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The New SCHIP Bill: The Senate Must Protect Private Coverage

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The United States Senate will soon consider legislation to reauthorize the State Children's Health Insurance Program (SCHIP). Its decisions on that legislation will have a major impact on the private health insurance coverage of millions of American children.

The House of Representatives recently passed a major SCHIP expansion and removed any provision to protect private coverage. Among many other provisions, the House bill would extend the program to target children in families with annual incomes of $66,150, and in some cases even higher.[1] In other words, the House version of the bill would expand the program beyond low-income working families far into the middle class.

When the Senate considers the House legislation or a companion proposal to expand SCHIP to children in families with higher incomes, it should recognize that public program expansions would result in "crowd-out," or displacement, of both private health insurance coverage and funding. Expansions would impose higher and unnecessary costs as the program enrolls children who would have otherwise had private coverage. In particular, expanding eligibility beyond the current target population becomes a one-for-the-price-of-two proposition akin to taxpayers spending $1.00 to get 50 cents worth of new coverage.

The Purpose of SCHIP. As part of the Balanced Budget Act of 1997, SCHIP was enacted to provide assistance to uninsured children in low-income families. The idea was to help working families that earned too much to qualify for Medicaid but presumably not enough to afford private coverage.[2] Originally, the purpose of the law was "to initiate and expand the provision of child health assistance to uninsured, low-income children in an effective and efficient manner that is coordinated with other sources of health benefits coverage."[3] With an initial appropriation of $4 billion a year, Congress offered states a higher federal matching-rate percentage than under Medicaid to encourage them to participate in the new federal-state program.

Although it expanded public assistance beyond the traditional scope of Medicaid, SCHIP was clearly intended to target low-income uninsured children in families at or below 200 percent of the federal poverty level (FPL): $44,100 for a family of four in 2009.[4] State officials, however, have used their broad authority to expand eligibility to children in families with higher incomes.[5] By 2009, only seven states had eligibility below 200 percent FPL. Thirty-three states set eligibility between 200 and 250 percent FPL. Eleven states expanded eligibility above 250 percent FPL.[6]

SCHIP and Previous Research on "Crowd-Out." With the creation of SCHIP and subsequent

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state expansions in eligibility beyond the initial target population, concern has been raised about the unintended consequence of public programs crowding out private coverage and funding. There is a robust body of research on crowd-out. In 1996, economists David Cutler of Harvard University and Jonathan Gruber of MIT were the first to provide quantitative support for the notion that expansions in public program eligibility can reduce a program's "bang for the buck" in reducing the ranks of the uninsured.[7] Looking at Medicaid eligibility expansions between 1987 and 1992—mostly expansions to cover children from families with higher incomes—Cutler and Gruber found that approximately 31–40 percent of the increase in Medicaid coverage of children was offset by reductions in private coverage. In other words, for every 100 children who became newly eligible for Medicaid, 31–40 would have otherwise had private insurance.

More recent research has for the most part corroborated Cutler and Gruber's findings. In one widely cited study, Gruber and Kosali Simon of Cornell University focused on public program expansions between 1996 and 2002—the time during which SCHIP was enacted and implemented—and concluded that crowd-out was "significant."[8]

The Congressional Budget Office (CBO) initially assumed that the creation of SCHIP would lead to sizeable crowd-out, around the level of 40 percent.[9] Later, in 2007, the CBO concluded that reliable estimates of crowd-out as a result of SCHIP expansions to date were probably somewhere between 25 and 50 percent.[10] Likewise, a report commissioned by the Centers for Medicare and Medicaid Services

1. This figure represents 2009 dollars for a family of four. The eligibility for SCHIP coverage at this level would thus equal 300 percent of the Federal Poverty Level (FPL), well above the 200 percent level that was the original target level and purpose of the SCHIP legislation.
2. Public Law 105-33. For more background on SCHIP see, Nina Owcharenko, "Fixing SCHIP and Expanding Children's Health Care Coverage," Heritage Foundation *Backgrounder* No. 2029, May 2, 2007, at *http://www.heritage.org/Research/HealthCare/bg2029.cfm*.
3. Section 2101(a) of the Social Security Act describes the purpose of the SCHIP statute 'to initiate and expand the provision of child health assistance to uninsured, low-income children in an effective and efficient manner that is coordinated with other sources of health benefits coverage.'" See letter from Dennis Smith, Director of Center for Medicaid and State Operations, Center for Medicare and Medicaid Services, to State Health Officials, August 17, 2007, at *www.cms.hhs.gov/smdl/downloads/SHO081707.pdf* (January 23, 2009).
4. U.S. Department of Health and Human Services, "The 2009 HHS Poverty Guidelines," January 23, 2009, at *http://aspe.hhs.gov/poverty/09Poverty.shtml* (January 23, 2009).
5. See, for instance: Donna Cohen Ross et al., "Determining Income Eligibility in Children's Health Coverage Programs: How States Use Disregards in Children's Medicaid and SCHIP," Kaiser Commission on Medicaid and the Uninsured, May 2008, at *http://www.kff.org/medicaid/upload/7776.pdf* (January 23, 2009).
6. Donna Cohen Ross and Caryn Marks, "Challenges of Providing Health Coverage for Children and Parents in a Recession:: A 50-State Update on Eligibility Rules, Enrollment and Renewal Procedures, and Cost-Sharing Practices in Medicaid and SCHIP in 2009," Kaiser Commission on Medicaid and the Uninsured, January 2009, p. 6, at *http://www.kff.org/medicaid/upload/7855.pdf* (January 26, 2009). The original SCHIP legislation allowed states with Medicaid eligibility near 200 FPL to expand eligibility 50 percentage points above their initial Medicaid levels. However, today many of these states have exceeded this threshold set in law.
7. David M. Cutler and Jonathan Gruber, "Does Public Insurance Crowd-out Private Insurance?" *Quarterly Journal of Economics*, Vol. 111, No. 2 (May 1996), pp. 391–430.
8. Jonathan Gruber and Kosali Simon, "Crowd-Out Ten Years Later: Have Recent Public Insurance Expansions Crowded Out Private Health Insurance?" NBER Working Paper No. w12858, January 2007.
9. Congressional Budget Office, "Expanding Health Insurance Coverage for Children Under Title XXI of the Social Security Act," February 1998, p. 18, at *http://www.cbo.gov/ftpdocs/3xx/doc353/kids-hi.pdf* (January 23, 2009).
10. See Congressional Budget Office, "The State Children's Health Insurance Program," May 2007, at *www.cbo.gov/ftpdocs/80xx/doc8092/05-10-SCHIP.pdf* (January 23, 2009).

states that estimates of crowd-out in SCHIP have ranged between 10 and 56 percent.[11]

However, crowd-out would likely be larger if income eligibility were further expanded since children in families with higher incomes are more likely to have private insurance to lose if they were to become newly eligible for public coverage. Crowd-out thus has major implications for the sources of health insurance coverage for millions of children and the most prudent use of taxpayer dollars.

If Congress expands SCHIP eligibility to children with higher incomes without real protections against crowd-out, taxpayers would be required to fund coverage for both the targeted uninsured population as well as many children who would have otherwise had private health insurance. Congress should therefore be concerned about the inefficiencies inherent in pursuing public program expansions as a blunt instrument for covering the uninsured.

Heritage Research: Higher Income, Bigger Crowd-Out. A Heritage Foundation econometric analysis of crowd-out, using data from 1996 to 2003, supports several important conclusions. First, as SCHIP eligibility levels were extended to include children with higher incomes, roughly *one-third* of the children who became publicly insured had private insurance before the expansion.

A second important finding is that crowd-out of private health coverage grows as coverage under SCHIP becomes available to children with higher incomes. Such a result is expected, since the families of these children are more likely to be able to afford their own insurance or have a parent with access to employer-provided insurance before an expansion in program eligibility.[12] In fact, the Heritage study found that as eligibility for public coverage was extended to children in families with incomes between 200 and 300 percent of FPL, as many as *half* of those children who had been transitioned into public coverage would have otherwise had private insurance.

A third important finding of the Heritage analysis is that the magnitude of the crowd-out effect depends on the measurement of the group that has become publicly insured. If it includes children who were privately insured *before* the expansion and then have *both* public and private coverage—that is, those with overlapping coverage—the magnitude of crowd-out is slightly higher than those identified as transitioning from private-only to public-only coverage. In measuring the movements of children in families that initially have only private insurance and have only public coverage after the expansion, it is possible to miss a significant number of the transitions from private insurance and to public programs.[13]

Crowd-Out Caused by SCHIP Expansions From 1996 to 2003

Family Income as a Percent of the Federal Poverty Level (FPL)	Income for a Family or Household of Four	Crowd-Out	
		Private Only to Public Only	Private to Public, Factoring in the Overlap Group
Entire sample	$22,050–$88,200	27%	35%
100 to 200 % FPL	$21,050–$44,100	32%	42%
200 to 300 % FPL	$44,100–$66,150	33%	51%
300 to 400 % FPL	$66,150–$88,200	47%	60%

Source: Estimates of crowd-out are based on Heritage Foundation calculations using the 1996 and 2001 panels of the Survey of Income and Program Participation (SIPP); the family income data is from U.S. Department of Health and Human Services, "The 2009 HHS Poverty Guidelines," January 23, 2009, at *http://aspe.hhs.gov/poverty/09poverty.shtml* (January 23, 2009).

Table 1 • WM 2246 heritage.org

11. So Limpa-Amara, Angela Merrill, and Margo Rosenbach, "SCHIP at 10: A Synthesis of the Evidence on Substitution of SCHIP for Other Coverage," September 2007, at *http://www.mathematica-mpr.com/publications/pdfs/SCHIPsubstitution.pdf* (January 23, 2009).
12. Congressional Budget Office, "The State Children's Health Insurance Program."
13. One potential explanation for these missed transitions could be that families whose children are transitioned onto public insurance have parents who stay with their employer-based or other private insurance plan.

Imposing Higher and Unnecessary Costs. Congress's proposal to expand public programs as a means of covering uninsured children up to 300 FPL would come at a cost to both the federal government and the states who share in both the financing of SCHIP and Medicaid.

Static estimates for covering uninsured children below 300 percent of the FPL—through public programs, in the absence of crowd-out—would produce an additional cost of $15.3 billion in year one (the federal government would contribute $9.6 billion and the states would contribute $5.7 billion). Without accounting for crowd-out, however, cost estimates are likely to significantly underestimate the true cost of a program expansion.

SCHIP Expansion Costs

One-Year Costs of SCHIP Expansion to 300% of the Federal Poverty Level

	No Crowd-Out	Lower Bound	Upper Bound
Federal	$9,655,287,540	$13,854,590,393	$15,772,835,025
State	$5,691,622,964	$8,096,352,587	$8,990,733,652
Total	$15,346,910,504	$21,950,942,979	$24,763,568,677

Source: Heritage Foundation calculations using the March 2008 Supplement of the Current Population Survey (CPS) and Centers for Medicare and Medicaid Services, Office of the Actuary and the Federal Register: November 28, 2007, Vol. 72, No. 228, p. 67304-67306.

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Heritage estimates that the total cost of covering uninsured children below 300 percent of the FPL is likely between $21.9 and $24.7 billion in the first year—the federal government contributing between $13.8 and $15.7 billion and states contributing between $8 and $9 billion. Under the Heritage estimate, crowd-out itself could add an additional $6.6 billion to $9.4 billion per year.

The cost of crowd-out alone under Congress's expansion could, therefore, be larger than the total current federal allotment for SCHIP ($5 billion) and possibly even larger than the entire total—federal and state—cost ($7.1 billion) of the SCHIP program today. The Senate must reverse these dynamics by including policies that restrict the crowding out of private coverage and funding while enabling children in families with existing private health insurance to keep it.

Protecting Private Coverage. The Senate should address the problem of crowd-out by focusing SCHIP on children in low-income families while adding further measures to protect the private coverage of millions of American children. That way, more families would be able to keep private coverage and taxpayers would not be billed for higher and unnecessary costs while low-income uninsured children gain access to the coverage they need.

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