

GAO

Testimony

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MEDICAID

**Matching Formula's
Performance and Potential
Modifications**

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064238 / 154852

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the formula used to share the cost of the Medicaid program between the federal and state governments. As the Congress deliberates on whether to restructure the Medicaid program, the formula for determining the federal match, or the level of federal funding each state is eligible to receive, becomes an important consideration.

In 1965 when the Medicaid program was established, the matching formula was adopted with the objective of narrowing the differences likely to result among the Medicaid programs of wealthier and poorer states. By giving poorer states (as measured by per capita income) a higher federal match, the formula was designed to reduce disparities across states in (1) population groups and services covered in each state program and (2) the tax burden imposed by the financing of Medicaid relative to the size of the state's financial resources.

You have asked that we comment today on the status of the matching formula in reducing the disparity across Medicaid programs and on our work regarding potential modifications. My remarks are based on numerous GAO analyses conducted and reports issued on this subject over the past few years. (See app. V for a list of related products.)

In brief, we have found that the Medicaid matching formula, with its reliance on per capita income as a measure of state wealth, has not significantly reduced wide differences in states' Medicaid programs or the tax burdens to support them. Large disparities persist in coverage of population groups and types of services as well as in the burdens state taxpayers bear in financing state programs. Certain modifications to the formula could enhance the ability of federal payments to narrow program disparities.

BACKGROUND

Medicaid is not 1, but 56 separate programs (including the 50 states, the District of Columbia, and 5 U.S. territories). Federal mandates impose a core of eligibility and benefit requirements, but states have discretion to use Medicaid funds to cover additional low-income individuals and provide additional medical services. As a result, differences in populations served and benefits provided can vary dramatically across states.

To illustrate, Nevada serves 284 Medicaid beneficiaries for every 1,000 poor or near-poor individuals in the state, whereas Rhode Island serves 913 per 1,000. Similarly, Mississippi spends, on average, less than \$2,400 per person on Medicaid services, while New York spends an average of almost \$7,300 per person. These

differences reflect the states' respective spending priorities and their abilities to pay.

State programs also vary in the percentage of program expenditures that are covered by the federal government. The federal percentage is predominantly determined by a formula based on a state's per capita income. The federal government must match what the state spends on Medicaid by this percentage, which by statute must fall within the range of a 50-percent minimum for high-income states to an 83-percent maximum for low-income states.

By federally financing a larger share of total program costs in states with high poverty rates and weak tax bases, the formula was designed to encourage these states to provide levels of medical care services comparable to those provided by states with fewer persons-in-need and stronger tax bases. Per capita income was selected as the formula's proxy measure to reflect the greater burden associated with high poverty rates and limited resources. It was assumed that low-income states experienced a greater incidence of poverty. Policymakers also thought that per capita income could be used in the formula as a good measure of differences in the abilities of states to finance program benefits. Because per capita income was to serve two functions, it was entered into the formula with its value squared.

The use of per capita income squared magnifies income differences among the states and results in wider differences in federal funding percentages. Mississippi, with the lowest per capita income, receives 79 cents from the federal government for each dollar it spends for medicaid benefits. Higher-income states receive lower federal shares. However, current law guarantees that no state will have to pay more than one-half of the total cost of its Medicaid program. Under this provision, 13 higher-income states receive a higher federal share than they otherwise would.¹

WIDE DISPARITIES IN STATES'
MEDICAID PROGRAMS SHOW FORMULA
NOT WORKING AS INTENDED

In fiscal year 1994 the number of people in Nevada's Medicaid program represented 61 percent of the state's population whose income was below the federal poverty level (FPL). Vermont's Medicaid population that year equaled 139 percent of the state's population "below FPL." (See app. I for a complete list of coverage rates and spending per recipient.) Such coverage disparities signal the limitation of the current Medicaid matching formula in making the provision of health benefits to the poor more

¹Alaska, California, Connecticut, Delaware, the District of Columbia, Hawaii, Illinois, Maryland, Massachusetts, New Hampshire, New Jersey, New York, and Virginia.

uniform across the 50 states.

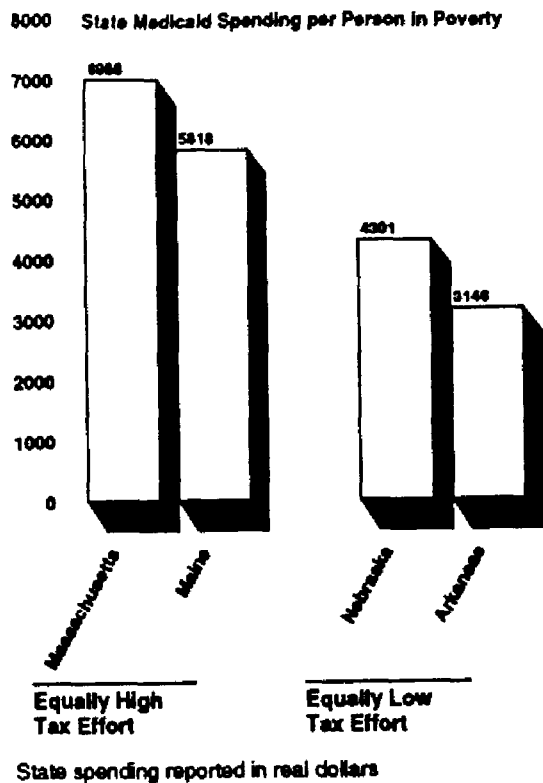
The formula has reduced, but not eliminated, inequities in the tax burdens states bear in financing their Medicaid programs. States making the same effort--devoting the same portion of their tax base to funding Medicaid services--are not able to provide the same spending per person in need.

A comparison of four states illustrates these inequities.² (See fig. 1.³) Massachusetts and Maine, which have relatively extensive Medicaid programs, incur roughly equal tax burdens (the percentage of their tax base spent on Medicaid). Yet Massachusetts, because of its richer tax base, is able to spend 20 percent more per person in need than Maine, even though Maine receives a higher federal match. Nebraska and Arkansas have smaller programs and also equal tax burdens, but Nebraska's richer tax base enables the state to spend (adjusted for cost of services) 37 percent more per person in poverty than Arkansas. Despite the higher match rate, Medicaid's federal matching formula does not compensate for the smaller tax bases of Maine and Arkansas. Taxpayers in these states are at a disadvantage, because they have expended comparatively the same effort or borne the same burden as their wealthier counterparts but can only afford a smaller program.

²For purposes of this illustration we have used the number of people below the official poverty line to reflect the number of people in need and we have adjusted state Medicaid spending by a health care cost index derived from the Medicare hospital reimbursement program in order to compare dollars of comparable purchasing power across states.

³Appendix II contains comparable data for all states.

Figure 1: Equal State Tax Effort Does Not Yield Equal Medicaid Spending on the Poor



FORMULA CHANGES WOULD MODERATE DIFFERENCES IN STATES' MEDICAID COVERAGE AND TAXPAYERS' MEDICAID CONTRIBUTIONS

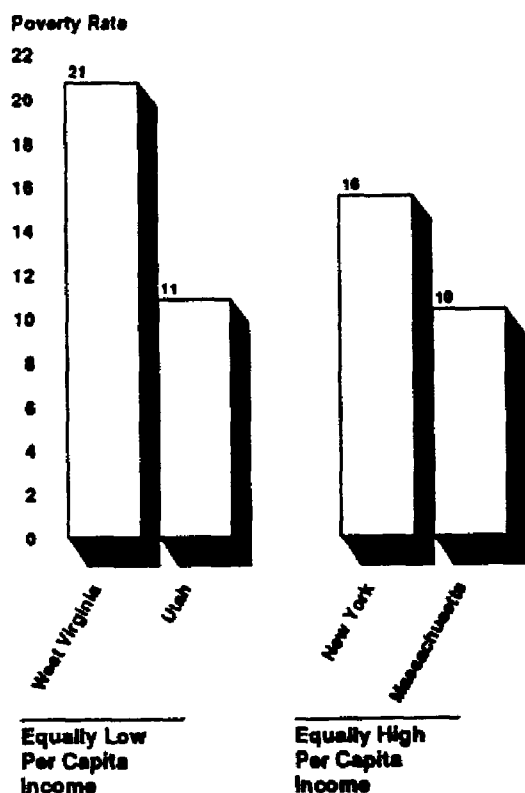
Our work indicates that modification of the formula could improve the prospect of achieving its original goals. Specific changes might include better and more direct measures than per capita income for both the incidence of poverty and states' ability to finance program benefits, adjustors for geographic differences in the cost of health care, and a reduced guaranteed federal minimum match.

Number of People in Poverty More Precise Measure of Poverty than Per Capita Income

Using a state's actual incidence of poverty (the number of people at or below FPL) would significantly improve the measurement of people in need. Per capita income is not always a good proxy for the incidence of poverty because two states with the same per capita income can have very different poverty rates. For example, because West Virginia and Utah both have almost the same average per capita income, the formula treats them as if they had the same

percentages of people in need. However, West Virginia's and Utah's poverty rates--the percentage of the state's population that is poor--are dramatically different. West Virginia's poverty rate is nearly twice as high as Utah's, as shown in figure 2.⁴ This dramatic difference is not an isolated example. Despite similar per capita incomes, New York's poverty rate is nearly 50 percent greater than Massachusetts', and Florida's rate is over 35 percent higher than Minnesota's.

Figure 2: Income Is Not A Good Proxy for Poverty



Total Taxable Resources Better Indicator of State's Funding Capacity

Per capita income as an indicator of a state's ability to finance program benefits does not reflect all the income states can potentially tax. In particular, per capita income includes only a portion of business income generated in a state. Neither corporate profits retained for investment purposes nor dividends paid to out-of-state shareholders are included. Yet states can tax both through various business taxes.

⁴Appendix III contains comparable data for all states.

When income-based formulas were first adopted for federal grant-in-aid programs in the 1950s, per capita income was probably the best available indicator of a state's wealth. The Department of the Treasury now estimates each states' total taxable resources, called TTR. TTR is a more comprehensive measure of states' ability to finance program benefits because it reflects both income produced within the state and income received by state residents. Because TTR is a better measure of states' financing capacity than per capita income, the Congress approved its use as a substitute for per capita income for distributing federal funds under the Alcohol, Drug Abuse and Mental Health Services block grant program.⁵

Differences in a state's TTR and per capita income can be substantial. In such states as New Mexico, Louisiana, Delaware, Wyoming, and Alaska, per capita income understates taxable resources by 5 to 40 percent. At the other extreme, per capita income overstates taxable resources from 4 percent to 7 percent in New Hampshire, Pennsylvania, Rhode Island, Florida, and Maryland. (Data comparing per capita income and TTR for all 50 states are in app. IV.)

Accounting for Differences in Health Care Costs Would Enhance Equity

States' ability to purchase comparable services with similar tax efforts also depends on the cost of health care services in each locale. In states in which the costs of doctors, hospitals, and other health care professionals are relatively high, a dollar of state spending buys less medical care than where these costs are lower. Consequently, inclusion of adjustors to reflect geographic cost differences could enhance the Medicaid formula's ability to moderate disparities.⁶

Although an index based on Medicaid service prices does not exist, other available indices that suggest the geographic differences in the cost of health care are substantial. For example, the index used to adjust Medicare hospital payments for employee wage differences shows that hospital workers in New York and California are paid about 25 percent above the national

⁵In fiscal year 1994, about \$1.3 billion was distributed under this formula.

⁶Adjustments may also be appropriate to account for the cost differences in types of persons served. Medicaid provides services to poor and near-poor elderly, disabled, working-age adults and children. Because serving the elderly and disabled is much more expensive on average than serving other adults and children, adjusting federal payments to reflect these cost differences may be appropriate.

average. In contrast, wages paid to similar workers in Alabama and Wyoming are about 20 percent below the national average.

Reducing Guaranteed Minimum Match Would Likely
Make Benefits More Comparable Among States

The considerable differences among states in the breadth and depth of their Medicaid programs is attributable in part to the formula's guarantee of at least 50 percent in federal matching dollars and the absence of a threshold limiting federal liability. Currently, the guaranteed minimum of 50 percent federal funds allows high-income states with low poverty rates to finance Medicaid programs with relatively low tax burdens. The low tax burden encourages these states to provide more generous programs than most other states may choose to provide. A lower federal minimum would create a stronger incentive for the wealthier states with more generous programs to scale back their programs, making them more comparable with other states.

CONCLUSIONS

In conclusion, the Medicaid formula for calculating a state's entitlement to federal matching funds could play an important role in the restructuring of Medicaid. The current formula has not moderated disparities across states with respect to the populations and benefits Medicaid covers and the relative financial burden states bear in funding their programs. Our work over the years shows that the use of per capita income to reflect a state's wealth sometimes overstates or understates the size of a state's poverty population and its financial resources. Our work also suggests that the inclusion in the formula of such measures as poverty rates, TTR, geographic adjustors of health care cost differences, and a reduction in the guaranteed federal match would help moderate program disparities.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions you or other Committee members may have.

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MEDICAID GRANT, EXPENDITURES, RECIPIENTS, AND POVERTY (FISCAL YEAR 1994)

Census regions and states	Federal grant per person in poverty		Recipients as a percent of persons in poverty		Federal plus state real expenditure per recipient	
	Amount	Index	Percent	Index	Amount	Index
		(U.S. = 100)		(U.S. = 100)		(U.S. = 100)
New England	\$3,951	181.7	113.1	123.6	\$5,985	144.3
Connecticut	4,341	199.6	122.7	134.1	5,815	140.2
Maine	3,325	152.9	98.9	108.1	5,970	143.9
Massachusetts	3,974	182.8	114.7	125.4	5,969	143.9
New Hampshire	4,380	201.4	90.3	98.8	9,440	227.6
Rhode Island	4,112	189.1	106.7	116.6	6,570	158.4
Vermont	2,814	129.4	139.0	152.0	3,648	87.9
Middle Atlantic	3,355	154.3	97.9	107.1	5,862	141.3
New Jersey	3,044	140.0	99.1	108.3	5,478	132.0
New York	3,887	178.8	103.7	113.3	6,004	144.7
Pennsylvania	2,499	114.9	86.3	94.3	5,220	125.8
East North Central	2,141	98.5	90.6	99.1	4,257	102.6
Illinois	1,874	77.0	85.9	93.9	3,937	94.9
Indiana	2,444	112.4	81.4	88.9	5,177	124.8
Michigan	2,166	99.6	88.2	96.4	4,144	99.9
Ohio	2,363	108.7	105.5	115.4	3,933	94.8
Wisconsin	2,505	115.2	84.6	92.5	5,459	131.6
West North Central	2,262	104.0	85.5	93.5	4,953	119.4
Iowa	2,425	111.5	102.2	111.7	4,555	109.8
Kansas	1,984	91.2	82.0	89.6	4,633	111.7
Minnesota	2,635	121.2	78.7	86.0	6,099	147.0
Missouri	2,010	92.4	84.7	92.6	4,432	106.8
Nebraska	2,411	110.9	99.7	108.9	4,397	106.0
North Dakota	2,640	121.4	80.1	87.6	5,546	133.7
South Dakota	2,072	95.3	71.4	78.1	5,339	128.7
South Atlantic	1,882	88.8	90.0	98.3	3,811	91.9
Delaware	2,516	115.7	124.0	135.5	3,864	93.1
District of Columbia	3,382	155.8	104.8	114.6	5,294	127.6
Florida	1,357	62.4	77.6	84.9	3,365	81.1
Georgia	2,019	92.9	103.4	113.1	3,446	83.1
Maryland	2,412	110.9	84.2	92.0	5,708	137.6
North Carolina	2,150	98.9	99.3	108.5	3,781	91.1
South Carolina	2,147	98.7	74.9	81.9	4,740	114.2
Virginia	1,626	74.8	106.0	115.9	3,415	82.3
West Virginia	2,588	118.9	97.9	107.1	4,234	102.1
East South Central	1,868	85.9	89.4	97.7	3,604	86.9
Alabama	1,732	79.7	73.3	80.1	4,134	99.7
Kentucky	1,877	86.3	88.2	96.4	3,578	86.2
Mississippi	1,659	76.3	83.3	91.0	3,635	87.6
Tennessee	2,132	98.1	108.7	118.8	3,387	81.7
West South Central	1,975	90.8	78.9	86.3	4,236	102.1
Arkansas	1,853	85.2	78.5	83.6	4,306	103.8
Louisiana	3,098	142.5	79.6	87.0	6,095	146.9
Oklahoma	1,304	60.0	65.0	71.0	3,612	87.1
Texas	1,766	81.2	81.8	89.4	3,728	89.9
Mountain	1,818	83.6	82.2	89.9	3,588	86.5
Arizona	1,953	89.8	89.9	98.3	3,372	81.3
Colorado	1,802	82.9	82.4	90.1	4,125	99.4
Idaho	1,557	71.6	72.7	79.5	3,570	86.1
Montana	2,103	96.7	78.6	86.0	4,476	107.9
Nevada	1,416	65.1	60.9	66.6	4,111	99.1
New Mexico	1,604	73.8	84.0	91.8	2,821	68.0
Utah	2,080	95.7	80.3	87.8	3,739	90.1
Wyoming	2,086	95.9	94.8	103.6	4,160	100.3
Pacific	1,558	71.7	100.2	109.5	2,482	59.8
Alaska	3,007	138.3	123.7	135.2	3,473	83.7
California	1,376	63.3	96.8	105.6	2,256	54.4
Hawaii	2,314	106.4	116.9	127.8	3,471	83.7
Oregon	2,032	93.4	111.8	122.2	2,811	67.8
Washington	2,664	122.5	120.6	131.8	3,851	92.8
U. S. average	\$2,174	100.0	91.5	100.0	\$4,148	100.0

STATE TAX EFFORT COMPARED WITH MEDICAID SPENDING
PER PERSON IN POVERTY (FISCAL YEAR 1994)

State	Tax effort as percent of U.S. average	Real Medicaid benefits per person in poverty	Federal medical assistance percentage
New York	211.8	\$6,411	50.00
Rhode Island	164.7	7,095	53.87
New Hampshire	154.6	8,554	50.00
Massachusetts	146.2	6,988	50.00
Maine	143.6	5,818	61.96
District of Columbia	135.2	5,699	50.00
Louisiana	122.5	4,746	73.49
Connecticut	119.9	7,323	50.00
Minnesota	108.6	4,800	54.65
Michigan	107.3	3,681	56.37
Pennsylvania	107.1	4,514	54.61
New Jersey	103.5	5,514	50.00
Vermont	100.9	5,016	59.55
West Virginia	99.4	4,021	75.72
Washington	96.5	4,677	54.24
Illinois	93.3	3,373	50.00
Maryland	92.2	4,803	50.00
Ohio	90.3	4,110	60.83
Missouri	90.1	3,680	60.64
California	88.4	2,248	50.00
Indiana	86.4	4,155	63.49
Tennessee	86.0	3,597	67.15
Georgia	85.0	3,511	62.47
Florida	84.4	2,590	54.78
Wisconsin	83.0	4,543	60.47
South Carolina	83.0	3,462	71.08
Kentucky	77.0	3,068	70.91
North Carolina	77.0	3,681	65.14
Texas	76.1	3,002	64.18
Arizona	74.5	3,020	65.90
Hawaii	74.4	4,130	50.00
Delaware	73.8	4,814	50.00
Kansas	72.8	3,720	59.52
Oregon	72.3	3,163	62.12
Iowa	70.7	4,512	63.33
North Dakota	68.0	4,321	71.13
Arkansas	67.3	3,146	74.46
Mississippi	67.3	2,844	78.85
Montana	67.2	3,424	71.05
Nebraska	66.7	4,301	61.98
Alabama	65.9	2,922	71.22
Alaska	65.5	4,447	50.00
Colorado	63.3	3,362	54.30
Virginia	62.2	3,556	50.00
South Dakota	61.7	3,655	69.50
Nevada	61.3	2,542	50.31
New Mexico	58.5	2,336	74.17
Oklahoma	55.5	2,262	70.39
Idaho	48.5	2,532	70.92
Wyoming	47.9	3,803	65.63
Utah	43.8	2,977	74.35
U.S. average	100.0	\$3,795	---

**STATE PER CAPITA INCOME COMPARED WITH
STATE POVERTY RATES (CALENDAR YEARS 1991-93)**

State	Per capita income as percent of U.S. average	Average poverty rate
District of Columbia	140.1	20.7
Connecticut	134.6	8.8
New Jersey	129.0	10.2
New York	119.5	15.5
Massachusetts	117.9	10.3
Maryland	115.8	10.0
Hawaii	112.1	9.0
Alaska	111.2	9.5
Nevada	108.9	11.7
Illinois	108.0	14.5
New Hampshire	107.9	8.7
California	107.1	16.8
Washington	105.2	10.8
Delaware	105.1	8.7
Virginia	104.0	9.5
Colorado	102.8	10.1
Pennsylvania	102.3	12.1
Rhode Island	101.2	10.7
Minnesota	101.2	12.1
Florida	99.2	16.5
Michigan	98.0	14.3
Kansas	95.4	12.2
Nebraska	94.9	10.3
Wisconsin	94.7	11.2
Wyoming	94.6	11.5
Missouri	94.2	15.2
Ohio	94.1	13.1
Vermont	93.2	11.4
Oregon	93.1	12.4
Georgia	92.0	15.5
Texas	91.6	17.4
Indiana	91.2	13.1
Maine	90.3	14.5
Iowa	89.2	10.6
North Carolina	88.7	14.5
Tennessee	87.4	17.2
Arizona	87.1	14.8
South Dakota	86.1	14.3
Idaho	83.3	14.2
North Dakota	82.9	12.4
Montana	82.6	14.9
Alabama	81.9	17.9
Oklahoma	81.8	18.8
Kentucky	81.2	19.3
South Carolina	80.6	18.0
Louisiana	79.0	22.9
New Mexico	77.7	20.2
Utah	77.2	10.8
West Virginia	77.1	20.7
Arkansas	76.6	18.5
Mississippi	69.8	24.6
U. S. Average	100.0	14.6

**DIFFERENCES IN STATE PER CAPITA INCOME AND STATE
PER CAPITA TOTAL TAXABLE RESOURCES (TTR) (CALENDAR YEARS 1991-93)**

State	Per capita income		Per capita TTR		Differences in percent of U.S. average
	Amount	Percent of U.S. average	Amount	Percent of U.S. average	
Alaska	\$22,289	111.2	\$36,868	155.9	40.23
Wyoming	18,968	94.6	25,940	109.7	15.94
Delaware	21,057	105.1	28,736	121.6	15.70
Louisiana	15,839	79.0	21,167	89.5	13.30
New Mexico	15,570	77.7	19,315	81.7	5.17
Texas	18,352	91.6	22,673	95.9	4.74
North Carolina	17,784	88.7	21,908	92.7	4.44
Hawaii	22,477	112.1	27,392	115.9	3.32
Utah	15,470	77.2	18,791	79.5	2.98
Nebraska	19,014	94.9	22,899	96.9	2.11
California	21,459	107.1	25,772	109.0	1.82
Georgia	18,449	92.0	22,116	93.5	1.63
Tennessee	17,518	87.4	20,958	88.6	1.43
North Dakota	16,618	82.9	19,864	84.0	1.34
Kentucky	16,282	81.2	19,461	82.3	1.34
Nevada	21,819	108.9	26,064	110.2	1.28
South Carolina	16,154	80.6	19,293	81.6	1.25
Minnesota	20,279	101.2	24,201	102.4	1.18
Mississippi	13,994	69.8	16,651	70.4	0.88
South Dakota	17,255	86.1	20,431	86.4	0.39
Iowa	17,870	89.2	21,130	89.4	0.25
Illinois	21,650	108.0	25,510	107.9	(0.11)
Kansas	19,121	95.4	22,511	95.2	(0.19)
Indiana	18,279	91.2	21,471	90.8	(0.41)
Oklahoma	16,394	81.8	19,252	81.4	(0.44)
Arkansas	15,352	76.6	18,020	78.2	(0.48)
Massachusetts	23,633	117.9	27,719	117.3	(0.56)
Ohio	18,855	94.1	22,088	93.4	(0.68)
Washington	21,093	105.2	24,709	104.5	(0.69)
New York	23,947	119.5	28,040	118.6	(0.73)
Virginia	20,837	104.0	24,324	102.9	(1.03)
Alabama	16,406	81.9	19,143	81.0	(1.08)
Connecticut	26,986	134.6	31,472	133.1	(1.12)
Wisconsin	18,973	94.7	22,090	93.4	(1.29)
Missouri	18,880	94.2	21,968	92.9	(1.35)
Colorado	20,614	102.8	23,911	101.1	(1.68)
Idaho	16,705	83.3	19,303	81.6	(2.03)
Oregon	18,659	93.1	21,477	90.8	(2.42)
Montana	16,548	82.6	19,044	80.6	(2.43)
New Jersey	25,863	129.0	29,662	125.5	(2.76)
Vermont	18,686	93.2	21,397	90.5	(2.92)
Arizona	17,465	87.1	19,930	84.3	(3.25)
Maine	18,095	90.3	20,625	87.2	(3.37)
West Virginia	15,450	77.1	17,607	74.5	(3.39)
Pennsylvania	20,496	102.3	23,326	98.7	(3.51)
Michigan	19,641	98.0	22,227	94.0	(4.06)
Rhode Island	20,294	101.2	22,893	96.8	(4.36)
New Hampshire	21,623	107.9	24,337	102.9	(4.58)
Maryland	23,207	115.8	25,744	108.9	(5.95)
Florida	19,874	99.2	21,749	92.0	(7.22)
U. S. average	\$20,043	...	\$23,641

RELATED GAO PRODUCTS

Medicaid: Spending Pressures Drive State Toward Program Reinvention (GAO/HEHS-95-122, Apr. 4, 1995).

Medicaid: States Use Illusory Approaches to Shift Program Costs to Federal Government (GAO/HEHS-94-133, Aug. 1, 1994).

Medicaid: Alternatives for Improving the Distribution of Funds to States (GAO/HRD-93-112FS, Aug. 20, 1993).

Medicaid Formula: Fairness Could Be Improved (GAO/T-HRD-91-5, Dec. 7, 1990).

Changing Medicaid Formula Can Improve Distribution of Funds to States (GAO/GGD-83-27, Mar. 9, 1983).

