Policy Center provides independent research and analysis of state budget and tax policies, as well as economic issues, that affect low- and moderate-income people in Massachusetts.

About the Massachusetts Medicaid Policy Institute

The Massachusetts Medicaid Policy Institute is an independent and nonpartisan source for information and analysis about the Massachusetts Medicaid program (often referred to as "MassHealth"). MMPI seeks broader understanding of MassHealth and a rigorous and thoughtful public discussion of the program's successes and challenges ahead.

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