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ADDENDUM

The Budgetary Effects of Medicaid Expansion on Pennsylvania

An Expansion on Previous Work

Carter C. Price  •  Christine Eibner
The research described in this report was produced by RAND Health, a division of the RAND Corporation.
Preface

The Affordable Care Act is a substantial reform of the health care insurance system in the United States. Its effects will have a significant impact on state and local economies that require detailed analysis. In the spring of 2013, the RAND Corporation conducted an analysis assessing the budget effects of the expansion of Medicaid on the Commonwealth of Pennsylvania. The findings of that study were published in


Our analysis was in part based on a specific set of assumptions 1) regarding the application of Pennsylvania’s tax code and 2) about expenditures and revenue sources that could have a material impact on the budgetary outcomes. In this addendum to our earlier work, we examine the sensitivity of our findings to alternative assumptions about the state budgetary effects.

The research described in this report was conducted within RAND Health, a division of the RAND Corporation. Questions concerning this report may be addressed to

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## Abbreviations

<table>
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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ACA</td>
<td>Affordable Care Act</td>
</tr>
<tr>
<td>CHIP</td>
<td>Children’s Health Insurance Program</td>
</tr>
<tr>
<td>GRT</td>
<td>gross receipts tax</td>
</tr>
<tr>
<td>IFO</td>
<td>Independent Fiscal Office</td>
</tr>
<tr>
<td>IT</td>
<td>information technology</td>
</tr>
<tr>
<td>MCO</td>
<td>managed care organization</td>
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1. Introduction

The Pennsylvania State Legislature is currently weighing the decision to expand Medicaid. A RAND report released in March 2013 analyzed the effect of Medicaid expansion for Pennsylvania, focusing on how the expansion decision might affect health insurance coverage, economic growth, and the Commonwealth’s budget.¹

We estimated that Medicaid expansion would cover 350,000 more Pennsylvanians relative to a scenario in which Medicaid is not expanded. While the expansion would initially be financed entirely with federal funding, by 2020 the Commonwealth would need to contribute 10 percent of the costs associated with covering newly Medicaid-eligible adults. We estimate that the new federal spending associated with expansion would increase economic growth in Pennsylvania and sustain tens of thousands of jobs. However, the state’s required funding contribution over time could strain its budget. We estimated that if Pennsylvania expands its Medicaid program, the annual expense to the Commonwealth could reach $593 million by 2020.

Our initial estimates regarding the budgetary impact relied on several assumptions related to factors, including growth in administrative costs and applicability of Pennsylvania’s gross receipts tax for Medicaid managed care organizations (MCOs) for new enrollees. Our initial analysis also omitted some expenditures and revenue sources that could have a material impact on budgetary outcomes. A more thorough discussion of the COMPARE model and the methodologies in the initial analysis can be found in the earlier report.² In this addendum, we examine the sensitivity of our findings to alternative assumptions about the state budgetary effects.

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² Price, Donohue, Saltzman, et al., 2013.
Our initial budget analysis contained two types of expenditures that will need to be funded by the Pennsylvania Treasury: the coverage costs for those newly enrolled in Medicaid and the administrative costs associated with this population. We also included revenue from the gross receipts tax (GRT) on Medicaid MCOs.

To help policymakers understand the possible impacts of uncertainties in the budgetary assumptions, this addendum supplements our original work by presenting additional budget components and calculations based on alternative assumptions. We considered alternative assumptions for Medicaid administrative costs and about the applicability of the GRT. We also considered additional components not included in the initial analysis, such as costs from children moving to Medicaid from the Children’s Health Insurance Program (CHIP), other tax revenue from economic growth, and savings from the General Assistance Program.

Consistent with the statute, both the initial analysis and this addendum assume that the costs associated with individuals newly eligible for Medicaid are borne entirely by the federal government in 2014, 2015, and 2016. Beginning in 2017, Pennsylvania will be responsible for 5 percent of these costs. This share will grow to 10 percent by 2020 and remain constant from there on under current law. We estimated these costs using the COMPARE microsimulation model.

Below, we describe the assumptions that we varied or added to supplement our original study.

**Medicaid Administrative Costs**

Pennsylvania will be responsible for the administrative costs of covering the new eligible Medicaid enrollees. These administrative costs are associated with managing the Medicaid program, such as processing claims or managing enrollment. In the original study, we estimated the per capita administrative costs using current administrative costs associated with Medicaid and assumed that the additional costs scaled with enrollment. This should be thought of as an upper bound on the administrative costs because the fixed costs associated with delivering Medicaid are not discounted. Specifically, the information technology (IT) costs, which amount to about 60 percent of the administrative costs, may not scale with the number of enrollees.

To account for the possibility that IT costs are fixed, in this addendum we report an alternative calculation that excludes IT costs from the Medicaid administrative costs attributable

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to Medicaid expansion. This alternative would be a lower bound on the administrative costs because it is unlikely IT costs would not have some component that would vary with enrollment. This was estimated using COMPARE enrollment numbers and budget documents.

**Gross Receipts Tax**

Pennsylvania levies a 5.9 percent tax on the gross receipts of Medicaid MCOs. There is concern among some policymakers that this tax may not be allowed on the expansion population. However, our initial report assumed that Pennsylvania would be able to collect the GRT on all new Medicaid funds.

In this addendum, we report calculations using two alternative assumptions. First, we assume the state is not allowed to collect the GRT on the newly eligible population until 2017, when the state begins to pay for some of the costs for the expanded population. Second, we model an alternative in which the state is not allowed to collect the GRT on any of the new Medicaid funds. These calculations were done using results from the COMPARE model.

**CHIP to Medicaid Costs**

As part of the Affordable Care Act (ACA), children ages 6–18 with incomes between 100 and 138 percent of the federal poverty level who are enrolled in CHIP will be moved to Medicaid—if it is expanded. These children will continue to receive the CHIP federal matching assistance percentage, which is higher than the matching percentage for Medicaid. However, the movement from Medicaid to CHIP could affect state spending if the total cost of insuring a child in CHIP differs from the total costs associated with insuring a child in Medicaid (for example, due to differences in reimbursement or the scope of services covered). In our original report, we implicitly assumed that the cost to the state of enrolling a child in Medicaid was equivalent to the cost associated with enrolling a child in CHIP.

In this addendum, we account for the fact that Medicaid has slightly higher provider reimbursement rates than CHIP, which means that the costs of insuring a child in Medicaid may be slightly higher than the costs of insuring a child in CHIP. We used estimates from Pennsylvania’s Independent Fiscal Office (IFO) to estimate these costs.4

**Tax Revenue**

In our original report, we estimated that the increase in federal spending associated with the Medicaid expansion would result in higher incomes and jobs for Pennsylvanians. This is because the federal payments for the Medicaid expansion population will go to the doctors, nurses and

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other medical professionals providing care. Those people will spend the money in the general economy, producing economic growth and sustaining jobs in Pennsylvania. Although this economic growth would produce revenue in the form of income, sales, and corporate taxes, our initial report did not quantify this budget impact. In this addendum, we account for increased tax revenue using estimates from the IFO.

**General Assistance Program**

The General Assistance Program provides health insurance to low-income Pennsylvanians not eligible for other coverage. It is funded out of Pennsylvania’s general revenue and, because this population will largely be eligible for Medicaid, the medical component of the program will largely become superfluous. Thus, funding for general assistance could be counted as a savings to Pennsylvania if the state expands Medicaid. Our initial study did not provide a dollar figure of these savings for comparison. In the current addendum, we explicitly account for savings to the general assistance program using estimates from the IFO.
3. Results

The itemized results for this additional analysis can be found in Table 4.1. The first row shows the estimated state budgetary costs associated with covering adults who are newly eligible for Medicaid as a result of expansion. These costs are derived from our original report, and we assume they are insensitive to the assumptions described above.

In the remaining rows, we present alternative assumptions about cost components that may be uncertain. For example, we present two sets of assumptions about administrative costs. In the row labeled “Administrative Costs, Initial Assumption,” we show estimates from our original approach, which assumed the administrative costs associated with Medicaid would be a constant amount per capita. With these assumptions, we estimate that the state would spend an additional $42 million on administrative costs in 2016 due to Medicaid expansion, growing to $51 million by 2020. Below these estimates, in the row labeled “Administrative Costs, Alternative Assumption,” we present an alternative estimate in which we assume the IT costs associated with Medicaid administration are fixed, and therefore will not increase with expansion. With the revised assumption, the state administrative costs associated with expansion would be only $17 million in 2016, growing to $20 million in 2020.

Readers can “mix and match” assumptions from the table by choosing the scenarios that they believe are the most realistic. For example, in the most pessimistic case, we assume that the IT costs grow with enrollment and that Pennsylvania will not be able to collect the GRT for those who are newly eligible for Medicaid. In this case, the cumulative budget impact of Medicaid expansion from 2014 to 2020 would be a net increase in state revenue of $2.3 billion relative to a scenario in which Pennsylvania does not expand Medicaid, calculated by adding rows 1, 2, 5, 7, 9, and 12 ($1,333+$308+631-629-3,927-0 =–$2.3 billion. Because we are considering costs, the negative number indicates additional revenue to the state.) The cumulative budget impact is positive over that timeframe. Furthermore, even after the state is responsible for 10 percent of the coverage costs for the newly insured, we estimate that the state’s revenue would be $78 million higher per year than if the state did not expand Medicaid. Thus, from 2020 onward, the annual impact from expansion is a slight surplus relative to not expanding in the most pessimistic case.

A more optimistic case would assume that existing IT investments will be sufficient to account for the new enrollees and that the state will be allowed to collect the GRT. In this case, (by adding rows 1, 3, 5, 7, 9, and 10) the state would see a cumulative increase in state revenue of $3.9 billion over the 2014–2020 timeframe from the decision to expand Medicaid. Additionally, with a $350 million net increase in revenues in 2020 compared with if the state did not expand Medicaid, the budget trend would remain a surplus in 2020 and beyond in the optimistic case.
4. Limitations

As with all estimates and analysis, this work has limitations. There are some possible revenues and expenditures that we have not taken into account. There are also some trends that will affect the outcome.

One aspect that we did not include in this assessment is the effect of the reduction in private uncompensated care. Some of the uncompensated care costs paid by hospitals may be transferred to the insured patients. To the degree this is true, expanded Medicaid coverage of otherwise uninsured low-income persons would translate into lower premiums for everyone and have add-on economic effects not included in this analysis. The level of cost shifting to due to uncompensated care costs is not known.

We did not assume that the temporary increases in Medicaid’s primary care reimbursement would be made permanent. If Pennsylvania’s policymakers decide to maintain these rates with state funds, Medicaid expansion would have a marginal impact on the budget but this would be a separate policy decision from expansion.

In addition, the initial RAND analysis assumed that medical inflation would follow pre-ACA trends for the timeframe considered. The latest medical inflation estimates have come in below these levels and, if this is a permanent shift, the cost and revenue numbers could be proportionally lower.

Some of the Medicaid take-up will depend on outreach efforts. Lower take-up will result in proportionately lower costs. A more thorough discussion of the limitations can be found in the initial report.
5. Conclusions

This analysis, along with the initial study, should help put the budget issues in a more complete context. While Medicaid expansion will require additional spending by the Commonwealth of Pennsylvania, these costs will be more than offset by additional revenue or reductions in other spending in the 2014–2020 timeframe.

The magnitude of the budget impacts will vary for each of the components. Savings from the General Assistance Program will be the single largest driver of changes in the budget from Medicaid expansion. Medicaid coverage costs resulting from expansion have a lower but still substantial impact on the budget. The revenues from the GRT and other taxes as well as administrative costs and the costs for CHIP have a smaller impact on the budget.

However, in 2020, the budgetary trajectory is highly dependent on the assumptions. In the most pessimistic case, Medicaid expansion will have very little impact on annual spending in 2020. Alternatively, in the more optimistic case, the Commonwealth will have a permanent net reduction in spending.

Regardless of the budgetary effects, our projections regarding total economic growth and the change in insurance enrollment are unaltered by the estimates developed in this addendum. As in our original report, we continue to estimate that an additional 350,000 individuals will have insurance, and the Pennsylvania economy will experience a $3 billion increase in Pennsylvania’s domestic product in 2016 if Medicaid is expanded, relative to the alternative of no expansion.
<table>
<thead>
<tr>
<th>State Budget Component</th>
<th>Assumptions</th>
<th>Source</th>
<th>2016 Costs ($millions)</th>
<th>2020 Costs ($millions)</th>
<th>2016–2020 Costs ($millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coverage Costs</td>
<td>1. Initial Assumption: State costs are as defined in ACA</td>
<td>RAND Calculations</td>
<td>0</td>
<td>493</td>
<td>1,333</td>
</tr>
<tr>
<td></td>
<td>2. Initial Assumption: Administrative costs include state and county administration as well as information system costs</td>
<td>PA Budget</td>
<td>42</td>
<td>51</td>
<td>308</td>
</tr>
<tr>
<td></td>
<td>3. Alternate Assumption: Administrative costs include state and county administration but not information system costs</td>
<td>PA Budget</td>
<td>17</td>
<td>20</td>
<td>123</td>
</tr>
<tr>
<td>Administrative Costs</td>
<td>4. Initial Assumption: Not considered in initial analysis</td>
<td>NA</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>5. Alternate Assumption: This will have an effect on budget</td>
<td>IFO Calculations</td>
<td>84</td>
<td>126</td>
<td>631</td>
</tr>
<tr>
<td>CHIP to Medicaid Costs</td>
<td>6. Initial Assumption: Not considered in initial analysis</td>
<td>NA</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>7. Alternate Assumption: This will have an effect on budget</td>
<td>IFO Calculations</td>
<td>(97)</td>
<td>(102)</td>
<td>(629)</td>
</tr>
<tr>
<td>Tax Revenue from</td>
<td>8. Initial Assumption: Not considered in initial analysis</td>
<td>NA</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Economic Growth</td>
<td>9. Alternate Assumption: This will have an effect on budget</td>
<td>IFO Calculations</td>
<td>(524)</td>
<td>(646)</td>
<td>(3,927)</td>
</tr>
<tr>
<td>Savings from</td>
<td>10. Initial Assumption: Pennsylvania is allowed to collect GRT on new Medicaid funds</td>
<td>RAND Calculations</td>
<td>(199)</td>
<td>(241)</td>
<td>(1,461)</td>
</tr>
<tr>
<td>General Assistance</td>
<td>11. Alternate Assumption 1: PA is only allowed to collect GRT on new money beginning in 2017</td>
<td>RAND Calculations</td>
<td>0</td>
<td>(241)</td>
<td>(897)</td>
</tr>
<tr>
<td>Program</td>
<td>12. Alternate Assumption 2: PA is not allowed to collect GRT on any new Medicaid funds</td>
<td>RAND Calculations</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Note: All dollar figures are in millions. The original report did not consider the budget effects from CHIP to Medicaid Costs, Tax Revenue from Economic Growth, and Savings from General Assistance Program. Thus, these were implicitly considered zero.
