Policy in Brief

MACPAC

State Options to Address Medicaid Spending Growth

Summary

The federal government and the states share responsibility for financing Medicaid. States receive federal matching funds for allowable state expenditures on an open-ended basis. Therefore, as state spending increases or decreases, so does federal spending. When states experience circumstances such as unexpected variation in economic conditions on the health system and changes to federal policy, Medicaid's flexibility allows states to incorporate program modifications that can affect coverage, benefit structure, and provider payment, among other considerations. In MACPAC's 2016 report to Congress, the Commission explored state options to address spending growth.

Medicaid's Share of State Budgets

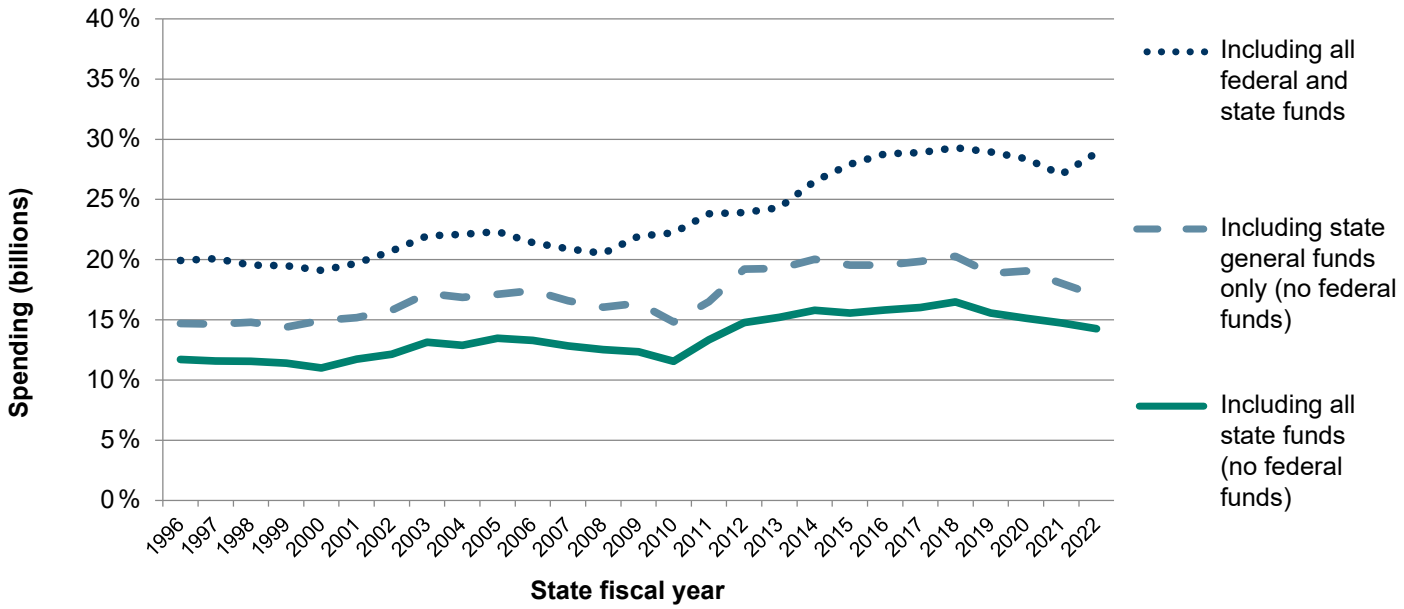
Medicaid accounts for a large share of state budgets. In state fiscal year (SFY) 2022, Medicaid accounted for 28.9 percent of state budgets (Figure 1). Another way to look at state spending is to consider the state-funded portion of budgets (i.e., excluding federal funds). States must finance this amount on their own through, for example, state general revenue and local government contributions. Excluding federal funds, Medicaid accounted for 17.0 percent of spending from state general funds in SFY 2022 (Figure 1).

By the numbers...
(as of SFY 2022)

28.9%
Medicaid accounted for 28.9 percent of state budgets

17.0%
Medicaid accounted for 17.0 percent of spending from state general funds

FIGURE 1. Medicaid as a Share of State Budgets Including and Excluding Federal Funds, SFYs 1996–2022



Sources: MACPAC, 2024, analysis of state expenditure reports from the National Association of State Budget Officers, http://nasbo.org/mainsite/reports-data/state-expenditure-report/state-expenditure-archives.

State Incentives Under a Balanced Budget

Although the availability of federal Medicaid funding may give states an incentive to increase program spending, most states also have requirements to manage spending growth. All states but one have a constitutional or statutory requirement to balance their operating budget (NASBO 2024). States may leverage Medicaid flexibilities to respond to economic conditions and meet their balanced budget requirements.

State Options to Address Spending Growth

States have options in how they design and administer their programs. States may decide whether to cover optional eligibility groups and services, determine provider payment methods and rates, define coverage parameters for services, and adopt strategies to address the volume and intensity of services. Many state cost containment strategies are intended to minimize direct effects on beneficiaries.

Eligibility. States must cover mandatory Medicaid eligibility groups such as low-income children and parents, seniors, and persons with disabilities. State decisions to cover optional eligibility groups affect Medicaid spending. Although states can eliminate optional eligibility groups, most do so only when other opportunities to contain costs have been exhausted.

Benefits. States must cover mandatory Medicaid benefits, such as inpatient hospital and physician services, and have discretion in covering optional services such as prescription drugs and home- and community-based services. States can exercise control over spending by choosing whether to cover optional benefits, defining coverage parameters for services, implementing utilization management tools, or imposing nominal cost sharing. For more information about optional and mandatory benefits in Medicaid, visit www.macpac.gov/subtopic/mandatory-and-optional-benefits/.

Provider payments. States have flexibility in determining fee-for-service provider payment methods and amounts. Although states are required to demonstrate that payment changes do not jeopardize access to care, for the most part federal rules do not specifically direct amounts or changes in the payment. In addressing growing costs, states typically freeze or reduce provider payment rates first.

Delivery systems. States may contract with Medicaid managed care plans, paying them a capitated payment for serving beneficiaries. Federal rules allow the plans to use certain tools to limit the growth of per-person spending, including selective provider contracting and the use of drug formularies.

Program integrity. States must ensure eligibility decisions are made correctly, that providers meet federal and state requirements, services provided to enrollees are medically necessary and appropriate, and provider payments are made in the correct amount and for the appropriate services. When an improper payment is identified, the state must return the federal share to the Centers for Medicare & Medicaid Services (CMS), but may use the retained state share for any approved purpose. In 2024, CMS estimated that the Medicaid program had an overall improper payment rate of 5.1%, a decrease from the 2023 rate of 8.6% (CMS 2024). Improper payments include both expenditures that should not have occurred and instances where there is insufficient or no documentation to support the payment or eligibility decision as proper. While program integrity activities address fraud, waste, and abuse, improper payments are not necessarily caused by fraud.

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References

Centers for Medicare & Medicaid Services (CMS), U.S. Department of Health and Human Services. 2024. *Fiscal year 2024 improper payments fact sheet*. Baltimore, MD: CMS. https://www.cms.gov/newsroom/fact-sheets/fiscal-year-2024-improper-payments-fact-sheet.

National Association of State Budget Officers (NASBO). 2024. *Budget processes in the states*. Washington, DC: NASBO. https://www.nasbo.org/reports-data/budget-processes-in-the-states.

About MACPAC

The Medicaid and CHIP Payment and Access Commission (MACPAC) is a non-partisan legislative branch agency that provides policy and data analysis and makes recommendations to Congress, the Secretary of the U.S. Department of Health and Human Services, and the states on a wide array of issues affecting Medicaid and the State Children's Health Insurance Program (CHIP).