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FACT SHEET

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CONGRESS HAS A NUMBER OF OPTIONS TO PAY FOR EXTENDING HEALTH COVERAGE TO MORE LOW-INCOME CHILDREN

There is growing consensus that SCHIP reauthorization should make substantial progress toward covering all uninsured low-income children. The cost, however, will be substantial. Immediately enrolling the roughly 6 million children who are eligible for publicly funded coverage but are unenrolled would cost the federal government more than $50 billion over five years. (This amount is in addition to the $7.9 billion in federal funding that CBO estimates will be needed just to sustain existing state SCHIP programs.)

In the House and, most likely, in the Senate as well, SCHIP reauthorization legislation will be subject to "pay-as-you-go" rules, which require that the cost of increases in mandatory programs (such as SCHIP) be fully offset through entitlement reductions and/or revenue increases. Some have argued that the goal of reaching many of the eligible uninsured children should be shelved because the cost cannot be "paid for." Others have argued that Congress should not try to offset the cost of SCHIP legislation because it is too difficult. (Since legislation without offsets would have to overcome substantial procedural obstacles, such as the need to get 60 votes in the Senate, the latter course could undermine hopes for significant progress in covering more low-income children.)

In fact, however, ample offsets exist on both the spending and revenue sides of the budget to cover the costs of SCHIP reauthorization several times over — *if* there is political will to pursue them. These offsets have strong justification on their merits, and the Senate passed some of them in 2005. The potential offsets include:

- **Reducing Medicare overpayments to private health plans.** Private plans were brought into Medicare to save the program money. Instead, the Medicare Payment Advisory Commission (MedPAC), Congress' expert advisor on Medicare payments, has documented that private plans are costing the Treasury tens of billions of dollars because they are significantly overpaid. According to MedPAC, Medicare payment rates to private plans average *12 percent higher* than the cost of providing fee-for-service Medicare to comparable beneficiaries. MedPAC recommends that Medicare level the playing field by adjusting the payment formula to essentially pay private plans the same amounts it would pay to treat the same patients under fee-for-service. CBO estimates this would save $54 billion over five years (and $149.1 billion over ten years).

- **Adopting other MedPAC recommendations regarding overpayments to private plans and the Medicare "stabilization fund."** Because teaching hospitals offer a wider array of services than other hospitals and generally serve sicker patients, Medicare reimburses them for the "indirect medical education" costs they incur when treating Medicare beneficiaries. However, Medicare also builds in extra payments to private managed care plans so they can reimburse teaching hospitals for these same costs. This means Medicare essentially pays for indirect medical education *twice*: directly to the teaching hospitals themselves, and indirectly through private plans. To remove the double payments, MedPAC recommends eliminating indirect medical education costs from the payments made to private plans. CBO estimates this would save $5.2 billion over five years (and $12.9 billion over ten years).

Another MedPAC recommendation concerns regional Preferred Provider Organizations (PPOs), created by the 2003 Medicare drug law to provide care to Medicare beneficiaries. To encourage PPOs to enter regional markets, the law established a $10 billion stabilization fund to provide additional funds to PPOs, beyond the regular Medicare payments these PPOs receive. MedPAC recommended eliminating the stabilization fund in order to eliminate unnecessary costs and level the playing field for competing types of Medicare plans. Last year Congress eliminated about $6.5 billion of the fund; by eliminating the rest, Congress could comply fully with the MedPAC recommendation in this area. This would save $1.6 billion over five years (and $3.5 billion over ten years), according to CBO.

- **Increasing the rebates that drug manufacturers pay under Medicaid.** Drug manufacturers must pay rebates to the federal government and the states for the prescription drugs that Medicaid dispenses. Some states have been able to negotiate additional rebates with manufacturers, which suggests that the federal government is not making the most of Medicaid's large purchasing power. Strengthening the rebate program, such as by increasing the size of the minimum rebate manufacturers must pay and by extending the rebate to drugs dispensed through Medicaid managed care plans, would reduce federal and state Medicaid costs without harming beneficiaries. These two reforms — which have been endorsed by the National Governors Association and were passed by the Senate in 2005 — could save over $4 billion over five years (and over $11 billion over ten years), based on CBO estimates.

- **Allowing the Food and Drug Administration to approve generic versions of biological drugs.** Derived from living cells, these drugs treat a variety of medical conditions, including anemia, hepatitis, rheumatoid arthritis, some forms of cancer, and multiple sclerosis. But since there is no FDA-approved process to bring generic versions of these drugs into the market, manufacturers usually have permanent monopolies on them, and the drugs can remain very costly for long periods of time. Allowing generic versions of biological drugs would make such drugs more affordable and reduce federal and state costs for Medicare, Medicaid, and SCHIP, as well as costs for private insurance. (No estimate of the savings is currently available.)

- **Canceling two high-income tax cuts enacted in 2001 that have not yet taken effect.** These tax cuts, related to the value of itemized deductions and the personal exemption, are aimed exclusively at high-income taxpayers and take effect in three stages: in 2006, 2008, and 2010. Canceling the portions of the tax cuts scheduled for 2008 and 2010, while leaving the 2006 portion in place, would save approximately $13 billion over five years, according to the Urban Institute-Brookings Tax Policy Center.

  Such a step would not deprive a single taxpayer of a dollar in tax cuts he or she now receives. Households with incomes over $1 million, for example, will receive an average tax break of $146,000 in 2010 even if the two tax breaks are canceled. And the effect on people with incomes between $100,000 and $200,000 would be miniscule; they would forgo an average additional tax cut of just $7 in 2010. Virtually no households below $100,000 would be affected.

- **Reducing the capital gains "tax gap."** Capital gains taxes are based on the sales price of an asset minus the purchase price. Many taxpayers are believed to overstate the purchase price of their financial assets to the IRS, thereby understating their capital gains tax liability, in part because financial institutions are not required to report the purchase price of these assets to taxpayers or the IRS. (In contrast, firms *are* required to report dividends, interest payments, and sales prices of financial assets.) To address this problem, the Administration's budget would require firms to report the purchase price of financial assets to taxpayers and the IRS; similar legislation has been introduced in both houses of Congress. The Joint Committee on Taxation estimates that this would save $465 million over five years (and $3.3 billion over ten years).

- **Raising federal tobacco and/or alcohol taxes.** The federal excise tax on cigarettes has remained at 39 cents per pack since 2002. Simply adjusting it for five years of inflation would justify an increase to 46 cents in 2008, which would raise close to $4 billion over five years — and also reduce smoking, which

in turn would reduce tobacco-related health costs. A recent proposal by Senator Gordon Smith would go further, raising the cigarette tax by 60 cents per pack. CBO estimates that increasing the tax by *50* cents per pack would raise $26.6 billion over five years (and $53.2 billion over ten years).

Like the cigarette tax, taxes on alcoholic beverages are fixed in nominal terms; they have not been adjusted for inflation since 1991. Moreover, alcohol use, like smoking, creates external costs such as higher health care costs and lower productivity. (Alcohol-related accidents also cause extensive loss of lives and property.) CBO estimates that increasing the federal excise tax on all alcoholic beverages to $16 per gallon would raise $28 billion over five years (and nearly $60 billion over ten years).

Other potential offsets also could be considered, including additional MedPAC recommendations to curb excess Medicare payments and Joint Tax Committee recommendations to close unproductive tax breaks and improve tax compliance. The issue is not whether options exist to offset the cost of covering uninsured low-income children, but whether Congress has the political will to undertake this task.

TABLE 1

List of Representative Spending Reduction and Revenue Raising Options

	5 Year Savings (2008-2012)	10 Year Savings (2008-2017)
	(in billions of dollars)	
Spending Reduction Options		
1. Pay Medicare private plans at same levels as fee-for service*	$54.0	$149.1
2. Remove indirect medical education costs from the benchmarks used to set Medicare payments for private plans.*	$5.2	$12.9
3. Eliminate the remaining Medicare stabilization fund for PPOs.*	$1.6	$3.5
4. Take into account upcoding in implementing risk adjustment for Medicare payments to private plans.**	$7.0	$31.0
5. Require in Medicare that regional PPO bids and benchmarks be determined in same manner as the bids and benchmarks for local plans.**	$2.0	$6.0
6. Increase the minimum Medicaid drug rebate paid by drug manufacturers.**	$2.4	$6.5
7. Provide an additional Medicaid drug rebate adjustment if generic drug prices rise faster than inflation.	n/a	n/a
8. Extend the Medicaid drug rebate to drugs dispensed through managed care plans.**	$1.8	$5.1
9. Establish an explicit pathway for FDA approval of generic versions of biological drugs.	n/a	n/a
Revenue Raising Measures		
1. Hold two tax cuts for high-income taxpayers that are now phasing in (related to use of itemized deductions and personal exemptions) at their current levels.***	$13.0	$13.0
2. Require financial institutions to report the "basis" of financial assets to IRS for purposes of determining capital gain taxes.*	$0.5	$3.3
3. Increase the federal excise tax on tobacco.*	$26.6	$53.2
4. Adjust the tobacco excise tax for inflation since 2002.****	$3.7	$7.4
5. Increase and make uniform the federal excise taxes on alcoholic beverages.*	$28.0	$59.5
6. Adjust alcohol excise taxes for inflation since 1991	n/a	n/a

* Current Congressional Budget Office or Joint Committee on Taxation estimates.
** Based on prior estimates by the Congressional Budget Office.
*** Tax Policy Center estimates.
**** Rough estimate based on CBO estimate of savings from a larger tobacco tax increase.