



Global Highlights

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Health

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Health spending in the US: better projections to promote the right policies

➤ The latest Congressional Budget Office (CBO) [projections](#), shows **US spending on health care doubling by 2035, reaching 30.7 percent of GDP**, on a trend that will continue to rise. Net public federal spending on Medicare and Medicaid would amount to 9.2 percent of GDP in 2035 (4.1 in 2007). All other health spending, including private spending and other public programs, will rise from 11.4 to 21.5 percent.

➤ These developments will have a huge impact in the US economy. First, the health industry will become the biggest sector in the economy. Second, the challenge to public finances will be enormous, and much more important than other usual suspects, such as pension expenditure (according to the CBO baseline, public pension spending would increase to 7.1 percent of GDP in 2100). Third, the private health services market will boom, getting a share of GDP similar to that of the financial and insurance sector today (20 percent of GDP).

➤ The main determinant of this projection is the so-called **“excess cost growth”, that is, the difference between the increase of the cost per beneficiary and the growth of per capita income** (after adjusting for changes in age distribution of the population). This factor, set at 2 percent annually, explains three quarters of the increase in spending, while the remaining one quarter would be due to ageing. However, at the same time, the excess cost growth is the main source of uncertainty, so that the CBO presents a range of projections depending on this variable (from zero growth to 2.5 percent). The problem is that this variable is unobservable, and mixes at least four different supply and demand factors:

1. The emergence, adoption and diffusion of **new medical technologies**, highlighted in CBO (2008). Some new technologies are cost-saving, such as vaccines, preventive medical care techniques or health IT application. However, advances that allow the treatment of previously untreatable situations, or improve medical outcomes at an added cost boosting existing types of spending, compensate them.

2. **The rising relative price of medical goods and services**. As Anderson et al. (2003) show, the US spends more on health care than any other country, but on most measures of health service use it is below the OECD median. This suggests the existence of inefficiencies that properly dealt with, could slowdown expenditure.

3. The **growth in personal income** will lead to excess cost growth to the extent that income elasticity is greater than one. Hall and Jones (2007) argue that this is the case, and according to their estimations, the optimal share of health spending, based on standard economic assumptions, could exceed 30 percent of GDP by 2050.

4. The significant **decline in out-of-pocket payments** by consumers has lowered the cost and increased demand for health care, as pointed out by Follette and Sheiner (2005). This comes from the shift to government financing, as well as deductibles and co-payments for private insurance have not kept pace with expenses.

➤ Getting this analysis right is crucial, both on its dimension (a 50 percent of GDP of health spending projected by the CBO in 2080 seems implausible), and on its factors (mainly on the excess cost growth determinants). Particularly, if these numbers are correct, fiscal policy in the US, and probably in most of the industrialized economies, is on an unsustainable path and merits immediate action. Concerning the market economy, private health services providers, and the financial sector, should accelerate their strategies to respond to this demand.