Principle 4: Addressing Other Areas of the Budget
January 19, 2010

The Committee for a Responsible Federal Budget put forward five principles for fiscally responsible health care reform (http://crfb.org/document/five-principles-responsible-health-care-reform). In our first three principles, which deal with the design of reform itself, we argue that reform must focus on controlling health costs (http://crfb.org/document/principle-1-slowing-health-care-cost-growth-0), new spending must be fully-offset (http://crfb.org/document/principle-2-paying-health-care-reform), and Medicare and Medicaid growth must be brought under control (http://crfb.org/document/principle-3-making-medicare-sustainable).

As the House and Senate are putting the finishing touches on a compromise reform bill, our fourth principle has becoming painfully clear: **Health care reform, alone, cannot alleviate our nation's budget woes.**

Advocates of health care reform have frequently argued that "health care reform is entitlement reform." Medicare and Medicaid are projected to be the two fastest growing components of the budget, they explain, and the growth of these two programs is due mainly to overall health care cost growth. According to this argument, health care reform which slows "excess cost growth" – the amount by which health care costs grow faster than the economy – can substantially improve the long-term fiscal picture. Some have even gone as far as to argue that economy-wide health care cost growth is our only real fiscal problem.

Indeed, properly designed health care reform can contribute to short- and long-term deficit reduction. Given enough time, the savings from slowing health care cost growth would compound, and could considerably reduce future deficits.

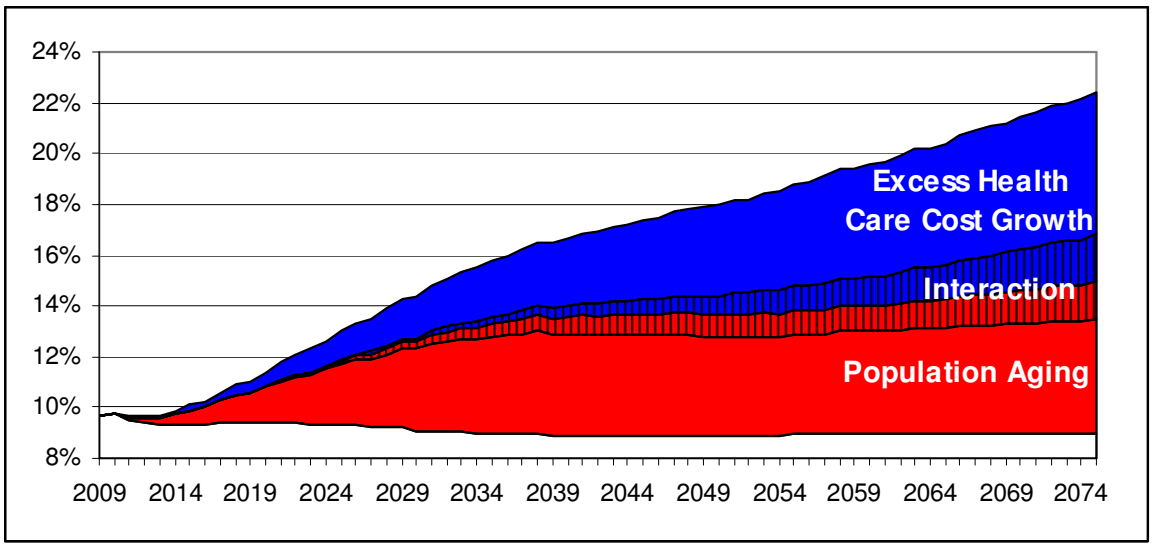
But it is extremely unlikely that savings would be large enough, or accrue fast enough, to bring the debt under control or close the nation's large fiscal gap. Even if the legislation being considered by Congress is successful in bringing down costs, other major budget reforms will also be needed.

Drivers of Debt

Medicare and Medicaid are growing at an unsustainable rate. If current policies continue, they will double as a portion of the economy, from roughly 5 percent of GDP today to 10 percent by 2035. In total, this will sum to about 80 percent of entitlement growth through 2035, and nearly 90 percent by 2080.

This will not be the only area of growth in the budget, though. Social Security, over the next two decades, is expected to grow by well over 1 percent of GDP, and its dedicated revenue source will likely shrink. Non-entitlement programs may also contribute to the widening fiscal gap. Discretionary spending as a whole, in fact, has grown faster than either Medicare or Medicaid over the last decade.

Fig. 1: Drivers of Growth in Social Security, Medicare, and Medicaid (percent of GDP)



Source: Congressional Budget Office

And even as Medicare and Medicaid are projected to be the most significant contributors to spending growth, health care cost growth itself is not the only cause of this. As the baby boomers retire and life expectancy continues to grow, the number of people covered by Medicare (and to a lesser extent Medicaid) also grows. This population aging accounts for nearly 44 percent of the growth in Medicare and Medicaid through 2035, and 64 percent of all entitlement growth (when interactions are distributed proportionally).

As time passes the effect of excess health care cost growth will overtake population aging as the leading driver of entitlement growth, which is why controlling this growth is absolutely vital to stabilizing the debt. But given the significant role aging plays, especially in the short- and medium-term, it would be a mistake to view growing health care costs as the sole cause of growth in federal spending.

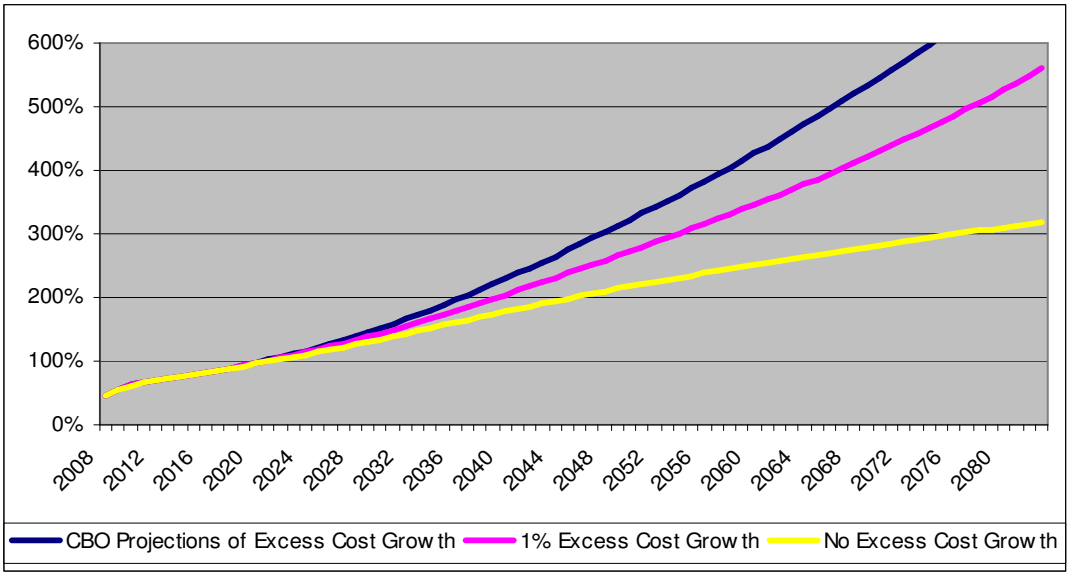
The Effect of Cost Control

Especially given that health care cost growth is not the only source of our mounting debt, it is difficult to imagine a scenario in which controlling it would do enough to restore fiscal sustainability.

Based on a fiscal scenario developed by the Peterson-Pew Commission on Budget Reform,[1] we estimate public debt levels will surpass 100 percent of GDP before 2021, reach 230 percent by 2040, and exceed 610 percent by 2075 absent a course change. If health care cost growth were to slow to one percentage point beyond GDP (currently, it grows around 2.5 percentage points faster), we estimate that debt levels would barely differ in the early years, pass 200 percent of GDP in 2040, and reach nearly 480 percent by 2075. Even if health care costs grew at the same pace as the economy – a highly unlikely scenario given demand for new technologies – debt would hit 100 percent of GDP in the early 2020s, pass 175 percent by 2040, and reach nearly 300 percent by 2075.

Of course, debt levels of 175 percent of GDP are *much* preferable to 230 percent. And as time passes, the compounding effects of slowing health care cost growth make a greater and greater difference. But even if reform could somehow halt excess health care cost growth, we would still be moving toward crisis-inducing debt levels. This is why, even in the ideal case, other non-health budgetary efforts would be necessary over the medium-term in order to give savings from health care changes time to compound.

Fig. 2: Debt Held by the Public Under Three Health Care Growth Rates (percent of GDP)



Sources: CBO, Peterson-Pew Commission on Budget Reform and Authors' Calculations.

[1] This scenario, featured in the report *Red Ink Rising* (http://budgetreform.org/document/red-ink-rising), essentially assumes that the 2001-2003 tax cuts will be renewed for families making under $250,000, the AMT will receive annual "patches," Medicare physician payments will be frozen rather than allowed to drop, the Iraq war will phase down, and regular discretionary spending will grow with the economy.

Evaluating the Current Bills

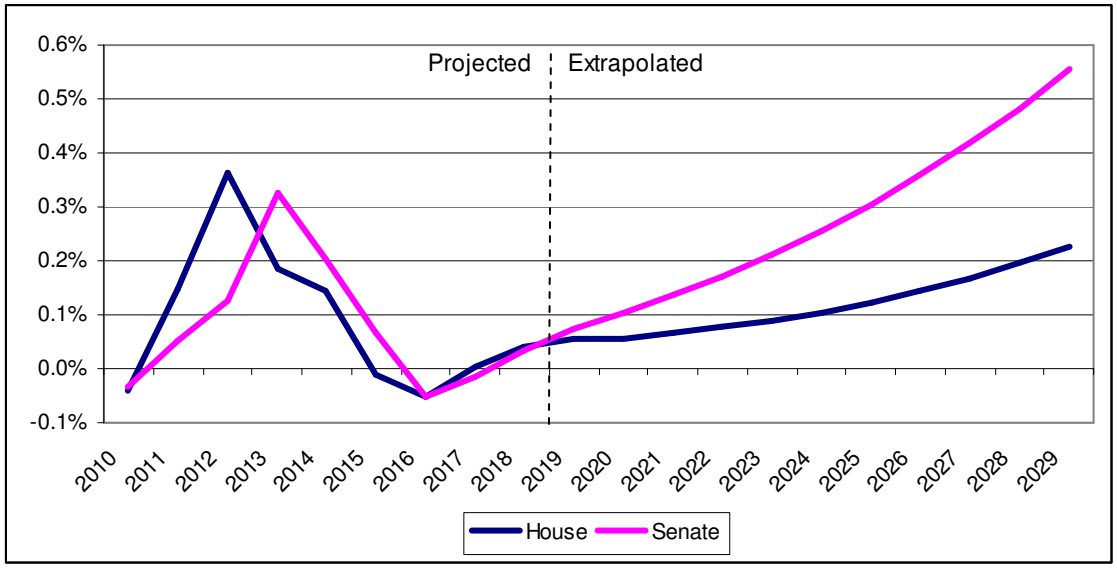
If health care reform which truly constrains health care cost growth cannot do enough to bring the debt under control, the bills currently being considered certainly will not. As we wrote in our previous principles papers, reform must focus on controlling health costs, fully-offset new spending, and begin to bring Medicare and Medicaid growth under control. Only time will tell the extent to which health care reform will accomplish these goals. We believe there are some important measures in both the House and Senate version, but are disappointed both bills did not go further.

Importantly, both bills include a number of reforms designed to control cost growth. However, with the exception of the excise tax and Medicare payment commission in the Senate bill, these come largely in the form of small pilot programs that may or may not achieve results.

In addition, and to Congress' credit, both bills more than offset their costs over ten years, in the tenth year, and beyond. But they both include their fair share of omissions, phony offsets, and timing gimmicks which exaggerate their savings.

And ultimately, neither bill would do enough to bring Medicare or Medicaid under control. True, both bills would reduce spending in these programs, but the savings would be used primarily to finance coverage expansion. The Senate bill does generate more savings than the House bill, mainly because the Independent Payment Advisory Board would continue to cut costs. However, it will not halt Medicare spending growth.

Fig. 3: Budgetary Impact of House and Senate Health Care Bills (percent of GDP)



Source: Congressional Budget Office and Authors' Calculations.
Note: Extrapolations based on broad growth measures provided by Congressional Budget Office.

All told, the House and Senate bills would both reduce the deficit by more than $130 billion over the next decade – although this number shrinks substantially after accounting for budget gimmicks. Between 2020 and 2029, the CBO estimates very roughly that the House bill would reduce the deficit by somewhere in the broad range of 0 percent to 0.25 percent of GDP, while the Senate bill would reduce it by between 0.25 percent and 0.5 percent.

These are by no means small numbers. But compared to projected deficit levels – over 11 percent of GDP in 2029, according to our projections – they do seem relatively insignificant. This deficit reduction also stems partially from tax increases, rather than Medicare and Medicaid savings alone. More troubling, there is a substantial risk that some of the changes in the bills are unsustainable and will therefore be reversed.

Conclusion

Well designed health care reform which slows health care cost growth, offsets its new spending, and brings Medicare's and Medicaid's long-term finances under better control can significantly reduce the nation's fiscal gap. But even this type of reform would likely be too small and too slow to avert a debt crisis by itself. Other areas of the budget must therefore be addressed as well – with an eye toward medium-term deficit reduction.

Social Security may be a good starting point, as it still represents the largest government program, and policymakers clearly understand the options available to balance its books (http://crfb.org/document/analysis-social-security-trustees-report). Both defense- and domestic-discretionary spending will also have to be brought under control. These areas of the budget have been growing quite rapidly over the last decade – more so than Medicare and Medicaid – and will need to be controlled if there is any hope for stabilizing the debt (http://crfb.org/document/controlling-discretionary-spending).

Additionally, policymakers will have to reform the tax code so that it raises enough revenue to finance growing spending levels without adversely impacting the economy to a significant degree.

We are not giving up on health care reform as a way to contribute to solving the budgetary problems. In fact, we strongly encourage policymakers to strengthen the cost-control and deficit-reduction efforts as they continue to move forward with reform. We also believe that, as we learn more about which types of payment reforms work and which do not, Congress and the President will be able to revisit health care reform and implement new deficit-reducing policies.

But none of this will be enough. Instead, all areas of the budget and the tax code will need to be put up for debate. And cuts and increases will be needed to ensure the nation's finances, and economy, remain strong.