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CONGRESS CAN PRESERVE $1.1 BILLION IN EXPIRING CHILDREN'S HEALTH INSURANCE FUNDS AND HELP AVERT SCHIP CUTBACKS

by Edwin Park and Matt Broaddus

Before Congress adjourns in October, it has the opportunity to enact bipartisan legislation to extend the availability of nearly $1.1 billion in federal funds for the State Children's Health Insurance Program (SCHIP) that are scheduled to expire and revert to the Treasury after September 30. Such legislation would help lessen or defer looming cuts in children's health insurance enrollment by providing more adequate federal funding to states that will face federal SCHIP funding shortfalls over the next several years.

State budget deficits have taken a toll on the SCHIP program. According to a recent Kaiser Commission survey, SCHIP enrollment fell for the first time in 2003, as states instituted SCHIP eligibility cuts, capped enrollment and raised premiums.[1] State budgets are now beginning to recover in many states, and states should be better able to fund their share of SCHIP costs. But a number of states now face the prospect of receiving insufficient *federal* funding in coming years to sustain their existing SCHIP programs. Under current law, 18 states are projected to have insufficient federal funding for their SCHIP programs between now and fiscal year 2007. As a result, the number of children insured through SCHIP is expected to fall by more than 200,000 by 2007.

Bipartisan legislation introduced in July in the Senate by Senators Jay Rockefeller (D-WV) and Lincoln Chafee (R-RI) and in the House by Representatives by John Dingell (D-MI) and Joe Barton (R-TX), the Ranking Member and Chairman, respectively, of the House Energy and Commerce Committee (which oversees SCHIP), would preserve nearly $1.1 billion in federal SCHIP funds that are slated to expire and revert to the federal Treasury on September 30.[2] This legislation, which the National Governors Association has endorsed,[3] would target the large majority of these funds to the states that need the funds the most to sustain their children's health insurance programs. The legislation (S. 2759 in the Senate and H.R. 4936 in the House) also would ensure that no other federal SCHIP funds expire and revert to the Treasury through the end of 2007. Finally, the legislation would extend current rules governing how federal

[1] Vernon Smith, David Rousseau and Molly O'Malley, "SCHIP Program Enrollment: December 2003 Update," Kaiser Commission on Medicaid and the Uninsured, July 2004.

[2] The Senate bill was also initially co-sponsored by Senator Olympia Snowe (R-ME) and Senator Edward Kennedy (D-MA) and now has 14 co-sponsors.

[3] Letter from Governors John Hoeven (R-ND) and Jennifer Granholm (D-MI) to Senate Majority Leader Bill Frist and Senate Minority Leader Tom Daschle and House Speaker Dennis Hastert and House Minority Leader Nancy Pelosi, June 8, 2004.

SCHIP funds that remain unused after three years by the state to which they were originally allocated are to be redistributed to other states.

Extending these expiring funds is an essential step. Ultimately, Congress will need to develop a more comprehensive SCHIP financing solution; the legislation discussed here would limit or delay, but not entirely eliminate, the federal funding shortfalls that a number of states eventually will face. This legislation does not, and is not intended to, ensure that every state has sufficient federal funding to sustain (and where possible to grow) its SCHIP program over the longer term. Those federal SCHIP funding issues can be addressed more adequately when Congress considers reauthorizing the SCHIP program in 2007.

Looming Federal SCHIP Funding Shortfalls

Under current law, a number of states are expected to have insufficient federal funding to sustain their SCHIP programs. Using the state-by-state SCHIP financing model originally designed by the Office of the Actuary at the Centers for Medicare and Medicaid Services in the U.S. Department of Health and Human Services, one can project whether states will have adequate federal SCHIP funds to maintain their existing SCHIP caseloads in coming years.[4] Such an analysis finds that six states are projected to face federal funding shortfalls in fiscal year 2005, with the number rising to 18 states by fiscal year 2007 (see Table 1 at the back of this paper).[5] As a result, by fiscal year 2007, the number of children insured through SCHIP could fall by more than 200,000, as compared to the number of children covered in fiscal year 2003.

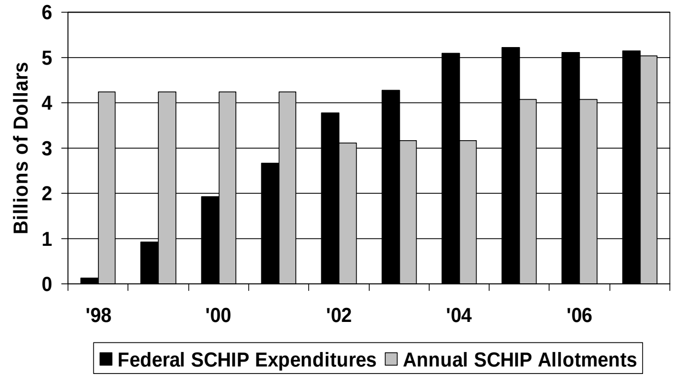
These expected federal funding shortfalls are the result of several factors.

[4] The SCHIP financing model used here is based on the financing model developed by the Office of the Actuary at CMS, with several adjustments. We have updated the CMS model to reflect estimates of federal SCHIP expenditures that states submitted to HHS in May 2004 and the actual fiscal year 2005 SCHIP allotments that CMS recently announced. This updated model also includes a modification to the model to reflect more current information on state spending sequences (the order in which states spend their annual SCHIP allotments and any funds made available through the SCHIP reallocation process) and to reflect additional SCHIP spending that is occurring under section 1115 waivers that expanded SCHIP programs in several states to cover additional populations such as pregnant women, parents and childless adults.

[5] The six states in fiscal year 2005 are Arizona, Minnesota, Mississippi, Nebraska, New Jersey and Rhode Island. By 2007, states facing federal funding shortfalls also will include Alaska, Georgia, Illinois, Iowa, Maine, Maryland, Massachusetts, Michigan, Missouri, New York, South Dakota and Wisconsin. Source: CBPP SCHIP financing model updated to reflect states' estimates of federal SCHIP spending submitted as of May 2004. The previous version of this analysis, issued in August 2004, included Louisiana among the states projected to have insufficient federal SCHIP funding and did not include Michigan and New York. The revisions reflect data that have become available since August. In addition, Alaska is now projected to first face a federal funding shortfall in fiscal year 2007; our previous analysis projected Alaska to have insufficient federal funding starting in fiscal year 2005.

- **Annual expenditures of federal SCHIP funds now exceed annual federal SCHIP allocations.** After SCHIP funds were first made available in fiscal year 1998, it took several years for states to develop and fully implement their SCHIP programs. As a result, annual federal *funding* exceeded states' needs for these funds in the early years of the program from 1998 through 2001, and states developed reserves of unspent SCHIP funds from those years. Since 2002, however, the amount of federal SCHIP funds expended each year has exceeded the federal SCHIP funding being made available for that year; the additional costs have been financed out of the reserves of prior-year funds (see Figure 1). With health care costs continuing the rise, annual SCHIP expenditures are projected to continue to exceed federal SCHIP allotments in the years ahead. But the reserves of unspent funds from prior years are either being exhausted or are slated to revert to the federal Treasury. (See bullet below.)

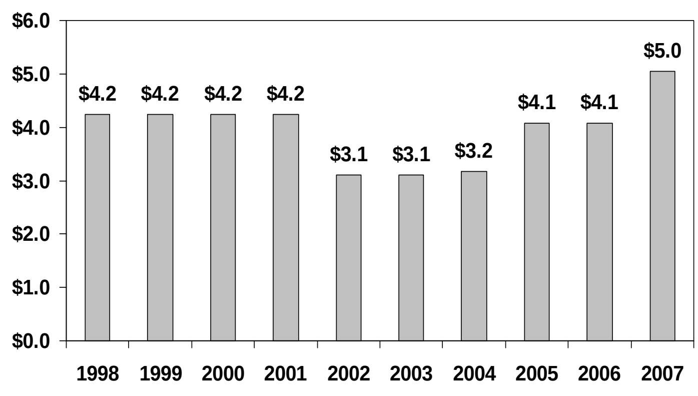
Figure 1
Beginning in FY2002, Expenditures of Federal SCHIP Funds Exceeds Federal SCHIP Allotments



Source: Center on Budget and Policy Priorities' SCHIP financing model.

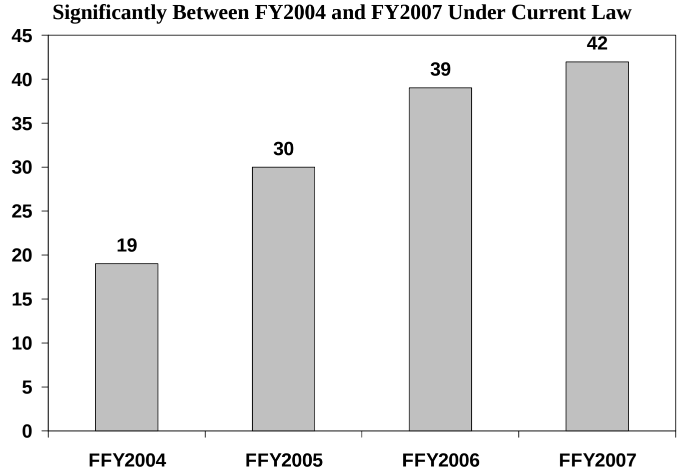
- **Annual federal SCHIP funding was reduced 26 percent, starting in 2002.** Under the terms of the 1997 Balanced Budget Act, which created SCHIP, in order to meet overall deficit reduction goals for the out-years, total federal funding for SCHIP was reduced by more than $1 billion — or about 26 percent — in fiscal year 2002, as compared to the amount of funding provided each year from 1998-2001. Federal funding remains at this reduced level through fiscal year 2004. (See Figure 2.) During a period in which SCHIP costs have continued to grow, federal SCHIP funding has declined by more than one-quarter.

Figure 2
Significant Decline in Federal SCHIP Allotments in FY2002 Through FY2004 (in billions of dollars)



- **The unspent SCHIP funds from earlier years have provided an essential SCHIP funding reserve, but those funds are being expended or are expiring.** Because billions of dollars in SCHIP funds allocated to states in the early years of the SCHIP program remained available, states have been able to draw on those surplus funds in recent years to help finance their SCHIP programs. Those unspent funds, however, are being exhausted. Only nine states are expected to have unspent funds from fiscal years 1998-2000 remaining at the end of this fiscal year. (It is the SCHIP funds in these nine states, totaling nearly $1.1 billion, that are scheduled to expire and revert to the Treasury just a few weeks from now, on September 30. See Table 2.)

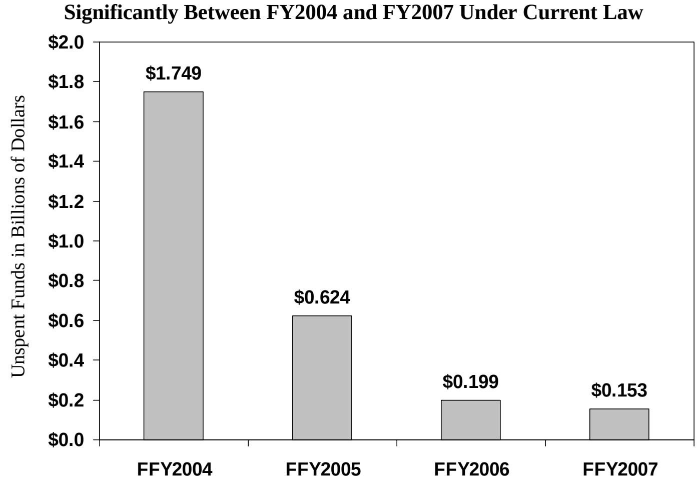
Figure 3
States Qualifying to Receive Redistributed Federal SCHIP Funds Increase Significantly Between FY2004 and FY2007 Under Current Law



Source: Center on Budget and Policy Priorities' SCHIP financing model.

- **Most states will qualify over time for redistributed SCHIP funds, but the pool of funds available for redistribution is dwindling.** Another reason that up until now, all states have had sufficient federal funding to sustain their SCHIP programs is that the states that fully expended their SCHIP allotments could qualify for *additional* SCHIP funds, consisting of unspent funds redistributed from other states. Under SCHIP program rules, states have three years to spend their annual SCHIP allotments. Any funds remaining unspent at the end of the third year are reallocated to states that have fully used their allotments.

Figure 4
Unspent Federal SCHIP Funds Available for Redistribution Decline Significantly Between FY2004 and FY2007 Under Current Law



Source: Center on Budget and Policy Priorities' SCHIP financing model.

Because many states initially did not fully expend their allotments for the early years of the program, a relatively small number of states initially qualified to receive additional SCHIP funds through this redistribution process. That trend is now reversing, however, as more states fully expend their annual allotments and need redistributed funds to maintain their SCHIP programs. In fiscal year 2004, some 19 states qualified for the nearly $1.75 billion in unspent fiscal year 2001 funds that were redistributed. In fiscal year 2005, some 30 states are projected to qualify under current law for an anticipated redistribution of about $624 million in unspent fiscal year 2002 funds. By 2007, a projected 42 states will qualify for redistributed funds. (See Figures 3 and 4.)

But as more states fully expend their allotments and qualify for — and need — additional funds to maintain their programs, the amount of unspent funds available for redistribution will dwindle. In 2007, when 42 states are expected to qualify for redistributed funds, *only $153 million* is projected to be available for redistribution. (See Figure 4.) As a result, the amount of redistributed funds states will receive will increasingly fall short of the amounts that states will need to maintain their programs. As a result, more and more states will have to shrink their programs and to insure fewer low-income children.

The Bipartisan SCHIP Legislation

The bipartisan legislation cited above seeks to address in part the risks that these federal funding shortfalls pose to SCHIP enrollment over the next few years. The legislation would extend the availability of the nearly $1.1 billion in unspent SCHIP funds allocated for fiscal years 1998, 1999, and 2000 that are scheduled to expire and revert to the Treasury on September 30 of this year (see Table 2). The legislation would extend the availability of these funds through the end of fiscal year 2007 and target the majority of these funds to the states that need them most.

Under the legislation, 70 percent of the fiscal year 1998-2000 funds that otherwise would expire on September 30 would be allocated to the 29 states that have fully exhausted their fiscal year 2002 funds and thus will qualify next year for a redistribution of unspent fiscal year 2002 funds. The legislation uses the fact that these states will qualify for redistributed funds in the coming year as a way to identify states that are fully expending their federal SCHIP funds and are likely to face a shortage of federal SCHIP funds over time. In this manner, the legislation is able to reallocate the funds to the states that have the greatest need for them and would be expected to make most use of them to insure low-income children. These redistributed funds would be available to qualifying states through the end of fiscal year 2007. The remaining 30 percent of the expiring funds would be retained by the nine states that currently possess these funds, giving those states more time to use the funds. These retained funds, as well, would be available through 2007.

In addition, the legislation would extend current SCHIP rules regarding how unspent federal SCHIP allotments are redistributed to states that have expended their SCHIP allotments. Last year, Congress enacted legislation establishing redistribution rules for unspent fiscal year 2000 and fiscal year 2001 funds. Under those rules, 50 percent of the unspent fiscal year 2000 and 2001 funds have been redistributed to states that fully expended their 2000 and 2001 allotments. These redistributed funds remain available for another two years. The other 50 percent of the unspent funds have been retained, also for an additional two years, by the states to which they originally were allocated. The new legislation would apply these same rules to unspent funds from fiscal years 2002, 2003 and 2004.[6]

[6] Under the proposed legislation, any redistributed or retained funds from fiscal years 2001 and 2002 that remain unspent after two years would be redistributed a second time, with the new distribution following the same rules as those that the legislation applies to the nearly $1.1 billion in fiscal year 1998-2000 funds otherwise slated to expire on September 30, 2004. In other words, 70 percent of the unspent fiscal year 2001 and 2002 funds that remain

Finally, the legislation would continue to help financing Medicaid coverage of children in states that expanded children's coverage *prior* to the enactment of SCHIP. To provide more equity among states, the SCHIP legislation enacted last year allowed states that expanded Medicaid coverage to children with incomes up to 185 percent of the poverty line prior to 1997 to use up to 20 percent of any unspent SCHIP funds they have from fiscal years 1998-2001 to help finance the costs of insuring children being covered under the pre-1997 Medicaid expansions that these states instituted. This provision would now be applied to the unspent 2002-2004 SCHIP funds as well.

Effects of the Proposed Legislation

By preserving the expiring funds and extending the rules for redistributing unspent SCHIP funds, the legislation would ensure that nearly every state has more federal funding for its SCHIP program over the next three years (fiscal years 2005, 2006 and 2007) than it would have under current law. (See Table 3.)[7] The legislation also would assure that no federal SCHIP funds expire and revert to the Treasury through 2007.

Of particular importance, by targeting 70 percent of the expiring funds to the states most in need, the legislation would ameliorate the federal funding shortfalls that 18 states otherwise will face over the next several years. The legislation would reduce the magnitude of the federal funding shortfall in every one of these states and thereby reduce the size of the SCHIP enrollment decline that otherwise will result over the next several years.[8]

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unspent after two years would be reallocated to qualifying states, with the remaining 30 percent of these funds being retained by the states that now have them. All of these funds would remain available through the end of fiscal year 2007.

[7] The lone exceptions are Vermont in fiscal years 2006 and 2007 and Connecticut in fiscal year 2006 for technical reasons. The proposed bipartisan legislation makes more SCHIP funds available to these states than under current law. Vermont and Connecticut both qualify as states that expanded Medicaid coverage to 185 percent of the poverty line prior to the creation of SCHIP and thus can use 20 percent of their unspent 2002-2004 SCHIP funds to finance Medicaid coverage for some children. Our financing model assumes that both Vermont and Connecticut would use all 20 percent of their share of these unspent SCHIP funds to finance Medicaid coverage for children in fiscal year 2005. That would increase both states' federal SCHIP expenditures in 2005 to such a degree that it would leave both states less SCHIP funding in subsequent years than they would have under current law, even with the additional funding made available under the proposed legislation. The greater spending, however, would benefit Vermont and Connecticut in 2005 by reducing their share of the cost of Medicaid coverage for some children in FY 2005 and would still result in an overall increase in the amount of federal funding for these states over the three-year period from FY 2005 through FY 2007.

[8] Five of these states no longer would have any shortfall in federal funding through 2007. In two other states, the shortfall would be reduced, and the year in which they would first have insufficient federal SCHIP funding would be pushed back. In the remaining eleven states, the year in which the shortfall would first emerge would not change but the size of the shortfall would be reduced.

Need for More Comprehensive Federal Financing Solution

Extension of the expiring SCHIP funds is a necessary next step to avert SCHIP enrollment cutbacks resulting from federal funding shortfalls. Passage of the bipartisan legislation would preserve the nearly $1.1 billion in expiring funds in the SCHIP program, target a majority of the funds to the states that most need them, and ensure that no SCHIP funds will expire through the end of 2007.

The legislation would not completely address the growing SCHIP funding problem that states will face over time. A growing number of states still would eventually have inadequate federal funding to maintain their programs. In addition, many states would lack the resources with which to build on SCHIP's success and extend coverage to more uninsured low-income children. Even with this legislation, SCHIP enrollment will ultimately decline unless other remedial measures are instituted.

But the bipartisan legislation has the virtue of providing Congress additional time to develop a more comprehensive funding solution to head off SCHIP cutbacks. A more comprehensive solution could be developed and included in legislation to reauthorize the SCHIP program in 2007.

Table 1
States in Which Projected SCHIP Funding Will Be Insufficient under Current Law to Meet SCHIP Funding Needs Between Fiscal Years 2004 and 2007

(Projected available SCHIP funds as a percentage of SCHIP funding needed to maintain existing enrollment levels)*

STATE	2004	2005	2006	2007
Alaska				**78%**
Arizona		**46%**	**31%**	**34%**
Georgia			**70%**	**56%**
Illinois			**71%**	**46%**
Iowa				**89%**
Maine				**87%**
Maryland			**56%**	**44%**
Massachusetts				**60%**
Michigan				**78%**
Minnesota		**29%**	**11%**	**9%**
Mississippi		**91%**	**39%**	**43%**
Missouri				**88%**
Nebraska		**92%**	**39%**	**43%**
New Jersey	**95%**	**56%**	**35%**	**40%**
New York				**99%**
Rhode Island	**83%**	**63%**	**38%**	**41%**
South Dakota			**79%**	**60%**
Wisconsin			**60%**	**53%**
Number of States With Insufficient Funding	**2**	**6**	**11**	**18**

* Available SCHIP funds include all annual allotments available to the state in that year (including any unspent allotments from previous years), as well as any additional funds made available through the SCHIP reallocation process.

Source: Center on Budget and Policy Priorities' SCHIP financing model updated to reflect states' expenditure projections reported to the Centers for Medicare and Medicaid Services (CMS) in May 2004.

Table 2
Approximately $1.06 Billion in Unspent Federal SCHIP Funds Are Projected to Revert to the Federal Treasury at the End of FY 2004 Under Current Law

(all figures in thousands of dollars)

	Funds Projected to Remain Unspent and Expire After September 30, 2004 (after the end of fiscal year 2004)		
STATE	**Original FY 1998 and FY 1999 SCHIP Funds**	**Original FY 2000 SCHIP Funds**	**TOTAL**
Nation	**$425,011**	**$638,072**	**$1,063,083**
Alabama	0	0	0
Alaska	0	9,511	9,511
Arizona	0	0	0
Arkansas	0	18,896	18,896
California	0	0	0
Colorado	0	0	0
Connecticut	0	0	0
Delaware	0	0	0
District of Columbia	0	0	0
Florida	0	0	0
Georgia	0	0	0
Hawaii	0	0	0
Idaho	0	0	0
Illinois	0	0	0
Indiana	0	0	0
Iowa	0	0	0
Kansas	0	0	0
Kentucky	8,609	71,982	80,591
Louisiana	0	0	0
Maine	0	7,778	7,778
Maryland	0	0	0
Massachusetts	0	45,632	45,632
Michigan	0	0	0
Minnesota	0	0	0
Mississippi	0	0	0
Missouri	0	0	0
Montana	0	0	0
Nebraska	0	0	0
Nevada	0	0	0
New Hampshire	0	0	0
New Jersey	0	0	0
New Mexico	0	0	0
New York	281,502	414,465	695,967
North Carolina	2,796	0	2,796
North Dakota	0	0	0
Ohio	0	0	0
Oklahoma	0	0	0
Oregon	0	0	0
Pennsylvania	0	0	0
Rhode Island	0	0	0
South Carolina	119,560	32,649	152,209
South Dakota	0	0	0
Tennessee	12,545	37,113	49,658
Texas	0	0	0
Utah	0	0	0
Vermont	0	0	0
Virginia	0	0	0
Washington	0	0	0
West Virginia	0	0	0
Wisconsin	0	0	0
Wyoming	0	0	0
Territories	0	46	46

Source: Center on Budget and Policy Priorities' SCHIP financing model updated to reflect states' expenditure projections reported to the Centers for Medicare and Medicaid Services (CMS) in May 2004.

Table 3
Additional Federal SCHIP Funds Per Year that Would be Available Under the Proposed Legislation for Fiscal Years 2005-2007, As Compared to Current Law*

(all figures in thousands of dollars)

STATE	FY 2005	FY 2006	FY 2007
Alabama	$8,865	$10,296	$10,243
Alaska	6,194	9,733	9,718
Arizona	29,481	5,093	322
Arkansas	23,815	35,464	19,981
California	66,510	78,122	77,653
Colorado	4,792	5,564	5,537
Connecticut[1]	7,546	-3,214	1,479
Delaware	4,260	5,978	4,077
District of Columbia	3,615	2,299	1,484
Florida	44,954	51,652	51,433
Georgia	22,557	26,926	199
Hawaii	2,591	2,760	2,752
Idaho	4,013	2,831	1,942
Illinois	13,629	17,712	28
Indiana	23,515	13,342	13,296
Iowa	4,564	5,319	5,290
Kansas	5,200	9,135	9,107
Kentucky	34,802	31,817	31,759
Louisiana	10,567	12,395	12,322
Maine	5,343	5,821	5,803
Maryland	23,018	14,559	249
Massachusetts	24,886	26,940	26,854
Michigan	9,101	11,640	11,512
Minnesota	11,041	1,814	121
Mississippi	13,331	4,949	140
Missouri	9,779	11,353	11,294
Montana	1,601	1,843	1,833
Nebraska	3,199	730	30
Nevada	8,050	7,682	7,283
New Hampshire	4,546	302	339
New Jersey	40,651	5,856	486
New Mexico	16,747	1,581	1,752
New York	265,534	211,845	211,483
North Carolina	17,539	20,572	20,454
North Dakota	222	338	333
Ohio	18,903	21,933	21,814
Oklahoma	20,665	10,226	7,417
Oregon	17,968	13,208	8,195
Pennsylvania	15,412	17,964	17,866
Rhode Island	5,343	746	66
South Carolina	46,632	28,504	28,467
South Dakota	1,412	1,654	12
Tennessee	45,879	59,200	76,625
Texas	49,662	50,283	53,752
Utah	3,130	3,605	3,585
Vermont[1]	269	-913	-895
Virginia	8,233	9,389	9,340
Washington	21,223	3,313	1,786
West Virginia	4,110	4,738	4,713
Wisconsin	14,790	8,070	152
Wyoming	2,212	1,294	1,291
Territories	11,176	19,258	24,549
Nation	**$1,063,083**	**$903,518**	**$817,327**

* The amount of additional federal SCHIP funds shown here reflects the funds that otherwise would expire on September 30, 2004, funds that would otherwise expire in coming years but, under the proposed legislation, would be extended through FY 2007, and funds made available under the reallocation rules that the proposed legislation would set for FY 2002-2004 funds. The additional funds shown in this table for each of the fiscal years from 2005 to 2007 represent the additional amount of federal funds available to the state for SCHIP in that particular year, as compared to the amounts projected to be available under current law. The amounts shown for these three fiscal years cannot be added; some dollars are shown in more than one year, because not all of the funds are expected to be spent in the first year in which they are made available.

[1] Vermont in fiscal years 2006 and 2007 and Connecticut in fiscal year 2006 have reduced funding for technical reasons. See footnote 7.

Source: Center on Budget and Policy Priorities' SCHIP financing model updated to reflect states' expenditure projections reported to the Centers for Medicare and Medicaid Services (CMS) in May 2004.