

Medicaid Expenditures and State Budgets: Past, Present, and Future*

**James Marton
University of Kentucky
Martin School of Public Policy and Administration
Lexington, KY 40506-0027**

and

**David E. Wildasin
University of Kentucky
Martin School of Public Policy and Administration
Lexington, KY 40506-0027**

March, 2007

* Prepared for presentation at a conference on “State and Local Finances: After the Storm, Is Smooth Sailing Ahead?” at the Urban Institute, Washington, DC, March 30, 2007. We are grateful to J. Poulette for research assistance.

I. Introduction

Medicaid is one of several major components of the nation's health care system. It has grown dramatically over time and now provides health benefits for approximately 52 million people, about one-sixth of the national population. A program of this magnitude touches on all aspects of economic life, affecting beneficiaries, health-care providers, private insurers, taxpayers, and every level of government. In particular, Medicaid has become a major expenditure item for state governments, with Medicaid spending of more than \$230 billion in 2003, accounting for more than 15% of total state government spending in the nation as a whole. A large fraction of state Medicaid spending is financed by grants from the Federal government, and these grants are now major elements in the system of Federal transfers to the states.

The present discussion examines the Medicaid program from a fiscal perspective, especially with reference to the fiscal systems of state governments. The steady growth of Medicaid spending raises questions about fiscal sustainability. The states experienced a period of significant fiscal stress beginning in 2000, partly the consequence of weakened revenue flows and partly the result of earlier growth in expenditures. Revenue growth has since increased, but perhaps this offers only a temporary respite before the next economic downturn triggers another round of fiscal crises. Ominous demographic and other trends suggest that health care costs will continue to grow for decades to come. Will states be able to cope with the fiscal burden of Medicaid? Rising health care and other costs will subject the Federal government to fiscal stress as well. Will the states

find the Federal government less willing in the future to share in the financial burden of Medicaid?

Lacking a crystal ball with which to provide definitive answers to these and other forward-looking policy questions, it is tempting to retreat to a cautious review of past trends and policy experience. However, while it is not our purpose to engage in demographic, economic, fiscal, or political forecasting, it seems useful nonetheless to discuss, even if only in somewhat speculative terms, some of the policy options that the nation will face in the coming years.

We begin, in Section II, with an overview of Medicaid spending from the viewpoint of its impact on state budgets, describing its growth in aggregate terms and also the wide interstate variation in Medicaid spending. In Section III, we summarize some recent analytical efforts to explain observed Medicaid expenditures. Because the Federal government plays such a large role in the Medicaid program, through its financing of state expenditures and through its regulation of the program, we focus particularly on the Federal regulatory and fiscal determinants of Medicaid spending. We also present some preliminary results from ongoing research, highlighting possible interactions between the 1996 welfare reform and recent Medicaid spending growth.

Section IV discusses the prospects for Medicaid in coming decades. Demographic change is likely to play a major role in the evolution of health care spending in the nation as a whole and may have very important effects on Medicaid in particular. The future of Medicaid in state budgets will also depend crucially on Federal government policies, such as the recently-instituted prescription drug coverage provided by Medicare, Part D. Recognizing that the Federal government faces growing fiscal

stress, it is natural to consider also the prospect of more fundamental alterations in the Federal/state division of labor in providing and financing health care benefits for the poor, the elderly, and for other groups. We therefore discuss, in an admittedly somewhat speculative spirit, the implications of a policy reform for Medicaid similar to the welfare reform of a decade ago. Section V concludes with a brief summary.

II. Medicaid Growth and State Government Finances, 1988-2003

The rapid growth of Medicaid spending is well-known and widely documented. Here, we offer a concise review of this growth, mainly from the perspective of its implications for state government finances and intergovernmental fiscal relations.¹ We will frequently compare it to the major “cash welfare” programs – Aid to Families with Dependent Children (AFDC) prior to the 1996 welfare reform (the Personal Responsibility and Work Opportunity Reconciliation Act, or PRWORA) and Temporary Assistance to Needy Families (TANF) subsequent to it. This comparison is of interest for at least two reasons. First, both Medicaid and cash welfare have been broadly targeted at low-income households, and indeed they constitute two of the largest and most durable means-tested transfer programs in US history. Second, in both cases, a large proportion of state government spending has been financed by transfers from the Federal government. Prior to the 1996 welfare reform, the structure of intergovernmental transfers for both programs was substantially the same: the Federal government provided each state with open-ended matching grants for both programs, with matching rates varying among the states inversely to state per capita income, subject to a minimum

¹ For a more detailed discussion on programmatic development in the Medicaid program, see Gruber (2003). McGuire and Merriman (2006) provide a thorough discussion of how state spending on social assistance programs varies over the business cycle.

Federal share of 50%. The welfare reform replaced the matching grants for welfare by a system of lump-sum grants similar in amount to those previously awarded, while leaving matching grants for Medicaid unaffected. Comparison of these two programs provides a unique opportunity to study the response of state governments to changes in intergovernmental grants.

Table 1A summarizes some of the key trends in Medicaid spending since 1988. Medicaid spending now amounts to approximately 17% of aggregate state government spending, this share having approximately doubled in the past 15 years (column 3). The rate of growth varies somewhat over time and by state, but the overall trend is unmistakably and almost monotonically upward (see Figure 1). This may be compared with cash welfare spending, which was about 3.4% of state spending in 1988 but which fell to only 1.9% by 2003 (column 4). At its inception in 1967, Medicaid and welfare spending were approximately equal in amount, but Medicaid spending has grown substantially faster over time. By 1988, Medicaid spending was nearly three times as large as cash welfare spending, and by 2003, it was nearly nine times as large (column 5).

Medicaid spending varies substantially among the states, as is illustrated in Table 1B. In 2003, two states (Hawaii and Wyoming) spent slightly less than 10% of their budgets on Medicaid. At the top end, Medicaid spending exceeded 20% of the state budgets for five states (Missouri, Rhode Island, Tennessee, New York, and, finally, Maine – at more than 30%, the highest of all of the states) (column 3). Cash welfare spending also varies widely by state, with seven states (Arizona the lowest, at 0.45%) spending less than 1% of their budgets on TANF in 2003, while three (Rhode Island, California, and New York) spent more than 2.5% (column 4). Although New York

stands out for high spending on both programs, California, which has the second-highest TANF expenditure share, is ninth from the bottom in Medicaid spending as a share of the state budget, and the simple correlation between expenditure shares on Medicaid and TANF spending, as shares of total state spending, is only 0.14. Thus, simple generalizations about state “generosity” toward welfare and Medicaid beneficiaries, based on this metric, are unlikely to withstand scrutiny.

As noted, intergovernmental transfers have played a critical role in the financing of Medicaid and cash welfare programs. In 2003, Medicaid matching rates² were at the matching-rate floor of 50% in a dozen states but exceeded 75% in West Virginia and Mississippi (Table 1B, column 6). Prior to welfare reform, matching rates for AFDC exhibited similar variation among the states, but these “matching rates” all fell to zero after 1996. Given the large size and rapid growth of state Medicaid spending and given the high matching rates for this program, it is not surprising that Federal transfers for Medicaid are a major source of revenue for state governments. As a proportion of aggregate state government spending, Table 2A, column 2 shows that Federal Medicaid grants have risen from about 5.6% in 1988 to nearly 10% in 2003, making these grants one of the main sources of revenue for state governments. (By comparison, state individual income taxes and general sales taxes each brought in about 15% of total state government revenue in 2003.) The role of Federal grants for cash welfare in state revenue systems, on the other hand, has declined steadily over time. In 1988, AFDC

² We shall abuse terminology somewhat in speaking of “matching rates” when referring to the Federal government share of state spending.; thus, for instance, by “a matching rate of 75% (or 0.75)” we mean that the Federal government pays 75% of each dollar of state expenditures – what in more “classical” usage might be called a “3 to 1 match.”

grants were about 1.9% of total state spending, a figure that fell to only 1.2% by 2003 (column 3).

Table 2B, column 2 shows that the amount of revenue derived from Medicaid grants exceeded 5% of 2003 total expenditures in all states (Virginia, at 5.5%, was the lowest), while these grants exceeded 15% of spending for two states, Tennessee (16.8%) and Maine (20.5%). TANF grants, by contrast, were comparatively insignificant, with amounts ranging from a minimum of 0.26% of total state expenditures in Arizona to 1.8% in California and 2.2% in New York; aside from these last two, the corresponding figure was less than 1.5% in all other states (column 3).

Finally, it is interesting to note that intergovernmental transfers of all types increased from about 22% of state spending to 27% in 2003; most of this increase occurred prior to 1993, with intergovernmental transfers remaining fairly steady as a share of state spending since that time, at about 25-26% (Table 3A, column 2). There is substantial interstate variation in this figure, however: in 2003, it ranged from a low of 15.7% (Massachusetts) to a high of 55.1% (Wyoming) (Table 3B, column 2). Table 3A, column 3 shows that Medicaid grants account for a rising proportion of fiscal transfers to the states; having increased from about 25% to over 36% of all intergovernmental grants between 1988 and 2003. AFDC assistance accounted for about 8.5% of all Federal grants to the states in 1988, but this share has dwindled over time to less than 4.5% in 2003 (column 4). For Wyoming, Medicaid grants constituted only 11% of all intergovernmental transfers in 2003, but were more than 50% of intergovernmental revenues for three states – Florida (51%), Massachusetts (62%), and Maine (67%) (Table 3B, column 3).

To summarize these observations, Medicaid spending has increased dramatically as a share of state government expenditures in the past two decades. It now constitutes a major expenditure item for all states, but there is nonetheless wide variation among the states. Medicaid grants from the Federal government defray a large portion of Medicaid spending costs for every state, both on average and, because of matching provisions, at the margin: each dollar of Medicaid costs states at most \$0.50 and as little as \$0.24. Medicaid grants have become a revenue mainstay for state governments, though there is again wide interstate variation in this respect, and these grants now constitute one of the major elements in the system of Federal fiscal support for the states. In all of these respects, cash welfare programs present a marked contrast. Federal support of state cash assistance to the poor long antedates state Medicaid programs (the Aid to Dependent Children program, a predecessor of AFDC and TANF, was first established during the Great Depression). For many years, AFDC spending by states was supported, as Medicaid has been since its inception, with open-ended matching grants, but these matching grants were replaced in 1996 with a system of block grants. AFDC and now TANF expenditures have been declining as a share of state government spending and are now almost an order of magnitude smaller than Medicaid expenditures.

III. Medicaid Spending and Federal/State Policy Interactions

What can account for the observed growth of Medicaid spending and its variation among states? This basic question is of crucial importance both from the viewpoint of budgetary planning and forecasting and from the viewpoint of policy analysis. Changes in medical technology, the prices of pharmaceutical drugs, and other “supply” factors clearly affect the cost of health care and thus must be important expenditure

determinants. Other factors clearly influence the “demand” side of health spending generally and Medicaid spending in particular. Since much health care spending occurs late in life, for instance, the age structure of the population is certain to be an important spending determinant. Medicaid benefits are means tested: eligibility for Medicaid depends on a potential beneficiary’s income and asset holdings. Thus, income variations among states or over time are likely to influence Medicaid spending. A number of other demand and supply factors may plausibly be conjectured to influence Medicaid spending.

From the perspective of public finance, it is important to recognize that Medicaid is only one category of state government spending and that it competes with other types of spending for scarce budgetary resources. The determination of the size and composition of sub-national government budgets has often been analyzed using some variant of the median voter model, as pioneered by such authors as Bergstrom and Goodman (1973). These models are helpful in highlighting the effects of the fundamental budget constraints facing a jurisdiction’s residents and policymakers. In particular, household and government constraints depend on the incomes of state residents, but may be significantly affected by Federal grants, tax policies, and regulations. The effects of past or prospective policy reforms can be studied by analyzing how they alter the constraints, incentives, and, ultimately, expenditure and tax policies chosen by policymakers.

We have already discussed the role of matching grants in Medicaid financing. However, Medicaid grants are subject to significant regulatory controls that affect the types of households and medical expenditures that are eligible for financial support. In order to limit Medicaid benefits to “poor” households, the Federal government has

generally required states to impose means tests based on income and assets. In addition, regulations have restricted eligibility based on age (for instance, some beneficiaries qualify by virtue of their participation in the Federal Supplemental Security Income (SSI) program, which provides cash benefits to the elderly poor), health status (e.g., disability) or other individual or household attributes. The regulatory structure of Medicaid has varied over time; as Gruber (2000, p. 5) characterizes the evolution of Medicaid during the period 1987—2000, “[t]he pattern of legislative action ... was one of initial federal permission for states to expand their programs, followed within a period of several years by federal mandates to cover [various beneficiary] groups.”

Many of the determinants of Medicaid spending, such as the age structure of the population, the level and distribution of income, or the rate of technological progress in the health care sector, are only indirectly influenced by state or Federal policies. From the viewpoint of potential policy reforms, the impact of Federal financing and regulatory policies on Medicaid spending are of particular interest because they may provide a much more direct mechanism through which to influence state government spending. Several studies have shed considerable light on this issue.

As is reported in Chernick (2000), both Granneman (1983) and Chernick (1999) attempt to estimate a matching rate (or own price) elasticity of demand for state Medicaid expenditures. Granneman (1983) uses data from 1977 to 1980 and finds a matching rate elasticity of 0.78. Using a longer time series of data between 1983 and 1995, Chernick (1999) finds a matching rate elasticity of .65.³ In addition, Chernick (1999) reports a

³ Interestingly, Chernick (2000) surveys several studies that have attempted to estimate the matching rate (or own price) elasticity of demand for AFDC/TANF and concludes that “... the fiscal impact of matching grants for cash assistance is negligible, suggesting that even very deep price subsidies are incapable of eliciting an expansion in cash transfers to low income families.”

strong positive cross-price elasticity between cash benefits and Medicaid spending on AFDC recipients (whose enrollment in Medicaid is mandatory). This cross-price effect is somewhat at odds with the finding presented in Kousser (2002) that states exercise more discretion over expenditures on optional Medicaid enrollees. Finally, Baicker (2001) analyzes the impact of mandated Medicaid expansions during the late 1980s and finds that states responded to these mandates by increasing Medicaid expenditures, while at the same time reducing other welfare expenditures by almost exactly the same amount.

In a recent theoretical analysis (Marton and Wildasin (2007)), we build a stylized model to study how Federal grant policies may affect state government spending on cash and health programs that benefit low-income households. In that model, state expenditures are financed either by state taxes on high-income residents or by grants from a higher-level government. High-income households are postulated to benefit from cash and in-kind transfers to poor residents because they value both the well-being (utility) of the poor and their health. In their preference structures, which are respected by policymakers, state expenditures on cash and health benefits are partial but not perfect substitutes. Intergovernmental transfers for each program may take the form of matching or lump-sum grants. In contrast to lump-sum grants, matching grants lower the price of program expenditures to taxpayers.

This model can be used to examine the impact on state government expenditures of changes in matching grant rates, such as those brought about by the 1996 welfare reform. The analysis shows that a reduction in matching grant support for one program results in an “own price effect” that leads a state to reduce spending on that program, a standard result in the literature. It also shows, however, that a reduction in matching

grant support for one program gives rise to a “cross price effect” that can influence spending on the other program, as well. The magnitude of these cross-price effects depends on the degree of substitutability, in the preference structure of high-income households, between the health of the poor and their general welfare, as well as upon the substitutability, in the preference structure of low-income households, between health and other consumption. For instance, suppose that matching grant support for state cash welfare expenditures is cut. Intuitively, if both high- and low-income households view cash and health benefits as nearly perfect substitutes, a reduction in the matching rate for cash welfare will result in a large reduction in cash benefits, which are now relatively more costly, and a large increase in health benefits, which are now relatively cheaper and are “just as good” from the viewpoint of taxpayers and beneficiaries. By contrast, low substitutability in taxpayer and beneficiary preferences would reduce the magnitude of such “cross-program substitution.”

This analysis shows how the effects of a change in matching grant support for state cash welfare programs need not be confined to expenditures on those programs alone, but may “spill over” to programs that are “close substitutes” to cash welfare. By eliminating matching grants in support of state AFDC/TANF expenditures, the 1996 welfare reform increased the price to the states of providing cash welfare benefits to the poor, and by a large amount. In all states, the marginal cost of financing an additional dollar of cash welfare benefits rose by at least a factor of two and, for those states that previously had faced the most generous matching grant support, by a factor of four. Since Medicaid matching grant rates were unaffected by the welfare reform, the relative price of providing cash and health benefits also changed in the same proportion. For a

state facing a matching grant rate of 0.75, for instance, the relative price of expenditures for cash welfare and health benefits, prior to welfare reform, was $0.25/0.25 = 1$, whereas after the welfare reform, this price changed to $1/.025 = 4$. The substitution effect resulting from this change in relative price is equivalent to that which would be produced by a 75% reduction in the cost of all health care services, a very large relative price change over a short period of time. Relative price changes of this magnitude could be expected not only to reduce state government expenditures on cash welfare but to increase expenditures on Medicaid, possibly substantially, if these programs are substitutable.

We have begun to examine this hypothesis in some ongoing empirical research. As yet, we are only able to report some preliminary but suggestive findings. Our analysis begins by determining the prices that states face for their expenditures on cash welfare (AFDC/TANF) and Medicaid, as determined by the matching grant rates for each state, year, and program. We estimate the effects of these prices on the composition of state budgets and, in particular, on the share of each state's budget devoted to Medicaid and AFDC/TANF expenditures. The estimated own-price elasticities for these programs are generally negative and – of particular interest – the cross-price elasticities are generally positive, although the precise magnitudes of these estimates depend on the detailed specification of the model. By way of illustration, in one simple specification, we estimate that a one percentage point increase in the “price” of Medicaid spending results in a decrease of -0.16 percentage points in the share of Medicaid expenditures in state budgets, that is, a negative own-price elasticity, while a one percentage point increase in

the “price” of cash welfare results in an increase of 0.06 percentage points in the share of the state budget devoted to Medicaid spending, that is, a positive cross-price elasticity.

To interpret the meaning of these estimates, note that the 1996 welfare reform raised the price of cash welfare expenditures by at least 50 percentage points for each state, and by as much as 75 percentage points for some, with a simple mean increase of about 60 percentage points. Given an estimated cross-price coefficient of 0.06, this would lead to an estimated increase in the Medicaid share of state budgets of about $0.06 \times 60 = 3.6$ percentage points. This estimate may be compared with the observed 1996-2003 increase in the Medicaid share of state budgets from 14.0% to 17.0%, as reported in Table 1. We reiterate that our estimates are provisional.

Our preliminary results, if taken at face value, suggest that the 1996 welfare reform may have contributed to recent increases in Medicaid spending. However, they do not imply, and we do not suggest, that the welfare reform is solely responsible for the changes in Medicaid spending in recent years. On the contrary, as our earlier discussion emphasizes, Medicaid spending depends on many factors, all of which should be presumed to play a role in the growth of expenditures over time. The potential spillover effects between cash welfare and Medicaid spending that we have identified are only one part of the extremely complex regulatory and fiscal interactions between the state and Federal governments. Additionally, a host of other demographic, technological, political, and economic factors have played a large role in the evolution of Medicaid spending. This is a topic that warrants and will no doubt receive considerable attention in future research.

IV. Policy Options and Prospects

States continuously re-examine budgetary priorities in the face of changing circumstances. Medicaid is now such a large element in state budgets that large fiscal consequences will flow from continued growth or possible retrenchment. Furthermore, Federal Medicaid assistance to the states has become a mainstay of state revenue systems. Significant changes in the level or type of assistance to the states offered through Medicaid would have potentially quite large impacts on revenues and on the intergovernmental fiscal system. In this section, we discuss what Medicaid-related changes may be in store for state finances and intergovernmental transfers in the future.

Of course, predicting “turning points” in fiscal policy – moments when spending program or tax policies break with past practice and start on what appears in retrospect to be significant new paths – is as difficult as predicting macroeconomic turning points, to which, incidentally, they may or may not be related. As McGuire and Merriman (2006) observe, cyclical shocks sometimes do, and sometimes do not, appear to affect different components of state fiscal policies. In fact, their analysis suggests that social welfare expenditures are, if anything, somewhat immune to cyclical shocks. To paraphrase Herbert Stein, however, unsustainable trends will not be sustained. Medicaid spending growth is bound to stop short of the point where it consumes 100% of state budgets. This simple observation is worth bearing in mind as we discuss some of the demographic trends that are relevant for Medicaid. Growing incentives for fiscal adjustment are likely to bring about one or more of several possible significant changes in Medicaid policy, and thus in state finances, the intergovernmental fiscal system, and the nation’s health care system.

A. Demographics

The elderly account for a very large share of all medical expenditures and a very large share of current Medicaid spending in particular. As noted in the Economic Report of the President (2007, p. 95), “the elderly and disabled covered by Medicare account for about one-quarter of Medicaid enrollees, but they account for about two-thirds of Medicaid spending,” an observation that also highlights the fact that a large portion of health care spending for the elderly is presently allocated through the Medicaid program rather than through Medicare. In 2003, Medicaid payments for aged beneficiaries were approximately \$13,677, compared to an average of \$4,487 for all beneficiaries, and only \$1,606 for children (CMS, 2006). The national old-age dependency ratio is expected to rise from its current value of 0.20 to 0.31 in 2025, 0.38 in 2050, and 0.41 by 2075 (Board of Trustees of the Federal OASDI Trust Funds (2006, p. 78)). A 50% increase in the relative size of the aged population by 2025 and a doubling by 2075 portend rapid and large increases in the demand for health care and corresponding upward pressure on Medicaid spending, at least in the absence of significant reforms.

As important as the total size of the elderly population is its distribution among the states. As of 2005, the old-age dependency ratio varied from a low in Alaska of 0.10 to a high of 0.28 in Florida. According to Census estimates, this ratio is expected to range from 0.22 (Utah) to 0.44 (Florida) in 2025, having increased in all states (US Census, 2007). At that time, the dependency ratio is expected to be lower than Florida’s 2005 value of 0.28 in ten states (Alaska among them) but to exceed 0.40 in seven states. The projected rate of increase varies from less than 50% in six states to more than 90% in

five states (and more than 100% in three). State Medicaid budgets are thus likely to be affected quite unevenly by population aging.

Immigration, an important determinant of population size and composition, can have significant impacts on state (and Federal) expenditures and revenues. The rate of immigration is expected to be almost as large as the rate of natural increase of the population in coming decades (see, e.g., OASDI Trustees (p. 76)), and the foreign-born population will rise well beyond the current 12.4% share of the US population.

Immigration impacts differ dramatically by state: the population share of the foreign born ranges from less than 5% in 20 states to a high of 27.2% in California (U.S. Census Bureau, 2005a). On average, recent immigrants are relatively young and have high fertility rates, dampening the shift toward an older age structure. On the other hand, many immigrants are poorly educated and have low earnings; these immigrants are disproportionately low contributors to state and Federal fiscal systems and impose significant fiscal burdens, illustrated by the fact that about 18% of participants in the Food Stamp, AFDC/TANF, and Medicaid programs are non-natives.⁴ The Deficit Reduction Act of 2005 attempts to address this issue by holding states responsible, for the first time, for Medicaid expenditures for individuals who claim to be US citizens but are unable to provide documentation supporting their citizenship and identity.

International migration in the US is dwarfed in magnitude by internal migration. Between 1995 and 2000, about 20% of the US population – both elderly and young -- moved from one state to another. High lifetime mobility explains the fact that only 60%

⁴ We are grateful to C. Bollinger (private communication) for providing these figures. See Wildasin (2006a, b) for further discussion of the fiscal impacts of migration and immigration. This is an issue of global importance, as all developed nations grapple simultaneously with aging populations and rising immigration, especially from less-developed countries.

of the US population resided in their state of birth in 2000 -- a figure that was under 40% for five states (Nevada was lowest, at 21.3%, followed by Florida, at 32.7%) but that exceeded 75% in three states (Louisiana was the highest, at 79.4%) (US Census, 2005b).

In summary, the states do now and are expected in the future to vary widely along demographic dimensions that are important for health care and, more particularly, for state government Medicaid spending. In the absence of policy reforms, immigration and the aging of the population are likely to impose rapidly increasing health care costs on state governments, but the distribution of these among the states will be far from uniform. We return below to some of the potential fiscal implications of interstate migration.

B. Intergovernmental Coordination of Health Policy: Medicare, Part D

The provision of Medicaid assistance to the states is only one aspect of the Federal government's involvement in the nation's health care system, and is by no means the largest in budgetary terms. The Federal government spent \$330 billion in 2006 to provide benefits for more than 42 million Medicare beneficiaries, accounting for about 12% of the Federal budget, as compared to Federal Medicaid spending of \$191 billion. (Economic Report of the President (2007, p. 86)) For many elderly and disabled beneficiaries, health care costs are divided between these two programs, and changes in Medicare policy inevitably interact with the Medicaid system, as illustrated by the recent expansion of Federal government responsibility for the costs of prescription drugs, principally through Medicare Part D.

This reform has potentially far-reaching implications for Medicaid, which has experienced rapid growth in prescription drug expenditures in recent years. For the aged,

Medicaid drug costs per beneficiary doubled in real terms between 1996 and 2003, from \$1,256 (\$2003 dollars) in 1996 to \$2,514 in 2003, accounting for 12.0% of Medicaid spending per aged beneficiary in 1996 but rising to 18.4% by 2003 (CMS, 2006). The new Medicare benefit may relieve the states of some of this burden, as elderly beneficiaries obtain coverage from Medicare Part D instead of Medicaid.⁵ The states are still in the initial stages of adapting to this new Medicare program, but the potential expenditure impact on the states is substantial, particularly over a horizon one or two decades, as compared with the trajectory that might otherwise occur given the rapid aging of the population. This will particularly be true if large numbers of beneficiaries, perhaps with state government encouragement, transition from Medicaid to Medicare for drug coverage.

The prescription drug benefit is only one of many possible changes in Federal health care policy that may affect Medicaid spending in future years. While the recent establishment of the Medicare Part D prescription drug benefits may offer significant fiscal relief for state Medicaid systems, other policy reforms may shift financial burdens to the states.

⁵ In the Centers for Medicare and Medicaid Services publication "Medicare & You 2007," Medicare recipients are informed that (p. 49) if they receive full drug coverage from their state Medicaid program and are eligible for Medicare, then Medicare will automatically enroll them in Medicare prescription drug coverage if they have not already chosen to do so. Therefore, Medicare, not Medicaid will provide their drug coverage. Placing the primary financial burden of dually-eligible recipients on the Medicare program is not unusual. States often pay the Medicare Part B premium on behalf of their dually eligible citizens so that Medicare becomes the primary insurer of physician services, rather than the state Medicaid program. According to Phelps (1997, p. 453) states covered the part B premium for 75% of their dually eligible elderly citizens and 20% of their dually eligible permanently disabled citizens.

C. Medicaid Reform and the “Assignment Problem”

In this subsection, we consider the potential for Medicaid reform from a federalism perspective, recognizing that both the Federal and state governments face pressures for reform that will surely increase over time. Any major reform of Medicaid is likely to redraw the boundaries of Federal and state responsibilities for health care. In the literature of federalism, the division of responsibilities among different levels of government is known as the “assignment problem” (see, e.g., Oates (1972)). A persistent theme in this literature suggests that responsibility for redistributive policy belongs at the national level. On the other hand, sub-national governments should play a prominent role in the provision of public goods for which the benefits and costs vary in accordance with local conditions about which these governments are better informed. Intergovernmental transfers from higher- to lower-level governments are often seen either as a form of generalized assistance or as a means by which the higher-level government can influence the allocative decisions of recipient governments, especially to take spillover effects into account. The evolution of policy responsibilities in a federation can be viewed as a reflection of a shifting balance among these sometimes conflicting considerations.

In the US, the Federal government does assume a leading role in financing cash and in-kind redistributive transfers. For the elderly, the Social Security system and Medicare, both entirely Federal programs, are the two major sources of cash and health care benefits. Other Federal-only policies provide cash or near-cash benefits targeted at the poor, including the Supplemental Security Income (SSI) and Food Stamp programs and the Earned Income Tax Credit (EITC). The budgetary costs of these programs fall on

the Federal government, either through increased outlays or through foregone tax revenues (tax expenditures). However, as exemplified by Medicaid, AFDC/TANF, and the State Children's Health Insurance Program (SCHIP), redistributive policy in the US federation has long involved the state governments as well, although in ever-changing proportions.⁶ The recent introduction of prescription drug benefits in Medicare Part D is one more step in this evolution, an "upward reassignment" that consolidates more of the responsibility for health care for the elderly in the hands of the Federal government.

The timing and nature of future major reforms of Medicaid, of related health programs such as Medicare, or of related cash or in-kind programs of assistance to the poor such as TANF, SSI, Food Stamps, or the EITC, cannot be known. However, the Federal government is entering a multi-decade period of fiscal stress, driven largely by the demographic trends discussed earlier.⁷ There will be strong incentives to limit expenditure growth under these conditions, and the amount and form of Federal Medicaid assistance to the states is certain to face close scrutiny. Because Federal grant support for AFDC and Medicaid were so similar in structure prior to the 1996 welfare reform, and because this reform was followed by significant reductions in welfare expenditures, a similar reform of Federal Medicaid assistance to the states is one policy option that will surely attract attention. Indeed, as discussed by Lambrew (2005), Medicaid reforms of

⁶ Prior to the Great Depression, cash assistance to the poor was mainly a state and local function. Indeed, the tradition of local involvement in assistance to the poor goes back much further, as described, for instance, in Brown and Oates (1987). Wallis (1984) discusses the beginnings of Federal government participation in poverty relief during the Depression. Aid to Dependent Children, the forerunner of AFDC and finally TANF, began at this time.

⁷ Unfunded liabilities for Social Security and Medicare over a 75-year horizon are estimated to be more than \$15 trillion of current GDP, larger than the current Federal debt of \$8.8 trillion. See Board of Trustees of the Federal Hospital Insurance ... (2006, p. 61) and Board of Trustees of the Federal OASDI Trust Funds (2006, p. 56).

this type have previously been proposed, by President Reagan in 1981, Speaker of the House Newt Gingrich in 1995, and President Bush in 2003.

In hindsight, the fact that a number of states had applied for and received administrative waivers prior to 1996, enabling them to experiment with significant welfare reforms, was an early indicator of major changes to come. Indeed, some of those experiments served as models for the 1996 reform. For instance, in one widely-cited case, Wisconsin was permitted to introduce training and work requirements as a condition for the receipt of welfare benefits. The 1996 welfare reform codified this trend toward increased policy autonomy for all states, contributing to significant changes in welfare administration in many states that continues today. Coupled with a shift toward lump-sum grants, the 1996 reform effectively resulted in a significant “downward reassignment” of regulatory and “marginal” financial responsibility for cash welfare benefits for the poor. This reassignment allows the states to adapt policy to local conditions, even as it shifts an important element of redistributive policy away from the national government.⁸

Whether an early indicator of major Medicaid reform or not, a number of states have been granted waivers enabling them to experiment with their Medicaid systems, showing that policy experimentation continues in the “laboratory of the states.” The National Conference of State Legislatures (2007) provides information on recently approved “1115” Medicaid waivers in eleven states, as well as proposals being circulated

⁸ Some states have used the flexibility afforded by TANF to decentralize important aspects of welfare policy to local governments, a “second generation devolution” of the welfare system. See Fording (forthcoming) for discussion of Florida's post-TANF decentralization of many aspects of TANF implementation to county-level bodies. Florida now contracts out significant welfare-administration tasks to private-sector firms. Interstate variation in TANF policy presumably reflects local benefit and cost variations.

in ten other states. In Kentucky, for example, CMS recently approved the “KYHealth Choices” waiver, which restructures the standard Medicaid benefit package into four distinct plans tailored towards different types of enrollees (the general population, children, elderly and beneficiaries with disabilities or mental retardation) and increases cost sharing for enrollees on an income-based sliding fee scale.⁹

Reforms being implemented or considered in other states include making risk-adjusted premiums available to enrollees to purchase private insurance plans (Florida and South Carolina) and the provision of personal health savings accounts (multiple states) to purchase health related products and services. Some states (Vermont and Georgia) have even proposed conversion of their Federal matching grant to a block grant (thus providing more cost certainty to the Federal government) in return for greater state control of the administration and structure of their programs.¹⁰ The fact that state Medicaid waiver proposals differ widely may be an indication that local benefit and cost conditions do vary from one state to another and that there may be efficiency gains from decentralization of Medicaid policy.

Perhaps another leading indicator of future changes in state Medicaid programs has been the evolution of and the current reauthorization debate surrounding the State Children’s Health Insurance Program (SCHIP). SCHIP was created by the Balanced Budget Act of 1997 under Title XXI of the Social Security Act. The purpose of the program is to expand health coverage for low income, uninsured children that are not income eligible for Medicaid.

⁹ Two studies that examine the impact of increased cost sharing in public insurance programs are Kenney et al. (2007) and Marton (2007).

¹⁰ Vermont received Federal approval for its proposal and was scheduled to begin a five year demonstration of this new financing arrangement in 2006.

The structure and the financing of the SCHIP program were no doubt influenced by the political climate during which it was created. Like TANF, SCHIP provides states a great deal of flexibility in terms of the generosity and structure of their programs. States were able to choose whether or not to create a new program to cover children, expand their existing Medicaid program, or some combination of the two.¹¹ In order to give states a financial incentive to take advantage of this new program, the Federal government offered states matching rates on SCHIP expenditures that are more generous than the standard Medicaid matching rates. Unlike the Medicaid program, Federal funds allocated to each state for their SCHIP program are capped annually, though states can roll over any unused balances into the future.¹²

As SCHIP moves towards its 10 year anniversary, it is coming up for reauthorization. Many states have balanced their SCHIP budget in recent years by using unspent funding from previous years but are now exhausting these funds and face the full cost of additional expenditures. Some states are adjusting by freezing SCHIP enrollments or are considering the scaling back of income eligibility thresholds. States are lobbying for increased support from the Federal government under the reauthorization in the form of more generous annual allotments. In an effort to control costs, the Bush administration has proposed holding the allotments at their current levels and restricting some of the program's flexibility by limiting coverage to children in families with

¹¹ Some policymakers were initially concerned that such state flexibility may give rise to "substandard" care. Today others are concerned that states have pushed this flexibility "too far" by increasing the income eligibility ceiling too high in their state or enrolling parents as a means to attract more children to their program.

¹² A state's annual allocation is a function of the number of children in families with incomes below 200% of the Federal Poverty Level and the number of uninsured children in families with income below 200% of the Federal Poverty Level.

income up to 200% of the Federal Poverty Level (FPL).¹³ The resolution of this debate may provide insight into the sorts of issues that could arise should Medicaid financing be reformed in a similar way.¹⁴

A reform of Medicaid financing that (like the 1996 welfare reform) replaces the current system of open-ended matching grants with lump-sum grants similar to those introduced under TANF, coupled with further regulatory liberalization, would result in a substantial “downward reassignment” of responsibility for the provision of health care for the poor. By raising the cost of Medicaid spending by at least a factor of two for all states, and much more than this for some, such a reform would create powerful new incentives for states to limit Medicaid expenditures. Such a reform would still leave the financing of health care benefits for the elderly largely in the hands of the Federal government.

Federal government assumption of responsibility for the costs of health care for the elderly protects state governments from the fiscal disparities that arise from the uneven interstate distribution of the elderly described above. Open-ended matching grants do the same, to a substantial degree, but they also change the relative price of health care spending for the states in ways that encourage high expenditures. For this reason, an “upward reassignment” of financial responsibilities for the health care of the aged may represent a superior policy outcome.

To conclude, we note that there remain two potential sources of significant fiscal externalities associated with state government spending on health care for the non-elderly poor. Both are related to the fact that health care costs are concentrated near the end of

¹³ Some states have used the flexibility afforded to them under SCHIP to enroll parents as well as children and /or extend the income eligibility ceiling above 200% FPL.

¹⁴ For more on SCHIP reauthorization, see Kenney and Yee (2007).

life and to the high lifetime mobility of the US population. Some health care expenditures for the young, including children, produce benefits throughout life. The high mobility of the US population implies that a substantial share of the later-in-life benefits of health care costs incurred on behalf of a state's younger residents will accrue to future residents of other states, that is, a large portion of the long-term benefits of health care spending spill across state boundaries. This is a "horizontal" fiscal externality. In a federal system in which the Federal government bears a large share of the cost of health for the elderly, there are also "vertical" fiscal externalities associated with state-level medical interventions for the young. Such interventions -- programs for children or younger adults that preserve cardiovascular fitness, for instance -- will reduce Federal government health care costs in later years.

To our knowledge, these horizontal and fiscal externalities have not previously been studied, but they appear to warrant further investigation. If they give rise to significant horizontal or vertical spillovers, complete decentralization of the responsibility for the health care costs of the non-elderly poor may result in inefficiently low state government health care spending. Matching grants might be used to "internalize" these externalities, the magnitudes of which would depend upon the effect of early-in-life state government health interventions on subsequent health care costs covered by the Federal and other state governments. More precisely, the external benefit from a particular health intervention could be estimated by calculating the present value of future health care cost savings at the Federal level and for other state governments. The latter amount would depend on the estimated probability of migration. Creating fiscal incentives for state governments to take these spillover effects into account could

encourage them to direct their health care spending in ways that benefit the broader society. There is little reason to presume that the current system of matching grants with matching rates inversely dependent on per capita income internalize these spillovers effectively. Furthermore, spillover effects are greatest for early-in-life interventions that produce later-in-life health benefits, a fact that should be reflected in a well-designed system of fiscal incentives to internalize these external effects.

IV. Conclusion

Due to its rapid growth in recent years, Medicaid has become one of the major components of state government budgets. Perhaps ominously, there is little prospect that spending pressures will diminish in the foreseeable future. On the contrary, powerful demographic forces are likely to stimulate demand for still higher Medicaid expenditures. Continued growth in a program that already accounts for a large share of state government spending may impose significant stress on state fiscal systems. It is true that the current system of matching grants relieves states from much of the financial burden that Medicaid spending would otherwise impose; these costs are instead absorbed by the Federal government. But this cost shifting may stimulate Federal interest in policy reforms that limit future expenditure growth.

Major Medicaid reforms are likely to involve some change in the intergovernmental fiscal and regulatory relations that now underpin the program. Already, many states are seeking waivers that allow them to experiment with programmatic modifications. Similar developments preceded the welfare reform of 1996 which, as we have emphasized, led to a fundamental restructuring of Federal government

financial support for, and oversight of, the system of cash welfare benefits provided to the poor. Parallel reforms for Medicaid have been proposed. Such reforms have potentially far-reaching effects on subnational governments. Our earlier theoretical analysis highlights the possibility that the welfare reform may have encouraged states to shift their redistributive transfers to the poor toward health care benefits and away from cash welfare, and our preliminary empirical research finds some tentative support for this hypothesis. A major reform of Medicaid – which, by now, is of far greater budgetary importance to the states than AFDC/TANF spending ever was – would affect all aspects of state government finances, both on the expenditure and on the revenue sides. Prospective policy reforms could profit from additional analytical effort devoted to understanding what some of these effects might be.

Determining the appropriate roles of the state and Federal governments in health care policy is a difficult and complex task. We have identified some but certainly not all of the issues that need to be taken into account in determining what each level of government is best able to do and how their policies should be mutually-adapted. Students of fiscal federalism and of health policy alike can and should contribute much to ongoing and future policy debates regarding Medicaid and the broader health care policy issues facing the nation.

References

- Baicker, Katherine.
“Government Decision-Making and the Incidence of Federal Mandates.” *Journal of Public Economics* 82 No. 2 (November, 2001): 147 - 194.
- Bergstrom, Theodore C. and Robert P. Goodman.
“Private Demand for Public Goods.” *American Economic Review* 63 No. 3 (June, 1973): 280-296.
- Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.
2006 Annual Report of the Board of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds.
- Board of Trustees of the Federal OASDI Trust Funds.
The 2006 Annual Report of the Board of Trustees of the Federal OASDI Trust Funds. Washington, DC: US Government Printing Office, 2006.
- Brown Charles C. and Wallace E. Oates.
“Assistance to the Poor in a Federal System.” *Journal of Public Economics* 32 No. 3 (April, 1987): 307-330.
- Centers for Medicare and Medicaid Services.
Medicare & Medicaid Statistical Supplement. 2006

Medicare & You 2007, CMS Pub. No. 10050. Baltimore, MD: US Department of Health and Human Services, 2007.
- Chernick, Howard.
“Federal Grants and Social Welfare Spending: Do State Responses Matter?” *National Tax Journal* 53 No. 1 (March, 2000): 143-152.
- Chernick, Howard.
“State Fiscal Substitution between the Federal Food Stamp program and AFDC, Medicaid, and SSI.” JCPR Working Paper 123. Northwestern University / University of Chicago Joint Center for Poverty Research, 1999.
- Fording, Richard, Sanford F. Schram, and Joe Soss.
“Devolution, Discretion, and Local Variation in TANF Sanctioning,” *Social Science Review* (forthcoming).
- Granneman, Thomas and Mark Pauly.
Controlling Medicaid Costs: Federalism, Competition, and Choice. Washington, DC: American Enterprise Institute Studies in Health Policy, 1983.

Gruber, Jonathan.

“Medicaid.” In *Means-Tested Transfer Programs in the United States*, edited by Robert A. Moffitt, 15-77. Chicago: University of Chicago Press, 2003.

Kenney, Genevieve, R. Andrew Allison, Julia F. Costich, James Marton, and Joshua McFeeters.

“Effects of Premium Increases on Enrollment in SCHIP: Findings from Three States.” *Inquiry* 43 No. 4 (Winter, 2006 / 2007): 378-392.

Kenney, Genevieve and Justin Yee.

“SCHIP at a Crossroads: Experiences to Date and Challenges Ahead.” *Health Affairs* 26 No. 3 (March/April 2007): 356-369.

Kousser, Thad.

“The Politics of Discretionary Medicaid Spending, 1980-1993.” *Journal of Health Politics, Policy and Law* 27 No. 4 (August, 2002): 639-671.

Lambrew, Jeanne M.

“Making Medicaid a Block Grant Program: An Analysis of the Implications of Past Proposals.” *The Milbank Quarterly* 83 No. 1 (January, 2005): 1-23.

Marton, James.

“The Impact of the Introduction of Premiums into an SCHIP Program.” *Journal of Policy Analysis and Management* 26 No. 2 (Spring, 2007): 237-255.

Marton, James and David E. Wildasin.

“State Government Cash and In-Kind Benefits: Intergovernmental Fiscal Transfers and Cross-Program Substitution.” *Journal of Urban Economics* 61 No.1 (January, 2007): 1-20.

Marton, James and David E. Wildasin.

“Intergovernmental Transfers, State Medicaid, and State Cash Welfare Programs: An Empirical Analysis.” In Preparation and Unpublished, 2007.

McGuire, Therese J. and David F. Merriman.

“State Spending on Social Assistance Programs Over the Business Cycle.” In *Working and Poor: How Economic and Policy Changes are Affecting-Low Wage Workers*, edited by Rebecca M. Blank, Sheldon H. Danziger, and Robert F. Schoeni, xx-xx. New York: Russell Sage Foundation, 2006.

National Conference of State Legislatures

URL: <http://www.ncsl.org/programs/health/1115waivers.htm>

Oates, Wallace E.

Fiscal Federalism. New York: Harcourt, Brace, Jovanovich, 1972.

Phelps, Charles E.

Health Economics Second Edition. New York: Addison Wesley, 1996.

U.S. Census Bureau.

Percent of People Who Are Foreign Born: 2005. American Community Survey 2005a.

State of Residence in 2000 by State of Birth: 2000, Special Tabulation. 2005b.

State Interim Population Projections by Age and Sex: 2004 – 2030, 2007.

Wallis, John J.

“The Birth of the Old Federalism: Financing the New Deal, 1932-1940.” *The Journal of Economic History* 44 No. 1 (March, 1984): 139-159.

White House.

Economic Report of the President. Washington, DC: US Government Printing Office, 2007.

Wildasin, David E.

“Global Competition for Mobile Resources: Implications for Equity, Efficiency, and Political Economy.” *CESifo Economic Studies* 52 No. 1 (March, 2006), 61-111.

Wildasin, David E.

“Public Finance in an Era of Global Demographic Change: Fertility Busts, Migration Booms, and Public Policy.” Unpublished, 2006b.

Tables and Figures

Table 1A
State Government Total, Medicaid, and Cash Welfare Expenditures, 1988-2003, US
Aggregate

(1) Year	(2) State Total Expenditure	(3) Medicaid Expenditure		(4) Cash Welfare Expenditure		(5) Medicaid Budget Share / Cash Welfare Budget Share
	<i>millions of \$</i>	<i>millions of \$</i>	<i>% of State Total Expend</i>	<i>millions of \$</i>	<i>% of State Total Expend</i>	
1988	484,667	48,217	9.95%	16,677	3.44%	2.89
1989	525,077	54,110	10.31%	17,310	3.30%	3.13
1990	572,318	64,463	11.26%	18,906	3.30%	3.41
1991	628,836	76,452	12.16%	20,744	3.30%	3.69
1992	701,601	90,152	12.85%	21,915	3.12%	4.11
1993	743,244	100,992	13.59%	22,481	3.02%	4.49
1994	779,459	107,479	13.79%	22,582	2.90%	4.76
1995	836,894	119,353	14.26%	21,821	2.61%	5.47
1996	859,599	120,709	14.04%	20,208	2.35%	5.97
1997	893,393	123,476	13.82%	18,928	2.12%	6.52
1998	930,037	141,327	15.20%	21,881	2.35%	6.46
1999	998,365	146,614	14.69%	22,992	2.30%	6.38
2000	1,084,097	167,650	15.46%	24,624	2.27%	6.81
2001	1,185,260	186,083	15.70%	25,500	2.15%	7.30
2002	1,282,852	212,460	16.56%	25,205	1.96%	8.43
2003	1,359,048	232,006	17.07%	26,161	1.92%	8.87

Table 1B
State Government Total, Medicaid, and Cash Welfare Expenditures, 2003, by State

(1) State	(2) State Total Expenditure	(3) Medicaid Expenditure		(4) Cash Welfare Expenditure		(5) Medicaid Budget Share / Cash Welfare Budget Share	(6) FMAP
	<i>millions of \$</i>	<i>millions of \$</i>	<i>% of State Total Expend</i>	<i>millions of \$</i>	<i>% of State Total Expend</i>		
AL	18,471	3,471	18.79%	171	0.92%	20.34	70.60
AK	8,122	836	10.29%	88	1.09%	9.48	58.27
AZ	19,606	3,285	16.76%	342	1.74%	9.62	67.25
AR	12,085	2,212	18.30%	54	0.45%	40.78	74.28
CA	204,438	25,812	12.63%	5,851	2.86%	4.41	50.00
CO	17,691	2,269	12.82%	236	1.34%	9.61	50.00
CT	20,721	3,359	16.21%	450	2.17%	7.47	50.00
DE	4,858	750	15.44%	56	1.16%	13.29	50.00
FL	56,317	11,104	19.72%	852	1.51%	13.03	58.83
GA	32,527	5,358	16.47%	501	1.54%	10.70	59.60
HI	7,611	753	9.90%	134	1.76%	5.62	58.77

ID	5,415	867	16.01%	43	0.80%	20.10	70.96
IL	51,291	9,391	18.31%	989	1.93%	9.49	50.00
IN	23,090	3,951	17.11%	313	1.36%	12.61	61.97
IA	13,088	1,996	15.25%	156	1.19%	12.79	63.50
KS	10,954	1,615	14.74%	150	1.37%	10.76	60.15
KY	19,117	3,558	18.61%	191	1.00%	18.62	69.89
LA	18,681	3,615	19.35%	267	1.43%	13.53	71.28
ME	6,706	2,074	30.93%	100	1.49%	20.74	66.22
MD	24,592	4,398	17.88%	366	1.49%	12.02	50.00
MA	32,710	6,392	19.54%	697	2.13%	9.18	50.00
MI	51,016	6,479	12.70%	1,205	2.36%	5.38	55.42
MN	28,899	4,702	16.27%	498	1.72%	9.45	50.00
MS	13,503	2,570	19.03%	120	0.89%	21.41	76.62
MO	21,566	4,407	20.43%	299	1.38%	14.76	61.23
MT	4,437	536	12.09%	56	1.26%	9.63	72.96
NE	6,824	1,283	18.80%	79	1.16%	16.25	59.52
NV	7,816	881	11.28%	85	1.09%	10.39	52.39
NH	5,276	786	14.90%	72	1.37%	10.85	50.00
NJ	44,948	6,030	13.41%	842	1.87%	7.16	50.00
NM	10,673	2,033	19.05%	123	1.15%	16.53	74.56
NY	127,475	35,207	27.62%	4,463	3.50%	7.89	50.00
NC	34,361	6,521	18.98%	457	1.33%	14.28	62.56
ND	3,121	445	14.25%	42	1.34%	10.61	68.36
OH	56,392	10,235	18.15%	1,007	1.79%	10.17	58.83
OK	15,125	2,129	14.07%	203	1.34%	10.48	70.56
OR	18,006	2,116	11.75%	226	1.25%	9.38	60.16
PA	57,428	9,450	16.46%	1,109	1.93%	8.53	54.69
RI	5,977	1,338	22.39%	162	2.72%	8.24	55.40
SC	21,040	3,642	17.31%	148	0.71%	24.53	69.81
SD	2,898	542	18.70%	26	0.91%	20.46	65.29
TN	21,022	5,459	25.97%	274	1.30%	19.90	64.59
TX	76,386	12,525	16.40%	898	1.18%	13.95	59.99
UT	10,252	1,201	11.71%	131	1.28%	9.18	71.24
VT	3,859	642	16.63%	67	1.73%	9.63	62.41
VA	29,129	3,181	10.92%	273	0.94%	11.64	50.53
WA	32,600	4,524	13.88%	572	1.75%	7.91	50.00
WV	10,004	1,830	18.29%	157	1.57%	11.67	75.04
WI	27,658	3,921	14.18%	489	1.77%	8.02	58.43
WY	3,264	325	9.94%	71	2.18%	4.56	61.32

Table 2A
Federal and State Government Medicaid and Cash Welfare Expenditures, 1988-2003, US
Aggregate

(1) Year	(2) Federal Spending on Medicaid		(3) Federal Spending on Cash Welfare		(4) State Spending on Medicaid		(5) State Spending on Cash Welfare	
	millions of \$	% of State Total Expend	millions of \$	% of State Total Expend	millions of \$	% of State Total Expend	millions of \$	% of State Total Expend
1988	27,023	5.58%	9,125	1.88%	21,194	4.37%	7,552	1.56%
1989	30,447	5.80%	9,460	1.80%	23,663	4.51%	7,850	1.50%
1990	36,437	6.37%	10,330	1.80%	28,026	4.90%	8,576	1.50%
1991	43,374	6.90%	11,345	1.80%	33,078	5.26%	9,398	1.49%
1992	51,821	7.39%	12,074	1.72%	38,331	5.46%	9,842	1.40%
1993	58,138	7.82%	12,371	1.66%	42,854	5.77%	10,110	1.36%
1994	61,543	7.90%	12,376	1.59%	45,936	5.89%	10,206	1.31%
1995	67,954	8.12%	11,886	1.42%	51,399	6.14%	9,935	1.19%
1996	68,459	7.96%	10,939	1.27%	52,250	6.08%	9,270	1.08%
1997	69,908	7.82%	10,005	1.12%	53,568	6.00%	8,924	1.00%
1998	79,690	8.57%	11,273	1.21%	61,637	6.63%	10,608	1.14%
1999	82,719	8.29%	12,292	1.23%	63,895	6.40%	10,699	1.07%
2000	95,124	8.77%	13,302	1.23%	72,526	6.69%	11,321	1.04%
2001	105,834	8.93%	14,868	1.25%	80,250	6.77%	10,632	0.90%
2002	120,334	9.38%	14,456	1.13%	92,126	7.18%	10,750	0.84%
2003	131,651	9.69%	16,163	1.19%	100,355	7.38%	10,011	0.74%

Table 2B
Federal and State Government Medicaid and Cash Welfare Expenditures, 2003, by State

(1) State	(2) Federal Spending on Medicaid		(3) Federal Spending on Cash Welfare		(4) State Spending on Medicaid		(5) State Spending on Cash Welfare	
	millions of \$	% of State Total Expend	millions of \$	% of State Total Expend	millions of \$	% of State Total Expend	millions of \$	% of State Total Expend
AL	2,451	13.27%	131	0.71%	1,021	5.53%	39	0.21%
AK	487	5.99%	44	0.55%	349	4.29%	44	0.54%
AZ	2,209	11.27%	260	1.33%	1,076	5.49%	81	0.41%
AR	1,643	13.60%	32	0.26%	569	4.71%	22	0.18%
CA	12,906	6.31%	3,671	1.80%	12,906	6.31%	2,181	1.07%
CO	1,134	6.41%	111	0.62%	1,134	6.41%	126	0.71%
CT	1,680	8.11%	255	1.23%	1,680	8.11%	195	0.94%
DE	375	7.72%	28	0.57%	375	7.72%	29	0.59%
FL	6,533	11.60%	484	0.86%	4,572	8.12%	368	0.65%
GA	3,193	9.82%	326	1.00%	2,164	6.65%	174	0.54%
HI	443	5.82%	58	0.76%	311	4.08%	77	1.01%
ID	615	11.36%	30	0.56%	252	4.65%	13	0.24%

IL	4,696	9.15%	565	1.10%	4,696	9.15%	425	0.83%
IN	2,448	10.60%	200	0.87%	1,502	6.51%	114	0.49%
IA	1,268	9.69%	94	0.72%	729	5.57%	62	0.47%
KS	971	8.87%	82	0.75%	643	5.87%	68	0.62%
KY	2,487	13.01%	119	0.62%	1,071	5.60%	72	0.38%
LA	2,577	13.79%	228	1.22%	1,038	5.56%	40	0.21%
ME	1,374	20.48%	55	0.82%	701	10.45%	45	0.67%
MD	2,199	8.94%	183	0.74%	2,199	8.94%	183	0.74%
MA	3,196	9.77%	338	1.03%	3,196	9.77%	359	1.10%
MI	3,591	7.04%	736	1.44%	2,888	5.66%	469	0.92%
MN	2,351	8.13%	317	1.10%	2,351	8.13%	180	0.62%
MS	1,969	14.58%	98	0.73%	601	4.45%	22	0.16%
MO	2,698	12.51%	170	0.79%	1,709	7.92%	128	0.59%
MT	391	8.82%	41	0.92%	145	3.27%	15	0.33%
NE	763	11.19%	50	0.73%	519	7.61%	29	0.42%
NV	462	5.91%	58	0.74%	420	5.37%	27	0.35%
NH	393	7.45%	40	0.76%	393	7.45%	32	0.61%
NJ	3,015	6.71%	444	0.99%	3,015	6.71%	397	0.88%
NM	1,516	14.21%	90	0.85%	517	4.85%	33	0.31%
NY	17,603	13.81%	2,783	2.18%	17,603	13.81%	1,680	1.32%
NC	4,080	11.87%	252	0.73%	2,442	7.11%	205	0.60%
ND	304	9.74%	33	1.05%	141	4.51%	9	0.29%
OH	6,021	10.68%	614	1.09%	4,214	7.47%	393	0.70%
OK	1,502	9.93%	142	0.94%	627	4.14%	61	0.40%
OR	1,273	7.07%	155	0.86%	843	4.68%	70	0.39%
PA	5,168	9.00%	701	1.22%	4,282	7.46%	407	0.71%
RI	741	12.40%	86	1.44%	597	9.99%	76	1.28%
SC	2,542	12.08%	113	0.53%	1,099	5.23%	36	0.17%
SD	354	12.21%	18	0.62%	188	6.49%	9	0.30%
TN	3,526	16.77%	186	0.88%	1,933	9.20%	88	0.42%
TX	7,513	9.84%	664	0.87%	5,011	6.56%	247	0.32%
UT	855	8.34%	106	1.03%	345	3.37%	25	0.24%
VT	401	10.38%	35	0.90%	241	6.25%	32	0.83%
VA	1,607	5.52%	145	0.50%	1,574	5.40%	128	0.44%
WA	2,262	6.94%	307	0.94%	2,262	6.94%	264	0.81%
WV	1,373	13.73%	122	1.22%	457	4.57%	34	0.34%
WI	2,291	8.28%	321	1.16%	1,630	5.89%	168	0.61%
WY	199	6.10%	42	1.28%	126	3.85%	29	0.90%

Table 3A
Federal Government Medicaid and Cash Welfare Expenditures as a Share of State
Intergovernmental Revenue, 1988-2003, US Aggregate

(1) Year	(2) State Intergovernmental Revenue		(3) Federal Spending on Medicaid		(4) Federal Spending on Cash Welfare	
	<i>millions of \$</i>	<i>% of State Total Expend</i>	<i>millions of \$</i>	<i>% of State IG Rev</i>	<i>millions of \$</i>	<i>% of State IG Rev</i>
1988	107,241	22.13%	27,023	25.20%	9,125	8.51%
1989	115,765	22.05%	30,447	26.30%	9,460	8.17%
1990	126,329	22.07%	36,437	28.84%	10,330	8.18%
1991	143,534	22.83%	43,374	30.22%	11,345	7.90%
1992	169,928	24.22%	51,821	30.50%	12,074	7.11%
1993	188,256	25.33%	58,138	30.88%	12,371	6.57%
1994	204,518	26.24%	61,543	30.09%	12,376	6.05%
1995	215,558	25.76%	67,954	31.52%	11,886	5.51%
1996	221,369	25.75%	68,459	30.93%	10,939	4.94%
1997	230,859	25.84%	69,908	30.28%	10,005	4.33%
1998	240,789	25.89%	79,690	33.10%	11,273	4.68%
1999	253,692	25.41%	82,719	32.61%	12,292	4.85%
2000	274,382	25.31%	95,124	34.67%	13,302	4.85%
2001	305,621	25.79%	105,834	34.63%	14,868	4.86%
2002	335,434	26.15%	120,334	35.87%	14,456	4.31%
2003	361,617	26.61%	131,651	36.41%	16,163	4.47%

Table 3B
Federal Government Medicaid and Cash Welfare Expenditures as a Share of State
Intergovernmental Revenue, 2003, by State

(1) Year	(2) State Intergovernmental Revenue		(3) Federal Spending on Medicaid		(4) Federal Spending on Cash Welfare	
	<i>millions of \$</i>	<i>% of State Total Expend</i>	<i>millions of \$</i>	<i>% of State IG Rev</i>	<i>millions of \$</i>	<i>% of State IG Rev</i>
AL	6,669	36.10%	2,451	36.75%	131	1.97%
AK	1,997	24.59%	487	24.38%	44	2.22%
AZ	6,093	31.07%	2,209	36.26%	260	4.27%
AR	3,685	30.49%	1,643	44.58%	32	0.87%
CA	48,246	23.60%	12,906	26.75%	3,671	7.61%
CO	4,179	23.62%	1,134	27.15%	111	2.64%
CT	4,020	19.40%	1,680	41.78%	255	6.34%
DE	995	20.48%	375	37.70%	28	2.79%
FL	12,851	22.82%	6,533	50.83%	484	3.76%
GA	9,028	27.76%	3,193	35.37%	326	3.61%
HI	1,538	20.21%	443	28.79%	58	3.74%
ID	1,456	26.88%	615	42.27%	30	2.07%
IL	12,027	23.45%	4,696	39.04%	565	4.69%
IN	6,347	27.49%	2,448	38.58%	200	3.15%
IA	3,534	27.00%	1,268	35.86%	94	2.66%
KS	3,267	29.82%	971	29.73%	82	2.50%

KY	5,330	27.88%	2,487	46.65%	119	2.24%
LA	6,502	34.80%	2,577	39.63%	228	3.50%
ME	2,063	30.76%	1,374	66.60%	55	2.67%
MD	5,830	23.71%	2,199	37.72%	183	3.14%
MA	5,130	15.68%	3,196	62.30%	338	6.58%
MI	12,222	23.96%	3,591	29.38%	736	6.02%
MN	5,982	20.70%	2,351	39.30%	317	5.30%
MS	5,086	37.67%	1,969	38.71%	98	1.93%
MO	7,173	33.26%	2,698	37.62%	170	2.38%
MT	1,583	35.67%	391	24.73%	41	2.58%
NE	2,140	31.36%	763	35.68%	50	2.34%
NV	1,498	19.16%	462	30.82%	58	3.85%
NH	1,464	27.75%	393	26.84%	40	2.74%
NJ	9,065	20.17%	3,015	33.26%	444	4.90%
NM	3,221	30.18%	1,516	47.07%	90	2.81%
NY	43,442	34.08%	17,603	40.52%	2,783	6.41%
NC	10,279	29.91%	4,080	39.69%	252	2.45%
ND	1,128	36.14%	304	26.96%	33	2.91%
OH	14,058	24.93%	6,021	42.83%	614	4.37%
OK	4,255	28.13%	1,502	35.30%	142	3.34%
OR	4,216	23.41%	1,273	30.19%	155	3.68%
PA	14,467	25.19%	5,168	35.72%	701	4.85%
RI	1,855	31.04%	741	39.96%	86	4.63%
SC	5,739	27.28%	2,542	44.30%	113	1.96%
SD	1,111	38.35%	354	31.83%	18	1.61%
TN	8,292	39.45%	3,526	42.52%	186	2.24%
TX	24,350	31.88%	7,513	30.86%	664	2.73%
UT	2,494	24.32%	855	34.31%	106	4.25%
VT	1,152	29.86%	401	34.76%	35	3.01%
VA	5,679	19.50%	1,607	28.30%	145	2.56%
WA	7,012	21.51%	2,262	32.26%	307	4.38%
WV	2,975	29.74%	1,373	46.15%	122	4.11%
WI	7,094	25.65%	2,291	32.30%	321	4.52%
WY	1,798	55.08%	199	11.07%	42	2.33%

Figure 1: Annual Medicaid Expenditures as a Share of Annual State Total Expenditures

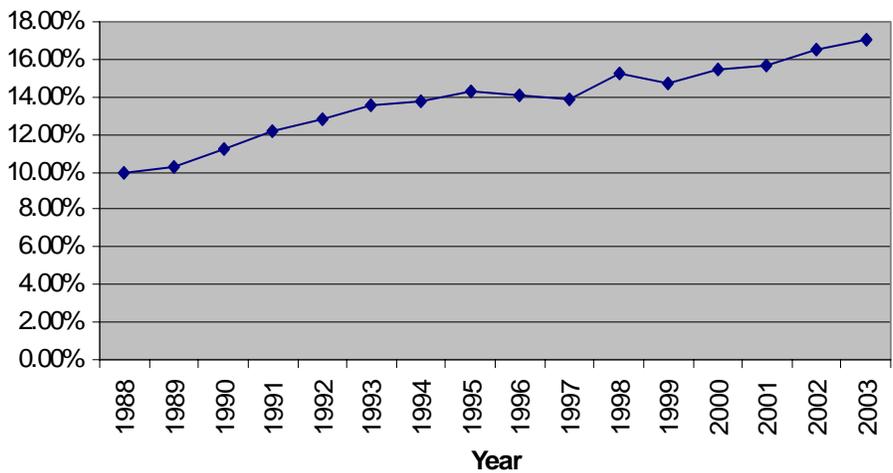


Figure 2: Annual Cash Welfare Expenditures as a Share of Annual State Total Expenditures

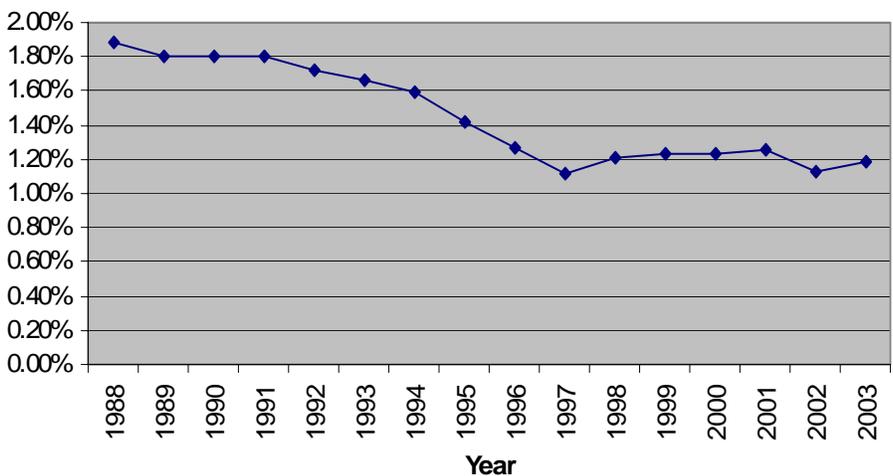


Figure 3: Ratio of the Annual State Medicaid Expenditure Share to the Annual State Cash Welfare Expenditure Share

