

medicaid  
and the uninsured

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## Issues Related To Unspent S-CHIP Money

### Introduction

According to new data released by the Bush Administration in early October, states began fiscal year 2002 (which started October 1, 2001) with \$11.3 billion in unspent S-CHIP funds at their disposal. These new data have spurred discussion among researchers, policymakers, and others about whether states should be given more flexibility to use their unspent S-CHIP funds for new purposes other than covering children, such as providing health insurance coverage to workers who lose their jobs during the economic downturn. Indeed, the Bush Administration recently announced a new policy under which states can apply for waivers to use their unspent S-CHIP funds for new purposes. The objective of this issue brief is to provide more information on the amount of unspent S-CHIP money that is available, to explore the reasons for the accumulation of unspent funds, and to discuss the implications for children's health coverage of expanding the allowable uses of S-CHIP funds to encompass new objectives.

This issue brief is based primarily on projections of states' S-CHIP expenditures that were prepared by the Office of the Actuary at the Center for Medicaid and Medicaid Services (CMS) earlier this year. The CMS projections show how much S-CHIP money each state is expected to use in the years ahead under the rules in place for using S-CHIP funds prior to the announcement of the Administration's new waiver policy. These rules generally limited states to using their S-CHIP funds to cover uninsured, low-income children and, in some circumstances, to providing family-based coverage to the parents and children in low-income families under a waiver. As a result, the statements in this issue brief describing the amount of S-CHIP money states are "expected" or "slated" to use reflect the amount of S-CHIP money that CMS projected states would use assuming they did not have broad new flexibility to cover newly unemployed workers with S-CHIP funds. The projections were developed by CMS using state-specific estimates of the likely growth in S-CHIP expenditures, and they take into account the "reallocation process" (described in detail below) by which S-CHIP funds in states that cannot use them for children's health coverage are re-directed to states that can make use of the funds.

## Overview

The data reviewed in this issue brief indicate that states built up substantial reserves of S-CHIP funds during the early years of implementing the program. By the beginning of fiscal year 2002, states had accumulated \$11.3 billion in unspent S-CHIP funds. At the same time, states' S-CHIP enrollment has been growing steadily and rapidly. As a result, many states will need a substantial portion of the reserves that they accumulated during the implementation phase of S-CHIP to supplement their annual S-CHIP allotments in order to maintain coverage for children. The need to draw on reserves will be increasingly significant in the years ahead in part because federal funding for S-CHIP dips by more than 25 percent for a three-year period beginning in fiscal year 2002.

Due to these dynamics, the fact that states began fiscal year 2002 with \$11.3 billion in "unspent" S-CHIP funds does not mean that the funds are uncommitted. To the contrary, CMS expects states to use \$8 billion of the \$11.3 billion in unspent S-CHIP money with which they began fiscal year 2002 to cover children. The remaining \$3 billion of the \$11.3 billion in unspent S-CHIP funds is expected to remain unused by states for children's health coverage by a statutory deadline for doing so. After the deadline for using these funds passes, the \$3 billion will revert to the U.S. Treasury and be lost to the S-CHIP program. However, in the year after states are expected to send most of the \$3 billion in unspent S-CHIP funds back to the U.S. Treasury, S-CHIP enters a period during which federal funding for the program falls short of what is needed to maintain children's health coverage. As a result of the funding shortfall, CMS anticipates that the number of children with S-CHIP coverage will decline.

## How Does the S-CHIP Financing System Work?

Since S-CHIP is not an entitlement program, the federal funds for the program are distributed to states under a formula that calculates an allotment for each state. Under S-CHIP financing rules, states then have three years during which to use their S-CHIP allotments. If any of a state's S-CHIP funds remain unused after three years, the funds are made available for redistribution to states that can use them for children's health coverage. States that receive redistributed funds have a year in which to use them after which they revert to the United States Treasury and are "lost" to the S-CHIP program. These rules effectively create a four-year "lifetime" for S-CHIP funds. For example, a state can use its fiscal year 2000 allotment in fiscal year 2000, 2001, and 2002. If the state did not use all of its fiscal year 2000 allotment by the end of fiscal year 2002, then its unused S-CHIP funds are reallocated to other states for their use in fiscal year 2003. At the end of fiscal year 2003, any of the reallocated funds that remain unused revert to the U.S. Treasury.

(In addition, for the first two years of S-CHIP funding, Congress has applied special rules to states' S-CHIP allotments. Among other things, these rules effectively give states until the end of fiscal year 2002 to use the funds distributed (or redistributed) to them out of the fiscal year 1998 allotment, creating a longer lifespan for fiscal year 1998 funds than for S-CHIP money distributed to states in other years.)

## How Much Unspent S-CHIP Money is There?

When the Administration notes that states have \$11.3 billion in unspent S-CHIP funds available, it is referring to the fact that states begin fiscal year 2002 with \$11.3 billion in S-CHIP funds that they have “carried” over from earlier years. Specifically, as shown in Figure 1, at the beginning of fiscal year 2002, states have at their disposal \$304 million in fiscal year 1998 funds, \$2.8 billion in fiscal year 1999 funds, \$3.9 billion in fiscal year 2000 funds, and \$4.2 billion in fiscal year 2001 funds, or a total of \$11.3 billion. In addition, states at the beginning of fiscal year 2002 received a new allotment of \$3.1 billion.

The \$11.3 billion in “carry over” funds with which states begin fiscal year 2002 represent a build up or reserve of funds that states accumulated during the early stages of implementing S-CHIP. When it established the funding stream for S-CHIP, Congress did not take into account that most states would take some time to establish and implement their S-CHIP programs. As a result, as shown in

Figure 1: Where Do the \$11.3 Billion in “Unspent” S-CHIP Funds Come From?

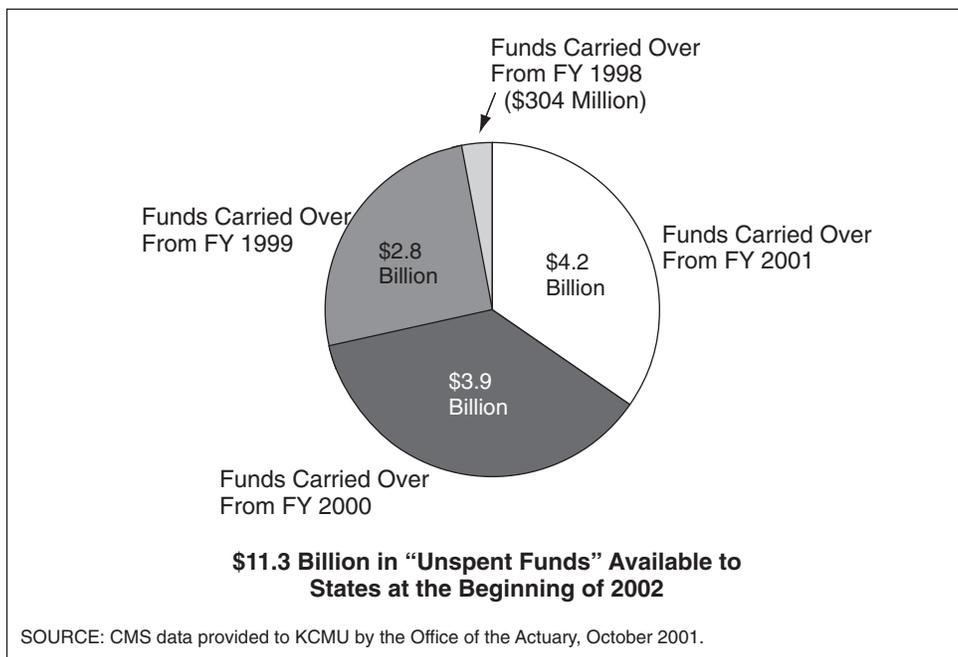
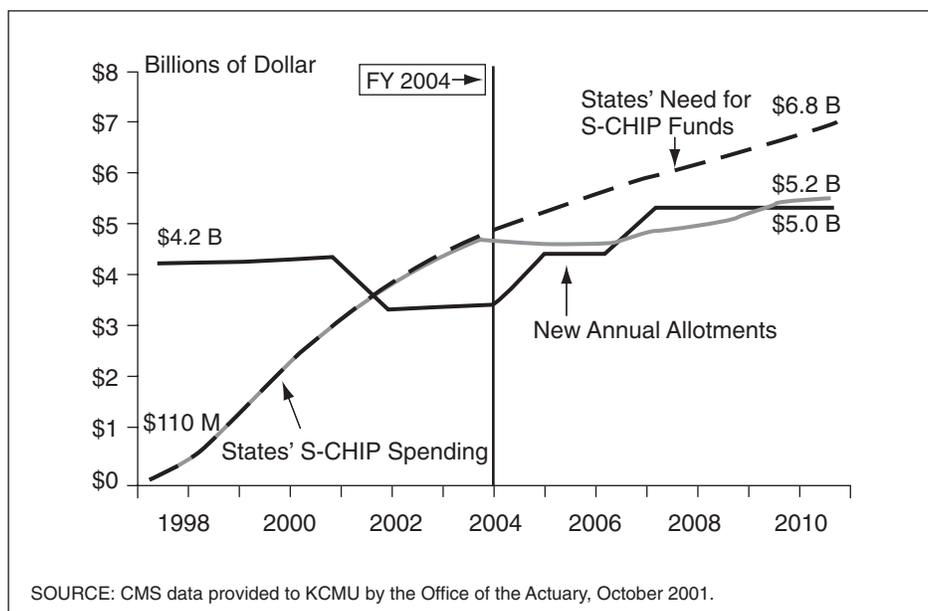


Figure 2 (see figure at end), states used only a fraction of the funds made available to them in the first few years of the program. As explained below, however, states' demand for S-CHIP funds is beginning to exceed the amount that they receive from their annual allotments due to rapid enrollment increases.

**Figure 2: Beginning in Fiscal Year 2004, States' Need for S-CHIP Money Exceeds Available Funds**

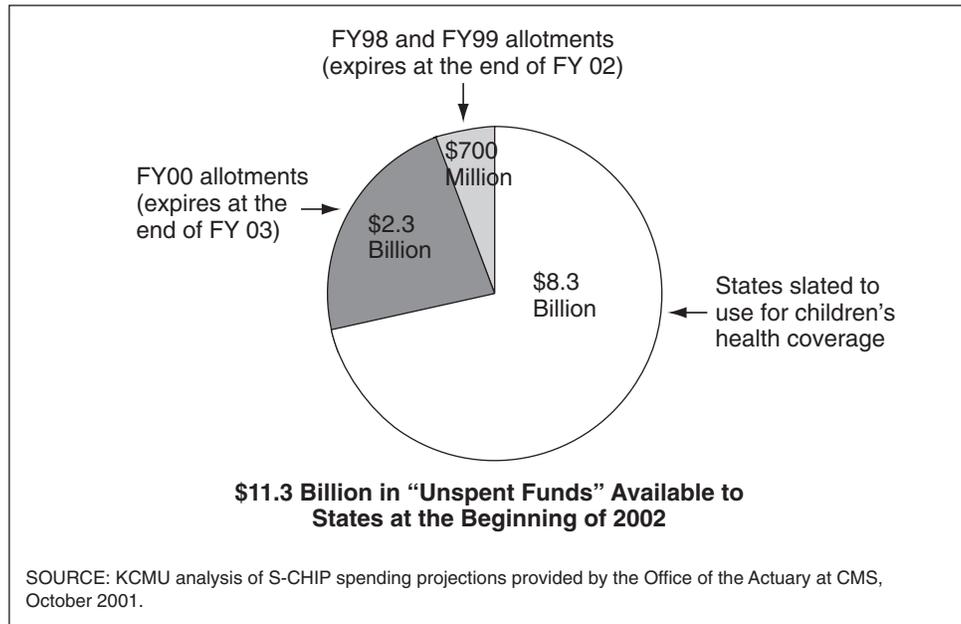


### How Much of the \$11.3 Billion in Unspent S-CHIP Funds is Needed for Children's Health Coverage?

The fact that states begin fiscal year 2002 with \$11.3 billion in unspent S-CHIP funds from earlier years does not mean that the program is overfunded or that these funds are not committed to be used for children's health coverage. To the contrary, CMS projects that the vast majority of these funds will be used by states to pay for the cost of providing children's health coverage in the years ahead. The S-CHIP program also is rapidly approaching a stage in which the reserves states built up during the implementation state of S-CHIP are not adequate to compensate for the shortfalls they are beginning to face in annual S-CHIP funding levels. Although enrollment in the S-CHIP program was initially low, it has been growing rapidly and reached 2.7 million in December of 2000.

As shown in Figure 3, although states began fiscal year 2002 with \$11.3 billion in S-CHIP funds at their disposal, states are expected by CMS to use close to three-quarters of these funds to cover children in fiscal year 2002 and future years. CMS anticipates that states will not be able to use the remaining one-

**Figure 3: Expected Uses of the \$11.3 Billion in “Unspent” S-CHIP Funds**



quarter of funds (27 percent or some \$3 billion) by statutory deadlines for doing so. For example, CMS expects states will not be able to use \$700 million of their fiscal year 1998 and 1999 allotments by a September 30, 2002 deadline for doing so, causing these funds to expire at the end of fiscal year 2002. Similarly, it anticipates states will lose \$2.3 billion of their fiscal year 2000 allotments at the end of fiscal year 2003 due to an inability to use these funds by a deadline of September 30, 2003.

However, the fact that \$3 billion in unspent S-CHIP funds expire due to statutory deadlines for using the funds does not mean that these funds are “unneeded” by states for children’s health coverage. Indeed, CMS anticipates that shortly after the \$3 billion in unused S-CHIP funds expire due to the statutory deadlines for using them, states will enter a period during which the amount of federal funding available for children’s health coverage falls short of what is needed with the result that states will reduce the number of uninsured children that they cover. As illustrated in Figure 2 (see Figure at end), CMS anticipates that beginning in fiscal year 2004 states will need more S-CHIP funds than are available to maintain the expected growth rate in children’s enrollment. By fiscal year 2005, the shortfall is expected to reach nearly half a billion dollars.

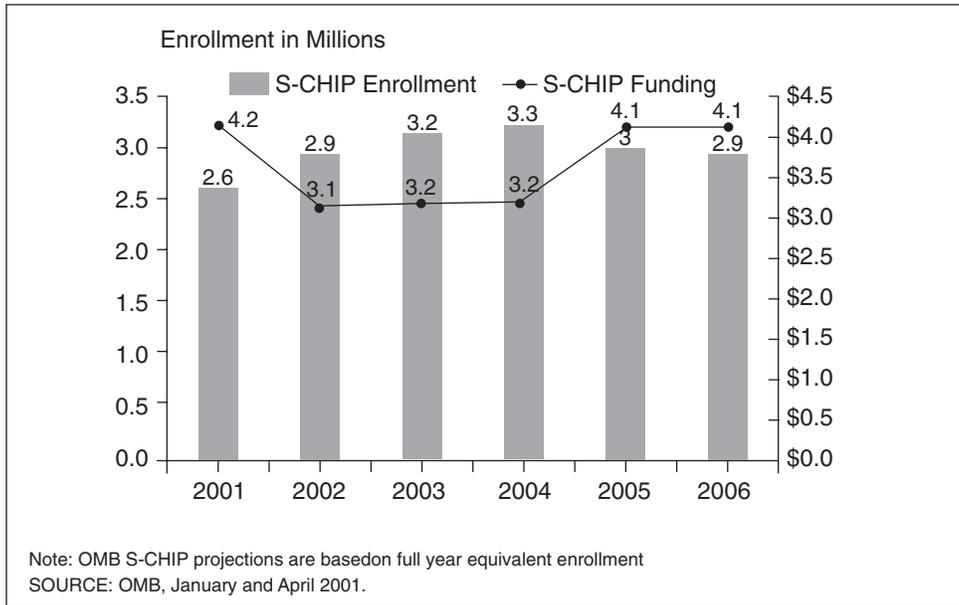
The primary reason for the pending shortfall is that when Congress authorized the S-CHIP program, it included a three-year dip in S-CHIP funding due to budget constraints it faced at the time that S-CHIP was enacted in August of 1997. Between fiscal year 2001 and 2002, states’ S-CHIP allotments drop by

more than 25 percent and remain at this reduced level through the end of fiscal year 2004 (Figure 4).

As a result of the shortfall, OMB estimates the number of children enrolled in S-CHIP will grow more slowly between fiscal year 2003 and 2004 than it otherwise would. Then, between fiscal year 2004 and fiscal year 2006, the number of children enrolled in coverage will actually decline by 400,000 due to the drop in federal funding (Figure 4).

This pending shortfall in S-CHIP funds raises questions about the appropriateness of using the relatively small, one-time reserves of funds that states accumulated during the implementation of the program for a new purpose, particularly given that the program is shortly expected not to have enough money even to meet its basic purpose of covering children.

**Figure 4: Enrollment of Children in S-CHIP Projected to Decline by 400,000 After 2004 Due to Dip in Funding**



## **How Might Individual States Fare Under the Administration’s Proposal to Allow Unspent S-CHIP Funds to be Used to Cover Newly Unemployed Workers?**

The data on S-CHIP expenditures and funding levels presented above provide information on what the Administration anticipates will happen with S-CHIP on average across the fifty states, the District of Columbia, and the territories. In practice, the particular circumstances in any given state could vary significantly from the experience of the nation as a whole. Most notably, there are a number of states in which the amount of S-CHIP funding that they receive through their allotments is far greater than they are likely ever to need if they continue to use their allotments exclusively to cover children. (See the accompanying Issue Brief on trends in S-CHIP expenditures to date for an explanation of why states’ use of S-CHIP funds can vary significantly.) In these individual states, the amount of available S-CHIP funding is likely significant enough to allow for coverage of all eligible children, as well as some unemployed workers or other new populations.

Although it would initially seem to have little consequence to grant states that have excess amounts of unspent S-CHIP funds the opportunity to use these funds for other purposes, there are implications for the nation as a whole. When it designed S-CHIP, Congress developed the reallocation process to assure that unspent S-CHIP funds are re-directed to states that need them to provide children’s health coverage. If, however, states with unspent S-CHIP funds are given the authority through waivers to use these funds for new initiatives, it will result in a reduction in the amount of S-CHIP funds available for reallocation. Given that some of the states that rely on reallocated funds to cover children already are expected to face shortfalls in S-CHIP funding—even with the reallocation process operating as Congress intended—it is clear that allowing states with unspent funds to use them for new purposes will increase the size of the funding shortfall that they already face and likely result in fewer children securing coverage.

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