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22 Million New Smokers Needed: Funding SCHIP Expansion with a Tobacco Tax

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Members of Congress seeking to expand the State Children's Health Insurance Program (SCHIP) to cover children from wealthier families are exploring new ways to pay for it. The Senate Finance Committee generally has agreed to reauthorize SCHIP for five years with a \$35 billion expansion funded by an increase in the federal tobacco tax by 61 cents per pack.¹

While a tobacco tax is a politically popular funding source, it has several significant shortcomings:

- A tobacco tax disproportionately burdens low-income Americans, lacks long-term stability, and ultimately results in significant shifting of health care costs onto others.
- With the number of smokers already declining, a tobacco tax would further reduce the number of smokers, thereby eroding the funding source.
- To produce the revenues that Congress needs to fund SCHIP expansion through such a tax would require 22.4 million new smokers by 2017.

Rather than making SCHIP dependent on increasing the number of smokers, Congress should refrain from narrow government program expansions and work on a broader strategy for improving access to affordable, private health insurance for all Americans—including children.

Who Would Pay? Increasing the tobacco tax is an inequitable way to fund SCHIP, because a large portion of the burden would fall on poor and low-income families and the relatively young. Around half of smokers are in families earning less than 200

percent of the federal poverty line (FPL), so increasing the tobacco tax would burden the families in the income class that SCHIP and Medicaid are trying to help.² Furthermore, smokers are more likely to be poor or low-income than wealthy.³ (See Chart 1.) With an expanded tobacco tax, SCHIP expansion to higher income levels would largely be funded by lower income persons, those who can least afford it.

Young adults are also disproportionately impacted by the tobacco tax: Forty-three percent of smokers are ages 24 to 44.⁴ (See Chart 2.) Placing the burden of expanding this program on the shoulders of any small subset of the population is unfair. Neither low-income families nor young adults should be held responsible for funding an unnecessary expansion of SCHIP.

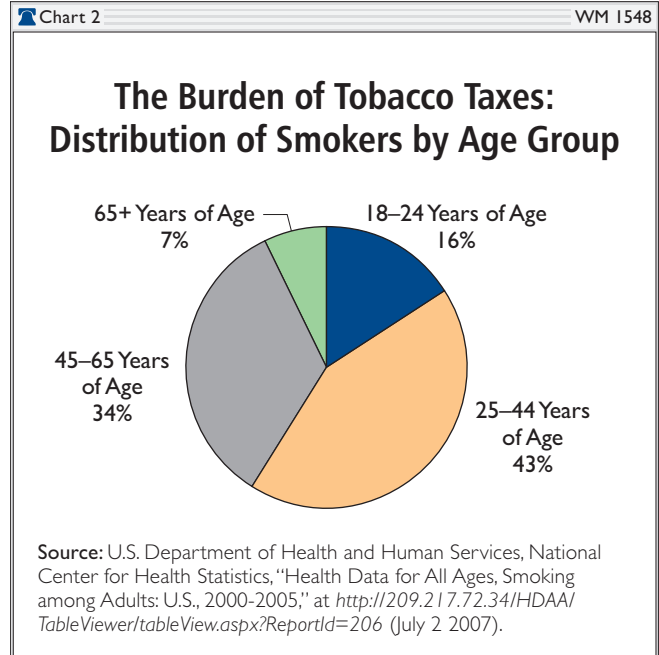
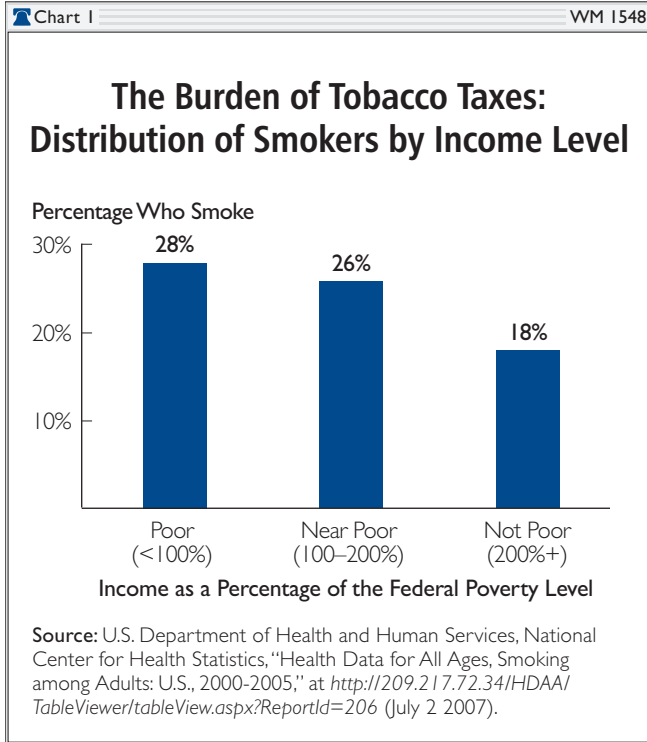
Congress Needs More Smokers. Not only are some policymakers considering imposing a large, new burden on a small portion of the population, but they have chosen a revenue source that is in decline and will decrease even faster if the tax rate rises. Due to the sensitivity of consumers to increases in the price of tobacco products (known as "price elasticity"), the average consumer purchases fewer cigarettes when the price increases.

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Consequently, the additional revenue generated from increasing the tax will decline over time. (See Chart 3.)

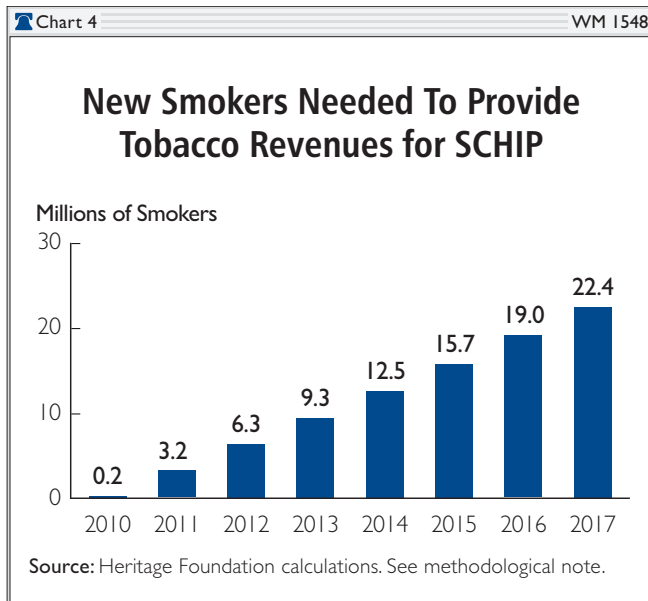
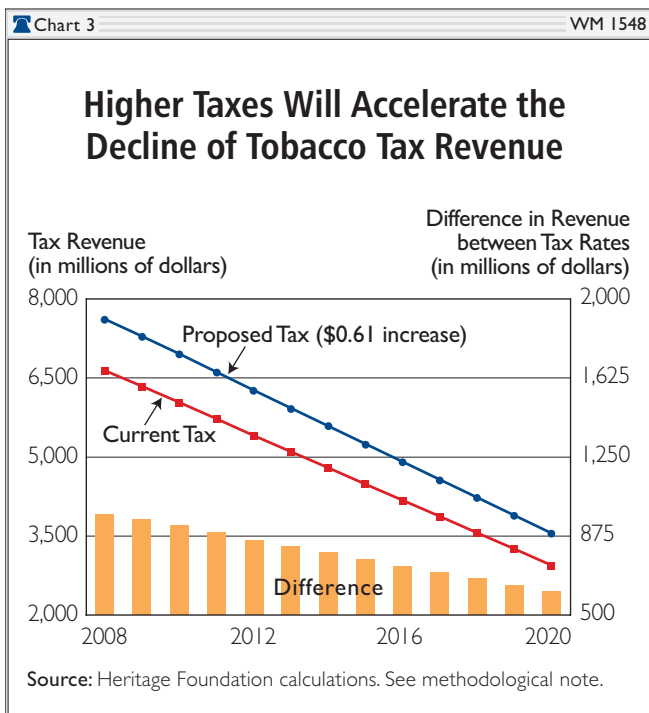
Due to this price elasticity, policymakers will somehow need to recruit new smokers if they insist on using the tobacco tax revenue to support SCHIP at proposed funding levels over the long term. In just five years, Congress will need over 9 million new smokers. Reauthorizing the program for 2013 to 2017 would require almost 22.4 million new smokers by the end of that period.⁵ (See Chart 4.)

But funding problems will likely begin before the end of the five-year horizon. Since the revenues

from the tobacco tax are declining while the amount of SCHIP funds needed to maintain a level of purchasing power are increasing, Congress could face a shortage of smokers in just two years. In this case, Congress will need over 6.3 million new smokers between 2010 and 2012, which grows to 9 million new smokers needed in 2013 to support the government's health program.

Funding the expansion of a government health program through a tax on a toxic product with a declining revenue stream is not only paradoxical but also fiscally irresponsible. It is not a reliable source of continued funding. Even with the tobacco tax hike, additional revenues, most likely from other tax increases, will be necessary to pay for SCHIP expansion.

1. CQ Today Midday Update, "Senate Finance Nears Deal on Expansion of Children's Health Care Program," July 10, 2007, at <http://public.cq.com/docs/cqm/cqmidday110-000002547587.html>.
2. U.S. Census Bureau, "Annual Demographic Survey," June 25, 2004, at http://pubdb3.census.gov/macro/032004/perincl/new01_001.htm.
3. National Center for Health Statistics, "Health Data for All Ages, Smoking among adults: US, 2000-2005," at <http://209.217.72.34/HDAA/TableView/tableView.aspx?ReportId=206>.
4. U.S. Census Bureau, "Annual Demographic Survey."
5. 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.



Shifting Costs to Non-Smokers. Current projections of the number of smokers reveal that the tobacco tax will be unable to support SCHIP expansion, leaving Congress with two options: somehow recruit millions of new smokers or, more realistically, find another funding source, either of which would result in significant cost-shifting.

If Congress is serious about using tobacco taxes to fund SCHIP expansion, Members should seriously consider the consequences of depending on new and existing smokers to fund health care. This funding source may appear to be cost-effective in the short run; after all, young people generally do not experience significant health problems due to smoking. The long-term cost-effectiveness does not look as promising, however, once new health care expenditures are included. The Centers for Disease Control and Prevention estimates that each adult smoker costs approximately \$3,702 annually in medical costs and lost productivity.⁶ If Congress is serious, the tens of millions of new smokers would be needed to sustain SCHIP funding. But assuming that

a new cohort of smokers would somehow materialize, the privately insured, as well as the taxpayers, would also carry a correspondingly heavier burden, as most of the additional costs would be shifted to them through higher insurance premiums.

As an alternative to the tobacco tax, Congress might look to raise income taxes to avert a SCHIP funding shortfall. Taxpayers would then face annual costs of approximately \$7 billion in 2010 to \$9.4 billion in 2017.⁷

A Better Alternative. A tobacco tax is an unreliable and inequitable way to finance SCHIP. More importantly, SCHIP should not be expanded beyond its original mission. Congress has better options at its disposal to improve the availability of health care for children and the poor. Congress should:

- **Focus SCHIP on Low-Income Children.** One way to avoid increasing taxes on smokers and taxpayers in general is to focus SCHIP on children in families earning between 100 and 200 percent of the FPL. Expansions further up the income ladder only cause families to drop private coverage in favor of government plans, which leads to the erosion of the private market.⁸ Under the President's proposal, which appropri-

6. Centers for Disease Control and Prevention, "Fact Sheet: Economic Costs and Years of Potential Life Lost Associated with Cigarette Smoking," April 2007, at www.cdc.gov/tobacco/data_statistics/Factsheets/economic_facts.htm.

7. Estimates are based on the assumption of constant purchasing power.

ately focuses on “children most in need,” no additional sources of revenue are necessary.⁹

- **Give Families Control.** Rather than lead SCHIP recipients to depend on tobacco revenue, policy-makers should enable families to gain greater control over their health care by helping them move into private coverage. Premium assistance, which allows SCHIP funds to be used to purchase private insurance for eligible children, is an obvious solution, but one that is underutilized because it is hampered by bureaucracy and red tape. Policymakers should encourage states’ use of premium assistance by removing these administrative burdens.¹⁰
- **Get the Big Picture.** With the reauthorization of SCHIP, Congress has the opportunity to reform health care for all Americans. The current tax code causes inequities, since only those with employer-sponsored insurance receive tax breaks. By contrast, the President’s plan to reform the tax code supports giving all families a tax incentive to purchase private insurance.¹¹

Integrating that broad reform with a focused SCHIP that offers premium support would direct resources to those truly in need while correcting many existing inequities, thus improving access to health care coverage for all Americans.

Conclusion. Current plans to fund SCHIP expansions with an increase in the tobacco tax would move more Americans further away from stable, affordable coverage. Fortunately, alternatives exist that focus on low-income children, empower families to own their health insurance, and make affordable private coverage a reality for all. Congress should recognize the long-term advantages to these alternatives and the detriments of the proposed SCHIP expansions.

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8. 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/wm1518.cfm.
9. President George W. Bush, “President Bush Discusses Health Care,” speech, June 27, 2007, at www.whitehouse.gov/news/releases/2007/06/20070627-10.html.
10. See Nina Owcharenko, “Reforming SCHIP: Using Premium Assistance to Expand Coverage,” Heritage Foundation *WebMemo* No. 1466, May 22, 2007, at www.heritage.org/Research/HealthCare/wm1466.cfm.
11. President George W. Bush, “President Bush Discusses Health Care.”