

MEDICAID DSH AND SUPPLEMENTAL PAYMENTS

Essential for children's hospitals

TYPES OF SUPPLEMENTAL PAYMENTS

What are State Directed Payments (SDPs)?

- SDPs are payments states may direct to managed care organizations (MCOs) to designated providers to promote access to and quality of care. SDPs are subject to federal approval and have surpassed other forms of supplemental payments, reflecting the shift toward Medicaid managed care.
- 40 states use SDPs to raise reimbursement rates for providers treating Medicaid patients.²
- SDPs are a critical payment stream in Medicaid that provide children's hospitals with funding to mitigate the financial challenges caused by low Medicaid base payments. For some children's hospitals, SDPs help to fill gaps in payment by an estimated 20%.
- CMS codified in 2024 that states can use the "Average Commercial Rate (ACR)" – the average amount hospitals and other providers would be paid by commercial insurers for the same service – as the payment ceiling for SDPs.³ Lowering this ceiling to Medicare levels would lead to inadequate payments for pediatric care, since many pediatric services are not reimbursed under Medicare and Medicare rates do not necessarily consider children and their needs.

What are Disproportionate Share Hospital (DSH) Payments?

- DSH payments are supplemental payments that states are statutorily required to provide to hospitals that are major Medicaid providers, including children's hospitals. These payments are intended to offset hospitals' uncompensated care costs and mitigate financial gaps caused by low Medicaid base rates.

In many states, Medicaid base payments – the initial payment to hospitals or other providers for a service provided to a Medicaid beneficiary – do not cover the cost of care and are significantly lower than Medicare and commercial payments. States utilize supplemental payments – any payment over and above base payments – to help mitigate these payment gaps.

Children's hospitals are major Medicaid providers, with 55% of their payments coming from Medicaid. However, Medicaid payments, including DSH and other supplemental payments, still on average cover less than 80% of children's hospitals' costs of providing care.¹ Supplemental payments, including state directed payments (SDPs) and disproportionate share hospital (DSH) payments, allow children's hospitals to continue providing high quality, life-saving services to all children across the country, including the 37 million children covered by Medicaid and CHIP.

Any cuts to supplemental payments, including the scheduled DSH cuts, will impact children's hospitals' financial sustainability and the care they provide to all children, regardless of insurance status. Any policies that would restrict states' use of supplemental payments would negatively impact children's access to care.

Latest Actions

- SDPs: On July 4, 2025, the budget reconciliation bill, H.R. 1, was signed into law and makes significant changes to the Medicaid program, including restrictions on how states can utilize SDPs. The law limits any new existing SDPs to Medicare rates and requires existing SDP rates to be phased down to Medicare rates beginning in 2028. These changes restrict how states can fund their share of their Medicaid programs and will ultimately reduce states' Medicaid funding over time.
- DSH: Congress previously delayed DSH cuts until Oct. 1, 2025, when \$8 billion per year in reductions will take effect.

The Bottom Line

Any policies that would implement the scheduled DSH payment cuts or reduce any Medicaid supplemental payments would negatively impact children's access to care.

- Children's hospitals make up less than 5% of the nation's hospitals but account for about 45% of all hospital days for Medicaid-enrolled children.⁴ Medicaid, on average, provides health insurance coverage for half of children's hospitals patients and for some children's hospitals patient mix, closer to three-quarters.⁵
- Supplemental payments are a critical funding source for children's hospitals who provide care to millions of children across the country. Even with these payments, Medicaid still does not cover the cost of care. Scaling back SDPs and cutting DSH payments would exacerbate the existing shortfall between Medicaid payments and children's hospitals' costs impacting their ability to provide care. With reduced funding, children's hospitals across the country will be forced to cut services, limiting access to life-saving health care for millions of children.

1. Annual Benchmark Report Fiscal Year 2023 Freestanding and Children's Hospital in Hospital Cohort, Children's Hospital Association, 2023.

2. "Directed Payments in Medicaid Managed Care," Medicaid and CHIP Access and Payment Commission, October 2024.

3. Ibid.

4. Children's Hospital Association's Analysis of Kids' Inpatient Database (KID), Healthcare Cost and Utilization (HCUP), Agency for Healthcare Research and Quality, 2019.

5. Annual Benchmark Report Fiscal Year 2023 Freestanding and Children's Hospital in Hospital Cohort, Children's Hospital Association, 2023.