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The Phantom Economic Benefits of SCHIP Expansion

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Proponents of federal spending programs commonly extol the many jobs that would be created if their spending wishes were met. Defense contractors do it. Highway bill supporters do it. Now even proponents of higher federal health care spending are claiming more funding translates into more jobs and higher wages. The trouble is that such claims are almost never true. A case in point is analysis published by Families USA in support of the reauthorization and expansion of the State Children's Health Insurance Program (SCHIP).[1]

Families USA's Research on SCHIP Expansion. SCHIP was created in 1997 to provide health insurance to children in low-income families whose earnings are too high to qualify for Medicaid but below 200 percent of the federal poverty level. Like Medicaid, SCHIP is jointly funded by the federal government and state governments. States can make their SCHIP program a simple extension of their Medicaid program, design a stand-alone program, or craft some combination of the two. The federal government's role is essentially to approve the program design and provide a chunk of funding to the respective states.

Federal SCHIP funding was originally set at $40 billion over 10 years. A straight extension of the program would cost $25 billion over the next five years, but there is great pressure to expand the program by allowing it to cover adults and children in wealthier families—those with incomes as high as 400 percent of the federal poverty level in some proposals.

Families USA, an advocacy organization, favors a much expanded SCHIP program as part of its broader effort to achieve nationwide government-run health insurance. To bolster its case, the group released projections of the economic effects of a doubling of the SCHIP program to $50 billion over five years.

To make its analysis more useful to state-based advocates and Members of Congress, Families USA created reports for all 50 states and the District of Columbia emphasizing how much additional federal money a state could expect if SCHIP were expanded to a $50 billion, five-year program, and how much "business activity," wages, and employment would rise due to the expansion. For example, the analysis suggests that business activity in Alabama would increase by $331.1 million a year; wages in Missouri would increase by $137 million; and employment in Wisconsin would rise by 3,032 jobs. Altogether, according to the analysis, business activity in the United States would increase by $21.4 billion, total wages by $7.7 billion, and employment by 227,065 jobs.

Erroneous Analysis. The problem is that higher government health care spending would not create

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net economic activity or increase real wages and jobs. There is still a debate in some quarters as to whether government spending can boost the economy when the economy is operating well below full employment. There is no serious debate, however, that such effects do not occur when the economy is operating at roughly full capacity, as it is today.

As a rule, a change in the composition or level of federal spending will shift the composition of demand in the economy from one area to another, such as from business investment to consumption or from consumption of goods to consumption of health care services. As demand shifts, the allocation of capital and labor resources shifts accordingly. For most federal spending, there is no resulting increase in the amount of capital or labor employed in the economy.

Expressed another way, there would almost certainly be an increase in employment in health services if SCHIP spending were doubled, and the increase could even be around the 227,000 jobs predicted by Families USA, but there would also then be 227,000 *fewer* workers employed in the rest of the economy. Higher health sector employment due to increased government spending on SCHIP would crowd out other types of employment; it would not increase employment.

Shifting the composition of demand by increasing federal spending does not generally increase overall economic activity, because it does not increase the level of productive resources available to the economy—that is, labor and capital. There are exceptions, such as when federal spending materially raises the quality of the infrastructure on which the private economy depends—which is rare today—or when federal spending expands the frontiers of technology applicable to producers. But these are exceptions, not the rule, and an expansion of SCHIP funding is not among the exceptions.

Herein lies an important distinction between tax relief and spending increases. A wide variety of tax relief options would increase the level of productive resources available to the economy. Reducing marginal individual income tax rates, for example, improves the incentive to work and, therefore, increases the supply of labor and the level of potential output. Reducing the tax rates on dividends, capital gains, or corporate income would each reduce the tax disincentive to invest in new plants and equipment, thereby encouraging growth in the capital stock and raising productivity and, therefore, wages and output. In general, spending increases lead to none of these things.

To argue that an SCHIP expansion would have *no* economic effects is actually generous toward Families USA's cause, because to do so ignores the increase in inefficiencies in the economy due to such spending, inefficiencies that would reduce wage and income levels. For example, expanding SCHIP would divert resources from other uses in which, according to economic incentives, they are more valuable. One can certainly make moving and valid arguments about the importance of health insurance for children. Those arguments move the heart, but they do not move the GDP.

Further, the Congressional Budget Office notes that increasing health care spending is likely to decrease, not increase, employment and output.[2] The reason is that, to the extent that additional health care spending is valued by consumers, the additional health resources "reduce people's incentives to work and save."[3] Thus an SCHIP expansion would reduce total employment by encouraging workers to leave the workforce.

In addition, this increase in spending must somehow be matched by a like increase in taxes, and this is the case whether the Budget Resolution or the economy dictates the outcome. Higher taxes—even higher taxes on tobacco, which is the announced intent of the Senate Finance Commit-

1. Families USA, "SCHIP Reauthorization: What's at Stake for the States," May 2007, at *www.familiesusa.org/issues/medicaid/schip-reauthorization.html*.
2. Letter to Senator Judd Gregg from CBO Director Peter Orszag, July 9, 2007, at *www.cbo.gov/ftpdocs/82xx/doc8295/07-09-Financing_Spending.pdf*.
3. *Ibid.*

tee—distort the allocation of resources and reduce economic output. Taxing tobacco may be popular, but that popularity does not displace the reality of economic incentives and the consequences of distorting those incentives with taxes.

Conclusion. Poor economic analysis only confuses those who receive it and muddies debate. Family USA's state-by-state economic analysis of an SCHIP expansion should be withdrawn or at least simply ignored.

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