

IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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March 22, 2007

Advisory No. 221

SCHIP FUNDING UP IN SMOKE? — TOBACCO TAXES NOT THE WAY TO FUND CHILDREN'S HEALTH INSURANCE

During the Budget Resolution debate this week, Senator Gordon Smith (R-OR) is expected to offer an amendment to raise the federal tobacco products tax, which could boost the tax on cigarettes from \$0.39 a pack to as much as \$1 a pack. The added revenue would be intended for an expansion of the Schip program (State Children's Health Insurance Program). Schip provides federal money to assist the states in providing health insurance for children in families that are of modest income but too well-off to qualify for Medicaid.

The budget baseline includes an expected renewal of the Schip program at previous levels of coverage, about \$25 billion over 5 years. However, many Senators want to expand the program. Budget Committee Chairman Senator Kent Conrad (D-ND) has included a "reserve fund" for Schip, suggesting that an additional \$50 billion over five years be authorized to cover an additional 8.3 million children (about \$1,200 per child). It would bring the total federal aid to \$75 billion, but only if offsets are found. Senator Smith's amendment suggests that a tobacco tax increase could be used as an offset.

Under the Senate Paygo rules, any proposed expansion of an entitlement or reduction in baseline revenues must be matched by a cut in another entitlement or a tax hike, even if the program expansion or revenue reduction was authorized in the Budget Resolution. If not, the proposal is subject to a point of order and would require a 60-vote super majority to be adopted. Trimming discretionary spending is not a recognized offset.

Conversely, if an offset for a program expansion or a tax reduction is found, then the program or tax cut does not have to have been mentioned in the Budget Resolution to be in order. Any such language in the Budget Resolution is merely laudatory and suggestive, a sort of sense of the Senate. It is not binding.

Furthermore, within the revenue and spending limits allocated to each category of spending by the Budget Resolution, the specific tax and spending decisions taken to conform to these floors and ceilings are up to the several authorizing Committees, or, for revenues, up to the Finance Committee. They are not binding if dictated in the Budget Resolution.

For all these reasons, any "reserve fund" recommended by the Chairman that requires offsets, and any tax recommended by floor amendment to fund a particular program, are purely advisory.

Having said that, would it make sense 1) to triple funding for Schip, and 2) to pay for the expansion with an increase in the tobacco products tax? No and no again.

1) More money for Schip is being urged by the states in large part because they have over-spent on the program.

- The federal aid was targeted at children in families with income of up to twice the poverty level. Several states have expanded their programs to include children in families with up to three or even

three-and-one-half times the poverty level (over \$72,000).

- Most of the states that are running short of Schip money have included coverage for the parents. In many cases, the parents could receive coverage at work, but do better taking the state subsidy, leaving the employer money on the table.
- Often, it would be cheaper to allow the parents a cash grant to add the children to their coverage at work, but the state programs make that option so cumbersome that few families take advantage of it.

Before the Congress caves in to pressure to toss the states more funding, it should review and overhaul the Schip program to ensure that the federal aid goes to those who most need it, and only up to a reasonable cut-off point, and that the most cost-effective options be used.

2) Using the tobacco products tax to fund an expansion of Schip is poor tax policy.

- Smokers are a minority. Taxing a minority for programs favored by the general population is poor political economy. It is of the Willie Sutton school of taxation. When asked why he robbed banks, Sutton is reported to have replied, "Because that's where the money is."
- Selective excise taxes distort the economy. They alter the mix of output, force consumers off their preferred consumption patterns, and hurt workers in the industry. Excises do more economic damage

than a broad-based sales tax that raises the same amount of money.

- The tobacco products excise tax is highly regressive. People of lower income are more likely to smoke than people of higher income. Also, for any given amount of daily cigarette consumption, spending on tobacco products takes a higher share of income among the bottom half of the income distribution than among the top half.
- Schip is a transfer program designed to help lower-middle income families buy insurance for their children. Such transfer programs are, in theory, best funded by very broadly based taxes that reflect the ability to pay.
- Many Schip parents are also smokers. The tobacco products tax falls disproportionately on the lower-middle income families that are supposed to be helped by the Schip program. Taxing tobacco would offset much of the income transfer to the Schip-eligible families. An increase in the cigarette tax of \$0.61 per pack would come to \$446 a year for a couple, each smoking a pack a day. That's about a third of the Schip subsidy per child.

Conclusion: The Budget Resolution is not the best place to make tax policy. Schip needs to be overhauled before being expanded. The tobacco tax is a bad way to fund programs for the near-poor.

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