April 2025 | **Medicaid Financing**

Policy in Brief MACPAC

Alternative Approaches to Federal Medicaid Financing

Summary

Financing the Medicaid program is a shared responsibility of the federal government and the states. As long as a state operates its program within federal requirements, it can receive federal matching funds toward allowable state expenditures. The federal share for most of these expenditures is determined by each state's federal medical assistance percentage (FMAP).

Some policymakers have expressed concerns about the growth and sustainability of Medicaid as spending has grown in both absolute and relative terms and the program has become a larger share of federal and state budgets.

Alternative Approaches

Policymakers have previously considered several alternative approaches to federal financing of Medicaid aimed at reducing the future rate of growth in federal Medicaid spending. Most of the historical growth in spending has been due to increases in enrollment. In MACPAC's 2016 report to Congress, the Commission explored alternative approaches to federal Medicaid financing.

Block grants. Typically structured to provide lump-sum grants to states based on a predetermined formula, this approach would eliminate the automatic increases in federal funding that occur under current law in response to enrollment growth and the increases in per enrollee spending. States typically do not need to provide matching funds to secure a block grant but some proposals may require a maintenance of effort.

- Proponents contend that by limiting federal spending and increasing state flexibility, states will have a stronger incentive to seek efficiency and spend Medicaid dollars more prudently. If block grant growth rates are set lower than the expected rate of growth in Medicaid spending, it is likely states would have to increase their share of funding over time or reduce program costs.
- Historically, once put in place, block grants have changed in ways not necessarily anticipated by their architects. For example, the real value of block grant funding has tended to decrease over time even though the initial funding for block grants has not been consistently higher or lower than the programs they replaced. The level of state flexibility in federal block grants has also shifted over time as Congress has added reporting requirements and other programmatic constraints.

Capped allotments. States would be required to contribute a state share to draw down federal matching funds from their state-specific allotment up to a cap on the total amount of federal financing allowed. This approach differs from a block grant because it requires states to contribute their share for a federal match.

- Some policymakers see the capped allotment approach used to finance the State Children's Health Insurance Program (CHIP) as well suited for Medicaid. In addition to providing the state with allotments and two years to spend them, the Social Security Act directs the Centers for Medicare & Medicaid Services to redistribute unspent allotments to states that had exhausted their funding. Historically, while some states received more funding than was needed, others experienced shortfalls.

By the numbers...

Total Medicaid spending, FY 2023 (billions)

$894.2

Total Medicaid enrollment, FY 2023 (millions)

98.2

What is FMAP?

The federal medical assistance percentage (FMAP) provides higher matching rates to states with lower per capita incomes relative to the national average (and vice versa) and is intended to account for states' differing abilities to fund Medicaid from their own revenues. The Social Security Act requires that state FMAPs be recalculated annually for the following fiscal year. Federal statute requires a minimum FMAP of 50 percent, and a maximum of 83 percent.

In the past, Congress has acted to prevent shortfalls by providing additional federal CHIP funding, changing the allotment formula, and making other financing changes.

- It is not clear whether state-specific allotments actually encouraged states to be more judicious in their spending or if the amount of funding available for the CHIP allotments was simply more than sufficient for states to run their programs.

Per capita caps. Federal Medicaid spending would rise based on the number of Medicaid enrollees with caps on federal payments per enrollee. Such caps could be designed on an aggregate level or on a targeted basis in recognition that some eligibility groups have substantially lower health care costs on average than others.

- Supporters argue that per capita caps create greater incentives for program efficiency and provide states with budget predictability. Additionally, per capita caps would provide states with additional funding in an economic downturn when states face decreased revenues but higher Medicaid enrollment.
- Since enrollment is the primary driver of Medicaid spending growth, per capita caps may not address the underlying driver of growth. Setting and risk-adjusting caps for each state and eligibility category could also be complex.

Medicaid shared savings. This approach would establish a per capita spending target while continuing to provide federal matching funds based on a state's FMAP. If states spent less than the target in a given year, they would be eligible for a higher than normal percentage of the savings. If states spent more, they would be responsible for a higher percentage of spending above the target. Sharing in savings would be contingent upon meeting standardized performance and quality metrics.

- Proponents argue that it would align federal and state incentives for program efficiency without resorting to financial constraints present in other approaches.
- This design has been applied in both Medicare and Medicaid on a small scale tied to provider performance but applying it at a program-wide level would likely be more complex.

Design Considerations

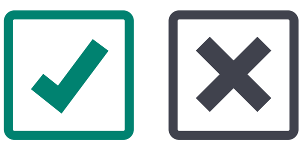
In each of the approaches to restructuring Medicaid financing outlined above, a number of policy design considerations should be addressed.

Establishing spending limits

Determine how to define the overall spending level, how to establish a growth trend, and, in some cases, how to set state-specific or eligibility group-specific limits. For block grants and capped allotments, policymakers would need to determine how to define the base year, whether and how to increase spending in future years, and how to allocate spending across states.

Defining the level of state contribution

Clarify expectations about continued state financing as the federal portion of the program is restructured. For capped allotments or a shared savings approach, policymakers would need to determine the federal matching rate or rates that would apply.



Deciding which programmatic pieces to include

Weigh which aspects of the program would fall under the new approach, whether to exclude certain groups of enrollees or types of spending, and whether different approaches may be appropriate for different purposes.

Determining the level of state flexibility and accountability

Decide what levels of state flexibility, and federal oversight are needed in exchange for the federal dollars that continue to flow to state Medicaid programs.

About MACPAC

The Medicaid and CHIP Payment and Access Commission (MACPAC) is a non-partisan legislative branch agency that provides policy and data analysis and makes recommendations to Congress, the Secretary of the U.S. Department of Health and Human Services, and the states on a wide array of issues affecting Medicaid and the State Children's Health Insurance Program (CHIP).