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Fitch: Medicaid Poses Increasing Risk to U.S. State Budgets.

Fitch Ratings-New York-07 August 2015: A rebound in healthcare spending and a shift in federal support will put more pressure on U.S. states' long-term budgets, Fitch Ratings says. We expect most states to manage this increase by accelerating their efforts to slow Medicaid spending and taking other budgetary actions. If they do not, they will face long-term budget imbalances.

Last week, the Centers for Medicare and Medicaid Services (CMS) forecast that state and local Medicaid spending growth will average 6.3% annually from 2014 to 2024. The increase is partially due to normalization after recession era rates bottomed at 5.2% in 2007, as well as the statutory downshift in federal funding for the Medicaid expansion that will begin in 2016. Despite the acceleration, spending growth will remain below historical trends. Between 1990 and 2007, state and local Medicaid spending averaged 9.3% annual growth – this is 3% higher than CMS' projection for average annual growth between 2014 and 2024. Fitch attributes part of the comparative improvement to states' ongoing focus on Medicaid cost control.

Fitch believes states have had some success in controlling growth in Medicaid spending, though the challenge remains substantial. One key initiative for a number of states has been implementation of managed care. Between 2001 and 2013, Medicaid managed care spending increased at nearly double the rate of total Medicaid spending. Fitch anticipates this shift toward managed care will likely continue given states' fiscal pressures. While state and local Medicaid spending growth will remain below historical levels, Fitch believes it will still outpace revenue growth and force states to make challenging budgetary decisions.

CMS' projections also reflect the scheduled partial shift of costs for expansion under ACA to states from the federal government. Federal coverage for newly eligible individuals in expansion states will begin a multi-year ramp-down in October 2016 from the current 100% to 90% in federal fiscal 2020 and thereafter. States will need to backfill the federal declines.

Fitch notes that several states have reported net budgetary gains from ACA expansion that could fully or partially offset those increased costs. Currently, 28 states and the District of Columbia have expanded under ACA, and three are actively considering it. Nineteen have rejected it but may expand at any time under current law.

CMS projects overall health spending growth will accelerate to 5.8% annually through 2024, up from 4% in 2007. The recession and its aftermath played a key role in suppressing growth of this metric in recent years as well. CMS also attributes the anticipated rebound (in part) to accelerating economic growth. Prescription drug prices are a key factor as well, with spending set to double between 2013 and 2024.