SCHIP's Financing Structure

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SCHIP Financing Overview

Established as part of the Balanced Budget Act of 1997, the State Children's Health Insurance Program (SCHIP) authorized $40 billion in federal funds over a ten-year period for helping states provide coverage to uninsured, low-income children. Over the years, SCHIP's financing structure has faced many issues, including concerns about whether there was too much or too little federal money in the system. Increasingly, the most pressing concern is that states' need for federal SCHIP funds is rapidly outpacing the amount available. The Bush administration estimates that this growing shortfall will cause more than a million children to lose SCHIP coverage over the next four years if unaddressed.

KEY ELEMENTS OF THE EXISTING SCHIP FINANCING SYSTEM	
Spending Rules	SCHIP funds can be used to provide coverage to uninsured, low-income children who do not qualify for regular Medicaid, either in a SCHIP-financed Medicaid expansion, a separate child health program, or through a combination approach. States also can use a limited amount of funds for administrative costs and other non-coverage initiatives. Some states also use SCHIP funds for other purposes under waivers, including coverage of parents.
Annual Allotments	The original SCHIP statute authorized a capped amount of federal SCHIP funding for each fiscal year from 1998 through 2007. This capped funding is divided among the states into state-specific allotments, determined each year by a formula set out in the law.
Enhanced Matching Rate and State Spending Requirement	States must spend some of their own money as a condition of using their SCHIP funds. The federal government pays for 65 percent to 85 percent of each state's SCHIP initiatives (depending on the state), a significantly higher share than it contributes to the cost of regular Medicaid. Unlike Medicaid, however, the amount that a state can draw down for SCHIP is capped.
Formula for Distributing Funds	The share of federal SCHIP funding made available to a state each year is determined by a statutory formula based largely on a state's share of 1) low-income children, and 2) uninsured, low-income children.
Redistributed Funds	If a state does not use all of its federal SCHIP funds within a specified period, the unspent funds are sent to other states. In the past, large amounts of funds were available for redistribution, but increasingly most states will have little or no unspent money left for redistribution.

How Can SCHIP Funds Be Used?

The SCHIP law requires that SCHIP funds be used to provide coverage to uninsured, low-income children with only a few exceptions. The allowable uses of SCHIP funds include the following[1]:

Coverage of targeted low-income children. States can use their SCHIP funds to provide coverage to low-income uninsured children who are not eligible for Medicaid under the rules a state had in place as of June 1997 (sometimes referred to as "targeted low-income children"). When expanding coverage, states can use their Medicaid programs, a separate health program, or a combination approach.

Administrative costs and limited non-coverage initiatives. States are allowed to use up to 10 percent of the amount that they spend on their SCHIP programs for administrative costs, child health outreach initiatives, and health services initiatives for children of any income level (e.g., public health campaigns).

Limited coverage of other populations. Selected states use their SCHIP funds for other purposes. Under waivers, six states use some of their SCHIP funds to cover parents, two to cover childless adults, and two to help finance small premium assistance programs that can be used by adults. Twelve states use SCHIP funds to cover pregnant women, many of them through an option put forth in 2002 to define a fetus as an unborn child. In addition, eleven states with major Medicaid expansions for children that pre-dated SCHIP have been allowed temporarily to use some of their SCHIP funds to refinance these expansions.

How Much SCHIP Money is Available and How Do States Access It?

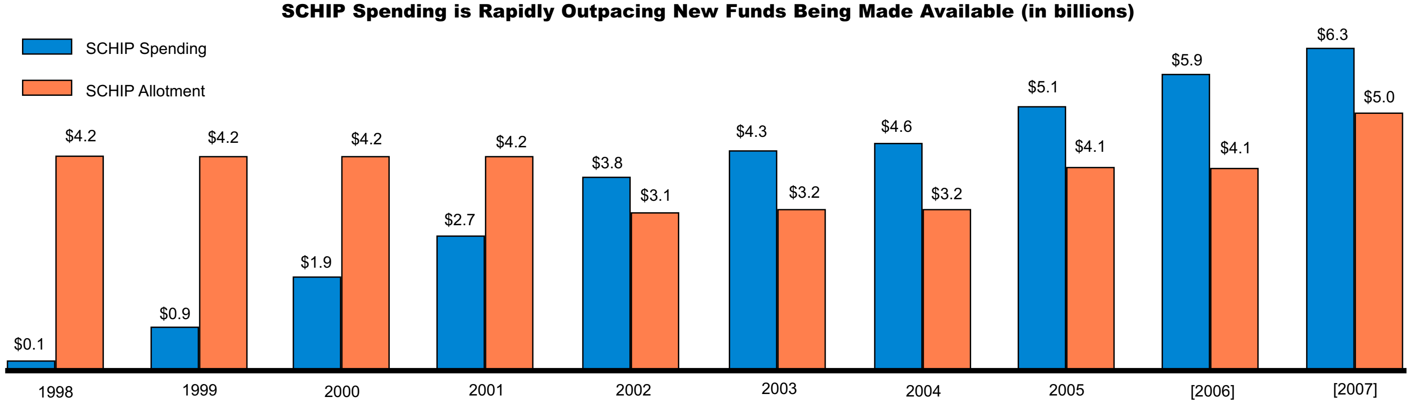
The original SCHIP statute authorized a capped amount of federal SCHIP funding to be made available each year for fiscal year 1998 through 2007, with a total of $40 billion available over the 10-year period. The annual allotments for any given year do not reflect an assessment of what is needed for children's coverage, but rather the amount available given the competing federal budget priorities that were operating when SCHIP was created. For example, budget constraints in 1997 led Congress to include a sharp drop (often referred to as the "SCHIP dip") in funding for fiscal years 2002 through 2004 (Figure 1).

Basic structure of state-specific annual allotments. SCHIP funds are divided each year among the states and territories (hereafter "states") into state-specific annual allotments. Under standard SCHIP rules, a state can use its annual allotment over a three-year period. For example, a state can use its fiscal year 2004 allotment in fiscal years 2004, 2005 and 2006. After the three-year period, unspent funds are redistributed to states that spent their allotments. If the states are unable to spend the redistributed funds within a certain period of time, they revert to the United States Treasury and are no longer available to finance coverage for children. (The rules for redistributing funds are discussed below.)

Enhanced federal matching rate. As in Medicaid, states and the federal government share responsibility for financing SCHIP under a matching rate system. In SCHIP, the federal funds are available to states at an "enhanced matching rate," which effectively reduces by 30 percent the cost to a state of providing SCHIP-financed coverage relative to regular

Figure 1

SCHIP Spending is Rapidly Outpacing New Funds Being Made Available (in billions)



Note: Allotments and spending include states and territories.
Source: Data from Chris Peterson. SCHIP Original Allotments: Funding Formula Issues and Options. Congressional Research Service, April 2006. FY2006 and FY2007 spending projections from CMS.

Medicaid. Designed to encourage states to take up the option to use SCHIP funds, the enhanced matching rate means that the federal government will pay for 65 percent to 85 percent (depending on the individual state's matching rate) of the cost of a state's SCHIP initiative.

Until SCHIP is reauthorized, no new SCHIP funds will be made available for fiscal year 2008 and beyond. The last year for which SCHIP funds have been authorized is fiscal year 2007, which ends September 30, 2007. After this date, states can use unspent funds from earlier years, but they will not receive new allotments until SCHIP is reauthorized. States, however, can receive regular Medicaid matching payments when SCHIP funds are no longer available if they operate a Medicaid expansion (or switch to one in the face of SCHIP shortfalls).

Budget rules require Congress to come up with new funds to avoid a freeze in SCHIP funding levels. Under budget rules, the Congressional Budget Office (CBO) must assume that Congress will reauthorize the SCHIP program and, moreover, that it will fund the program in fiscal year 2008 and later years at the fiscal year 2007 level ($5 billion). In effect, CBO begins with a baseline assumption that SCHIP funding is "frozen" for the indefinite future at $5 billion. If Congress wants to avoid this freeze and allow SCHIP allotments to keep pace with health care inflation and natural enrollment growth, it must come up with a substantial amount of new funds for SCHIP. Preliminary estimates suggest that some $12 billion in new federal funds are needed above the "baseline" level of $5 billion a year for states simply to sustain existing SCHIP initiatives.[2]

Federal SCHIP Funding Increasingly Falling Short

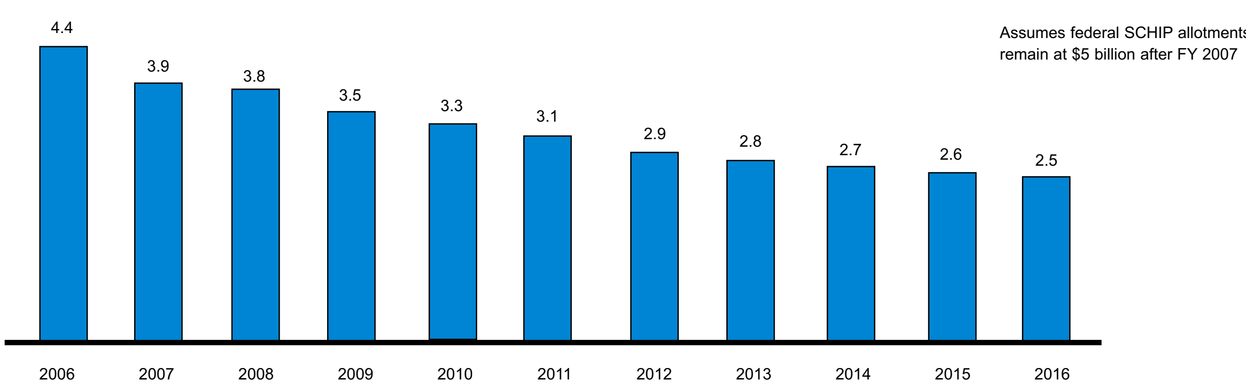
In the early years of SCHIP, available funds exceeded what states needed to launch their SCHIP initiatives, but now the reverse is true. Nationally, as well as in the vast majority of individual states, successful efforts to enroll children and rising health care costs have caused annual allotments to fall short of the amount needed to operate existing SCHIP initiatives. Many states largely have relied on surpluses accumulated during the early years of SCHIP to avoid running out of funds, but these surpluses are drying up. In fiscal year 2007, 17 states are expected to face a combined funding shortfall of $890 million.[3] In the years ahead, the problem will worsen significantly.[4] If Congress does not take action to adjust federal SCHIP funding levels, the Administration projects that more than a million children will lose SCHIP coverage over the next four years.[5]

How are SCHIP funds distributed among the states?

The SCHIP program relies on a formula to distribute available SCHIP funds among the states. The formula has been the subject of considerable controversy because it historically has sent too much money to some states and not enough to others, primarily because it does not take into account the extent to which a state is willing and able to make use of the SCHIP funds set aside for it at any given point in time. The key elements in the formula include the following:

Figure 2

SCHIP Enrollment Projections, 2006-2016 (millions of people)



Source: The Kaiser Commission on Medicaid and the Uninsured. Additional Detail of the FY 2007 Budget from Office of the Actuary at CMS.

Share of low-income and uninsured low-income children. Currently, the SCHIP distribution formula is based largely on two factors that are given equal weight: 1) a state's share of children with family income below 200 percent of the poverty line; and 2) a state's share of the uninsured children in the United States with family income below 200 percent of the poverty line. [6]

Limits on change in allotments over time. To help prevent states from experiencing abrupt changes in the size of their annual allotments, legislation adopted in 1999 established floors and ceilings on the extent to which a state's share of SCHIP funding can shift over time. For example, a state's share of the available funding cannot drop or increase by more than 10 percent from year to year. On a cumulative basis, it also cannot drop by more than 30 percent, nor increase by more than 45 percent relative to the 1999 level.

Geographic cost factor. In addition, the distribution formula includes a geographic cost factor based on the wages of health care workers, but it has only a minor effect on the distribution of funds.

How are Unspent SCHIP Funds Redistributed?

The original SCHIP law included a system for redistributing unspent SCHIP funds, but the Congress has modified this system on a number of occasions since 1997 to address some of the shortcomings with the SCHIP financing structure. For example, states have been given more time to use the surpluses they built up during the early years of SCHIP.

Original rules. Under the original SCHIP legislation, unspent SCHIP funds were to be redistributed after three years to states that have fully spent their allotments. The Secretary of Health and Human Services was to have the authority to decide how to distribute the funds. States receiving the redistributed funds would have a year to use them.

Variations on the original rules. Congress changed the redistribution rules applying to the annual allotments for fiscal years 1998, 1999, 2000, and 2001, primarily by allowing states with unspent funds to keep a share of these funds for a longer period of time. These modifications also have been used to extend the period of time for which states receiving unspent funds can use them. The adjustments created some time-limited relief from the federal funding shortfalls that have surfaced in recent years.

Conclusion

The SCHIP financing structure has been a source of debate and controversy since the program was initiated in 1997. Over time, the issues have grown only more intense as increasing numbers of states find themselves at risk of running out of federal SCHIP matching funds, putting children at risk of losing coverage. During reauthorization, it is likely that financing will be a focus of the debate, including how much money should be dedicated to the program; what is the best way to distribute the available funds among the states; and how should states be allowed to use SCHIP money.

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1 States also have the option to use their SCHIP allotments to provide Medicaid to children during a period of "presumptive eligibility." Under presumptive eligibility, states enroll children in Medicaid who appear to be eligible for coverage while their families gather the necessary documents to formally establish eligibility, preventing children from unnecessarily facing paperwork-driven delays in accessing care.

2 For more information on the growing federal SCHIP funding shortfall, see Park and Broaddus, Freezing SCHIP Funding in SCHIP Reauthorization Would Threaten Recent Gains in Health Coverage, Center on Budget and Policy Priorities, July 7, 2006.

3 Matt Broaddus and Edwin Park, SCHIP Financing Update: In 2007, 17 States Will Face Federal Funding Shortfalls of $800 Million in Their SCHIP Programs, Center on Budget and Policy Priorities, September 21, 2006.

4 For more information on the growing federal SCHIP funding shortfall, see Park and Broaddus, Freezing SCHIP Funding in SCHIP Reauthorization Would Threaten Recent Gains in Health Coverage, Center on Budget and Policy Priorities, July 7, 2006.

5 These estimates from the Bush Administration assume that SCHIP is reauthorized, but that the funding level for fiscal years 2008 and later years is "frozen" in place at the fiscal year 2007 level of $5.04 billion.

6 These factors are computed each year based on U.S. Census Bureau data. While this is the best available data for all states, there is general agreement that the state-level data has marked limitations. For more detail on the formula, see Federal Register Notice Volume 67, Number 190, Tuesday, October 1, 2002, pp. 61632 – 61638.

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CENTER FOR CHILDREN AND FAMILIES ■ GEORGETOWN UNIVERSITY HEALTH POLICY INSTITUTE

Box 571444 ■ 3300 Whitehaven Street NW, Suite 5000

Washington, DC 20057-1485

202.687.0886 ■ Fax 202.687.3110 ■ www.ccfgeorgetown.org