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Medicaid Plays a Critical Role in Illinois' Economy

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I. Introduction

Medicaid spending is often misunderstood and misrepresented because of the complexities of its financing structure. This report is intended to: (1) clarify how Illinois' Medicaid program is funded, (2) highlight the benefits to the state of Medicaid's financing structure, (3) identify the percentage of state, own-source general fund spending dedicated to the program and (4) demonstrate the economic impact Medicaid spending (or cuts) has on the state and local economy.

Medicaid, including the State Children's Health Insurance Program (SCHIP), is the bedrock of the nation's health care safety-net, providing health coverage to over 60 million poor and low-income children, the disabled, and impoverished elderly individuals.[1] Medicaid is financed jointly by the federal government and each state, and now ranks as the largest health insurance program in the country, surpassing Medicare, both in terms of enrollment and spending.[2] Medicaid is particularly important for families, covering one quarter of all children across the country.[3] Mirroring its importance nationally, Illinois' Medicaid program is essential to providing access to health care to families living in poverty across the state. The state's Medicaid program provided health care coverage to 2.6 million Illinoisans in 2008, more than half of which were children.[4] Twenty percent of the state's Medicaid enrollees are elderly, blind or disabled.[5] Without Medicaid, the overwhelming majority of enrollees would be forced onto the ranks of the 45 million uninsured Americans.

While the primary benefit of the Medicaid program is delivering health care to the most vulnerable members of society, Medicaid also has a significant economic dimension. First, Medicaid reimbursement plays a substantial role in the state's economy, supporting local hospitals, clinics, doctors' offices, nursing homes, community health centers and pharmacies that render services to program beneficiaries. In fiscal year 2008, an estimated $13.9 billion flowed to health care providers through the Medicaid program, paying for 50 percent of the state's births, 25 percent of nursing home care and 16 percent of all hospital admissions.[6] Medicaid accounted for approximately 15.9 percent of all health care expenditures in Illinois during 2008.[7] Indeed, cuts to Illinois' Medicaid program would result in an increase in the number of poor and low-income uninsured individuals and families, and would have a devastating impact on the state's economy.

Second, the long-standing trend of soaring health care costs has made it increasingly difficult for families to afford private health insurance. Between 1999 and 2008, the cumulative cost growth in average premiums for private family health coverage increased 119 percent.[8] This is more than four times cumulative inflation and more than three times cumulative wage growth over the same period.[9] For this reason, public health care programs like Medicaid have become increasingly important in ensuring access to basic health care when families can no longer afford private insurance. As millions of American workers lose their jobs and their employer-provided health insurance during the current recession, Medicaid has filled in a portion of the gap.

Third, state governments, like families and businesses, are also grappling with increasing health care costs. The combination of climbing health care costs, severe fiscal constraints and increasing demand for public services like Medicaid has created the perfect storm for many states with chronic budget shortfalls. Illinois' budget deficit for fiscal year 2011 is estimated to exceed $12 billion, primarily due to structural imbalances in the state's revenue system.[10] Even in good economic times, Illinois' revenue growth falls far short of keeping pace

with inflation.[11] For this reason, the state has widening budget deficits year after year. The state's ongoing deficits have been exacerbated by the recession as revenue shrinks further. All this at a time when Medicaid enrollment, and therefore public spending needs, are going up. That said, maintaining Illinois' Medicaid program is critical to ensuring access to basic health care for struggling families and to stimulating the state's economy.

II. Executive Summary

- State and federal Medicaid spending has a positive ripple effect throughout the state and local economy. The economic impact begins with the reimbursement of direct providers for services delivered, but does not end there. As Medicaid dollars funnel through the local economy, they support wages, employment, business income, consumer spending, state tax revenue and overall economic output. In essence, Medicaid reimbursement to providers becomes, in part, the earnings of doctors, nurses, technicians, pharmacists and other staff, as well as local businesses throughout the medical industry. These earnings are then used to support mortgage payments, household and business expenses, and the purchases of goods and services in the local economies across Illinois.

- Medicaid's "multiplier effect," as economists call it, is enhanced at the state level by the program's financing structure. Federal matching funds are dollars injected into the local economy that would not come into the state but for state Medicaid spending.

- Prior to the recent federal stimulus package, the cost of Illinois' Medicaid program was shared approximately equally between the federal government and Illinois, as prescribed under the Social Security Act.[12]

- To assist states in maintaining their Medicaid programs through the recession, the federal government included an increase in the federal Medicaid matching rate in the American Recovery and Reinvestment Act (ARRA).[13] The federal contribution to Illinois' Medicaid program increased from 50 percent of most Medicaid expenditures, to 61.88 percent.[14] This increased federal participation, which began in October 2008 and extends through December 2010, significantly alleviates the amount Illinois must spend from state tax revenue to preserve the state's Medicaid program.

- Using multipliers developed by Families USA that reflect the increased federal matching rate under ARRA, Illinois' investment in Medicaid (from both state dollars and federal matching funds) resulted in an estimated $46 billion in increased business activity in 2009. The estimated value of the wages generated through the multiplier effect was $15.8 billion, supporting approximately 385,742 jobs.

- If state Medicaid spending is cut, Illinois will lose federal matching dollars. With the higher matching rate under ARRA, if the state cuts state Medicaid spending by $10 million, it will lose an estimated $16.2 million in federal matching funds, resulting in a net cut to Illinois' Medicaid program of approximately $26.2 million. This is estimated to result in a loss of more than $80.4 million in business activity and $27.6 million in wages across the state. Accordingly, job loss would be certain if Medicaid is cut, worsening the recession in Illinois when the state unemployment rate has hit 11 percent, up from 6.8 percent in October 2008.[15]

- If Medicaid is cut after the temporary increase in the federal Medicaid matching rate under ARRA ends (December 2010), the state still stands to lose $10 million in federal matching funds for every $10 million reduction in state Medicaid spending. This means total program cuts of $20 million to save $10 million in state dollars.

- The positive economic impact of Medicaid spending on the state's economy is mitigated somewhat by Illinois' chronic payment delays to Medicaid providers. Because of the state's severe annual budget

deficits, it has resorted to holding back Medicaid vendor payments for months after services have been delivered. This puts an enormous financial strain on private sector health care providers that serve Medicaid patients, sometimes forcing them to borrow to cover their own business costs while waiting for reimbursement. The state's unpaid Medicaid bills totaled $2.1 billion at the end of fiscal year 2008.[16]

- Medicaid's financing structure also allows the state to partner with local governments and providers to trigger federal matching funds.[17] Pursuant to these partnerships, public and private health care providers make substantial financial contributions to Illinois' Medicaid program.

- In fiscal year 2008, the state spent an estimated $13.9 billion on Medicaid.[18] However, state general fund spending accounted for only one-third ($4.4 billion) of total spending.[19] Federal matching funds of $6.6 billion and contributions from local governments and providers ($2.9 billion) accounted for fully two-thirds of total Medicaid spending in 2008.[20] The ability of the state to trigger federal dollars with state, local and private provider contributions allows Illinois to fund health care for many more people than it would be able to do alone.

- Cuts in Illinois' Medicaid program would push thousands of impoverished people into the ranks of the uninsured, leaving them without access to health care. As a result, hospital and other providers around the state would be forced to bear the cost of providing additional charity and uncompensated care to the newly uninsured. In addition, reductions in Medicaid would reduce the flow of dollars to health care providers, reducing employment, family and business income, state tax revenue and general economic output.

III. The Fiscal Challenges of Financing an Entitlement Program in a Recession

Medicaid is an entitlement program, meaning that there are no caps on Medicaid spending at either the federal or state level. Hence, government must provide Medicaid health care benefits to everyone who is eligible and enrolls, regardless of cost. The rationale for the entitlement nature of Medicaid is that citizens that are struggling financially and, as a result, cannot afford private health insurance, should have access to basic health care.

Funding an entitlement program, however, can be a challenge. This is especially true for health care programs given the national trend in soaring costs combined with constrained federal and state budgets. During economic downturns, more families become eligible for Medicaid health care coverage due to job loss and the concurrent loss of employer-sponsored health insurance. The Kaiser Commission on Medicaid and the Uninsured projects that for every one percentage point increase in the unemployment rate, Medicaid and SCHIP enrollment will increase by one million.[21] In Illinois the unemployment rate has increased 4.2 percentage points over the one year period between October 2008 and October 2009.[22] As such, Medicaid's financing structure must be able to absorb all newly eligible individuals who enroll during difficult economic times. Illinois has a particularly hard time meeting this funding challenge given that the state's long-term structural deficit has been significantly worsened by declining state tax revenue during the recession. This leaves the public sector with less revenue to cover greater costs.

The countercyclical nature of Medicaid demand and tax revenue is exacerbated by skyrocketing health care costs which greatly outpace inflation. According to the Congressional Budget Office, federal Medicaid expenditures are expected to more than double in the next ten years.[23] The average annual growth rate is projected to be eight percent through 2018.[24] This continues a longstanding trend. In fiscal year 2008, all states combined spent approximately $152 billion on Medicaid, while the federal government spent $201 billion.[25]

IV. Medicaid: A Federal-State Partnership

A. The Federal Contribution to Medicaid Financing

Medicaid is financed jointly by the federal government and each state participating in the Medicaid Program.[26] A state must spend state or local funds on Medicaid first, and is then reimbursed a percentage of the amount spent.[27] The federal contribution to each state's program is determined by a federal matching rate called the Federal Medical Assistance Percentage (FMAP). A state's FMAP rate is based on the state's per capita income, with the poorest states receiving a larger percentage of federal funding than wealthier states.[28] Prior to the increase in the FMAP rate under the federal stimulus bill, the FMAP for states ranged from a low of 50 percent to a high of 76 percent. Illinois' match rate was 50 percent for most Medicaid expenditures.

Recognizing the strain the recession has had on state budgets, the federal government passed ARRA. Under ARRA, all states' federal matching rates increased to help off-set the financial pressures caused by growing Medicaid enrollment as millions of Americans lost their jobs and their employer-provided health coverage. The federal fiscal relief will provide states with $87 billion to maintain their Medicaid programs.[29] Illinois' federal Medicaid matching rate was increased from 50 percent to 61.88 percent.[30] The increased matching rate went into effect October 2008 and extends through December 2010. Accordingly, since Illinois' fiscal year is from July 1 to June 30, the state began to see the positive impact of increased federal Medicaid funds in fiscal year 2009. For state fiscal year 2009, Illinois will receive the increased FMAP for three-quarters of the fiscal year (October 2008 through June 2009). The increased federal funds will continue through half of the state's 2010 fiscal year. Illinois' FMAP rate will return to 50 percent for most of its Medicaid expenditures in January 2011 unless there is further Congressional action.

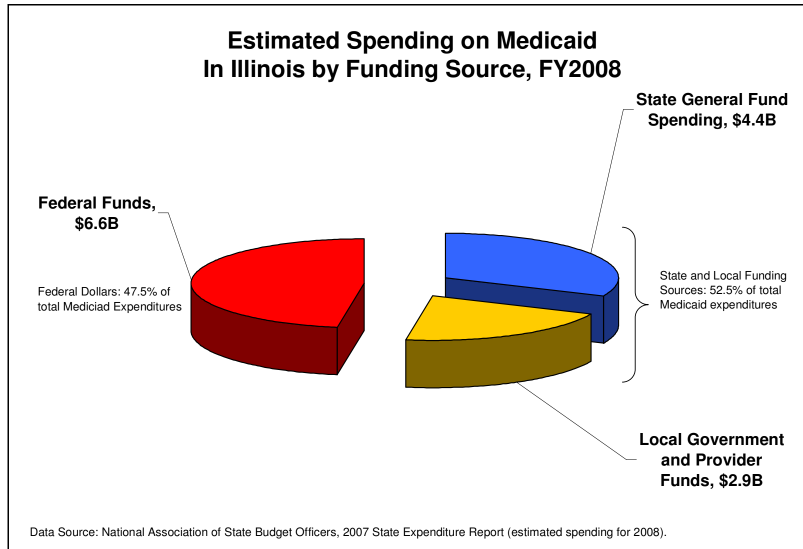
B. The State's Contribution to Medicaid Financing

A state has considerable flexibility with respect to how it finances its share of Medicaid. For instance, a state may use its own tax revenue or debt as permitted sources of Medicaid financing. It can also require local governments or providers to contribute up to 60 percent of the state's share of Medicaid expenditures.[31]

Illinois, like many states, has used partnerships with local governments, hospitals and nursing homes to leverage federal dollars to assist in funding the state's portion of its Medicaid program. Generally, these agreements have been in the form of intergovernmental transfers with public hospital systems, and assessments on private hospitals and nursing homes throughout the state. The contributions to Illinois' Medicaid program from local public and private providers have been extremely valuable to the state, alleviating Illinois' financial burden for the program to a significant degree.

Chart 1 illustrates the funding sources for Illinois' Medicaid program. In fiscal year 2008, Illinois spent an estimated $13.9 billion on its Medicaid program, covering 2.6 million enrollees.[32] However, only $4.4 billion of the total (about one-third) came from state tax revenue.[33] The remainder of the spending – over two-thirds – came from federal dollars and contributions from providers.[34] Local governments like Cook County and private providers like hospitals and nursing homes contributed $2.9 billion to Illinois' Medicaid program for the fiscal year, covering fully 21 percent of total spending.[35] The state's contribution and the amounts paid in by providers together totaled $7.3 billion, or 52.5 percent of the total. Together, these funds triggered federal Medicaid matching funds in the amount of $6.6 billion to Illinois Medicaid program, or 47.5 percent of total Medicaid expenditures, in 2008. It is important to note that the increased federal Medicaid contribution was not in effect in state fiscal year 2008.

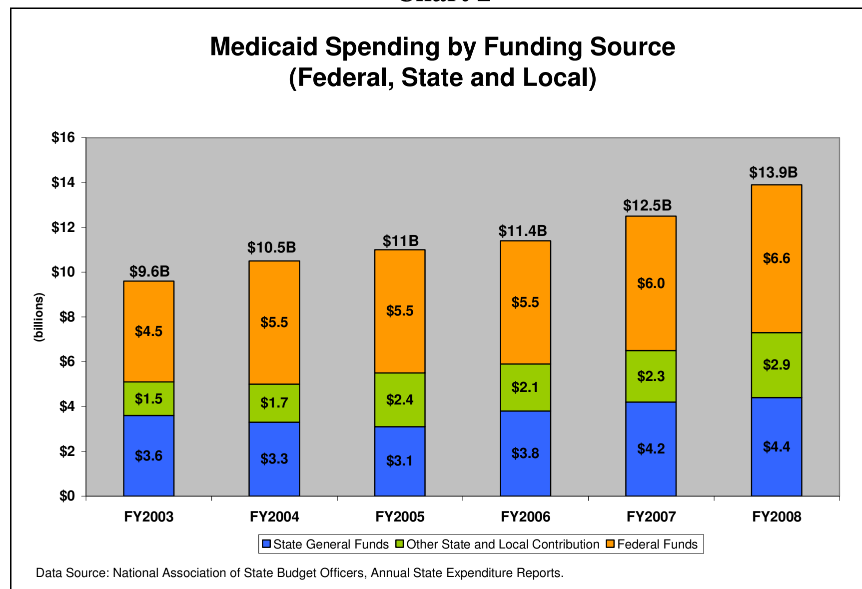
Chart 1



For state fiscal year 2009, it is estimated that Illinois' total Medicaid spending from all sources was approximately $14.4 billion.[36] As a result of the increase in federal matching funds under ARRA, which was in effect for three quarters of the 2009 state fiscal year, the federal contribution to Illinois' Medicaid program is expected to be approximately $7.7 billion, or 53 percent of total spending.[37] Even though Illinois has not yet felt the full benefit of the federal fiscal relief, the federal contribution rose by six percentage points from the previous year. The enhanced federal Medicaid matching funds should lessen the burden on the state's share of spending (state spending and provider contributions combined) as a percentage of total Medicaid spending.

Chart 2 reflects the annual breakdown of funding sources for the state's Medicaid program for fiscal years 2003 through 2008.[38] The state's share of general fund spending on Medicaid ranged from a high of 38 percent of total Medicaid spending in 2003, to a low of 28 percent of spending in 2005. Federal fiscal relief in the form of an increased federal matching rate in 2004 and 2005 enabled the state to decrease its contribution as a percentage of total Medicaid spending as the federal contribution expanded. In general, the chart highlights that increased funding from the federal government and providers has enabled the state to decrease its percentage share of total Medicaid spending despite overall program growth.

Chart 2



As Illinois' budget problems escalate, Medicaid is quickly becoming a target for reductions in spending. However, the incentives built into Medicaid's financing structure – the triggering of federal matching funds – also works as a disincentive to cut state spending. When state spending on Medicaid is reduced, the state loses out on federal matching dollars, resulting in even greater overall program cuts. Under the pre-ARRA matching rate of 50 percent, if one state Medicaid dollar is cut, Illinois loses one federal matching dollar. This results in an effective cut of two dollars in order save one state dollar. With the increased federal contribution under ARRA, if the state cuts one dollar, it loses $1.62 in federal matching funds, resulting in total program cuts of $2.62 – just to save one state dollar.

V. Medicaid's Multiplier Effect on the State's Economy

The state economy benefits a great deal from Medicaid's financing structure. Medicaid has what economists call a "multiplier effect" throughout the economy. This simply means that Medicaid dollars circulated through the economy have a far greater economic impact than just direct reimbursement to pay providers of Medicaid services. Medicaid also pays for a portion of the wages paid to the professionals, technicians, custodians and administrators employed by health care providers. These wages are then used to pay mortgages, buy groceries, pay bills and buy goods and services in the local consumer economy. Medicaid reimbursement is also used to acquire medical and other supplies from local businesses. These funds are then applied to support employees of the supply companies. In essence, Medicaid spending generates business activity throughout the medical industry, supports wages for health care workers, fosters consumer spending, boosts state tax revenue and produces general economic output. The multiplier effect is enhanced with respect to Medicaid because new dollars – federal matching funds – are pulled into the state economy.

Over half a million workers are employed in Illinois' health care industry. Many of these jobs are supported in part by Medicaid funds. According to the Illinois Department of Employment Security's labor market data for the first quarter of 2008, Illinois hospitals employed 260,789 workers, ambulatory health care clinics employed 205,926 health care workers, and nursing and residential care facilities employed 128,769 workers.[39]

Using multipliers developed by Families USA, which reflect the benefit of the increased federal matching rate under ARRA, Illinois' investment in its Medicaid program in 2009 will result in approximately $46 billion in additional business activity.[40] The wages generated as Medicaid dollars funnel through the state economy are estimated at $15.8 billion, supporting approximately 385,742 jobs.

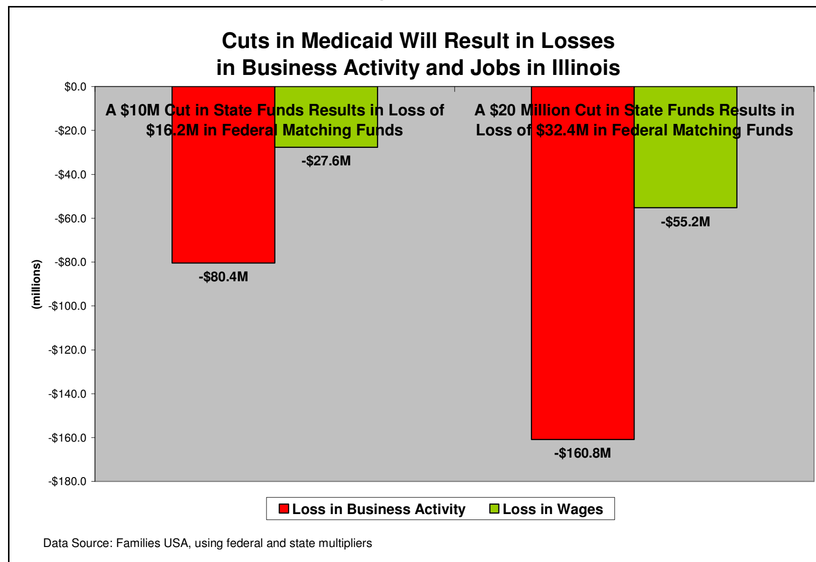
Chart 3: Medicaid's Multiplier Effect on the State Economy for FY2009

Economic Activity	Multiplier for State Spending	Multiplier for Federal Spending	Economic Impact of All Medicaid Spending in Illinois
Business Activity	3.99	2.49	$46 Billion
Wages	1.37	0.85	$15.8 Billion
Jobs/$1 Million	32.08	22.12	385,742 Jobs

The Medicaid multipliers used to project the estimated economic impact of state and federal spending are shown in Chart 3. The multipliers are based on the full implementation of Illinois' increased FMAP rate under ARRA. However, it is important to note that for fiscal year 2009, the higher federal matching rate was only in effect for three quarters of the fiscal year. The temporary increase in the state's FMAP rate is spread over two state fiscal years, but will not be in effect for any one, full state fiscal year. Nonetheless, applying the multipliers to historical 2009 spending data provides a reasonable estimate of the economic impact Medicaid spending has in the state's economy, adjusting for the increase in federal spending.

The flip side of the multiplier effect is the potential negative economic impact when spending is cut. Chart 4 shows what happens in terms of decreased economic activity if the state were to cut its Medicaid program. If the state cuts state Medicaid expenditures by $10 million, it will lose out on $16.2 million in federal matching funds. The economic impact of the total cut of $26.2 million translates into an estimated loss of more than $80.4 million in business activity and $27.6 million in lost wages. If the state cut its spending by $20 million, the losses would be even more significant. This would result in a loss of $32.4 million in federal Medicaid matching dollars. Using the multiplier effect of the cuts, it is estimated that Illinois would lose $160.8 million in related business activity and $55.2 million in wages. Budget cuts of this magnitude would be devastating to Illinois' already-struggling economy.

Chart 4

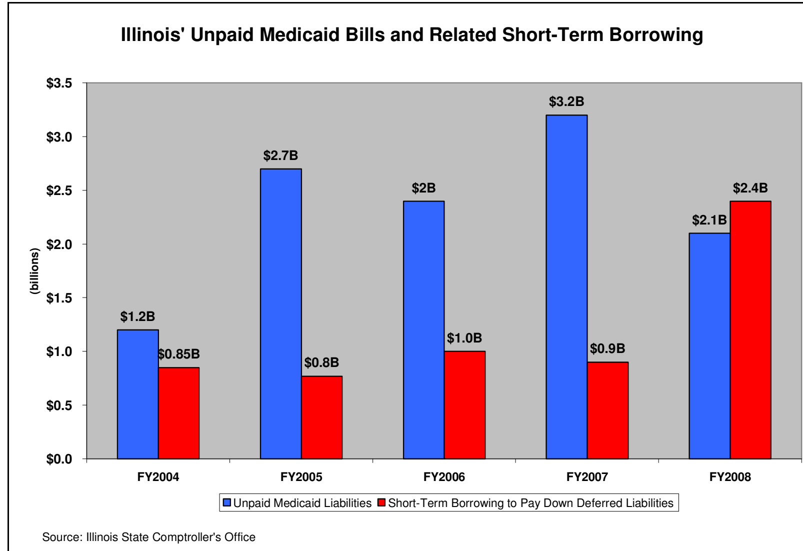


VI. The State's Long Payment Delays to Medicaid Vendors Diminishes the Economic Benefit

Despite Medicaid's importance as both an insurer for low-income families and as an economic driver, Illinois' chronic fiscal problems make it increasingly difficult for the state to pay its Medicaid bills on a timely basis. The key reason for Illinois' inability to pay providers on time is the state's revenue growth does not keep up with regular inflation, much less health care inflation, resulting in substantial annual deficits. Because Illinois is constitutionally required to balance its budget every year, it has resorted to accounting games to make the budget appear balanced annually, when, in fact, it is not. One way the state has been able to balance its budget is by deferring payments to Medicaid providers from one fiscal year to the next.[41] By holding back payments for months, the state pushes off a significant amount of liabilities into its next budget year. Additionally, due to a lack of cash flow, the state has had to borrow on a regular basis to pay down these liabilities. This results in additional costs to the state (*e.g.*, interest payments) and long payment delays to the providers like hospitals, doctors, clinics, nursing homes and pharmacists. Failing to pay vendors for services delivered in a timely manner puts an enormous, and unfair, financial strain on these health care providers. Many providers have even been forced to borrow to cover business costs while waiting for state reimbursement. Long payment delays to providers mitigate to some extent the positive impact Medicaid has in the state's economy.

Chart 5 shows the amount of the state's unpaid Medicaid bills to providers for fiscal years 2004 through 2008.[42] Fiscal year 2008 is the latest year for which year-end data is available. At the end of fiscal year 2008, the state had $2.1 billion in unpaid bills to Medicaid vendors.[43] Moreover, the state has had to borrow just to pay its operating expenses. From 2004 through 2008, the state has incurred a total of $5.9 billion in short-term borrowing just to pay down liabilities owed to health care providers.[44]

Chart 5

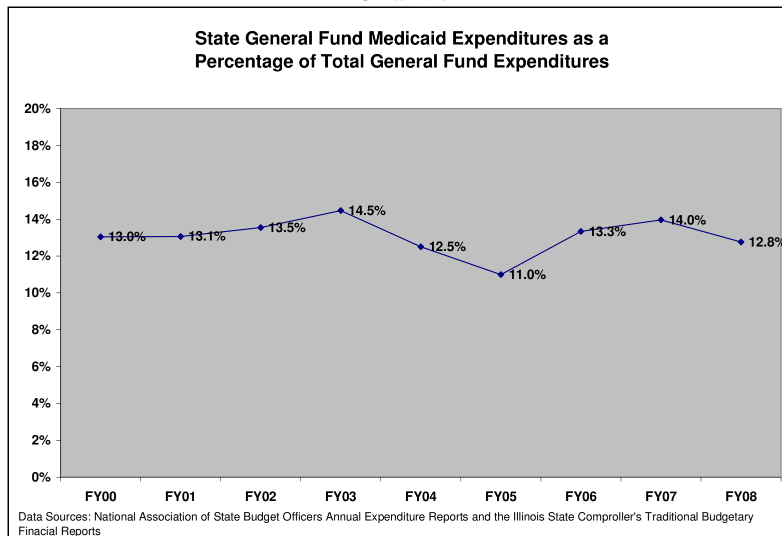


VII. Putting State Medicaid Spending into Context

A. State-Source General Fund Spending on Medicaid

When analyzing how much state-source general fund revenue is dedicated to Medicaid compared to overall general fund spending, it is critical to isolate state expenditures from federal, local and provider contributions. State-source Medicaid spending is frequently overestimated because other funding sources are included in the analysis. State-source general fund expenditures on Medicaid as a percentage of Illinois' total general fund expenditures has varied from a high of 14.5 percent to a low of 11 percent between fiscal years 2000 and 2008, as Chart 6 shows.[45] In 2003, state Medicaid expenditures reached a high of 14.5 percent of total general fund expenditures as the economy slowed and as the state fully implemented SCHIP. In state fiscal years 2004 and 2005, Illinois received federal fiscal relief, which increased federal matching funds, thereby decreasing state dollars needed to maintain the program. Accordingly, state general fund expenditures as a percentage of total general fund expenditures declined to 12.5 percent in 2004, and to 11 percent in 2005. In 2006, state Medicaid expenditures edged up once the temporary federal fiscal relief ended.

Chart 6



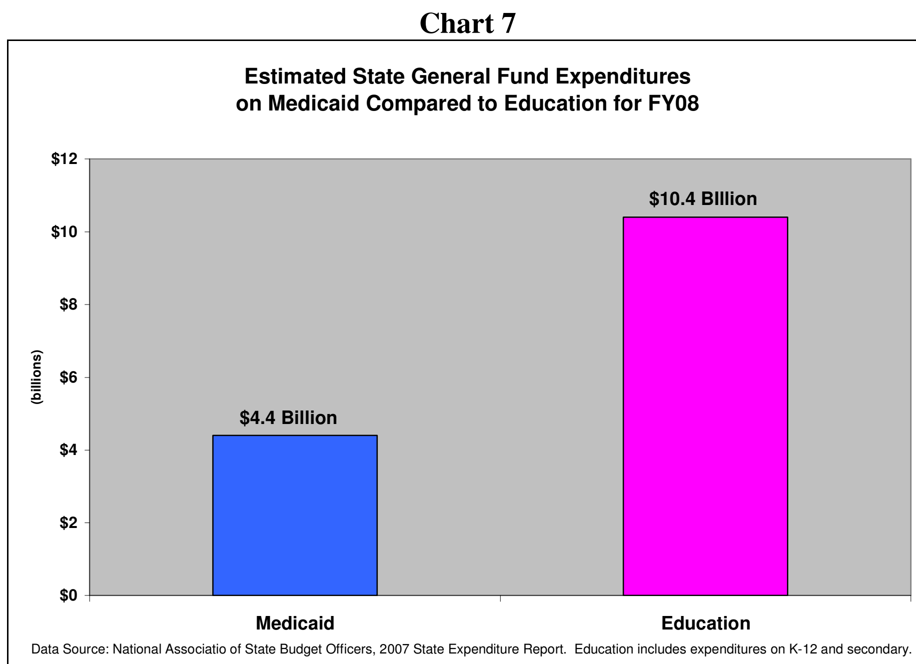
All the data are not yet in to demonstrate the decrease in the state general fund spending for Medicaid for fiscal year 2009 as a result of increased federal contributions under ARRA. However, it is fully expected that the increase in federal matching funds combined with the continued participation from local governments and private providers should translate into fewer state dollars spent as a percentage of total spending for Illinois' Medicaid program.

B. State General Fund Expenditures on Medicaid Compared with Education

It is often said that state health care spending is crowding out spending on education and other state services. It is certainly true that Illinois' Medicaid program has expanded over time. Enrollment has gone from 1.4 million poor and low-income individuals in 2000, to 2.6 million in 2008. However, the increased enrollment is due primarily to the unaffordability of private coverage for many struggling families as health care costs creep upward. Following national trends, employer-provided health care coverage in Illinois declined from 75 percent of the workforce in 1979, to just 61 percent in 2003, nearly a 15 percent decline.[46] Medicaid has played a crucial role in covering many families who have lost, or can no longer afford private coverage.

Chart 7 illustrates that if state, own-source spending is isolated, state general fund expenditures on education far exceed state general fund expenditures on Medicaid. In fiscal year 2008, the state spent $10.4 billion in general fund expenditures on education.[47] This is more than twice state general fund expenditures on Medicaid ($4.4 billion) for the same fiscal year.

Chart 7



VIII. Conclusion

Illinois' Medicaid program is funded through partnerships with the federal government as well as local government and private health care providers. This financing structure has enabled the state to provide health care coverage to more than one million children living in poverty, and thousands of blind, disabled and elderly Illinois residents. Without Medicaid, most of these individuals would be uninsured.

In addition, Medicaid is an integral part of the state's economy, supporting thousands of workers and local businesses across the state. Health care providers are reimbursed when health care services are delivered to Medicaid enrollees. This reimbursement is a vital revenue source for hospitals, community clinics, nursing

homes, pharmacies and other health care providers. Further, Medicaid payments are used in part to pay for a portion of the wages of doctors, nurses, technicians, custodians and administrators employed by providers. These earnings are then used by individuals to pay mortgages, buy groceries and purchase goods and services in the local economy. Medicaid also supports the purchase of medical equipment and supplies used in delivering health care from local businesses. This revenue is, in turn, used to pay wages at these businesses. Based on multipliers developed by Families USA, Medicaid spending resulted in an estimated $46 billion in additional business activity in Illinois in 2009, as Medicaid dollars filter through the economy. The estimated value of the wages generated through the multiplier effect was $15.8 billion, supporting approximately 385,742 jobs. Undoubtedly, cutting Medicaid would result in job loss and a contraction in business activity across the state, having a devastating impact on Illinois' already-struggling economy.

Endnotes

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[25] *Id.*
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[43] *Id.*
[44] Illinois State Comptroller, short term borrowing data.

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