

## SECTOR IN-DEPTH

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## Contacts

**Genevieve Nolan** 212-553-3912  
*VP-Senior Analyst*  
 genevieve.nolan@moody.com

**Nicholas Samuels** 212-553-7121  
*VP-Sr Credit Officer/Manager*  
 nicholas.samuels@moody.com

**Emily Raimes** 212-553-7203  
*VP-Sr Credit Officer/Manager*  
 emily.raimes@moody.com

**Timothy Blake** 212-553-4524  
*MD-Public Finance*  
 timothy.blake@moody.com

**Pisei Chea** 212-553-0344  
*Analyst*  
 pisei.chea@moody.com

**Tenzing T Lama** 212-553-4873  
*Associate Analyst*  
 tenzing.lama@moody.com

## State Government - US

# Medicaid Pressures State Budgets With or Without Federal Policy Changes

US states face significant growth in Medicaid expenses under current law and could face even higher expenses if the federal government enacts proposals to reduce funding or shift costs to states. Medicaid costs represent a credit challenge for the sector because expenditure growth under both scenarios is likely to grow at a faster pace than aggregate state tax revenues. Growing Medicaid expenses' effect on states varies because of the wide-ranging size and scope of the healthcare program for low-income families and individuals.

- » **State Medicaid spending will grow faster than tax revenue under current law.** Changes in federal Medicaid funding policy could cause additional expenditure growth, a significant funding burden for all states.
- » **At least 10% of residents in every state participate in Medicaid, but some states have significantly larger portions of residents enrolled.** Participation in the expansion program has been especially robust in states such as [Oregon](#) (Aa1 stable), [New Mexico](#) (Aa1 negative) and [Kentucky](#) (Aa2 stable).
- » **State spending on Medicaid is already a significant expenditure for some states.** The funding burden varies from 7%-32% of state own-source revenues, in part due to differing benefit levels, utilization rates and healthcare prices.
- » **The relative size of federal spending by state varies widely: in some states it is more than 40% of state own-source revenues.** The higher percentages are mostly for less wealthy states measured by per capita income.
- » **Federal spending specifically for Medicaid expansion exceeds 10% of own-source revenues in several states.** The 90% federal match rate for expansion under current law compares with core program match rates ranging from 50%-75% for states.
- » **States with high Medicaid participation rates and more federal funding are more exposed to potential future federal funding changes.** Eight expansion states — including [Arizona](#) (Aa2 stable), [Arkansas](#) (Aa1 stable), Kentucky, [Louisiana](#) (Aa3 negative), New Mexico, [Ohio](#) (Aa1 stable), Oregon and [West Virginia](#) (Aa2 stable) — are especially exposed to funding changes.
- » **The federal government may expand state flexibility to control Medicaid expenditures, a credit positive if not offset by other federal cost shifts.** Changes in federal law or through administrative waivers under current law could allow additional expense flexibility.

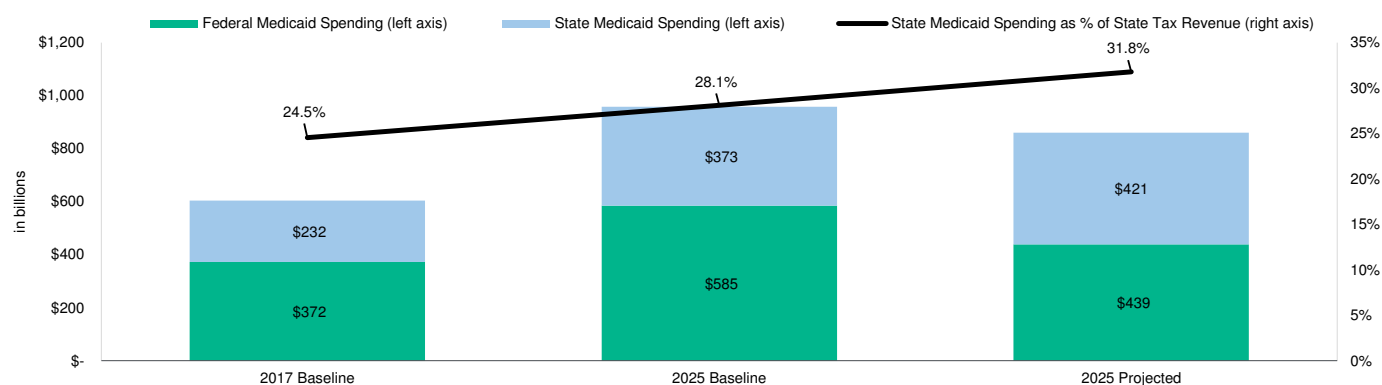
### Overview of Medicaid program and recent legislation

Currently the federal government and states share the funding burden for Medicaid expenses; the federal government pays as much as 75% of state Medicaid costs on an annual basis. The federal share is based on state per capita income. The Affordable Care Act (ACA) allows states to expand Medicaid eligibility requirements, affording non-elderly adults with incomes up to 138% of the federal poverty level the opportunity to enroll for benefits. Like the core Medicaid program itself, expansion under the ACA is voluntary and 19 states chose to maintain the status quo.

In May, the US House of Representatives passed legislation to repeal and replace the ACA. The bill proposed changing the current Medicaid funding formula to a per capita allocation and reducing the federal reimbursement rate for the Medicaid Expansion program. Based on an earlier and similar version of the House bill, the Congressional Budget Office estimated federal spending would be reduced by \$880 billion over the next decade, reaching a 25% reduction in annual federal spending by 2026. The US Senate has yet to vote on the bill.

Exhibit 1

### State Medicaid Spending Would Grow Above Baseline Projections If Federal Aid Reduced



Sources: Centers For Medicare and Medicaid Services, Congressional Budget Office, Moody's Investors Service

### Under current law, state Medicaid spending across the sector will grow faster than tax revenue due to medical inflation rates

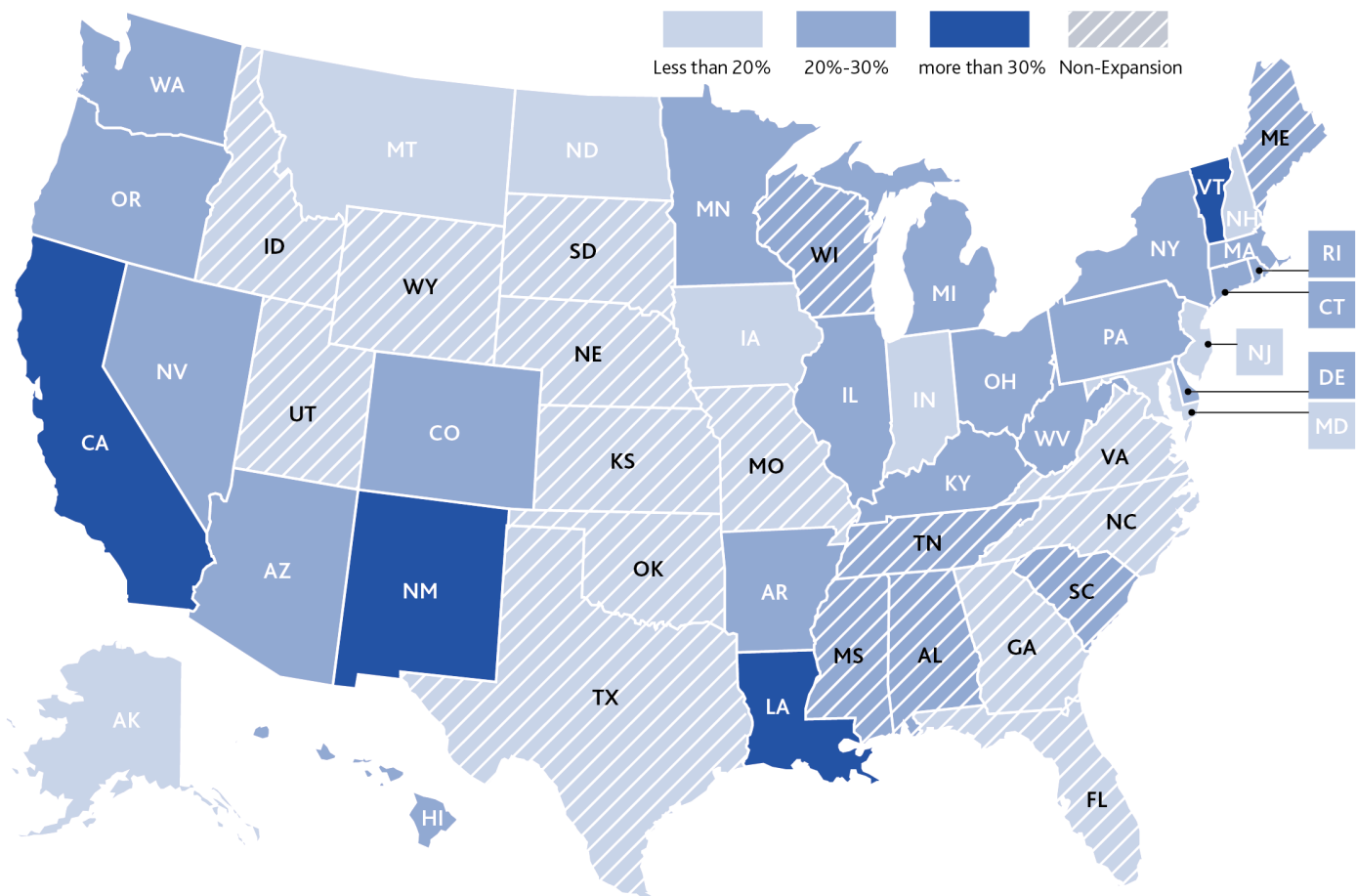
- » Medicaid expenditures under current law will grow to 28.1% of projected state tax revenue by 2025, we estimate, up from 24.5% of tax revenues in 2017 (see Exhibit 1 above).
- » A shift in federal Medicaid funding policy would result in even higher growth for states that decide to preserve benefits even with reduced federal aid.
- » Assuming the federal government reduces its Medicaid expenditures by 25% in 2025, or \$146 billion as projected by the Congressional Budget Office, and states assume a portion of the federal reduction, future state Medicaid expenditures could rise to an estimated 31.8% of projected state revenues.

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Exhibit 2

### New Mexico Has Highest Rate of Medicaid Enrollment

2016 total Medicaid enrollment as a % of state population

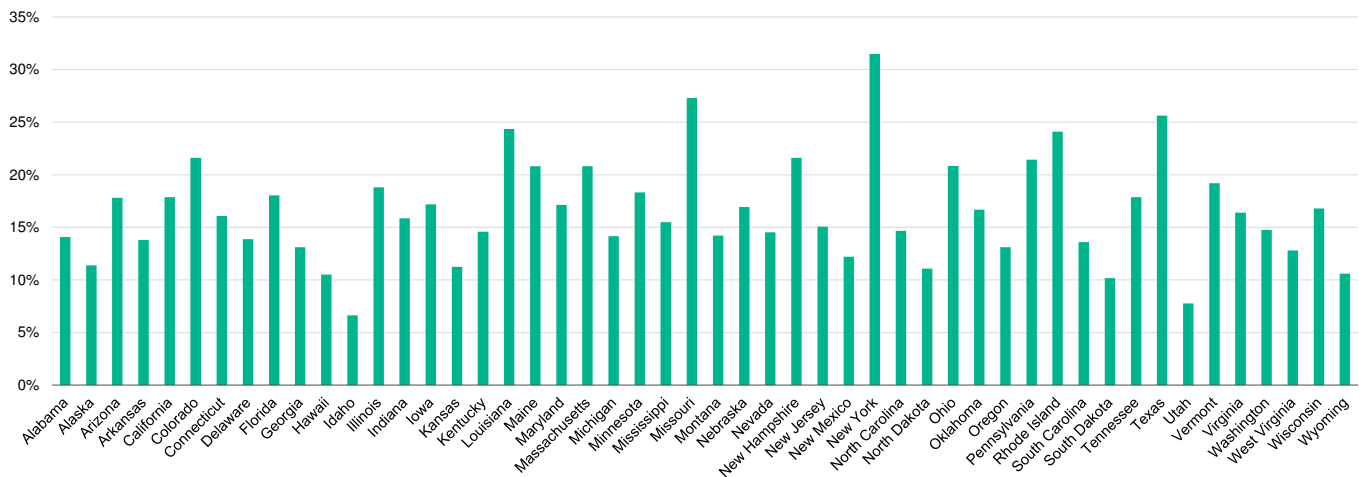


Sources: "Medicaid Expansion Enrollment" The Henry J. Kaiser Family Foundation, Moody's Investors Service

#### At least 10% of every state's residents participate in Medicaid, which makes instituting changes to the program politically difficult given the high utilization rate

- » New Mexico has the highest Medicaid participation rate, with enrollment at 41.1% of total residents (see Exhibit 2 above).
- » Participation in the expansion program has also been especially robust in other states, including Oregon (11.7%), New Mexico (11.7%) and Kentucky (10.0%).
- » Under the current law, states still have the option to expand Medicaid services. Recent experiences in [Kansas](#) (Aa2 negative) and [Virginia](#) (Aaa stable), however, demonstrate continued reluctance to expand. Kansas' governor vetoed a bill to expand coverage, while the Virginia legislature several times has voted down proposals to expand Medicaid.
- » While non-expansion states may decide to enroll in the future, we expect the change to be gradual, similar to the adoption of the core Medicaid program, which took 17 years to be adopted by all 50 states.

Exhibit 3

**State Medicaid Spending Averaged 16% of Revenues in Fiscal 2016****2016 state Medicaid spending as a % of state own-source revenue**

Sources: "Federal and State Share of Medicaid Spending" The Henry J. Kaiser Family Foundation, Moody's Investors Service

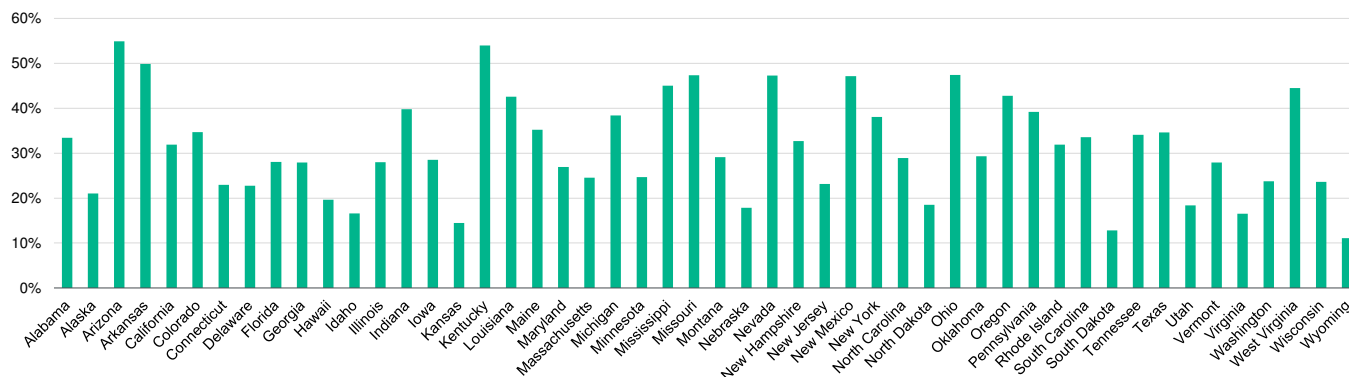
**State spending on Medicaid is already a significant expenditure for some states, although funding varies from 7% to 32% of state own-source revenue**

- » Own-source<sup>1</sup> Spending varies amongst states, in part, because of variations in eligibility, services covered and administration costs.
- » [New York](#) (Aa1 stable) and [Missouri](#) (Aaa stable) have the highest state Medicaid expenditures, at 31.5% and 27.3% of revenues, respectively (see Exhibit 3 above).
- » New York expenditures are higher largely due to higher prices for medical care, as well as higher utilization rates than other states and a lower match rate from the federal government.
- » [Idaho](#) (Aa1 stable) and [Utah](#) (Aaa stable) spent less than 10% of revenues on Medicaid expenditures in fiscal 2016.

Exhibit 4

**State Reliance on Federal Medicaid Revenues Varies Between 11% and 55% of Revenue**

2016 federal Medicaid revenues as a % of state own-source revenue



Sources: "Federal and State Share of Medicaid Spending" The Henry J. Kaiser Family Foundation, Moody's Investors Service

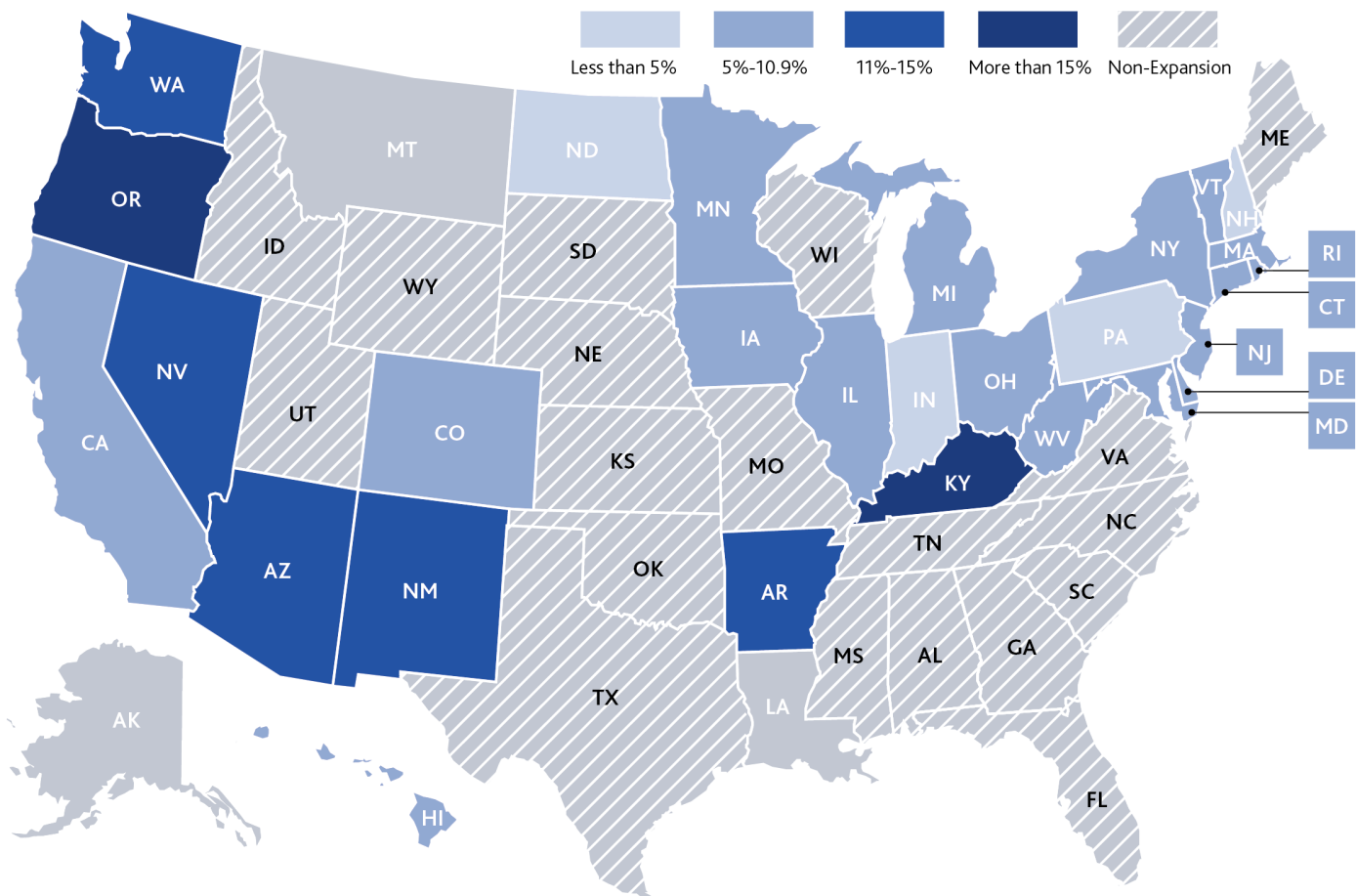
**The relative size of federal spending by state varies widely, and in some states is more than 40% of state own-source revenues, elevating their exposure to a potential future reduction of federal funding**

- » Eleven states receive federal Medicaid funds that exceed 40% of their own source revenue, including Arizona, Arkansas, Kentucky, Louisiana, [Mississippi](#) (Aa2 negative), Missouri, [Nevada](#) (Aa2 stable), New Mexico, Ohio, Oregon and West Virginia. These states may face more difficulty absorbing Federal revenue declines because the cost-shift could absorb a larger portion of available revenues (see Exhibit 4 above).
- » The elevated federal funding is largely due to demographics; states with lower average per capita income receive more federal Medicaid funding. Ohio and Oregon have somewhat higher wealth levels but robust enrollment trends.
- » Nine states receive federal Medicaid revenue that is 20% or less of their own source revenue — [Hawaii](#) (Aa1 stable), Idaho, Kansas, Nebraska, [North Dakota](#) (Aa1 negative), [South Dakota](#) (Aaa stable), Utah, Virginia and Wyoming — making it relatively easier to absorb potential federal aid losses.
- » Wyoming and South Dakota both receive less than 15% of revenues from the federal government.

Exhibit 5

**Federal Expansion Expenditures Comprise Significant Shares of Kentucky and Oregon Revenues**

Total Medicaid expansion expenditures as a % of state own-source revenue



Alaska (Aa2 negative), Louisiana and Montana (Aa1 stable) expanded Medicaid but did not have expansion expenditures during the data collection period. Expansion expenditure data is an annualized estimate based on available data

Sources: "What Coverage and Financing is at Risk Under a Repeal of the ACA Medicaid Expansion?" The Henry J. Kaiser Family Foundation, Moody's Investors Service

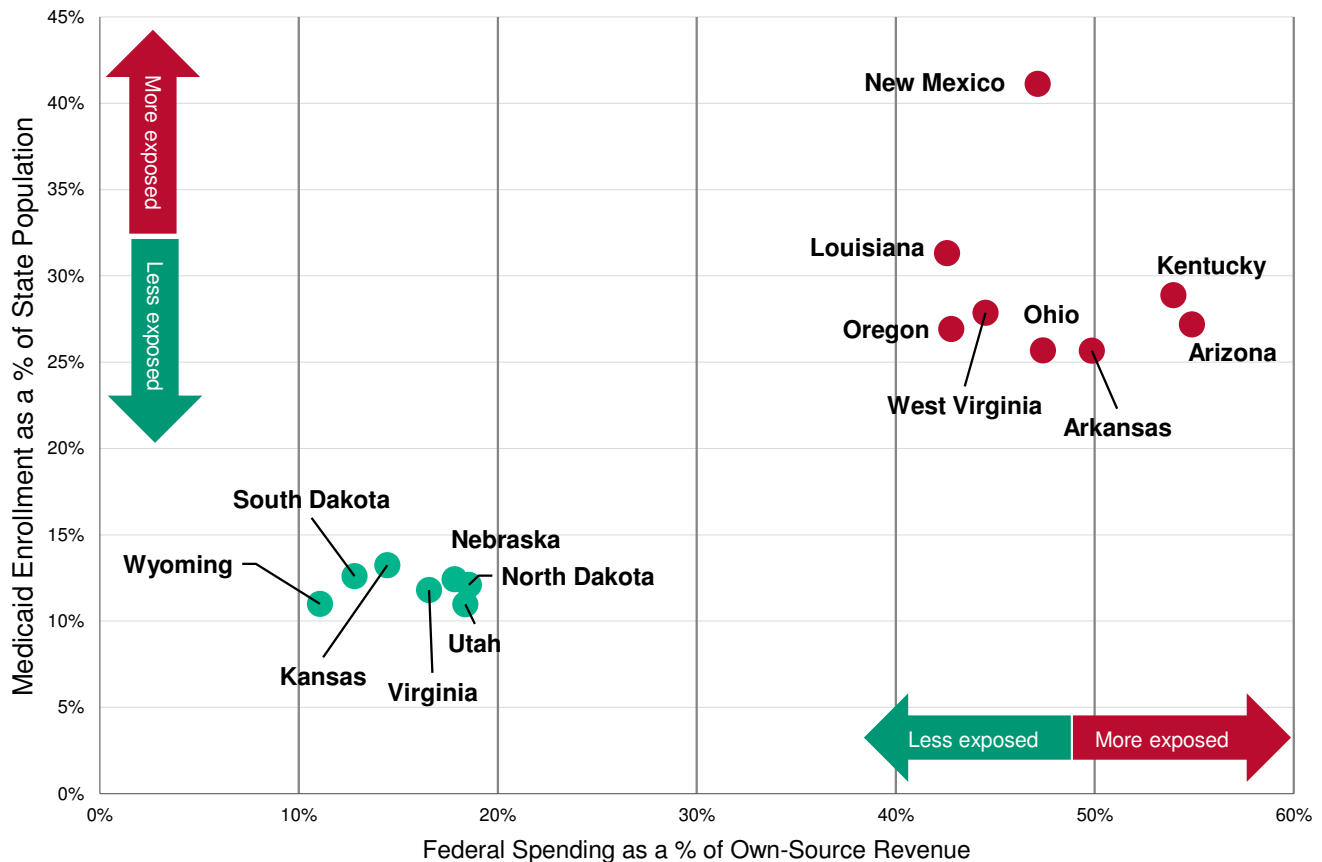
**Spending specifically related to Medicaid expansion exceeds 10% of state-source revenues in several states**

- » If the federal expansion program is eliminated, states face varying levels of budgetary exposure if they decide to maintain similar levels of coverage for the expansion population.
- » The 19 states that did not expand Medicaid are insulated from any future changes to federal funding for this portion of the program.
- » Of the states that expanded coverage, Oregon and Kentucky face the largest funding burdens for the expansion program. Estimated annualized expansion costs reached 15.8% and 16.5% of fiscal 2016 own-source revenue, respectively (see Exhibit 5 above).
- » Oregon, Kentucky, and New Mexico have the largest portions of their population enrolled in the expansion program of the 31 states that expanded coverage, as of 2016.
- » Across the sector, total estimated annualized federal expansion spending was only 6.5% of total fiscal 2015 own-source revenue for all states.

Exhibit 6

### Elevated Federal Medicaid Spending and High Enrollment Increase States' Exposure to Future Federal Policy Changes

Total Medicaid enrollment ratio + federal spending ratio



Sources: "Medicaid Expansion Enrollment" The Henry J. Kaiser Family Foundation, "Federal and State Share of Medicaid Spending" The Henry J. Kaiser Family Foundation, Moody's Investors Service

#### States with high Medicaid participation rates and higher federal spending are more exposed to future federal funding changes

- » All of the states with greater exposure to federal funding reductions, as measured by enrollment rates and federal Medicaid revenue received, have expanded coverage under the ACA (see Exhibit 6 above).
- » Arkansas and Kansas are taking steps to change participation in their expansion programs by imposing work requirements, but federal approval is still required for modifications.
- » Of the states with less exposure, due to lower enrollment and federal revenue, only one has expanded coverage — North Dakota.
- » Only 11% of Utah and Wyoming residents have enrolled in Medicaid, the lowest enrollment rates in the country.

Exhibit 7

**Previously Denied Waivers May Get A Second Chance Under New Administration**

	Previously denied waivers - old administration	New pending waivers - new administration
Work Requirements for Beneficiaries	X	X
Term Limits for Beneficiaries*	X	X
Drug Screenings for Beneficiaries		X
Premiums that Exceed 2% of Income		X

\*Arizona has yet to formally submit a waiver for term limits; it is currently out for public comment

Sources: "Key Themes in Section 1115 Medicaid Expansion Waivers" The Henry J. Kaiser Family Foundation, "Medicaid Waiver Requests in Wisconsin and Maine Seek to Impose Work Requirements and Time Limits for Beneficiaries" The Henry J. Kaiser Family Foundation, and Arizona Health Care Cost Containment System, SB 1092 Legislative Directive Waiver Proposal

### The federal government may expand state flexibility to control Medicaid expenditures, a credit positive if not offset by other federal cost shifts

- » Additional expenditure flexibility could be provided via changes in law or through administrative waivers under current law. The Centers for Medicare and Medicaid Services (CMS) approves waivers, which grant states additional programmatic flexibility above and beyond what is currently allowed (see Exhibit 7 above).
- » Secretary of Health and Human Services (HHS) Dr. Thomas Price and CMS Administrator Seema Verma issued a letter to governors highlighting the Trump administration's commitment to giving states greater flexibility in running their Medicaid programs.
- » States such as Arizona, Wisconsin and Maine have introduced waivers under the new administration to help control Medicaid costs, some of which were denied by the previous administration.
- » Florida is in the process of working with HHS to receive additional federal funds for low-income health care expenditures without formally expanding Medicare eligibility. With Disproportionate Share Hospital (DSH) funding falling beginning in fiscal 2018 for non-expansion states, the additional funds would provide an incentive to Florida to not expand.

This report was included in [MuniMonitor: July 2017](#).



## Moody's Related Research

» [Proposed American Health Care Act Would Be Credit Negative for the US States Sector](#) (March 2017)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

## Endnotes

<sup>1</sup> Total governmental funds revenue, less federal revenue, as reported in state CAFRs.

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Contacts

Genevieve Nolan  
*VP-Senior Analyst*  
genevieve.nolan@moody's.com

212-553-3912

Tenzing T Lama  
*Associate Analyst*  
tenzing.lama@moody's.com

212-553-4873

Pisei Chea  
*Analyst*  
pisei.chea@moody's.com

212-553-0344

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