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Nonpartisan Analysis for the U.S. Congress

Exploring the Effects of Medicaid During Childhood on the Economy and the Budget

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Elizabeth Ash, William Carrington, Rebecca Heller, and Grace Hwang
Labor, Income Security, and Long-Term Analysis Division and Health Analysis Division

For information about the American Academy of Pediatrics, see https://www.aap.org/.

Overview

This analysis examines the short-term and long-term fiscal effects of Medicaid spending on children.

- In the short term, costs for Medicaid are paid upfront when the children (or their mothers) receive health care.

- In the long term, Medicaid enrollment during childhood has been shown to increase earnings in adulthood. Those higher earnings imply greater tax revenues and lower transfer payments by the federal government in the future.

Sensitivity of the Findings

On a present-value basis, CBO estimates that long-term fiscal effects of Medicaid spending on children **could offset half or more** of the program's initial outlays, depending on sets of reasonable parameter values. That estimate is sensitive to the discount factor used to convert future effects to current dollars because long-term returns take over 70 years to fully materialize. This analysis uses two discount factors:

- Treasury rate discount factors reflect the government's cost of borrowing. Expected future cash flows are discounted by the yields on Treasury securities of similar maturities, following the approach used for credit programs that is prescribed by the Federal Credit Reform Act of 1990.
- Fair-value discount factors use a higher discount rate to capture market risk, a component of financial risk linked to macroeconomic factors like productivity and employment conditions.

The results also are sensitive to the predicted effect of Medicaid enrollment during childhood on earnings in adulthood (a parameter not known with precision) and to whether the changes in federal Medicaid spending come from noninvestment spending or from changes in federal borrowing.

Illustrative Policies in the Model

To develop its model, CBO first formed a synthetic panel of children who would be affected by each policy in the years from 2023 to 2032. The panel resembles current Medicaid enrollees, but the distributions by age and family income vary slightly across illustrative policies based on who CBO expects would be affected.

The analysis considers two illustrative policies.

- The first policy (referred to as the “continuous eligibility” policy) would require that all states provide children with 12 months of continuous Medicaid eligibility, allowing children to remain enrolled for a 12-month period regardless of changes in their family income or other factors that affect their eligibility for Medicaid.
- The second policy (referred to as the “block grant” policy) would establish block grants to states, and the amounts of those grants would be below CBO’s projection of federal spending on Medicaid under current law. That policy has two versions (A and B).

Estimating the Effects on Earnings

CBO projects children's future earnings with and without proposed changes to Medicaid policy. Baseline adult earnings for each affected child are projected on the basis of his or her family income during childhood, on the estimated distribution of income mobility across generations, and on CBO's projections of the earnings distribution in future years.

CBO then projects lifetime earnings under each illustrative policy by applying a percentage effect to the baseline earnings of each child in the synthetic panel.

- Children who gain (or lose) a year of Medicaid enrollment would earn **approximately 0.5 percent more (or less) per year** as adults compared with those whose Medicaid enrollment did not change, CBO projects, based on a literature review and further adjustments.

- The effects vary by age and family income of the children exposed to the policy—in particular, in CBO's projections, the effects are larger for children whose enrollment changes at younger ages and who are from lower-income families.

Estimating the Effects on Capital Income and the Federal Budget

CBO also projects the changes in capital income that would be induced by higher labor productivity.

- Higher earnings reflect improved labor quality that would increase returns to capital. In CBO's assessment, the change in capital income is proportional to the ratio of capital to labor income in the baseline.

CBO then estimates the budgetary effects of those illustrative changes by multiplying changes in earnings and capital income by the agency's projection of the applicable federal marginal tax rates.

Finally, those fiscal effects are discounted to present dollars using Treasury rate discount factors or fair-value discount factors.

Main Results: Net Present Value of Changes per Affected Child

Amounts, in 2023 Dollars and Rounded to the Nearest Hundred

Using Treasury Rate Discount Factors

	Change in Initial Federal Medicaid Outlays	Change in Gross Domestic Product	Fiscal Effects (% of the change in initial federal Medicaid outlays)
Continuous Eligibility	$1,700	$14,900	$3,400 (197%)
Block Grant A	-$1,700	-$15,600	-$3,600 (206%)
Block Grant B	-$1,700	-$20,100	-$4,600 (266%)

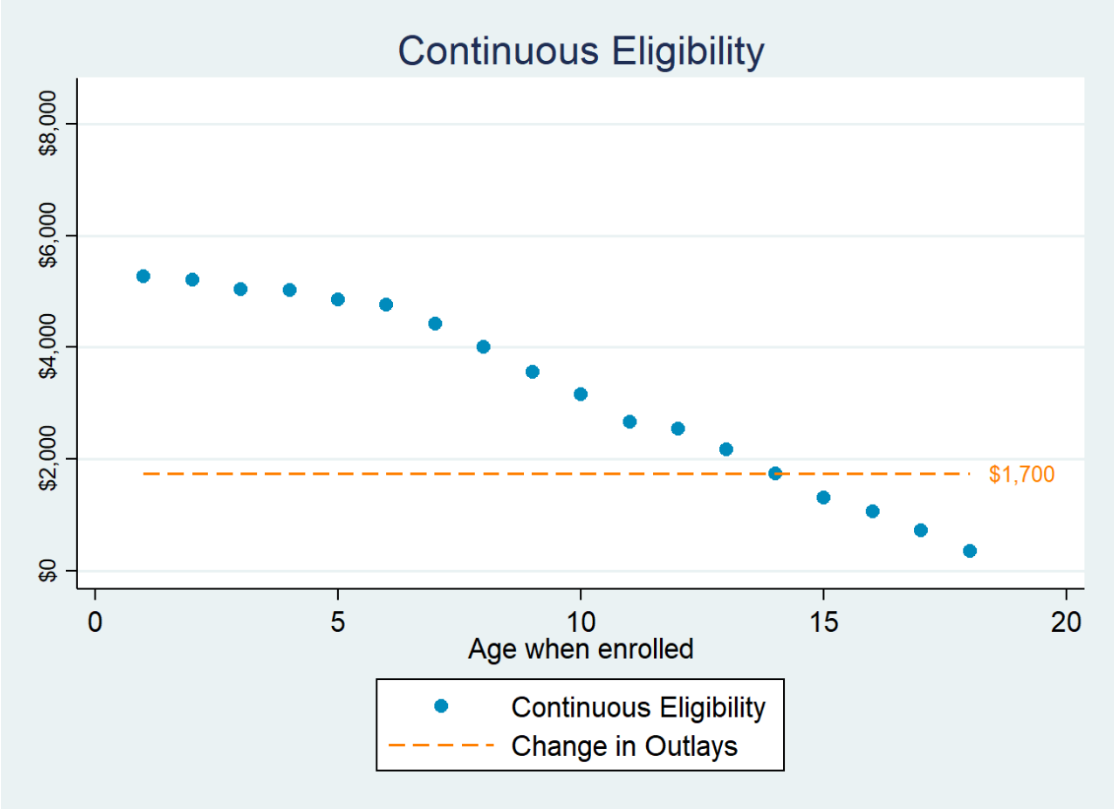
Using Fair-Value Discount Factors

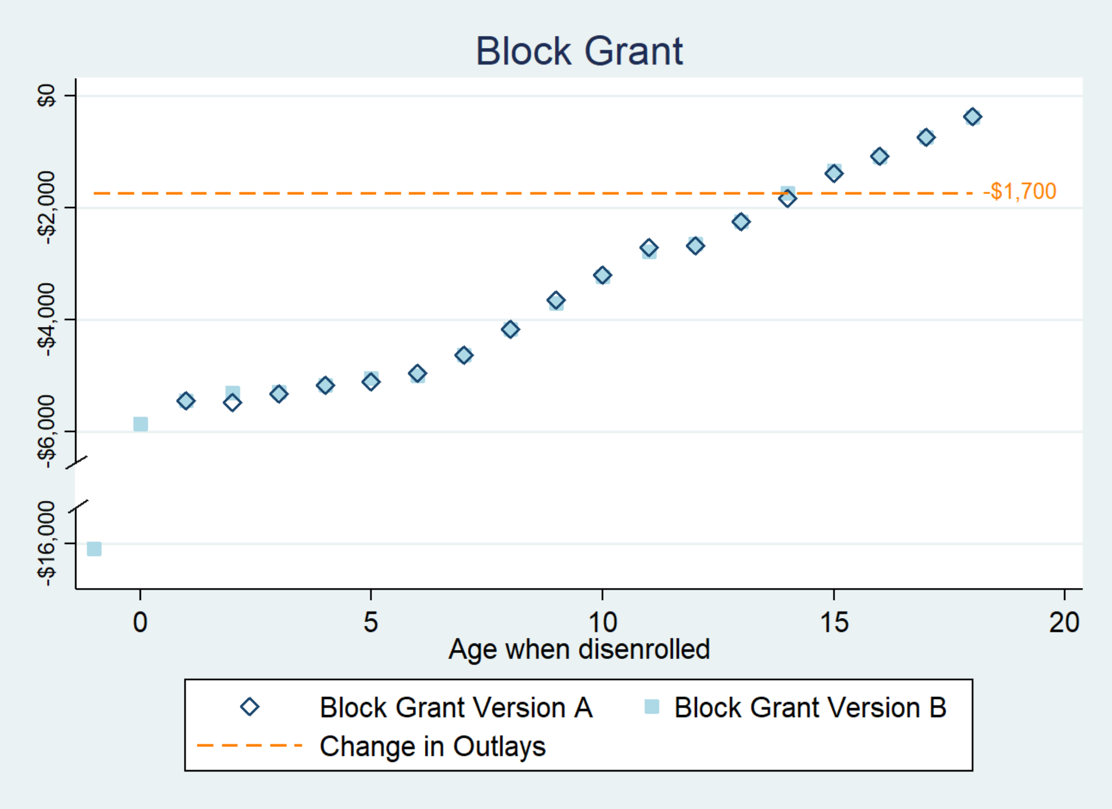
	Change in Initial Federal Medicaid Outlays	Change in Gross Domestic Product	Fiscal Effects (% of the change in initial federal Medicaid outlays)
Continuous Eligibility	$1,700	$3,700	$800 (49%)
Block Grant A	-$1,700	-$3,900	-$900 (51%)
Block Grant B	-$1,700	-$4,500	-$1,000 (60%)

Data source: Elizabeth Ash, William Carrington, Rebecca Heller, and Grace Hwang, *Exploring the Effects of Medicaid During Childhood on the Economy and the Budget,* Working Paper 2023-07 (Congressional Budget Office, November 2023), Table 3, www.cbo.gov/publication/59231.

Net Present Value of Long-Term Fiscal Effects of Medicaid Spending per Affected Child, by Age

Results Using Treasury Rate Discount Factors





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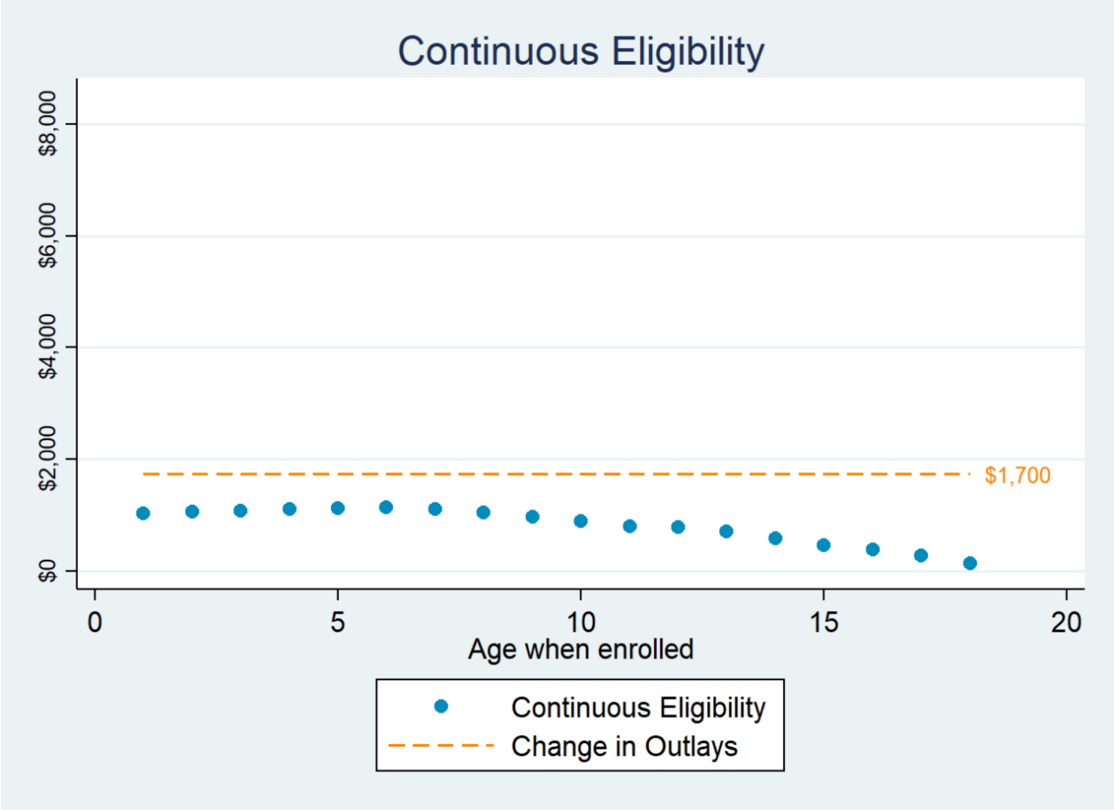

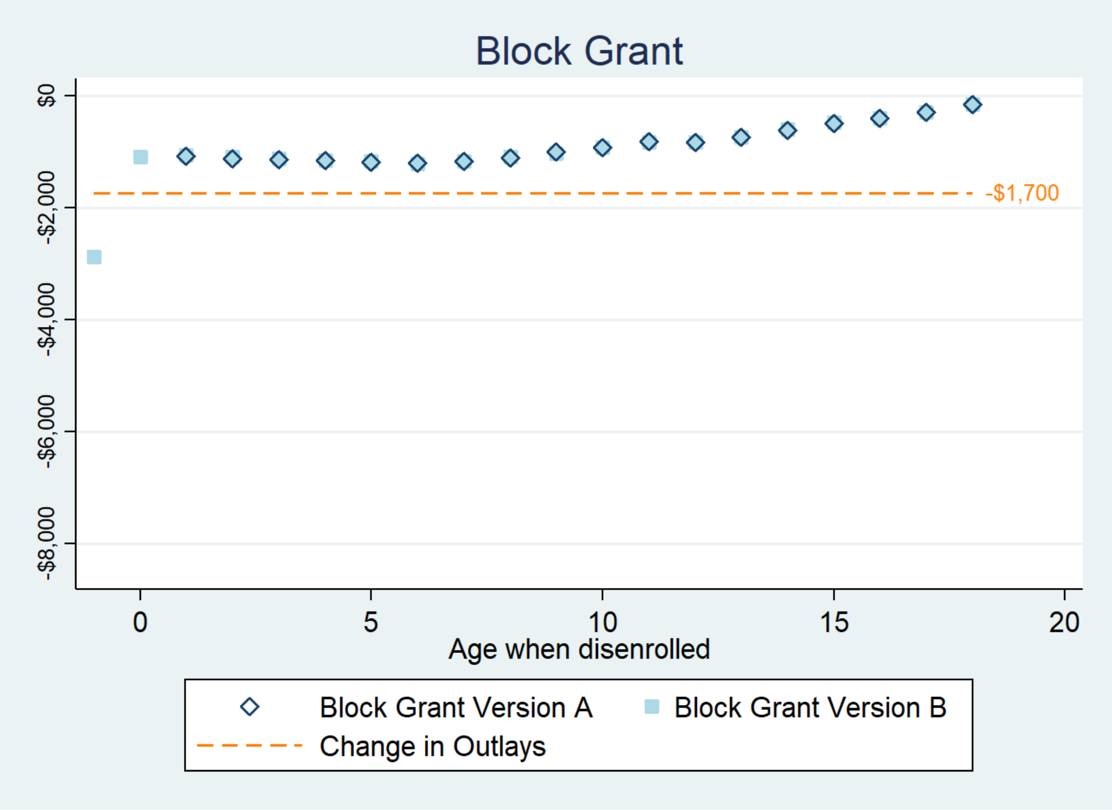

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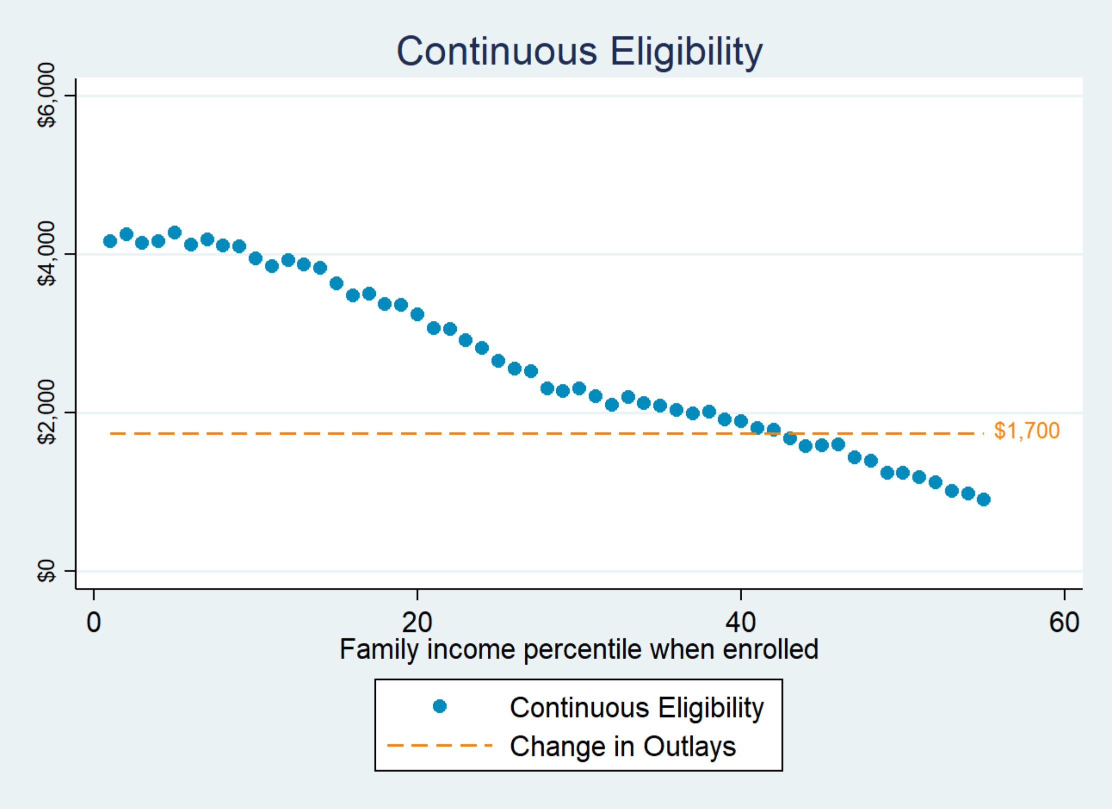
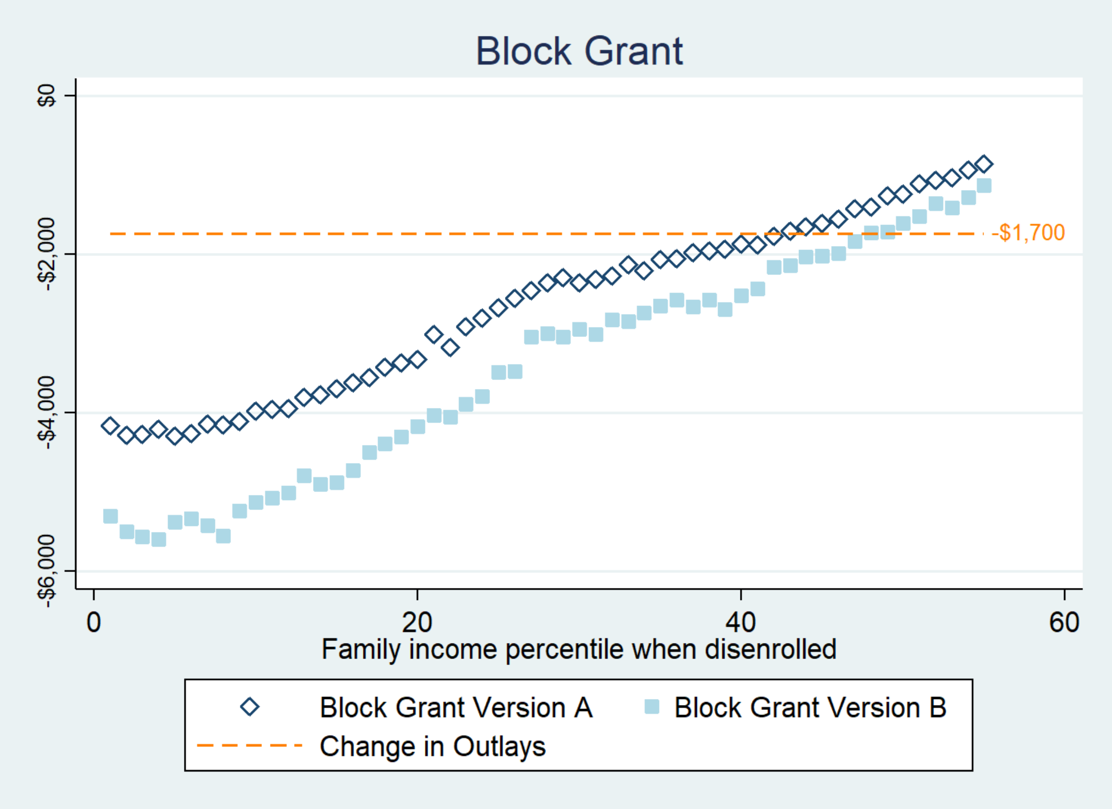
Net Present Value of Long-Term Fiscal Effects of Medicaid Spending per Affected Child, by Family Income Percentile

Results Using Treasury Rate Discount Factors





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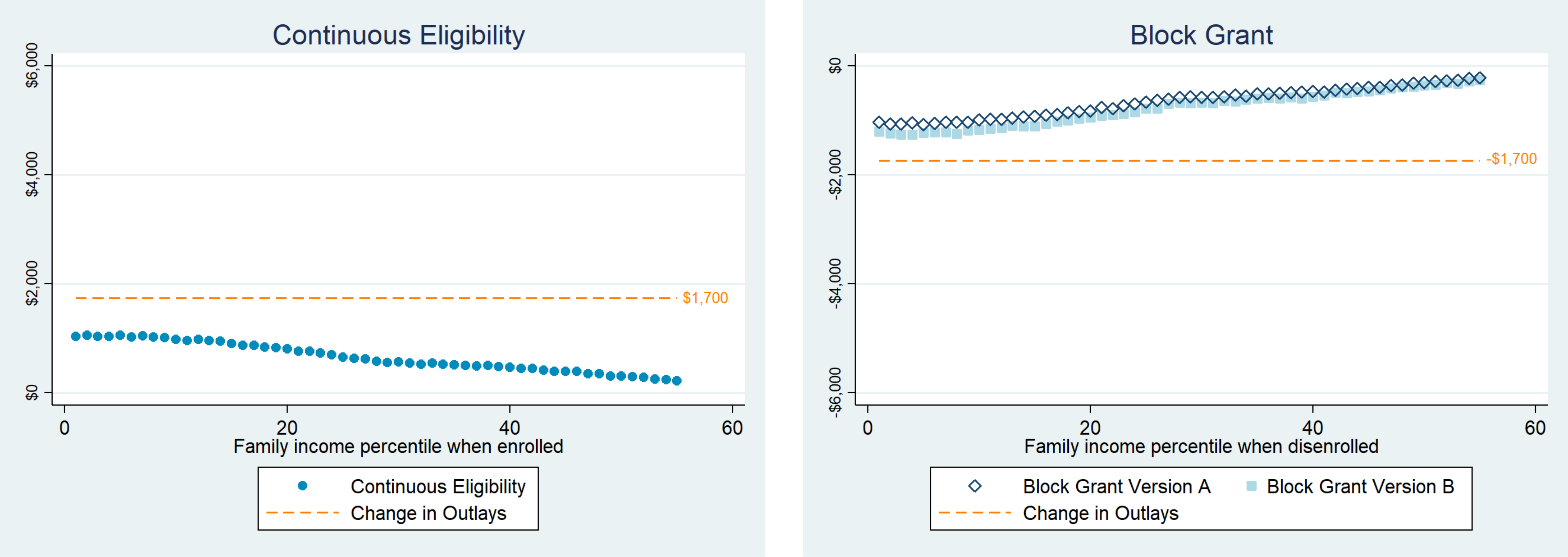

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Financing Mechanism

The preceding analysis incorporates the assumption that changes made in other areas of the budget would, on net, leave the federal deficit unchanged. The results would differ if an increase in Medicaid spending was instead financed by additional borrowing.

In that case, the federal budgetary cost of increasing children's enrollment in Medicaid would stem from two factors:

- The greater public borrowing needed to cover the added spending on Medicaid, and
- The crowding out of the funding available for private-sector investment from that additional borrowing.

In CBO's estimation, **roughly one-quarter to one-half of the costs of that additional borrowing** would be offset by the long-term fiscal effects of Medicaid spending.

For More Information

The information in this presentation is drawn from a more detailed analysis on the same subject.

For the full report, see Elizabeth Ash, William Carrington, Rebecca Heller, and Grace Hwang, *Exploring the Effects of Medicaid During Childhood on the Economy and the Budget,* Working Paper 2023-07 (Congressional Budget Office, November 2023), www.cbo.gov/publication/59231.