Editorial:

The Medicaid Penny

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It was a reality the politicians could no longer ignore. After paying the county's share of the Medicaid bill, Erie County, New York (home of Buffalo) had insufficient money left to run county government.

In November, 2004, Erie County Executive Joel Giambra announced the grim news: "The cost of one single state-mandated program–Medicaid–is greater this year than the entire Erie County property tax levy…. *In fact, in every budget year since 2001, the cost of Medicaid was greater than the entire Erie County property tax*."[1]

Over the past four years Erie County's Medicaid costs have increased by an astounding $81.8 million, an increase of $18.2 Million (11 percent) in 2004 alone. The County Executive's conclusion: "Medicaid is an unfunded mandate, which has grown beyond local governments' ability to pay…it's a county budget buster!"

As county property taxes had already reached oppressive levels, the County Executive said there were only two solutions left: (1) shut down county government and county services–the "Red Budget" or (2) raise the county sales tax from 8.25 percent to 9.25 percent (an actual increase of 12.12 percent)–"the Medicaid Penny." The actual solution, of course, ultimately involved raising both property taxes (by 4.3 percent) and the sales tax. Like most elected officials, when it comes to addressing the problem of government overspending versus raising taxes, legislators almost always choose the latter, as they did in this case.

The problem of Medicaid costs is particularly acute in New York State for a number of reasons. New York differs from other states, where Medicaid funding is generally split 50:50 between federal and state governments. In New York State, 50 percent of the cost is federally funded, 25 percent is state funded, and 25 percent is funded by counties or, in the case of New York City, by a city income tax. County property taxes are the principal source of Medicaid funding for all of the counties in New York State. As a result, local property taxes in New York are among the highest in the nation: 62 percent higher than the national average.[2] Moreover, property taxes are growing at an alarming rate–22 percent over the last two years. High property taxes have been particularly devastating in rural communities, where farmers are being driven out of business. One dairy farmer put it this way: "Other businesses don't pay taxes on fax machines and phones, so why should farmers have to pay taxes on resources they need to make their living?"[3]

There are many reasons for high and rising Medicaid costs, including increased medication costs and expanded enrollment through Family Health Plus and Child Health Plus. In New York State, Medicaid now covers an incredible 17.4 percent of the population[2]–almost one in every five. And the benefits in New York State are among the most generous in the nation. Medicaid has also become the preferred funding mechanism for long-term care for nearly everyone, including middle and upper-income families. The Public Policy Institute of New York State has noted the role of estate planners in this long-term care "entitlement": they develop "…estate-planning gimmicks that are aimed at helping middle and upper-income families pass the cost of long-term care over to the taxpayers."[2] In addition, lobbying by well-funded hospitals, nursing homes, and healthcare union workers exerts powerful pressure to maintain the government revenue stream.

The consequence of heavy taxation in Erie County is a local economy that is extremely hostile to business. Why would anyone choose to shop in a county where nearly ten cents of every dollar spent is confiscated by the county, when they can go to nearby Pennsylvania, which has no sales tax at all on clothing or shoes? Why would any business choose to locate in an area that is economically noncompetitive? And, as businesses close, jobs are lost, the tax base shrinks, and the problem becomes even worse. When will elected officials learn that increased taxation does not pave the road to prosperity?

The problem of increasingly unaffordable Medicaid costs is not unique to New York State. Medicaid is the fastest growing expense affecting all state budgets,[4] and is the reason that more than two-thirds of all the states experienced budget shortfalls in 2003 and 2004. In December 2004, the National Governors Association warned: "The growth rate on Medicaid is rapidly reaching its breaking point."[5]

Cost containment measures, implemented in some form by all states in 2004, have been a miserable failure. Hillary-style government-managed care, known as TennCare in Tennessee, is a prime example. TennCare was consuming a full third of the entire state budget and was growing at an unsustainable rate. As a result, Governor Phil Bredesen, a Democrat, has proposed that TennCare be dismantled and that the state return to traditional Medicaid.

Adding to the states' problem is the fact that the states' share of Medicaid funding is growing much faster than the federal share. According to the Fiscal Survey of States: "States estimate fiscal 2005 growth rates of 12.1 percent in state funds and 3.9 percent in federal funds."[6] The difference is attributed to removal of a federal "band-aid." As part of the Jobs and Growth Tax Relief Reconciliation Act of 2003, the federal government provided $10 billion in tax relief to the states–which expired in June 2004. All of this "cost shifting," favored by Senator Hillary Clinton and other promoters of socialized medicine, results in no net savings and in some instances may even cost more. In the case of local versus state cost-shifting, *Business Review* observed: "Simply shifting the Medicaid burden from local governments to the state actually would cost upstate taxpayers an extra $250 million per year."[7] In the end, taxpayers–federal, state, county or city–pay the cost of Medicaid, and cost-shifting is nothing more than a deceptive shell game played by cowardly politicians.

There are several economic lessons that can be learned from the Medicaid financing mess. Lesson number one is that the further away from a free market a financing structure strays, the quicker it will collapse. Both Medicaid and Medicare are entitlement programs that are headed for financial collapse. However, Medicare requires copayments and deductibles, whereas Medicaid does not. The Medicaid program, therefore, will probably collapse from unsustainable costs before Medicare.

Lesson number two is that shifting entitlement costs to the local level, as New York has done, hastens the crash.

Open-ended entitlement programs like Medicaid, with first dollar coverage, are akin to giving a teenage girl a platinum credit card, taking her to the shopping mall, and telling her that she may have whatever she desires. The result is highly predictable–a financially disastrous spending spree.

Most people don't carry a platinum medical card, and most cannot afford to pay the bill for others who do. When the cost of Medicaid consumes every penny of property and sales taxes, and taxpayers are left "centsless," where will states turn?

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Addendum: In a last-minute vote before midnight, the Erie County legislature passed the 1 percent sales tax increase in December 2004. A judge subsequently ruled that certain procedures had been violated during the vote. Ten votes were needed to increase the sales tax. During the first procedural revote, on Feb 1, 2005, the sales tax increase passed by 10 votes. Both the governor and the state legislature approved the increase in county sales tax, a legal requirement. During a second procedural vote on Feb 4, however, one legislator changed his vote, and the sales tax increase failed to pass. The "Red Budget" then went into effect. Multiple lawsuits, including those brought by the district attorney, county sheriff, county clerk, and unions representing county workers have been filed. The county-subsidized hospital, Erie County Medical Center, is threatened with the loss of 500 to 800 jobs. One thing is clear: the Medicaid Penny isn't dead, and the political drama will continue.

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