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Expanding SCHIP Will Challenge State Finances: A State-by-State Analysis

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The House and Senate recently passed bills to reauthorize the State Children's Health Insurance Program (SCHIP) that will soon be reconciled in conference. Both bills rely on increasing the federal tobacco tax—by 45 cents in the House bill and 61 cents in the Senate bill—to fund SCHIP expansions. An increase in the federal tobacco tax would cause states to lose tobacco tax revenue and would also result in the majority of states losing out under the redistribution of SCHIP expansion funds. Furthermore, the tax hike would not provide enough revenue to fund proposed SCHIP expansions; making up the difference would require millions of new smokers. As the legislation moves to conference under the threat of veto by the President, Members of Congress should consider the negative consequences that SCHIP expansion would have on their states.

States Would Lose Revenues. When consumers purchase a pack of cigarettes, they pay both a state and a federal tax. An increase in the federal tobacco tax would cause the price of a pack of cigarettes to increase. Due to sensitivity to increases in the prices of tobacco products (known as "price elasticity"), the average consumer purchases fewer packs when the price increases.

While the federal government would gain some additional revenue from increasing the federal tobacco tax, state governments also depend on tobacco tax revenue and would suffer financially. A hike in the federal tobacco tax would lead consumers to purchase fewer packs of cigarettes. The federal government would still gain revenue because the tax increase, whether 45 cents or 61 cents, is large enough to offset the decline in cigarette sales. State governments, however, would lose out, taxing fewer packs of cigarettes at the same state tax rate. Every state would collect less tobacco revenue under an increased federal tobacco tax. (See Table 1.)

Under the House bill, every state would suffer a budget loss of at least $1 million per year, and 17 states would have losses greater than $10 million per year. Under the Senate bill, every state would lose more than $1.4 million per year, and half of the states would have budget losses of over $10 million per year. California, Ohio, and Pennsylvania would lose over $50 million each under the Senate bill.[1]

With these enormous hits to their budgets, states would need to reduce funding for programs, such as education or transportation, or even eliminate some programs altogether. The Members of Congress who advocate raising the tobacco tax for the SCHIP expansion should be mindful of the consequences this tax increase would have on the fiscal stability of their home states.

Redistribution Would Hurt Most States. Not all states would fare the same under either cham-

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Table 1 WM 1586

Annual Potential Loss in State Revenue from the House and Senate Funding Plans

State	House	Senate
Alabama	–$7,387,707	–$10,014,000
Alaska	–$1,885,471	–$2,556,000
Arizona	–$9,630,194	–$13,054,000
Arkansas	–$6,633,223	–$8,992,000
California	–$45,153,581	–$61,208,000
Colorado	–$9,989,651	–$13,542,000
Connecticut	–$8,270,871	–$11,212,000
Delaware	–$3,312,823	–$4,491,000
Florida	–$21,926,112	–$29,722,000
Georgia	–$11,658,830	–$15,804,000
Hawaii	–$2,743,865	–$3,719,000
Idaho	–$2,451,527	–$3,323,000
Illinois	–$22,038,229	–$29,874,000
Indiana	–$14,987,002	–$20,316,000
Iowa	–$3,805,231	–$5,158,000
Kansas	–$5,148,460	–$6,979,000
Kentucky	–$9,582,248	–$12,989,000
Louisiana	–$4,656,995	–$6,313,000
Maine	–$4,932,478	–$6,686,000
Maryland	–$11,415,217	–$15,474,000
Massachusetts	–$14,619,493	–$19,818,000
Michigan	–$36,877,626	–$49,990,000
Minnesota	–$17,121,761	–$23,209,000
Mississippi	–$2,945,814	–$3,993,000
Missouri	–$5,725,131	–$7,761,000
Montana	–$3,208,347	–$4,349,000
Nebraska	–$2,993,717	–$4,058,000
Nevada	–$6,049,961	–$8,201,000
New Hampshire	–$6,521,087	–$8,840,000
New Jersey	–$22,365,740	–$30,318,000
New Mexico	–$2,114,782	–$2,867,000
New York	–$30,301,456	–$41,075,000
North Carolina	–$8,512,661	–$11,539,000
North Dakota	–$1,161,593	–$1,575,000
Ohio	–$42,990,804	–$58,276,000
Oklahoma	–$9,691,217	–$13,137,000
Oregon	–$11,272,845	–$15,281,000
Pennsylvania	–$39,834,347	–$53,998,000
Rhode Island	–$3,643,727	–$4,939,000
South Carolina	–$1,722,412	–$2,335,000
South Dakota	–$1,061,360	–$1,439,000
Tennessee	–$5,524,850	–$7,489,000
Texas	–$20,862,573	–$28,280,000
Utah	–$2,686,634	–$3,642,000
Vermont	–$1,677,634	–$2,274,000
Virginia	–$8,199,619	–$11,115,000
Washington	–$14,587,587	–$19,774,000
West Virginia	–$5,320,544	–$7,212,000
Wisconsin	–$13,722,777	–$18,602,000
Wyoming	–$1,175,834	–$1,594,000
Average	**–$11,042,073**	**–$14,968,120**

Source: Heritage Foundation calculations and Federal Funds Information for States, "Potential Loss in State Revenues from a 61–Cent Federal Cigarette Tax Increase," July 2007, at *http://inside.ffis.org/fff/tobaccotax.pdf.*

ber's SCHIP expansion plan. Under the Senate plan, 29 states would contribute more in tobacco tax revenue than they would receive in SCHIP expansion dollars. For instance, Florida would contribute approximately 7 percent of the increased tax revenues but is projected to receive only 5 percent of the federal allotment for SCHIP funding. Consequently, Florida would suffer a net loss of over $700 million over 5 years. In all, 29 states would wind up losers, 16 states would wind up winners, and 5 states would neither gain nor lose much. (See Map 1.)

An Unreliable Funding Source. Congress's choice of a tobacco tax hike to fund SCHIP expansion might make political sense, but a higher tobacco tax would not be a reliable or sufficient funding source. Already, tobacco tax revenues are in decline as the population of smokers continues to decrease, and the decline in sales of tobacco products would accelerate with a higher tobacco tax. Thus, the additional revenue generated from increased tobacco tax would decrease over time.

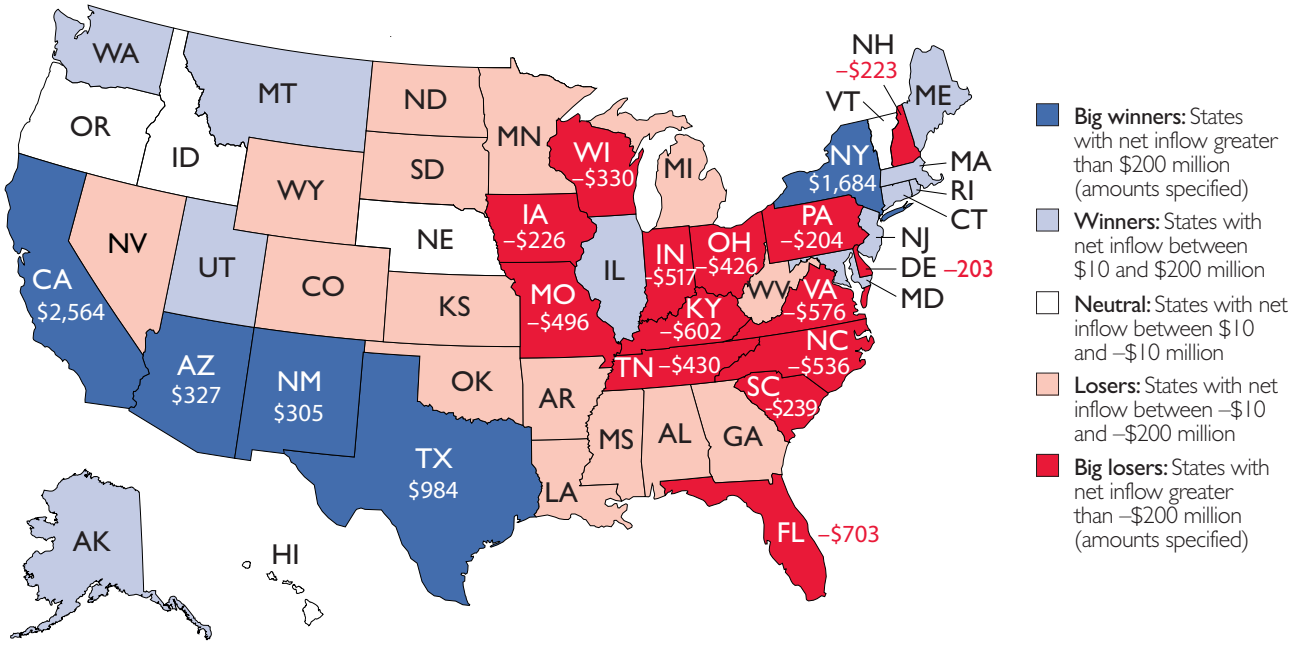
Due to this effect, policymakers will somehow need to recruit new smokers if they insist on using the tobacco tax revenue to support SCHIP at proposed funding levels over the long term. In just five years, Congress will need over 9 million new smokers. Reauthorizing the program for 2013 to 2017 would require almost 22.4 million new smokers by the end of that period.[2] To pay for SCHIP, Florida, Texas, and California would have to add about 1.5 million new smokers each by 2017, and other states would have to add smaller numbers.[3] (See Table 2.) While unrealistic, this scenario is apparently what Congress envisions in its SCHIP proposals.

Recommendations for Congress. Congress should consider the unintended effects of SCHIP expansion. Worse than its impact on state budgets, SCHIP expansion would increase dependence on government health care, displace private insurance coverage, and increase government spending.[4] Rather than expand SCHIP, Congress should reauthorize SCHIP so that it:

- *Focuses on low-income children.* The current bills in Congress allow states to expand eligibility beyond low-income families, the vast majority of

Map 1 WM 1586

SCHIP Expansion's Winners and Losers: Net Impact on States (New Grants – New Taxes) Under the Senate Proposal



Source: Centers for Disease Control and Prevention, "State Tobacco Activities Tracking and Evaluation (STATE) System: Detailed Report," at *http://apps.nccd.cdc.gov/StateSystem/index.aspx* (July 18, 2007) and Families USA, "SCHIP Reauthorization: What's at Stake for the States," May 2007, at *www.familiesusa.org/issues/medicaid/schip-reauthorization.html*.

whom already have private coverage. Expanding eligibility to children in families with higher income only causes those families to drop private insurance in favor of government-run, taxpayer-funded health care.[5] A more efficient use of SCHIP funds would be to focus only on children in low-income families, prioritizing those most in need.

1. Federal Funds Information for States, "Potential Loss in State Revenues from a 61-Cent Federal Cigarette Tax Increase," July 2007, at *http://inside.ffis.org/ff/tobaccotax.pdf*.
2. See Michelle C. Bucci and William W. Beach, "22 Million New Smokers Needed: Funding SCHIP Expansion with a Tobacco Tax," Heritage Foundation *WebMemo* No. 1548, July 11, 2007, at *www.heritage.org/Research/HealthCare/upload/wm_1548.pdf*.
3. For a description of the methodology employed in this paper, see William W. Beach and Andrew Nowobilski, "22 Million New Smokers Needed: Methodological Appendix," The Heritage Foundation, July 11, 2007, at *www.heritage.org/Research/HealthCare/wm1548-methods.cfm*.
4. For thorough discussions of the House and Senate bills, see Cheryl Smith and Robert E. Moffit, "The House SCHIP Bill: Cutting Medicare, Undercutting Private Coverage, and Expanding Dependency," Heritage Foundation *WebMemo* No. 1580, August 1, 2007, at *www.heritage.org/Research/HealthCare/upload/wm_1580.pdf*, and Nina Owcharenko and Robert E. Moffit, "Redesigning SCHIP to Strengthen Private Heath Insurance for Working Families," Heritage Foundation *WebMemo* No. 1564, July 23, 2007, at *www.heritage.org/Research/HealthCare/upload/wm_1564.pdf*.
5. See Andrew M. Grossman and Greg D'Angelo, "SCHIP and 'Crowd-Out': How Public Program Expansion Reduces Private Coverage," Heritage Foundation *WebMemo* No. 1518, June 21, 2007, at *www.heritage.org/research/healthcare/upload/wm_1518.pdf*.

- *Augments private coverage.* Instead of expanding a government program, Congress should make private coverage a more affordable option for low-income families. One way to do this within the original scope of SCHIP is through premium assistance, which essentially allows eligible families to use SCHIP funds to subsidize the purchase of health care for their children.[6] Congress should facilitate states' use of premium assistance by removing burdensome administrative procedures.
- *Is fiscally sustainable.* Current bills in Congress carelessly use the tobacco tax—a declining source of revenue—as the basis for their SCHIP expansion. Moreover, the House bill does not place a cap on SCHIP allotments, thereby creating another open-ended entitlement. Instead, Congress should follow a fiscally responsible approach, focusing only on low-income children and obligating states to operate their programs within their SCHIP budgets.
- **Conclusion.** With a presidential veto likely, the House and the Senate will have the opportunity to revise their respective bills and reauthorize SCHIP as a program that does not harm states but helps them to offer health insurance to children in low-income families in an affordable and efficient manner.

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Table 2 WM 1586

New Smokers Needed by 2017 from the House and Senate Funding Plans

State	House	Senate
Alabama	459,260	461,537
Alaska	44,568	44,789
Arizona	317,585	319,159
Arkansas	279,246	280,630
California	1,463,877	1,471,134
Colorado	308,048	309,575
Connecticut	217,723	218,802
Delaware	191,243	192,191
Florida	1,587,399	1,595,268
Georgia	779,407	783,271
Hawaii	75,307	75,680
Idaho	105,237	105,759
Illinois	806,533	810,531
Indiana	760,519	764,289
Iowa	310,449	311,988
Kansas	186,888	187,814
Kentucky	745,871	749,569
Louisiana	404,513	406,518
Maine	104,517	105,035
Maryland	335,148	336,809
Massachusetts	346,463	348,180
Michigan	696,152	699,603
Minnesota	350,625	352,363
Mississippi	327,511	329,135
Missouri	749,443	753,158
Montana	59,489	59,784
Nebraska	128,411	129,047
Nevada	208,629	209,663
New Hampshire	217,446	218,524
New Jersey	401,427	403,417
New Mexico	84,447	84,865
New York	763,419	767,203
North Carolina	968,482	973,284
North Dakota	57,195	57,478
Ohio	987,591	992,486
Oklahoma	380,913	382,801
Oregon	247,058	248,283
Pennsylvania	947,432	952,129
Rhode Island	61,630	61,936
South Carolina	508,403	510,923
South Dakota	66,037	66,365
Tennessee	727,427	731,033
Texas	1,557,876	1,565,599
Utah	107,372	107,904
Vermont	48,657	48,898
Virginia	735,962	739,611
Washington	263,055	264,359
West Virginia	249,012	250,246
Wisconsin	483,518	485,915
Wyoming	49,529	49,774
Average	**445,279**	**447,486**

Source: Heritage Foundation calculations.

6. See Nina Owcharenko, "Reforming SCHIP: Using Premium Assistance to Expand Coverage," Heritage Foundation *WebMemo* No. 1466, May 22, 2007, at *http://www.heritage.org/Research/HealthCare/upload/wm_1466.pdf.*