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Health Spending And The Golden Fiscal Rule

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Daniel Mitchell at the Cato Institute has proposed a "golden fiscal rule:" ensure that government spending, over time, grows more slowly than the private economy. This is an idea that should command support from fiscal conservatives on both sides of the aisle, not just libertarians.

Mr. Mitchell has done a more than adequate job demonstrating that "nations that imposed genuine spending restraint for multiyear periods reaped big benefits." But we also know that growth in federal health spending continues to outstrip growth in the economy. As I have stated repeatedly in other posts, Obamacare has not eliminated the nation's long term spending problem. My purpose in this post is to show how dramatically non-health spending (including defense) if we were to adopt the golden fiscal rule.

Let's start with the CBO's most recent long-term budget outlook from June 2015 showing what is expected to happen to federal health spending as a percentage of GDP between 2016 and 2090.

Although CBO does not do so, I have added in my own calculation of health-related interest costs. My figures for this component are very conservative, as explained in footnote [1]. But including an imperfect measure of health-related is far better than ignoring it entirely since as you can see, it steadily grows in size over time.

Two conclusions emerge. First, the federal health spending share of GDP will increase by 141% between 2016 and 2090 [2]. This powerfully illustrates how much Obamacare left unaddressed the very problem of exploding health spending that motivated the health reform debate back in 2007-2010. Obamacare manifestly did not save every American family of four $2,500 a year as was so often promised. Instead, taxpayers have been stuck with an ever-growing tab. All told, the share of GDP financed by federal taxpayers will increase by 7.3 percentage points. In today's dollars, such an increase is the equivalent of $1.4 trillion [3] or $4,165 per U.S. resident!

Second, over the next 75 years, 69% of the projected growth in the size of the federal government relative to the economy will be the result of growing federal expenditures on health care . Thus, any serious effort to control the size of government cannot avoid addressing health costs.

My analysis shows that if we were to adopt the Golden Fiscal Rule in 2016 without cutting health spending, non-health spending would have to decline by 18%. That is, since total federal spending will equal 20.9% of GDP and revenues will amount to 18.4% of GDP we would have to cut non-health spending by nearly one fifth in order to keep overall federal spending at the same percentage of GDP as in 2015.

The problem gets bigger as time goes by. By the year 2090, the draconian budget cuts needed to keep the federal Pac Man in check will have grown to 59%. And remember, these figures assume that current levels of spending relative to GDP are adequate. By 2025, defense spending is expected to fall to 2.6% of GDP [Table 4-1]–a figure lower than in any year since World War II. Cutting this figure an additional 18% in the near term or 59% over the long term arguably would severely compromise the nation's ability to defend itself (I wrote a piece nearly 3 years ago showing how the amount of federal health spending per dollar of defense spending was expected to more than double in the first 8 years of Obamacare).

Indeed, there is a strong consensus among the Republican candidates for president that an increase in defense spending is needed (although they disagree on how much). Given that defense constitutes about half of discretionary (non-health) spending, each dollar not cut from defense is an additional dollar that has to be cut from non-defense discretionary spending. Thus, if we merely wanted to protect defense against further cutting, this would require a 36% cut in all the other non-defense/non-health parts of the budget. And by 2090, the task becomes impossible. Even if we cut out every penny of non-defense/non-health spending that year, the golden fiscal rule would require that defense also be cut 36% to keep government's share of GDP from growing.

I personally believe that the fiscal golden rule has a lot of merit. I would not object if American voters elected a president able and willing to make that a permanent feature of the federal budgeting landscape. But as the figures outlined above suggest, adoption of this rule would greatly amplify pressures to do something about federal health spending else we will be forced to cut other components of government by amounts not likely to sustain public support.

[1] This is a very rough approximation that likely is conservative in estimating the actual amount of interest on the federal debt that can be attributed to health spending. I have calculated the health spending share of total federal spending (inclusive of interest) for the entire period for which CBO reports data (1962-2090). I have assumed that this calculated share of spending is a reasonable approximation of the health-related share of total federal public debt with a five year lag (i.e., the imputed share of interest payments attributable to health care in year 2016 is the estimated share of total federal spending accounted for by health-related spending (i.e., Medicaid plus net Medicare divided by total federal spending). This is conservative for two reasons: first Medicaid plus net Medicare spending entirely excludes all other federal spending that is health-related, including public health, research and construction, VA health, military health, health care for federal employees etc. Second, the calculated share of spending used to impute the health share of interest payments excludes the health share of interest payments itself.

[2] Total federal health spending in 2016 is projected to be 5.1% of GDP (including 2.3% for Medicaid/CHIP and federal Exchange subsidies, 2.5% for net Medicare spending–i.e., after deducting premium payments made by Medicare beneficiaries and state governments on behalf of those dual-eligible for Medicare and Medicaid–and 0.3% for health-related interest payments.

By 2090, the total will be 12.4% of GDP, i.e., 141% higher than in 2016. This includes 3.7% for Medicaid/CHIP and federal Exchange subsidies, 6.4% for net Medicare and 2.3% for estimated health-related interest payments.

[3] 2016 nominal GDP will be $18.8 trillion according to CBO; multiplying this figure by 7.3% = $1.37 trillion. Total population = 328 million.