Governance Program
Governors' Council

Reforming Medicaid Waivers:

The Governors' Council Perspective on Federalism Today

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BIPARTISAN POLICY CENTER

Governance Program
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Introduction

The federalist tenets at the heart of the U.S. Constitution have fuelled a dynamic debate about the balance of federal and state powers throughout our nation's history. Many of today's most complex and pressing challenges, from reviving the economy to controlling health care costs, are deeply entangled in the interplay between federal and state roles and responsibilities. As former state executives, we have each experienced the rewards and frustrations of working with the federal government. We have seen how federalism at its best marries the strength and resources of the federal government to the unique perspectives and capabilities of the states. But we have also seen a relationship that increasingly falls short of this ideal. Too often, policies adopted at the national level – though they may be well intended – result in federal over-reach and trigger unintended and undesired consequences. Too often, we have found the demands of federal agencies stifling state innovation. And we have seen firsthand how growing political dysfunction at the federal level adversely affects states and undermines the welfare of all our citizens.

It is precisely in times of economic hardship and social discontent that our nation needs federalism to work at its best. With states struggling through the third year of a jobless recovery and the federal government entering a period of unprecedented fiscal pressure, we see an opportunity to begin a fundamental realignment of the state-federal relationship. One area of particular opportunity and concern – for states and the federal government – is Medicaid. This is because Medicaid, which provided $401.4 billion in combined federal and state resources to finance health care for nearly 60 million people in 2010 alone, is by far the largest state-federal program in existence today.[i] By developing specific recommendations for improving the Medicaid waiver program, we hope to generate insights and provide a model for improving the state-federal relationship in ways that may be applicable to other areas of significant public policy importance as well.

This paper begins by describing some of the general challenges we see – from the perspective of former state executives – to the federalist relationship today. We then turn to a discussion of problems and options in the Medicaid program, particularly the Medicaid waiver process.

Federalism Today

Overall, federalism has served America well for more than two tumultuous centuries. Our system of government not only survived a devastating civil war, it enabled a large, diverse and geographically far flung population to enjoy long periods of political stability and prosperity, while also coming together to meet great challenges – from waging war to exploring space and building highways. Throughout, federalism has proved flexible and dynamic enough to keep America at the forefront of the economic, social and technological changes that have transformed modern life and the global economy.

Today, support for the basic idea of federalism remains strong and most Americans would endorse the proposition, first, that there are functions and powers that appropriately should and must be located at the federal level and, second, that the federal role should be limited to allow for maximum state and local control wherever possible. But it is also clear that the federal role has expanded steadily into areas not originally included among the enumerated powers. Today, a large share of federal resources is directed to broad-based social safety net programs; in addition, the federal government is actively engaged in delivering disaster relief, regulating on behalf of public health and safety, and promulgating education and technology policy. The largest federal budget items are Social Security and Medicare, which were established at a time when economic insecurity and access to medical care for elderly Americans were seen as major nationwide challenges that the states could not effectively address on their own.

In other areas, the federalist model has left states with primary responsibility for administering programs and policies even in areas that receive substantial amounts of federal funding. These include many programs for the non-elderly such as education, food stamps, welfare, Medicaid and job training. In theory, this division of responsibilities allows states to target resources and tailor programs that best serve the needs of their diverse populations, while also acting as the "laboratories of democracy" that Supreme Court Justice Louis Brandeis spoke of in 1932.[ii] The sequence Justice Brandeis envisioned, in which pioneer states enact legislation, other states follow suit with similar yet improved policies, and the whole process eventually prompts changes in federal policy, has played out in practice many times and across a wide range of issues. Thus, providing the flexibility needed to support state innovation is one of the most important strengths of a federalist system. The concern today is that the state-federal relationship in America is out of balance, and that the results of this imbalance – particularly in an age of increasingly constrained public resources – are eroding performance and public trust at all levels of government.

As governors from different parties, serving six very different states, we have worked with the federal government on a wide range of issues and under a wide range of circumstances. As a group, however, we have come to remarkably similar conclusions about the major challenges that confront our country and our federalist system of government today. From a state perspective, interactions with the federal government are increasingly dominated by three distinct challenges or concerns: (1) the impact of growing budget pressures at both the state and federal levels and the problem of unfunded mandates; (2) frustration with the inflexibility and bureaucracy associated with many federal policies and programs, particularly when it limits states' ability to innovate; and (3) growing dysfunction at the federal level, in terms of the most basic functions of government such as passing budgets on time. All of these challenges come together in the current Medicaid program. The remainder of this paper describes the need for Medicaid reform and recommends some concrete changes to the Medicaid waiver process. By looking in some detail at problems and opportunities in the Medicaid program, we hope to draw connections to larger issues of federalism and gain practical insights for improving the state-federal relationship in the future.

Medicaid

As noted in the introduction, Medicaid is the largest state-federal partnership program in existence. The Social Security Amendments of 1965 established Medicaid to provide health care services to low-income and high-need Americans, covering approximately 20 percent of today's U.S. population.[iii] It is a means-tested entitlement program jointly financed by the federal and state governments. While states are required to provide a basic set of health care benefits to certain eligible groups of individuals to receive federal matching dollars, state Medicaid programs and expenditures vary considerably. States, for example, have the authority to expand eligibility or benefits and to set provider reimbursement rates beyond federal requirements, producing various levels of coverage, access and costs.[iv] The federal matching rate, or the federal medical assistance percentage (FMAP), is calculated annually and reflects a state's per capita income level. On average, the federal government pays for 57 percent of state Medicaid expenditures. For FY 2013, state FMAP rates range from 50 percent (in 14 states) to 73.43 percent (in Mississippi).[v]

Since its inception, numerous legislative changes and thousands of new regulations have made the program increasingly rigid and complex. As in other programs, proliferating federal requirements and stipulations – despite being, in most cases, well intended or aimed at addressing a legitimate concern – have made it increasingly difficult for states to direct scarce resources in ways that allow them to maximize program benefits.

Medicaid is a significant burden on state budgets, representing an average of 16 percent of state general fund spending, second only to K-12 and higher education spending.[vi] As a result of the recent economic downturn, states experienced significant growth in Medicaid enrollment and spending in FY 2011. Meanwhile, a temporary, stimulus-based increase in federal assistance, which helped cover increased state Medicaid costs during the Great Recession, expired in June of 2011.[vii] As a result, state spending for FY 2012 jumped by 28.7 percent.[viii]

Looking forward, this growth trajectory is expected to continue. The Patient Protection and Affordable Care Act (PPACA), which was signed into law in 2010, will expand Medicaid coverage substantially: starting in 2014, nearly all individuals under age 65 with incomes up to 133 percent of the federal poverty line (about $14,856 for an individual and about $30,657 for a family of four in 2012) will be eligible for the Medicaid program.[ix] The number of people enrolled in Medicaid is projected to increase by 16 million by 2019. While the PPACA provides for 100 percent federal financing to cover newly eligible Medicaid recipients for 2014-2016, the federal share of costs for this mandated expansion will gradually decline, reaching a 90 percent FMAP for 2020 and beyond.[x] Additionally, any new enrollment among the previously eligible population prompted by awareness of the expansion will not be financed by the federal government.

Under growing budgetary pressure from rising Medicaid costs, states have been actively undertaking a number of cost-containment measures. Already, 18 states have reported eliminating, reducing or restricting benefits, 39 states lowered provider payments in 2011, and 46 are expected to do so in 2012.[xi] States are extremely concerned about their ability to manage costs going forward, particularly given the expansion in coverage that is mandated to occur in the next few years. As the National Governors Association has stated, "Plans for program expansion are deeply troubling for states that are already struggling with high Medicaid costs. Regulations that simply shift costs to the states are untenable and ultimately undermine the federal-state partnership as well as any national effort to expand coverage and access."[xii]

As state leaders struggle with budget deficits and reduced revenues, the need for additional flexibility in the Medicaid program is great.

Medicaid Waivers

Ensuring the Medicaid program's sustainability will require cooperation and compromise on behalf of both states and the federal government. As is the case with the health care system as a whole, innovation at the state, community and local levels is needed to address complex care financing and delivery challenges. The Medicaid waiver process offers a path forward for states seeking innovative solutions to pervasive problems.

Medicaid waivers allow states to test new strategies that could help improve care quality and lower costs for taxpayers.

The functionality of the Medicaid waiver process is a concern for many state leaders and is often singled out as a major stumbling block for states interested in innovating to reduce costs and improve outcomes among Medicaid recipients. There are three major types of waivers allowable in the current Medicaid law:

1. Section 1915(b) Managed Care/Freedom of Choice Waivers. Many states utilize managed care plans as a way to control rising health care costs. 1915(b) waivers allow states to enroll Medicaid beneficiaries in managed care plans, or exert state authority to control provider network options.

2. Section 1915(c) Home and Community-Based Services Waivers. Financing long-term care is a significant challenge for states. 1915(c) waivers allow states to move care out of costly institutional care settings and into communities.

3. Section 1115 Research & Demonstration Projects. These waivers allow the Secretary of Health and Human Services (HHS) to grant states broad exemptions from federal Medicaid requirements so that they can implement innovative demonstrations and pilot programs. Through Section 1115 waivers, states are able to expand eligibility to new categories of individuals, provide additional services and benefits, and implement novel health care delivery models.

States are also permitted to apply for concurrent 1915(b) and 1915(c) waivers.

Because Section 1115 waivers provide so much flexibility to state leaders, a streamlined Section 1115 waiver approval process is necessary to facilitate state innovation and progress. Currently, this process regularly takes well over a year and often necessitates countless meetings and telephone conversations. These waivers are subject to approval not only by HHS but also by the Office of Management and Budget (OMB), which must find that states' proposals are "neutral" with respect to the federal budget. To demonstrate budget neutrality, the state must project expenditures "with waiver" and "without waiver," and then defend its assumptions. When waivers are approved, they are generally approved for five years, though states can (and usually do) submit renewal requests to continue programs beyond this relatively short timeframe.

STATE PLAN AMENDMENTS

States are also allowed to make smaller changes to their Medicaid program through amendments to their state plan. Each state has its own legislative language for Medicaid, which contains the state's unique plan for managing the program in compliance with minimum federal standards and rules. States can make changes to this

through State Plan Amendments (SPA), provided these changes are "allowable" and do not conflict with federal rules.[xiii] The approval process for SPA is much faster than the waiver process, and the Centers for Medicare & Medicaid Services (CMS) recently initiated reforms to make the process faster and more efficient for states.[xiv]

REFORMING THE PROCESS

We believe the waiver process can and should be improved. Common sense reforms will benefit leaders at both the state and federal level, and more importantly, continue to ensure that the Medicaid program is effective and sustainable in the future. Broadly, these reforms should include strategies to rapidly diffuse and adopt successful program reforms, greater federal transparency, the possibility of lengthened wavier extensions and renewals, and the development of clear, mutually understood timelines for the waiver approval process. The states and the federal government are all highly motivated to identify reforms that could improve health care quality while reducing costs, and must work together to remove barriers to innovation. We describe broad recommendations for improving the current waiver process below that will allow states to innovate and foster a more effective state-federal partnership.

The following anecdotes help illustrate states' frustrations with the current waiver process.

In 2005, Vermont Governor Jim Douglas was seeking a waiver for a new preventive care initiative called Global Commitment to Health. After winning approval from HHS, Governor Douglas went to meet OMB officials. Outside the meeting room he encountered Florida Governor Jeb Bush, who was likewise paying a personal visit in search of a waiver. With the outcome for both states in doubt, Governor Douglas quipped that it would not bode well for Vermont's prospects if the president's own brother could not win OMB approval for a waiver.

In 2008, Tennessee sought a waiver from the federal government to shift the focus of its Medicaid program from nursing home care to home-based care. Even though this measure had broad support, was expected to produce cost savings, and portions of it had been successfully adopted by a number of other states, it still took more than a year for the federal bureaucracy to render a decision on Tennessee's waiver request.

Medicaid Waiver Recommendations

1. **Develop State Plan Amendment templates for effective Medicaid strategies.** Through the Deficit Reduction Act of 2005, CMS provided states with the tools to rapidly implement targeted program changes. For example, CMS provided state leaders with a pre-fabricated SPA template to create non-emergency medical transportation brokerage programs. Ensuring that low-income individuals are able to gain timely access to medical services can help prevent avoidable complications and encourage compliance with recommended treatments, ultimately lowering costs and improving beneficiary health. CMS should utilize a similar strategy to encourage the efficient dissemination of common sense reforms and best practices. One possible avenue for exploration would be combining the state public employee health care plan to select Medicaid populations into a common risk pool. The authority to implement this strategy already exists in statute, and offers an opportunity to spread risk and improve access to care.

2. **CMS should establish and circulate a detailed and transparent process for state-federal budget neutrality negotiations and waiver evaluations**. The recently released final regulation to increase the transparency of the waiver process is a commendable step forward in ensuring the waiver process is fair and efficient. The regulation includes many clear reporting requirements for states, but does not require corresponding transparent and detailed reporting requirements for the federal government. While we are not requesting that CMS make all internal deliberations or budget formulations public, it would be helpful to states if CMS established clear expectations and a consistent timeline for how the budget negotiation process will move forward. For example, it would be helpful if CMS ensured that all relevant parties were engaged at the beginning of the waiver approval process. Multiple layers of approvals create an inefficient and duplicative process for states. An obvious example is the late involvement of the OMB. Other additional parties, including the HHS Office of the General Counsel, similarly become involved late in the waiver approval process.

3. **CMS should design waiver templates that address time-sensitive and pertinent Medicaid challenges, supporting state efforts to quickly and effectively respond to changes in the marketplace attributable to provisions in the Affordable Care Act.** In the past, CMS has developed waiver templates that address specific needs of states. For example, CMS developed waiver templates to assist Medicare Part D implementation and HIFA waiver templates to increase Medicaid coverage. These templates offered states a simplified, streamlined and expedited application and approval process that remained consistent with the goals of the Medicaid program. We encourage CMS to similarly standardize certain components of the waiver application process to

provide states direction and reduce uncertainty as they look for creative and innovative ways to manage forthcoming changes in the Medicaid program. We believe CMS should provide templates that align with the goals, principles and or/provisions of the ACA. With limited resources at the state level, a more predictable waiver template would give states greater flexibility to reallocate resources. This may help states focus efforts on common challenges, such as addressing health care reform and dual eligibles and promoting new payment methods and innovative care delivery models.

4. **Establish a mechanism for converting successful waivers into permanent or semi-permanent state innovations in the Medicaid program.** A viable strategy must include clear guidelines and framework for approval, as well as any necessary statutory changes. The purpose of a waiver is to encourage innovation and allow states to serve as "laboratories of democracy" for testing new ideas and approaches. Implementing a process to make successful waivers more permanent is consistent with this notion. Permanent waivers are possible only if states and the federal government respect the fact that Medicaid is a partnership of shared accountability and resources. Permanent waivers are feasible in states with a long, well-established and documented history of successfully implemented innovation. Frequent waiver renewals are a burden on high performing state programs, and are an inefficient use of scarce resources for states as well as the federal government.

5. **HHS should make guidance and assistance provided to state leaders by the Medicaid State Technical Assistance Teams transparent and public.** In February 2011, HHS announced the creation of Medicaid State Technical Assistance Teams (MSTATs).[xv] The MSTATs are federal technical assistance teams dispatched to states to provide intensive and tailored assistance on day-to-day operations as well as on new initiatives. While we applaud the federal government's efforts to provide real-time assistance and guidance, we recommend that both the questions and answers be made transparent and available on Medicaid.gov. Many states are dealing with similar issues, and we believe state leaders would benefit from timely access to this information to support planning and decision making at the state level.

Conclusion

Several years into a period of prolonged economic weakness and instability, many Americans have lost faith in government and in the ability of state and federal decision makers alike to come to grips with a host of difficult challenges. Under these circumstances, it is not surprising that state-federal relations are under new strain. Today's challenges, however, create opportunities to put our federalist system on a new and stronger footing. If nothing else, the fiscal pressures currently being experienced at all levels of government will create powerful incentives for states and the federal government to work together more efficiently.

A good place to start exploring concrete improvements to the state-federal relationship is Medicaid. It has become clear that states need more flexibility to pursue their coverage and benefit goals in this program, while effectively managing costs. In this paper we recommend a number of reforms aimed at ensuring that the system for approving Medicaid waivers supports, rather than discourages, timely innovation and experimentation at the state level. We hope that these recommendations – focused on transparent, flexible, clear performance goals and shared responsibility – generate insights and provide a model for improving the state-federal relationship in ways that may be applicable to other areas of significant public policy importance as well.

In coming months, we will look to other policy areas for opportunities to improve the state-federal relationship. Solving the nation's problems with fewer resources is the reality for the foreseeable future. It is a reality – and a challenge – that could have some significant upsides if it spurs a thoughtful examination of how federalism could be made to work more effectively for the American people.

Endnotes

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