September 23, 1996

MEMORANDUM TO THE PRESIDENT

FROM: Carol Rasco and Chris Jennings

SUBJECT: Decline in the Medicaid Growth Rate and Baseline

Largely unnoticed, Medicaid baseline reductions have made a significant contribution to the decline in the Federal deficit. In fact, in their recently-released budget outlook report that reduced the 1996 Federal deficit to $116 billion, the Congressional Budget Office (CBO) stated that "the largest single re-estimate is a (1 year) $4 billion reduction in Medicaid outlays." The reduction in expenditures has produced an aggregate Medicaid growth rate of 3 percent between 1995 and 1996, the lowest growth rate in over 20 years. This translates into an astounding 1 to 2 percent per capita (or per person) increase in spending -- well below the 20-year average annual Medicaid per capita growth rate of 11 percent.

Since you unveiled your balanced budget last year, the CBO Medicaid baseline has declined by $52 billion. The comparable reduction in the Administration Medicaid baseline is about $20 billion; (it is less because OMB started with a lower spending base, has been assuming lower growth rates, and has integrated more accurate economic assumptions all along.) This trend will continue as we fully expect this winter's baseline adjustments (off both the CBO and OMB baselines) to produce tens of billions of dollars of additional savings. As a result, without enacting a single Medicaid cut, you will preside over a program whose CBO baseline (after this winter's adjustment) will have been reduced in the budget window by as much as (if not more than) $80 billion since 1995, and more than $50 billion off of the OMB baseline during that same period.

Many factors have contributed to the decline in the Medicaid baseline. They include: (1) increased utilization of managed care and other cost-cutting initiatives implemented by the states; (2) an improved economy with much lower inflation; and (3) reduced use of "creative" Disproportionate Share and provider donation financing mechanisms by states.

The fact that Medicaid's growth has slowed so rapidly is good news. It mirrors the positive news about health care inflation in the private sector you occasionally cite. However, we must be cautious about heralding it too much because it tends to undermine our criticism of the magnitude of the Republicans' Medicare cuts. For example, we appropriately criticized the Republicans' Medicare cuts, but their proposal (at the time of the veto) would have allowed for a 4.9 percent per person growth rate -- above what the 1995 to 1996 per capita Medicaid growth rate was by 2 to 3 percentage points. In short, when we highlight the success of the private and Medicaid sectors in constraining costs, we risk someone charging that we are being inconsistent in not suggesting that Medicare be held to the same standard.

Most health economists are dubious that last year's low growth rate can be extended for a prolonged period. They believe that much of the savings represent a one-time constriction of excess capacity and inefficiency in the health care system. Moreover, because of historically high health inflation (recall the 11 percent average per capita over the last 20 years), CBO and OMB estimators are extremely weary of lowering their projected Medicaid growth rates, particularly in the out-years. While they may lower their budget window per capita growth rates from 7 percent to 6 percent or at most 5 percent (which is probably the range that they will assume private sector growth rates will be), the estimators will not lower their projected growth rates to anywhere near last year's unofficial Medicaid per capita number of between 1 and 2 percent.

Regardless of the final projections, it is clear that our current Medicaid 5 percent per capita cap proposal will not score significant savings off the downsized CBO Medicaid 5 to 6 percent average per capita baseline. If we do need or want additional savings, we will need to tighten up the allowable average growth rates to probably no more than 4 percent over the budget window. The primary outstanding question is: Can this program sustain this level of constraint without undermining the care it provides to its population?

Clearly, medical and general health inflation have significantly moderated. Very few health care analysts would have projected two years ago that health inflation would be running as low as it is. If current trends are sustained, holding the Medicaid program to a 4 percent average per capita growth rate is conceivable.

Having said this, since Medicaid would have to grow 20-30 percent below what will likely be the revised CBO average private sector per capita rate (of 5-6 percent), we probably could not get many health care economists to validate such a low, sustained growth rate. This is particularly the case because of the increasing numbers of high-cost elderly and disabled populations served by Medicaid.

More importantly, we might re-open the door to another serious block grant debate, since states would be more likely than ever to reject such reductions in Federal support without the elimination of virtually all Federal strings. Coverage expansion through or with Medicaid would have to be put off for a while, since no or few states would have the appetite and the resources to take it on. And lastly, reducing Federal financing might place overwhelming pressures on the states to demand that their waivers (old or new) be exempted from changes in financing. If this occurred, we would have even a greater rush to grant and grandfather-in politically-charged state waiver applicants. If this happened, Medicaid savings would be much more difficult to achieve.

We still believe that the Medicaid flexibility reforms you have proposed can achieve savings for the states (and the Federal Government) and are good policy. Moreover, we probably could get some limited savings from a slightly tighter per capita cap, as well as some additional contributions from DSH. Having said this, as we continue to witness billions of dollars of additional Medicaid baseline reductions help lower the deficit, we may want to start lowering our expectations of how much savings we can or should include in our next budget proposal.

MEMORANDUM

TO: Laura and Gene
FR: Chris J.
RE: Medicare/Medicaid 7-year budget baseline problems
cc: Jen K.

February 21, 1996

As you know, the current CBO Medicaid and Medicare baselines are higher than our baselines. According to HHS, the CBO Medicaid baseline is $55 billion higher; the CBO Medicare baseline is $22 billion higher. Attached is a set of Medicaid and Medicare tables that illustrate the problem we face in releasing 7-year budget numbers.

As you will note, if one compares the Republican $85 billion Medicaid cut off of the CBO baseline with our $59 billion Medicaid cut off of our baseline (that we would show in a back-up table in the President's budget), it would look as though the Republicans are actually spending more than we are. Over 7 years, such a comparison would show that we are spending about $20 billion less than they are. In fact, the year-by-years make it "look" like the Republicans are spending more in 5 out of the 7 years.

If their $168 Medicare cut* off of the CBO baseline was compared with our $124 Medicare cut off of our baseline, our spending would "look" to be only $22 billion more over 7 years. We would "appear" to be spending less in the first two years and "look" like were spending no more than $5 billion more in 5 out of the 7 years in the budget window.

These are obviously unfair and inaccurate comparisons, and the Medicaid comparison in particular might make it easier to point out the absurdity of comparing cuts off of different baselines. However, it is at least as possible that the Republicans may use these numbers effectively against us. If I were them, I probably would just focus on the Medicare numbers anyway. That would make it even more difficult for us to easily explain to reporters the baseline argument; moreover, we can never forget that we are always held to a higher standard on anything related to Medicare.

I believe that Alice may not be overly concerned about the issues raised in this memo. I will forward the attached tables for OMB's clearance and review, but I thought I should not wait until that occurred prior to giving you this information.

* The $168 billion year-by-year numbers are based on a very rough estimate completed by HHS; it is based off an alternative Medicare cuts document attributed to the House Ways and Means Committee Republican staff. OMB would probably be horrified to use such non-official numbers, but it is the best we now have available and reflects the policy that my contacts on the Democratic Coalition tell me is consistent with their conversations with the Republicans.

Medicaid spending
(Dollars in billions; fiscal years)

	1996	1997	1998	1999	2000	2001	2002	'96-02
President's FY 1997 Baseline	94.9	102.3	112.0	121.7	133.1	145.6	159.4	869.0
President's Proposal								
Proposed Spending	94.9	105.6	111.3	116.2	121.9	128.0	132.4	810.2
Savings (1)	0.0	3.3	-0.6	-5.6	-11.3	-17.6	-27.0	-58.7
CBO December 1995 Baseline	97.3	107.3	118.1	129.7	142.5	156.8	172.6	924.3
Republican Plan								
Proposed Spending	97.0	104.2	111.2	118.4	125.8	133.7	140.6	830.9
Savings	-0.3	-3.1	-6.9	-11.3	-16.3	-23.1	-32	-93.0
Per Capita Adjustment (2)								8
Total Savings								-85

(1) Note: Given that transition grant spending is subject to FMAP, states may not spend more to draw down the extra funding in 1997.
(2) Per Capita Adjustment is not allocated by year.

Comparison of Medicare Savings under House $168b option and Administration Plan (in billions)

	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	96-02 7-Year Savings
Administration Plan								
Administration Baseline	$194.3	$213.4	$234.0	$254.9	$277.1	$301.2	$327.1	$1802
Proposed Spending	$194.6	$207.6	$224.1	$238.8	$252.4	$270.6	$290.2	$1678.3
Net Savings	$0.4	($5.8)	($10.0)	($16.1)	($24.7)	($30.6)	($36.9)	($123.7)
House Plan								
CBO Baseline	$196.4	$215.9	$236.4	$258.1	$280.7	$305.3	$331.8	$1824.6
Proposed Spending	$196.4	$210.1	$223.0	$234.9	$249.3	$263.6	$279.2	$1656.5
Net Savings	$0.0	($5.8)	($13.4)	($23.2)	($31.4)	($41.7)	($52.6)	($168.1)