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Guide to "Perspectives on Health Care Spending Growth"

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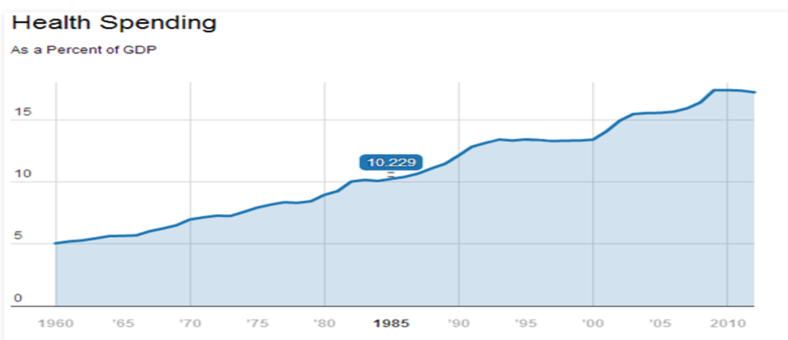
The share of health spending in GDP been rising for decades, but there has been a slowdown in recent years. Why is this slowdown happening, and will this trend continue? The evolution of health care spending has important implications for many aspects of our economy, ranging from government budgets to productivity. **In this working paper, Sheiner examines some of the key determinants of health spending growth, how these determinants have evolved over time, and whether the recent slowdown is a flash in the pan or is here to stay.** Sheiner identifies two main drivers of the long-term rise in health care spending since 1960 – declining out-of-pocket spending and the increased price of health services – and concludes that the recent slowdown in spending growth is likely only temporary. Many researchers and policymakers pay close attention to the question of what drives health spending growth, but, as we will see, much remains to be learned.

Why has the share of health spending in GDP been rising for decades?

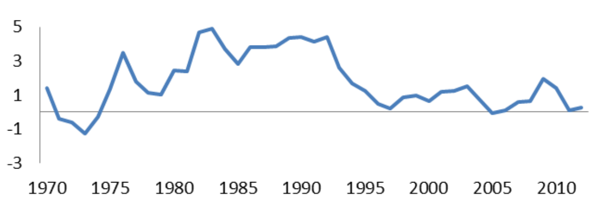
The share of health spending has increased from 5% of GDP in 1960 to over 17% of GDP today .



What's driving the long-term rise in health care spending?

Driver #1: The increased price of health services. Since 1970, the prices of health services have actually increased at a faster pace than inflation in the economy as a whole.

Chart 2A: Medical Price Inflation Less General Inflation



Abstract

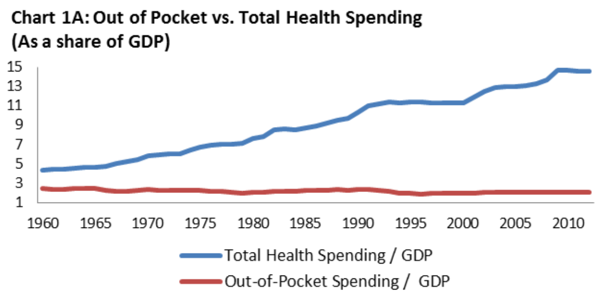
The evolution of health care spending has important implications for many aspects of our economy. The trajectory of health spending growth is a central determinant of the outlook for federal and state budgets and for workers' take-home pay. Health spending also affects other key economic variables, including measured productivity and prices. Further, the coming demographic change has important implications for both the level and financing of health spending. For these reasons, the question of what drives health spending growth is a subject that has received much attention from researchers and policymakers, although, as shown in this background paper, much remains to be learned.

The basic questions driving all this attention are simple: Why has the share of health spending in GDP been rising for decades? And when and how will this trend stop? Recently, there has been much debate about the slowdown in health spending growth observed over the past few years. Analysts have been trying to determine whether this slowdown is simply the result of the recent recession, or whether it reflects something new. In this paper, Sheiner first steps back from the question of the recent slowdown and attempts to provide some background on the key determinants of health spending growth, and how these have evolved over time. Sheiner then addresses the recent slowdown.

Policy Implications

Because a large percentage of both the federal budget and individual states' budgets are dedicated to health spending, the uncertainty in projecting future health care spending growth presents a dilemma for budget forecasters. Both economic researchers and policymakers need to consider how to best and most accurately deal with the inescapable uncertainty of long-term budget projections.

Driver #2: **Declining out-of-pocket spending.** Since 1960, Out-of-pocket spending as a share of GDP has been declining (see the red line in Chart 1A) even as healthcare spending as a share of GDP has soared (blue line).



Out-of-pocket spending refers to the money that patients pay to use healthcare (deductibles, co-pays, etc.) Why is the share of out-of-pocket spending declining? Two likely reasons:

Structure of private insurance: The price of the components of out-of-pocket-spending (things like deductibles and copays) haven't kept pace with the increased cost of care, implying increased coverage for health care services by all insurance companies (both public and private).

Fewer uninsured: The introduction, expansion, and increased usage of Medicare and Medicaid has reduced the share of the population that is uninsured (from around 26% in 1960, to 15% today), implying less out-of-pocket expenditures from the uninsured population.

Patients are not the ones bearing the brunt of rising health care costs, giving patients more of an incentive to use health services which, in turn, increases total health spending.

Why has health care spending flattened recently?

While health spending, as a percent of GDP, is still rising, it is rising at a slower rate than in years past. This change in trend caused many researchers and analysts to try to determine whether this slowdown is simply the result of the recent recession, or whether it reflects a new era of health care spending growth.

Health Care Spending by Type of Service	Lag Time for GDP to Significantly Affect Spending
Hospital	4 Years
Physician and Other Professional	4 Years
Prescription Drugs	3 Years
Long-Term Care	5 Years (not statistically significant)
Private Insurance Premiums	4-5 Years

Recent work by the Altarum Institute in conjunction with the Kaiser Family Foundation showed that changes in the annual GDP growth are powerful predictors of health spending growth. Sheiner tests this hypothesis by performing a simple regression of real per capita health spending growth on real per capita GDP growth from 1970 to 2012, and finds that the pattern of GDP growth can explain about 2/3 of the slowdown in health spending since 2002.

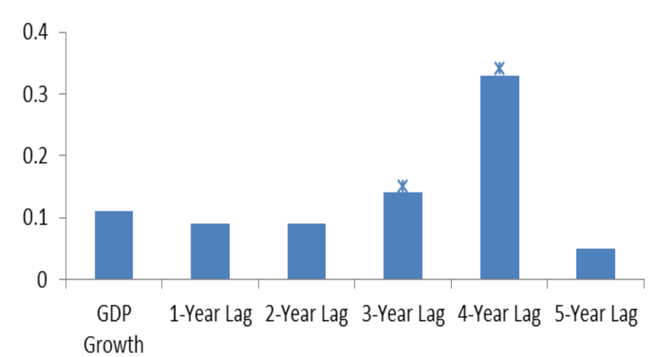
The regressions show two things:

1. The slowdown in health spending growth since 2002 is largely the result of the two most recent recessions (in 2001 and in 2007-2009).
2. Changes in GDP growth do translate into changes in health spending, but the changes take place over a number of years. For example, changes in GDP growth don't translate into increased consumption in hospital services for approximately 4 years (see chart below).

Depending on how you look at it, the four-year lag in the response of spending growth seems both surprisingly fast and slow. On the one hand, it does not seem likely that consumers would decide to cut back on health spending four years after they experienced a decline in income. On the other hand, changes in technology and insurance structures are quite sluggish, making a 4-year lag seem unusually fast.

A few years of slower health care spending growth should not be viewed as a turning point in bending the cost curve in health spending. This slowdown is likely temporary, and we can expect healthcare spending to continue rising until consumers are no longer willing to pay the costs of health services.

Significance of Lagged GDP on Growth in Health Care Spending (1970-2012)



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