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## South Carolina's Dilemma: Increase Taxes or Reform Medicaid?

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South Carolina is facing a serious crisis in providing funding for healthcare services to low-income persons through its Medicaid program – a problem other states also must address. Clearly policymakers are faced with a critical dilemma – either increase taxes to cover the funding shortfall for this program or actually sit down and evaluate the effectiveness of the entire Medicaid system. Yet even before the system has been reviewed in-depth, the representatives from the medical profession and operators of our state's hospitals have urged the General Assembly to increase taxes to increase Medicaid funding.

The responsible solution is to re-evaluate Medicaid and determine which services work and improve or eliminate those services that are not cost efficient. Meaningful reform is needed before a tax increase should be considered – a quick fix simply postpones tough decisions that will have to eventually be made by policy makers.

### **Medicaid In South Carolina:**

Medicaid keeps on growing and growing: Initially, Medicaid was a medical care extension of federally funded income maintenance programs for the poor, with an emphasis on the aged, the disabled and dependent children and their mothers. Over time, however, Medicaid has been diverging from a firm tie to eligibility for cash programs. Recent legislation ensures Medicaid coverage to an expanded number of recipients, including some Medicare beneficiaries who are not eligible for any cash assistance program, and would not have been eligible for Medicaid under earlier Medicaid rules.

- According to a study by the National Conference of State Legislatures, South Carolina had the second highest increase in Medicaid funding in fiscal year 2000-2001 South Carolina increased Medicaid funding by 17.6 percent. Delaware ranked first with an 18.5 percent increase.
- From fiscal year 1994 to 2000, the rate of growth for Medicaid in South Carolina was 9.7 percent – double the 5.0 percent rate of growth in General Fund revenue.



- The measures put in place by the Department of Health and Human Services to properly verify eligibility for Medicaid are wanting. There are ineffective follow-up procedures to ensure that recipients are still eligible for benefits. Consequently, some ineligible recipients do not come off the Medicaid rolls unless they elect to leave the program.
- There are varying eligibility guidelines for different groups of beneficiaries receiving Medicaid. Most of the eligible recipients consist of low-income parents and children, elderly, disabled, and blind. Even with stated income eligibility requirements Medicaid policy sometimes “disregards” income levels. This means individuals with incomes higher than the federal poverty level may qualify.
- Medicaid is funded by federal and state governments. In South Carolina, the federal government contributes about 70% of the costs.
- In South Carolina Medicaid provides services such as optical care and non-medical dental care – two benefits that many South Carolinians do not have through their privately funded health insurance policies.
- Other optional services and optional eligibility groups in South Carolina include: working disabled; Katie Beckett Children; Community Long Term Care Program; Hospice and Durable Medical Equipment.
- Nationally, the most common optional services include: clinic services; nursing facility services for individuals under 21; intermediate care facility/mentally retarded services; optometrist services and eyeglasses; prescription drugs; TB-related services for infected persons; prosthetic devices; and dental services.
- Most people consider Medicaid to be a safety net providing medical care to the less fortunate. However, the following state agencies receive Medicaid funds: Department of Health and Human Services, Department of Disabilities and Special Needs, Department of Mental Health, Department of Social Services, Department of Health and Environmental Control, Department of Education, Medical University of South Carolina, Department of Juvenile Justice, Department of Alcohol and Other Drug Abuse Services, Governor’s Office (OEPP) – Division of Continuum Care, School for Deaf and Blind, University of South Carolina, Commission for the Blind, Department of Social Services – Emotionally Disturbed Children.
- Currently approximately 700,000 South Carolinians receive Medicaid benefits, including several thousand state employees.
- In 2000, nearly 50 percent (one out of two) of all babies born in South Carolina were Medicaid recipients.
- In 1997, South Carolina became the first state to implement the CHIP program, when the State Children Health Insurance Program (CHIP) was established by Congress to provide insurance for



uninsured children. CHIP is required to provide all Medicaid services mandated by law and has accordingly led to an increase in the number of new Medicaid recipients. By December 2000, 44,392 children were enrolled in the CHIP program. The federal government pays 80 percent of this program.

### **Would A Tax Hike Negatively Impact South Carolina?**

There are a number of reasons to oppose tax hikes during a period of stagnant economic growth and recession. Many economists note that tax increases during recessions often prolong the economic misery and may actually delay recovery. The tax hike would ultimately place a high burden on small-business owners and low to middle-income consumers.

- The General Assembly is considering a 22 cents hike in the cigarette excise tax. The tax per pack would increase from 7 cents to 29 cents – this is a 314 percent increase.
- Experts also believe that a hike on cigarette taxes would hurt the poor and middle class. A study by KPMG Peat Marwick found that cigarette taxes are incredibly regressive, extracting a far greater percentage of income from modest wage earners compared to those with high incomes. The study looked at U.S. families in the bottom half of the income distribution, those earning approximately \$30,000 a year or less. While this group represents roughly 50 percent of all households in the country, it earns only 16 percent of all income generated nationwide. This group pays about 15.3 percent of all federal income and FICA taxes, but pays over 47 percent of all tobacco taxes. An additional 22 cents per pack increase is just one more burden that low- and middle-income wage earners would be forced to shoulder.
- South Carolina retailers and consumers would be hurt by this 314 percent tax increase. Even a small increase in cigarette taxes can lead to a substantial loss in sales.
- South Carolina stores sold nearly 400 million packs of cigarettes with a gross retail value of nearly \$1.2 billion and \$260 million in gross profits in fiscal year 2001.
- According to a 1998 study, nearly 5,500 retailers and wholesaler jobs were directly created from tobacco and cigarette sales.
- Tobacco sales in convenience stores accounted for nearly 35 percent of merchandise sales. Cigarettes often generate the most sales, following gasoline for stores. It can be argued that a tax increase would result in lower cigarette sales and there is no way for many store owners, especially smaller single-store operators, to make up the lost revenue.



- Retailers say the 314 percent tax increase is ineffective as public policy and makes small-business owners bear an unreasonable burden. The tax could be considered anti-small business.
- When faced with higher cigarette taxes most people don't quit smoking, they just find alternative sources. Instead of quitting, when cigarette taxes go up, smokers travel to neighboring states to buy cigarettes, buy them via the Internet or from stores on Indian reservations and military installations.
- If South Carolina's tobacco tax increases 314 percent, smokers could use the Internet to avoid taxes or even drive to Georgia where the tax is 12 cents or to North Carolina where the tax is a cheap 5 cents per pack.
- If the 22 cents increase is implemented, cigarette sales are expected to fall by about 15 percent. Cigarette sales dropped by 16 percent a year after Louisiana increased its tax by 4 cents.
- When South Carolina increased its tax from 3 to 5 cents per pack in 1950 the state lost about 19 percent of its tax-paid sales. Neighboring North Carolina, with no cigarette tax at the time, saw its sales jump by 20 percent. In 1951, South Carolina cut the tax by 2 cents and saw its sales climb by 23 percent. (Could history be repeating?)
- South Carolina cigarette sales increased when other high tax states increased their tobacco taxes during the 1990s. During that period, South Carolina sold an additional 70 million taxable cigarette packs annually.
- Cigarettes are one of the most heavily taxed consumer products. National cigarette prices have risen by over \$1 per pack to pay costs associated with the Master Settlement Agreement between the state attorneys general and the tobacco industry. Moreover, South Carolina smokers are also paying an additional 39 cents per pack due to recent hikes in the federal excise tax.
- The typical South Carolina smoker pays about \$530 in total cigarette state and federal taxes per year. The proposed 314 percent state tax hike would cost the typical South Carolina smoker an additional \$100 in new taxes per year. After a 22 cents tax hike the typical smoker would be paying \$630 per year in combined federal and state taxes.
- South Carolina was expected to collect \$2.3 billion over 25 years from the nation's cigarette manufacturers under the terms of the Master Tobacco Settlement Agreement. But because the state needed money to fix budget shortfalls and to pay for new programs, it agreed to securitized the settlement for a one-time payment of \$780 million. The tobacco money has been used to fund numerous programs in the state budget. This is money that should have been dedicated to health care.

### **Conclusion:**

The lesson is clear for South Carolina. By raising this tax, South Carolina may have a substantial reduction in tobacco sales. South Carolina retailers and wholesalers will be hit hard, and the state's economy could be adversely



affected. It is estimated that the proposed tax increase would result in a 60 million pack drop in sales. That is 60 million packs that would not be sold by South Carolina retailers and consequently not taxed by the state.

Tough decisions need to be made on Medicaid, but tax increases (specifically cigarette taxes) should not be an option. It is clear that a program as large as Medicaid has a bureaucracy that could be trimmed and recipients whose eligibility should be reviewed. In addition, Medicaid options not mandated by federal law should be reviewed and reformed as needed to save taxpayer dollars. But no decisions should be made until a comprehensive study of the Medicaid system is conducted.

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*Comments and questions regarding this Fact Sheet should be directed to Gerry Dickinson, Vice President for Policy at [gpd@scpolicycouncil.com](mailto:gpd@scpolicycouncil.com). Nothing in the foregoing should be construed as an attempt to aid or hinder passage of any legislation. Copyright 2002, South Carolina Policy Council Education Foundation, 1323 Pendleton Street, Columbia, South Carolina 29201. Visit the Policy Council on line at [www.scpolicycouncil.com](http://www.scpolicycouncil.com).*

