POLICY

A Medicaid Fix That Won't Stop Runaway Spending

A proposal to set a per-enrollee limit on federal money for the program is gaining traction. But states know how to game Medicaid rules and federal oversight is woefully inadequate.

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Minnesota Gov. Tim Walz speaks at a Jan. 3 press conference after signing an anti-fraud executive order. His recent budget proposal included a list of changes to strengthen the integrity of human services programs, particularly Medicaid. (Anthony Souffle/Minnesota Star Tribune/TNS)

With Medicaid now consuming 10 percent of the federal budget and covering more than one-quarter of Americans, taming its spending growth is a top priority for fiscal conservatives. But efforts to right-size the program need to focus on improving states' incentives.

Since its inception in 1965, Medicaid's spending has grown from $1 billion annually to over $835 billion in 2024, driven by an open-ended federal financing structure. While states administer Medicaid, the federal government covers about 65 percent of its costs, with no upper limit on what Washington is willing to pay. As a result, state policymakers have little reason to run the program efficiently.

One reform proposal gaining traction among congressional Republicans is to impose a limit on how much Washington reimburses states per Medicaid enrollee, potentially cutting federal expenditures by hundreds of billions of dollars over the next decade.

States would be on the hook for any spending above the per-enrollee cap, which would increase annually based on a pre-specified growth rate. By keeping the cap's growth rate below projected Medicaid spending under current law, the federal government could reap savings.

While per-enrollee caps could be an effective tool to limit federal Medicaid spending growth and encourage states to use Medicaid funds more wisely, this change alone is unlikely to get the program back on track. States are extraordinarily adept at devising schemes to exploit and circumvent Medicaid rules, and per-enrollee caps would introduce new opportunities for states to game the system.

Consider how per-enrollee caps would operate. Under most proposals, the federal government would establish different cap amounts for each Medicaid eligibility category. For example, the federal government would set a higher cap for beneficiaries with disabilities, who incur more than $25,000 in average annual health care costs, than for children on Medicaid, who typically cost less than $4,000 per year. While this structure has the attractive feature of tailoring funding to the composition of each state's Medicaid population, it would create strong incentives for states to misclassify enrollees from low-cost eligibility categories to high-cost categories to boost federal funding.

States have a long history of flouting Medicaid rules, especially when federal funding is at stake. Audits across several states have exposed significant infractions including millions of ineligible or misclassified enrollees. In recent research, my colleagues and I found evidence that states used the Affordable Care Act's expansion of Medicaid to reclassify huge numbers of enrollees and improperly collect billions of dollars in enhanced federal reimbursements.

A key challenge with implementing per-enrollee caps successfully is that federal oversight of state Medicaid practices is woefully inadequate. To obtain reimbursement for Medicaid expenses, states submit data on Medicaid enrollment and spending — including the distribution of enrollees across different eligibility categories — to the federal government. These state-reported numbers are rarely challenged by federal authorities, and sanctions against states that submit inaccurate information are lax or nonexistent.

These abuses could be curbed with stronger oversight, stiffer penalties for rule violations and improved data transparency.

Per-enrollee caps can be a step in the right direction to curb Medicaid's unsustainable spending, but they would need to be well designed and paired with other steps to address the program's deeper issues. True reform requires accountability measures to ensure Medicaid serves those who need it most while protecting taxpayers.

Liam Sigaud is an adjunct scholar at the Paragon Health Institute*. His research and writing focus on improving state health policy, including Medicaid.*

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