

Obama's Unhealthy Start: SCHIP Explosion, Medicaid Bailout, COBRA's Bite

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- Within three weeks of his inauguration, President Obama has succeeded in a dramatic government take-over of Americans' health care, although he is unable to nominate a tolerable candidate for Secretary of Health and Human Services.
- More than half of kids roped into Mr. Obama's kids' health program will drop their families' health coverage, and the SCHIP explosion has an unhealthy addiction to tobacco funding.
- By bailing out state Medicaid programs that have spent beyond our means, Mr. Obama punishes fiscally responsible states, and Medicaid's failure to pay its bills will result in a "cost-shift" causing private premiums to rise by about \$18 billion.
- Subsidies to COBRA, the already flawed program that allows departed workers to continue coverage with their previous employer, dramatically favor unemployment or part-time work, instead of full-time work with benefits.

Things are changing fast in American health care. Last month, we examined Tom Daschle's health care vision, in anticipation of his enthusiastic reception as President Obama's Secretary of Health and Human Services.¹ Mr. Daschle is now gone, and as yet nobody is at the controls, but that has not stopped the president from pouring billions of dollars into the machinery of government-run health care. Within three weeks of his inauguration, President Obama has seized control of Americans' health care choices in many areas. Let's focus on three.

The SCHIP Expansion: Denying Families Choice in Health Care

On February 4, the president blew the doors off the State Children's Health Insurance Program (SCHIP) by increasing the income-eligibility cut-offs, thereby roping in 4.1 million more children by 2013. This is on top of the seven million already captured by SCHIP.

He should have slowed down: Seven of 10 uninsured children are *already* eligible for taxpayer handouts through SCHIP or Medicaid.² What's more, the program doesn't just cover the uninsured, but picks off many who already have coverage, a phenomenon known as "crowd-out."

Mathematica Policy Research, Inc. estimates crowd-out to be as high as 56 percent.³ If the SCHIP expansion "succeeds," about six million kids will have unnecessarily fallen into government dependency for their health care. But it may be even worse: By increasing SCHIP eligibility to 250 percent of the Federal Poverty Level (FPL), the president has increased the chances of crowd-out, because higher-income families are more likely to be already privately insured than low-income families are.⁴

Another problem with SCHIP expansion is how the program will be funded. By agreeing to a 61-cent-a-pack increase in cigarette tax, President Obama has not only increased taxes on lower-income Americans (who smoke more), but increased the chances of a future funding dilemma as more Americans continue to give up smoking. Cigarette smoking rates among American teens in 2008 are at the lowest levels since the early 1990s.⁵ In 2007, scholars estimated that financing (a less expensive version of) SCHIP expansion through a 61-cent-a-pack increase would require 22.4 million new smokers by 2017 in order to be sustainable.⁶

Medicaid Bailout: Rewarding Spendthrift States

Medicaid is the joint federal-state program that funds health care for low-income residents. Since its creation four decades ago, Medicaid spending has accelerated out of control, largely because of the formula for transfers from the federal government to the states: the U.S. must pay *at least* 50 percent of a state's Medicaid costs. This is an extraordinarily perverse incentive. For the governor or state legislator

who gets federal funds, Medicaid offers “free” money. We have previously argued that the short-term solution to this is to convert the funding formula, known as FMAP (Federal Medical Assistance Percentages), to a per-head block grant to the states.⁷

Unfortunately, the American Recovery and Reinvestment Act (ARRA, signed on February 17) moves in the other direction, forcing productive states to increase their subsidies to unproductive states by *increasing* FMAP by 5.5 to 11.5 percent. This will drive up federal spending on Medicaid by \$90 billion in the next three years.⁸ Incredibly, the higher a state’s unemployment rate rises over the period, the higher its FMAP rises, actually *rewarding* states for bad policies that drive up unemployment!

Furthermore, throwing an extra federal \$90 billion at Medicaid increases the cost-shift that states impose on the privately insured. According to a 2008 study, Medicaid programs pay doctors only 56 percent of what private payers do, and hospitals only 67 percent, nationwide.⁹ This causes a cost-shift of about 15 percent, the increase in private payers’ premiums to subsidize failing government programs.¹⁰

The bigger Medicaid grows, the bigger the cost-shift. Before ARRA was passed, national health expenditure projections for Medicaid alone were about \$388 billion.¹¹ Currently, the average FMAP nationwide is 57 percent, which means that the federal government pays 57 cents of every Medicaid dollar and the state spends 43 cents.¹² The first year’s worth of the federal Medicaid bailout is \$34 billion.¹³ If we figure that the average FMAP will go up to 65 percent, total Medicaid spending will jump up by \$52 billion, bringing the total Medicaid spending this year alone to roughly \$440 – a 13-percent increase from the baseline.

Baseline spending on private insurance is running at \$879 billion this year.¹⁴ At a cost-shift of 15 percent, \$132 billion of this spending is already subsidizing Medicaid indirectly. Considering this cost-shift represents 34 percent of the original Center for Medicare & Medicaid Services (CMS) estimate of \$388 billion it can be roughly estimated that our new cost-shift number, post stimulus, would be \$150 billion—an \$18-billion increase that will be added on to private health-insurance premiums as a “hidden tax,” resulting in private health-insurance premiums of about \$897 billion this year.

Bitten by a COBRA

COBRA is the program by which people who lose their jobs continue coverage under their employer-based plan, without being underwritten for risk by the health insurer. Pre-stimulus, someone who lost his job was able to continue coverage by paying 102 percent of the total premium for his former employer’s plan, usu-

ally for up to 18 months. But COBRA has always been a very poor substitute for individual coverage that is portable from job to job and state to state.¹⁵

The biggest problem with the law is that the former employee has up to 60 days to exercise the option of buying into his former employer’s plan via COBRA. In most states, the law allows underwriting for risk in the individual market. Obviously, a smart former employee will wait two months to see if he gets sick. If he does, he can immediately claim COBRA coverage, paying little more than the same premium as the rest of the (healthier) employees at his former workplace. If he is very sick, he can continue COBRA coverage for another eleven months after the initial eighteen-month term expires, paying 150 percent of the premium. However, if he remains healthy, he can ignore COBRA and buy a low-priced individual policy. This option is very valuable to the departing employee, but his employer and former colleagues pay dearly for it. Former employees who take up COBRA coverage have medical claims 145 percent greater than active employees, whose premiums rise to pay these higher costs.¹⁶

ARRA amplifies COBRA’s problems by subsidizing premiums by 65 percent for nine months, at an estimated cost to taxpayers of \$25 billion, mostly over the next two years.¹⁷ This is not nearly as bad as the original House version of the bill, which also would have extended COBRA for employees aged 55 years or with 10 years of service to last until they become eligible for Medicare (usually age 65 years). This amplified the selection bias, discussed above, so badly that the HR Policy Association estimated that it would increase employer-based health-care premiums by \$39 to \$65 billion.¹⁸

The signed version is less harmful, reducing the selection bias somewhat: Because the subsidy is only for COBRA, not individual coverage, more healthy people will choose COBRA. Nevertheless, it increases the reward for staying unemployed or seeking only a part-time job without health benefits, and discourages people from buying health insurance of their own choice. Also, *anybody* who leaves his job enjoys this option, unless found guilty of gross misconduct. This would include Tom Daschle and his limo driver, even if they leave the Beltway swamp to go surfing.

To date, President Obama has failed to nominate a tolerable candidate for Secretary of Health and Human Services. He has, however, proved capable of increasing the fragmentation, bureaucracy, and cost of health care—an achievement both remarkable and shocking.

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Endnotes

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- ⁹ The Lewin Group, *Opening a Buy-In to a Public Plan: Implications for Premiums, Coverage and Provider Reimbursement*, presentation to Republican staff of the Senate Finance Committee (Falls Church, VA: The Lewin Group, December 5, 2008, <http://www.lewin.com/content/publications/OpeningBuyInPublicPlan.pdf>). Cited by Robert E. Moffit, *How A Public Health Plan Will Erode Private Care*, WebMemo #2224 (Washington, DC: The Heritage Foundation, December 22, 2008).
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