



THE POLITICAL ECONOMY OF MEDICAID EXPANSION Federalism, Interest Groups, and the ACA

Medicaid is a joint federal and state program designed to benefit low-income families and those who have difficulty paying for health care. Various factors have contributed to the Medicaid program's significant growth, from \$5.3 billion in 1970 to \$449 billion in 2013, leading to concern for cost containment.

A new study for the Mercatus Center at George Mason University examines the various factors contributing to Medicaid program growth as well as the earlier academic literature about Medicaid growth. It then looks at whether these factors correlate with the expansion of Medicaid by the states under the Patient Protection and Affordable Care Act (ACA).

Most of Medicaid growth is not due to an increase in the medical needs of poor Americans, but rather to the extension of program coverage to other groups. This interest group benefit also benefits state lawmakers, and the costs are passed on to taxpayers around the nation. This situation exists largely because of the incentives caused by the structure of grants and by interest group behavior. Moving away from an open-ended matching grant structure and toward a more conditional block grant structure could greatly reduce costs for taxpayers and Medicaid beneficiaries alike.

To read the study in its entirety and learn more about its author, Mercatus Affiliated Senior Scholar [Daniel Sutter](#), please see [“The Political Economy of Medicaid Expansion: Federalism, Interest Groups, and the ACA.”](#)

HIGHLIGHTS

The primary factors that have potential to contribute to Medicaid program growth include Medicaid need, Medicaid grant structure, the behavioral effects of grants, and the political economy of grants.

- A review of the academic literature demonstrates that political economy factors such as interest group behavior and the incentive effects of grant structure have had the largest impact on Medicaid growth.

For more information, contact
Kyle Precourt, 703-993-8196, kprecourt@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Boulevard, 4th Floor, Arlington, VA 22201

- Medicaid need, or the group of factors relating to the number Americans meriting assistance (the poor, children in poverty, and others unable to afford adequate care), is not as large a contributing factor to Medicaid cost growth as might be expected.

Correlating the main cost drivers of Medicaid expansion with the states' decisions to expand Medicaid under the ACA shows mixed results:

- States that have not expanded Medicaid have higher estimated costs and slightly higher matching rates, on average. In other words, states that have not expanded have seen a larger growth in Medicaid expenditures and higher enrollment. Higher matching rates mean that states use more of their own dollars for their Medicaid services.
- States that have not expanded Medicaid also display similar political leanings, as reflected by the partisanship of each state or by citizens' voting patterns during presidential elections. Differing preferences about the size and scope of government likely drive this trend.
- How much Medicaid costs states does not correlate with interest group behavior in the expected manner. Estimates show that states that have not expanded Medicaid also have more hospitals, nursing homes, and physicians; these are all signs of potential interest groups invested in Medicaid growth.

The Political Economy of Medicaid

Representative democracy is undermined when public policies reflect specific interest groups' ability to organize themselves rather than the underlying preferences of citizens in society. The academic literature on Medicaid demonstrates strong evidence that political economy factors drive state Medicaid spending:

- *Interest groups.* The senior citizen lobby and nursing homes stand out as interest groups that disproportionately affect the growth of Medicaid spending. The poor and children in poverty are at a disadvantage relative to these groups.
- *Political ideology.* The political party controlling a state legislature can shape a Medicaid program to fit its partisan goals, particularly in the case of discretionary spending. Citizen preferences play a much smaller role.
- *Information problems.* Intergovernmental grants act as a source of information asymmetries between government officials and citizens, making it difficult for politicians to act in the best interest of citizens.

The Impact of Matching Grant Structure

Medicaid allows federal money to flow to the states in the form of a matching grant. Once a state opts in, it is required to contribute a given amount of funding to the program for each dollar received from the federal government. Historically, the federal government has provided close to 60 percent of the funding for Medicaid. The matching-grant structure creates incentives that contribute to Medicaid spending growth in the states:

- *Matching grants make Medicaid program activities cheaper.* States receive between \$1 and \$3 from the federal government for each dollar they spend on Medicaid. This essentially

lowers the price of Medicaid program activities in the eyes of state policymakers. States taking advantage of matching grants will spend more than states covering the full cost of additional spending.

- *Medicaid grants are open-ended.* Because matching grants are open-ended, states using Medicaid dollars gain a systematic advantage over states that fund their own programs.
- *Medicaid funding rules allow states to use funding tricks.* States can use funding tricks to increase the number of federal dollars they receive. For example, they can count dollars from outside the state appropriations toward the state match. States have used the funds generated from untraditional revenue sources, such as special taxes imposed on hospital facilities, to count as money that they are required to put toward Medicaid.

The Behavioral Effects of Matching Grants

Grant dollars have the tendency to “stick where they hit,” meaning government money usually stays in the hands of government officials, even when the original intention was to eventually benefit citizens. This situation is largely driven by the overly complicated nature of calculating federal matching grants. It can confuse taxpayers and cause them to misperceive the true cost of government programs, which in turn can facilitate more spending growth.

- Empirical studies demonstrate that a grant from the federal government can cause state spending to rise by between 30 percent and 70 percent of the grant amount—a much larger increase than economic theory would predict.
- Matching grant dollars not only have the tendency to stick where they hit today, they also have the potential to persist, sometimes even after the initial grant disappears.
- By contrast, a block grant, in which the amount of the grant is independent of the exact actions taken by the recipient, would improve the incentives of state policymakers. Medicaid spending would be smaller under block grants than under matching grants receiving the same amount of federal funding.

CONCLUSION

Political economy factors explain the differences in Medicaid spending across states, even though empirical measures of interest group dynamics do not correlate closely with the ACA expansion of Medicaid. This is especially clear considering how almost two-thirds of Medicaid dollars go to the elderly and disabled, when Medicaid is commonly described as providing health insurance for the poor and for children. Many of these factors remain outside the control of politicians.

The most policy-relevant determinants of program growth are the matching rates and the open-ended nature of Medicaid grants to states. Matching grants are inefficient and remove spending responsibility from state policymakers by sharing state costs with the federal government. Policymakers interested in slowing Medicaid’s growth should consider conditional block grants as an alternative form of intergovernmental grants.