



Are We Taming Health Care Spending?

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Health care spending as a share of the economy has declined slightly for the second year in a row. Some commentators are trumpeting this slowdown seeing it as a sign that provisions in the Affordable Care Act (ACA) are working to tame health care spending. Others, however, are quick to point out that this may be the calm before the storm. They expect the ACA to actually spur spending growth as more Americans are insured through the exchanges and through the expansion of the Medicaid program. And looking forward, health care spending will inevitably rise as the population ages.

It is important to put the recent slowing in health care spending in perspective. Figure 1 depicts national health expenditures (NHE) as a percent of Gross Domestic Product (GDP). It was the release of this NHE data by the Centers for Medicare and Medicaid Services (CMS) that brought attention to the slowing pace of health care spending. As seen in the figure there has indeed been a decline in health care's share

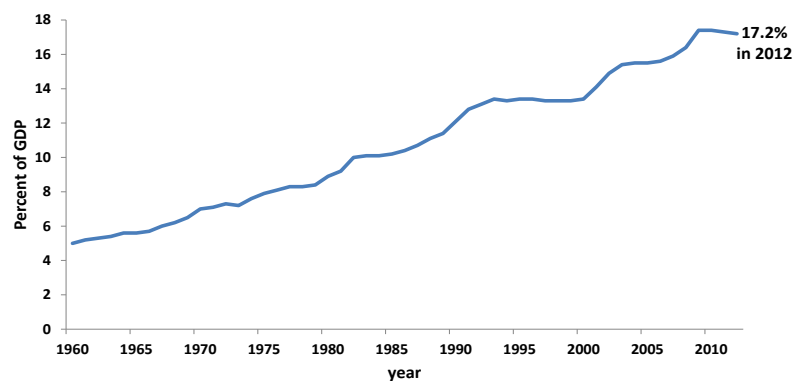
of GDP in recent years. In 2010, health care accounted for 17.4 percent of GDP, dropped slightly to 17.3 percent of GDP in 2011 and then dropped again to 17.2 percent of GDP in 2012.

As is also clear from the figure, there have been other periods in which health care spending as a share of GDP has remained relatively stable. At the beginning and end of the eight year period from 1993 to 2000, health care accounted for 13.4 percent of GDP. In four of the

years during that span, the share was 13.3 percent. Additionally, from 2003 to 2006, its share of GDP grew modestly from 15.4 to 15.6 percent. Importantly, the recent slowdown is not without historical precedent.

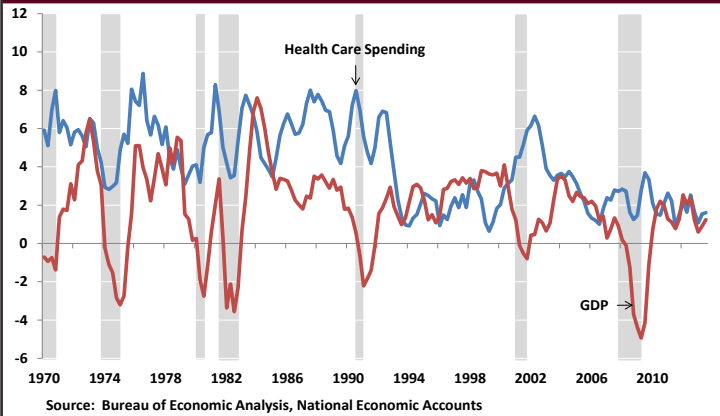
Another way to see how health care spending has grown relative to GDP is to track the growth rate in per capita health care spending and per capita GDP. When per capita health spending grows more rapidly than per capita GDP, health care's share of the economy rises and when the

Figure 1. National Health Expenditures as a Percent of GDP



Source: Centers for Medicare and Medicaid Services, National Health Expenditure Data

Figure 2. Real Per Capita Growth in GDP and Health Care Spending



two grow at about the same rate, the share is relatively stable.

Figure 2 presents the annual real per capita growth rates in GDP and health care spending from 1970 to the third quarter of 2013. The health care spending growth rates are based on the health services component of personal consumption expenditures. Though not identical to the national health expenditures series from Figure 1 the annual growth rates in per capita spending from the two series follow a similar pattern over time. As expected, real per capita health care spending growth typically exceeds per capita GDP growth.

Figure 2 also shows how the growth rates differ over the seven recessions – marked in grey – during this period. In contrast to the noticeable decline in real per capita GDP from the start to the end of each recession, real per capita health spending is less affected and in several cases, actually rose.

Periods of relative stability in healthcare’s share of the economy are also evident. From 1993 to 2000, 2003 to 2006, and then between 2010 and 2012 healthcare’s share

of GDP was relatively stable. Further, the annualized rates over the first three quarters of 2013 actually indicate that real per capita health spending growth is slightly higher than per capita GDP growth.

Some commentators have welcomed the lower annual per capita real growth rates in health spending without putting these lower rates in context with the rest of the economy. If per capita health care spending growth has slowed and at the same time the economy is growing slowly, then it is hard to call that progress.

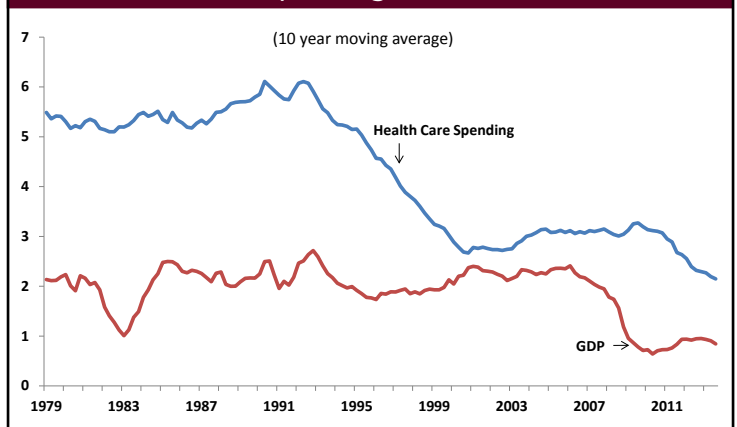
An easy way to remove variation in the data is to smooth it over 10-years. These moving average 10 year growth rates are shown in Figure 3. As the figure shows, smoothed real per capita health spending growth exceeded smoothed real per capita GDP growth for the entire period. The 10-year moving average real per capita health care spending growth ranged from an annualized rate of 5 to 6 percent for the period ending in 1979 to the period ending in 1992. It then declined steadily to less

than 3 percent for the 10 year period ending in 2001. After that it rose to about 3.3 percent for the 10 year period ending in the third quarter of 2009. It has declined since, and stood at 2.1 for the period ending in the third quarter of 2013.

The 10-year moving average of real per capita GDP growth averaged 2.2 percent between 1987 and 2007. There has been a noticeable decline in the 10-year moving average as the effects of the “great recession” have factored into the average. For the 10 year period ending in the second quarter of 2010, the 10-year moving average of GDP growth fell to just 0.6 percent and was 0.8 percent for the 10 year period ending in the third quarter of 2013. These two series reveal that the recent decline in the 10-year moving average in real per capita health spending has occurred at a time when long-run real per capita GDP has also experienced a decline.

The difference between per capita health spending growth and per capita GDP growth is referred to as “excess cost” growth by health care spending forecasters. Figure 4 shows the 10-year moving average of nom-

Figure 3. Smoothed Real Per Capita Growth in GDP and Health Care Spending





inal “excess cost” growth between 1979 and 2013. Excess cost growth remained high at 3 percent or above for the ten year periods between 1979 and 1995. Just as per capita real health spending declined during the 1990s, so did excess cost growth. For the 10 year period ending in the fourth quarter of 2000 excess cost growth declined to only 0.3 percent. Its long run average grew to 2.5 for the period ending in the second quarter of 2010 and dropped to 1.3 percent by the third quarter of 2013.

Contrary to some of the recent media reports, the recent stability in health care spending as a share of GDP is not without historical precedent. Further, per capita health care spending is less responsive to recessions than per capita GDP and so its share grows during recessions and then stabilizes as GDP growth rebounds. Attributing the recent slowdown in real per capita health spending to the ACA must be considered in light of previous periods of similarly low growth. Also, the longer term view reveals that while real health care spending growth has trended downwards the same is true for per capita GDP growth.

Further, the long run trend in the degree by which per capita health care spending grows in excess of per capita GDP bottomed out over a decade ago, rose gradually prior to the recession, then dramatically as recession period factored into the calculation and has since declined.

How do these past trends inform predictions about future health spending and how will the ACA’s provisions affect spending? The historical trends suggest that excess cost growth has experienced periods of long term declines and that apart from new legislation, future excess cost growth could reasonably be in the range of 1 to 1.5 percentage points.

The ACA includes provisions intended to both constrain and expand federal health care spending. However, ACA provisions designed to constrain Medicare spending, particularly the productivity adjustment, are not likely to have the desired effects in slowing spending growth.

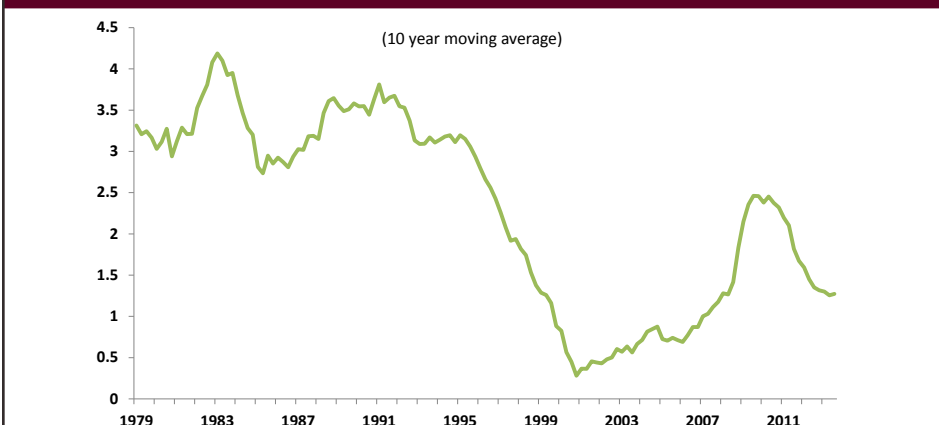
Further, the expansion of health insurance coverage through the exchanges and expanding Medicaid eligibility to adults under the age

of 65 who have income up to 138 percent of the federal poverty level will place upward pressure on overall health care spending. The framers of the law expected all states to expand Medicaid coverage given the “carrot” that the federal government will pay for most of the cost. The law also included a significant “stick” – the penalty for not expanding coverage would result in the loss of federal Medicaid funding.

During the summer of 2012, the Supreme Court decision invalidated the “stick,” and up to the present time, half of the states have decided not to expand their Medicaid programs. However, these states will face a difficult choice as time goes on because the ACA makes it extremely attractive to expand their coverage. Numerous factors will influence whether more states accept the carrot and how that acceptance will affect forecasts of government spending.

The Congressional Budget Office estimates that by 2038 health care spending will account for 22 percent of GDP under its baseline forecast and the CMS estimates a slightly higher percentage in that year. So, moving forward, Americans must decide to pay for this higher spending or attempt to tame the growth by readdressing health care’s tax treatment and the recent expansion the government’s role in the health care market.

Figure 4. Smoothed Nominal Health Care Spending “Excess Cost Growth”





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