

## What the Congressional Budget Office Doesn't Score: More Than \$6.5 Billion Annual State Revenue at Risk from Federal Health "Reform"

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### Key Points

- State revenues in 2008 included an estimated \$6.5 billion in revenues from premium taxes levied on health insurance.
- The federal takeover of health insurance will lure 15 million more people into Medicaid, and nine million into federally licensed "exchanges" from state-regulated health insurance.
- The "reform" will reduce states' premium-tax revenue, while increasing the number of residents dependent on states for medical care.
- States need to report their revenues from premium taxes levied on health insurance, and recognize the threat to their revenues posed by a federal takeover.

According to the CBO's score of H.R. 3590, the bill would insure 31 million more people.<sup>1</sup> Accepting the CBO's estimate (and ignoring the deeper question of who is uninsured, and for how long), 15 million of these newly insured will be enrolled in Medicaid and State Children's Health Insurance Program (SCHIP). The CBO estimates that this will cost states \$30 billion over the next 10 years, but there's another cost to states that the CBO does not score.

The CBO does not account for lost revenue due to Medicaid "crowding out" private coverage, as well as an estimated nine million people migrating from state-regulated health insurance to federally licensed exchanges. On average, states tax private health insurance 2 percent of premiums. For example, if a policy for a family costs \$13,000, the state rakes in \$260 straight off the top.

Revenue from premium taxes on health insurance can be a measurable factor in states' budgets – about \$6.5 billion in 2008 alone, generated from just under half a trillion dollars of premiums for state-regulated health insurance. These estimates result from *Taxing Health Insurance: How Much do States Earn?*, a new study published by PRI.<sup>2</sup>

Even without federal action, some states have responded to their budget crises by increasing their statutory premium-tax rates. Rhode Island increased its rate to 2 percent of premiums for health insurers, effective January 2009, and eliminated the previous exemption for Medicaid managed-care plans as of July 2009. Tennessee increased its HMO tax from 2.2 percent to 5.5 percent, effective July 2009. New York imposed a premium tax on for-profit HMOs as of January 2009.

These tax hikes are unlikely to raise the revenues their sponsors anticipate. Because premium taxes are passed on to buyers of health insurance, hikes in premium taxes can have one or more of three consequences: reduced wages, fewer jobs, or more uninsured residents. Economic research suggests that a 1 percent increase in premiums leads to an increase of about 0.5 percent in the number of uninsured. The figure is likely higher for small firms and much lower for larger firms. However, at least a state is in charge of its own statutory rate of premium tax. The proposed federal takeover presents a threat that is completely out of a state's control.

Premium taxes generally go into the state general fund, but it is conceptually useful to consider them as funding sources for Medicaid and SCHIP (State Children's Health Insurance Program), health programs for low-income residents that are now the largest item in states' budgets. Federal health "reform" will increase Medicaid costs while potentially shrinking premium-tax revenues.

Medicaid and SCHIP are joint state-federal programs to provide health benefits to low-income residents. In aggregate, Medicaid will comprise 21 percent of state spending in 2009, the same as K-12 education. However, when we just look at general-fund revenues, K-12 education will be 35 percent and Medicaid 16 percent of the total. This is because federal funds play a larger role in Medicaid.<sup>3</sup>

In total, Medicaid spending will account for 16 percent of expenditures from the general fund, 7 percent of expenditures from "other state funds," 42 percent of federal funds transferred to states, and none of states' bond funding, for an overall share of 21 percent of state expenditure (including federal transfers) in 2009.<sup>4</sup>

Although laws do not allocate premium taxes to the Medicaid or SCHIP budget, it is useful to report estimates of premium-tax revenue in the context of Medicaid spending, because the proposed federal "reform" has the goal of making more people dependent on Medicaid. So, while Medicaid and SCHIP spending will *increase* due to reform, revenue from premium taxes will likely *decrease*.

*Taxing Health Insurance* estimates that Nevada collected about \$144 million in premium tax from health insurers in 2008. Nevada's own Medicaid and SCHIP funding added up to \$455 million. So these tax revenues accounted for almost one-third of the state's spending on these huge government programs. Hawaii, New Mexico, South Dakota, and Georgia round out the five states at greatest risk from losing premium-tax revenue, where such income accounts for between one-fifth and one-eighth of state spending on Medicaid and SCHIP.

Until now, these figures have been absent from the debate on health reform. States bundle revenues from premium taxes on health insurers alongside those from premium taxes on other lines of insurance, such as homeowners, auto, and life, and report a consolidated figure. No official body breaks them out, but for insurance commissioners this may not matter.

Premium taxes are "profitable" in the sense that revenue from them is about 13 times greater than necessary to fund a state's insurance department. However, the fact that 92 cents of every premium dollar flows straight into the general fund suggests that state residents should be very aware of how their state budgets will be attacked by so-called federal insurance "reform," and demand more accurate accounting from their state governments.

## Endnotes

- 1 Douglas Elmendorf, *H.R. 3590, Patient Protection and Affordable Care Act*, letter to the Honorable Harry Reid, Majority Leader, U.S. Senate (Washington, DC: Congressional Budget Office, March 11, 2010), Table 3.
- 2 John R. Graham, *Taxing Health Insurance: How Much Do States Earn?* (San Francisco, CA: Pacific Research Institute, March 2010).
- 3 National Association of State Budget Officers, *2008 State Expenditure Report*, (Washington, DC: National Association of State Budget Officers, Fall 2009), pp. 2-5.
- 4 *Ibid.*, p. 8.