



## Budget Negotiations and a National Growth Target for Health Spending

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What made Wayne Gretzky such a great hockey player, it's said, is that he skated to where the puck was going to be. This is a metaphor for our definition of the sustainable rate of growth in health spending: the rate that puts health spending on a path to meet up with the nation's future willingness (and ability) to pay. (<http://healthaffairs.org/blog/2012/02/03/what-is-sustainable-health-spending/#more-16697>) This path is inextricably linked with the ongoing, highly politicized federal budget negotiations. Decisions about federal taxes and spending will determine the sustainable rate of growth in federal health spending and this will, in turn, largely determine the rate of growth in total health spending. The consequences of health spending feed back into the decision-making process to guide the search for equitable tax and spending policies, and thus health spending. The required tradeoffs are daunting and illustrate the extreme difficulty of setting a growth target for health spending that is both achievable and affordable.

### **SUSTAINABLE GROWTH IN FEDERAL HEALTH SPENDING**

The federal government is the largest health payer, accounting for about 37% of the \$2.7 trillion in national health expenditures in 2011 – primarily for Medicare and Medicaid but also for the military and veterans' health systems, public health programs, and medical research. This share will be driven upward by the ex-

panded coverage provisions of the Affordable Care Act (ACA) and, more important, the flood of baby-boomers aging into Medicare. How much of this upward trajectory can be sustained in the long run?

This is where budget policy enters the discussion. We use 2035 to represent the “long run” and assume that full employment and a balanced budget prevail at that time. The amount available for federal health spending will be determined by what the public is willing to provide in taxes (government revenues) minus spending on Social Security, national defense, and other non-health care items including safety net programs, food, housing, education, and transportation. The sustainable rate of growth in federal health spending is the rate that brings spending into alignment with what will be available in 2035.

Budget analysts often discuss federal tax collections and spending in terms of their share of gross domestic product (GDP), the national income. Similarly, the growth in health spending is often stated in terms of its deviation from the growth of GDP. For example, health spending growth of GDP+1 denotes a percentage point above the GDP growth rate. When health spending grows faster than GDP, its share of GDP rises. A rate of GDP+0 would hold its share constant. The long-run historical average is GDP+2.5.

The Congressional Budget Office (CBO) has projected that the fiscal-cliff deal struck in

Scenarios	A	B	C	Simpson-Bowles
Tax revenues	20.0	21.0	22.0	21.0
Social Security and interest	6.3	6.3	6.3	6.3
Defense and other non-health	8.0	8.0	8.0	6.5
Federal health spending	5.7	6.7	7.7	8.2
Sustainable growth in total health spending	GDP - 1.0	GDP - 0.3	GDP + 0.4	GDP + 0.6

**Figure 1. Alternative Budget Scenarios**

Revenues and spending are expressed as a percentage of GDP.

January 2013 will result in tax revenues equal to 19.1% of GDP by 2023. (<http://www.cbo.gov/publication/43907>) Suppose that policies maintain this percentage through 2035. Let's set Social Security spending at 5.8% of GDP, as projected under the Simpson-Bowles deficit reduction plan (CBO projects 6.1%, so our number is conservative), and defense and other non-health care spending to its historical minimum of 8% (with defense at 3%). Setting aside 0.5% for (partial) payment of interest on the debt leaves 4.8% of GDP for federal health spending in 2035. (<http://altarum.org/health-policy-blog/a-new-look-at-the-simpson-bowles-budget-plan-implications-for-sustainable-health-spending>) This represents a sharp reduction from the 5.9% spent in 2011, and federal health spending would have to grow 0.9%age points more slowly than GDP to achieve it. In short, the sustainable rate of growth in federal health spending is GDP minus 0.9 under this scenario. What this would mean for total health spending?

#### **SUSTAINABLE GROWTH IN TOTAL HEALTH SPENDING**

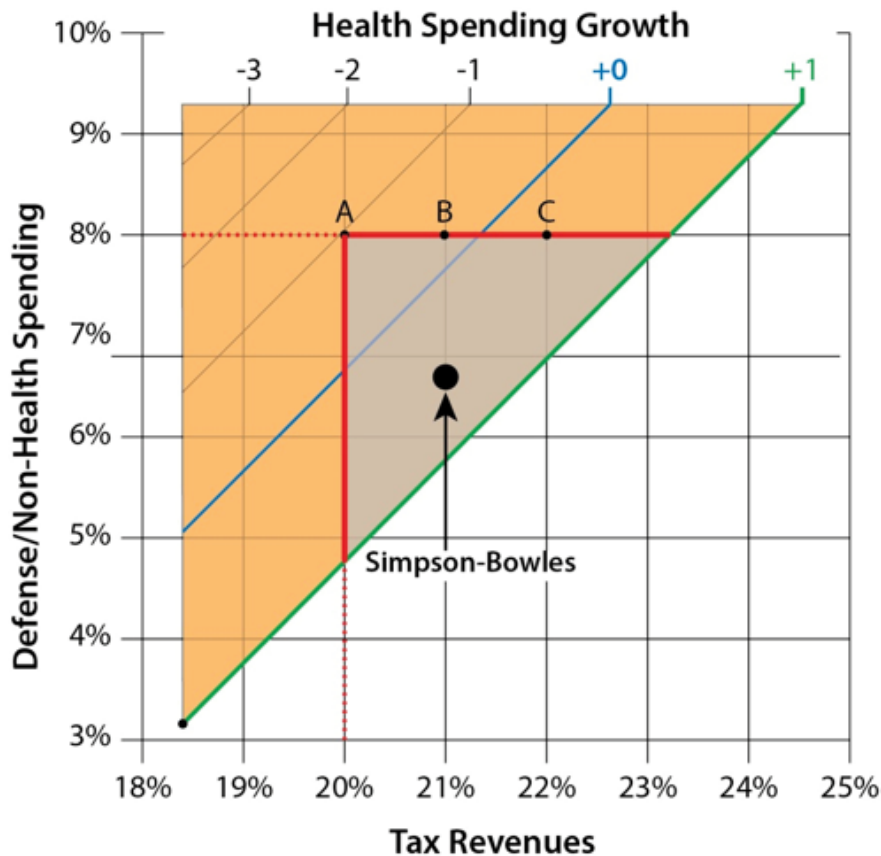
We estimate that expanded coverage under ACA and rapid aging into Medicare will cause federal health spending to grow faster than total health spending by an average of 0.8% per year through 2035. This assumes that policies to control health spending will impact public and private payers alike and that Medicare does not engage in significant cost shifting to other payers. Under these conditions, the sustainable rate of growth in total health spending is about 0.8%age points below that for federal health spending. Thus, the federal target of GDP-0.9 would require total health spending of GDP-1.7, a rate so low that it begs for alternative scenarios.

Figure 1 presents the sustainable total

health spending growth rate under higher tax scenarios. This includes the original Simpson-Bowles deficit-reduction plan, which was widely cited during the Presidential debates (a recent revision is not sufficiently detailed to include). Scenario A increases tax revenues to 20% of GDP, and the resulting sustainable total health spending growth rate increases to GDP-1.0, still well below anything in our historical experience. Increasing revenues to 21% (scenario B) raises sustainable growth to GDP-0.3, while a further increase to 22% (scenario C) allows sustainable growth of GDP+0.4. The Simpson-Bowles scenario has the same revenues as scenario B but reduces defense and other non-health spending to 6.5% of GDP (well below the historical minimum of 8% with a booming economy and no wars between 1998 and 2001). This results in sustainable health spending of GDP+0.6.

Figure 2 displays our triangle of painful choices, where the full range of tradeoffs among taxes, defense and other non-health spending, and sustainable health spending growth rates can be assessed visually. One might argue that an equitable solution falls in the smaller triangle, since it represents unprecedented sacrifice in all three dimensions – high taxes, low defense and other non-health spending, and low health spending growth. Scenarios A, B, and C lie along the top of this triangle, which represents the historical minimum of defense and other non-health spending. Simpson-Bowles is below point B, allowing higher health spending growth in exchange for lower defense and other non-health spending.

The blue diagonal line represents health spending growth of GDP+0, a target applied at the state level by Massachusetts and increasingly discussed as a potential national target. (<http://www.commonwealthfund.org/>)



**Figure 2. Triangle of Painful Choices**

Tax revenues and defense and other non-health spending are expressed as a percentage of GDP. Spending on Social Security and interest is 6.3% of GDP in all scenarios. Health spending growth is expressed relative to GDP growth (previous versions have used potential GDP). The smaller triangle represents historically high tax revenues, historically low spending for defense and other non-health, and health spending growth below GDP+1.

[Publications/Fund-Reports/2013/Jan/Confronting-Costs.aspx?page=all](#)) This rate is extraordinarily low by historical standards and seems more a hope than a plan. Yet even if it were achieved, it would take record high tax revenues (21.4%) to keep defense and other non-health spending from falling below its historical minimum of 8%. Holding tax revenues to 19% would require reducing defense and other non-health spending more than 2 percentage points below its historical minimum share of GDP. (A percentage point of GDP is

currently about \$160 billion.) If we cannot achieve GDP+0, the choices worsen. For example, at GDP+1 and 19% tax revenues, defense and other non-health spending would fall to less than half of its historical minimum.

As the nation ponders an appropriate growth target for health spending, consideration of these tradeoffs, and their implications for our future, is essential. The spirit of political compromise suggests a solution somewhere in the smaller triangle. But where?