Policy Research Perspectives

National Health Expenditures, 2014: Spending Grows by More Than 5% for First Time Since 2007

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Introduction

This Policy Research Perspective (PRP) provides an in-depth look at U.S. national health expenditures (NHE) in 2014. Data for 2014 are the most recent available and were released by the Centers for Medicare and Medicaid Services (CMS) over the November/December 2015 period. As with every annual release, estimates for previous years were also revised. This PRP also examines how certain components of spending have changed over the past 25 and 50 year periods.

NHE grew at a rate of 5.3 percent in 2014 to a level of $3,031.3 billion dollars or $9,523 on a per capita basis. In comparison, spending grew by 2.9 percent in 2013 and by an average of 4.0 percent per year over the five-year period from 2007 to 2012. Despite the uptick, the 5.3 percent growth rate is still low by historical standards. In addition to the recent period, there have been only five other years since 1961 when health spending grew by less than 6 percent (each of the years from 1994 through 1998) and in only one of them was the growth rate lower than that for 2014 (5.2 percent in 1996). Important factors behind the acceleration in growth include the coverage expansions of Affordable Care Act as well as the introduction of new drug treatments for hepatitis C, cancer, and multiple sclerosis.

Looking at spending as a percentage of GDP allows one to see what share of our national resources are devoted to health care and—on the flip side—are not available for other types of consumption or investment. Because the 2014 growth rate for health spending was greater than that for GDP (4.1 percent), this share increased from 17.3 percent in 2013 to 17.5 percent in 2014.

Breaking it down

CMS categorizes NHE in three different ways:

- The categories under type of expenditure answer the question, “Where does the money go?” Health care expenditures are either saved and put toward research, structures, and equipment (investment), or are consumed today (health consumption expenditures). The bulk of health consumption expenditures is what CMS terms “personal health care spending.” Personal healthcare includes spending on services, procedures, or products that are consumed (e.g. hospital stays, physician provided services, and prescription drugs). Separate from personal healthcare, health consumption expenditures also include spending on administration, public health, and the profits of private health insurers.

- The categories under source of funds answer, “Who pays the bill” for the health consumption expenditures? Here, CMS identifies the payments made under different types of health insurance programs (private, Medicare, Medicaid, and other) as well as payments made by other third party payers that are not considered to be a form of health insurance (e.g., workers compensation). Out-of-pocket spending is also a source of funds for health consumption expenditures. CMS does not allocate the investment component of NHE to any particular source of funds.
- Finally, the categories under sponsor answer, “And how is all that financed?” Financing is different than who pays the bill. For example, while the care of many patients is paid for by private health insurer payments (a type of source of funds), those payments come from the premium revenue of insurers. Premiums, in turn, are generally funded by employees and employers, so households and private businesses would be the ultimate financing sources for that spending and are two examples of sponsors. Federal, state, and local governments are others.

Spending by type of expenditure: where does the money go?

Figure 1 shows the breakdown of U.S. national health care spending by type of expenditure.

A small portion of U.S. health spending goes toward investment. In 2014, that amounted to $153.9 billion or 5.1 percent of total spending. This share fluctuated between 5.8 and 6.0 percent of total health spending over the 2001 to 2007 period and reached a high of 6.2 percent in 2008. In every year after that it has either decreased from the previous year, or remained the same.

Health consumption expenditures (HCE) capture the rest of health spending—the 94.9 percent which is not invested but is consumed today. HCE is further divided into spending on government public health activities, government administration, the net cost of health insurance, and on personal healthcare.

Spending on government public health activities in 2014 was $79.0 billion or 2.6 percent of total spending. Government administration spending amounted to $40.2 billion or 1.3 percent of total spending.

The net cost of health insurance is the difference between incurred premiums for private health insurance and the amount paid for benefits. It includes administrative costs, additions to reserves, rate credits and dividends, premium taxes and plan profits or losses. This category also reflects the difference between premiums and benefits for private health insurance companies that insure Medicare, Medicaid and CHIP enrollees. In 2014, the net cost of health insurance was $194.6 billion or 6.4 percent of total health spending. Spending in this category grew by 12.4 percent in 2014, the highest rate of growth since 2003, and more than double the rate of growth in each of the past three years. Much of the 2014 acceleration is tied to private insurers who insure Medicaid enrollees. There, net cost increased by almost 50 percent.

The remainder of HCE is personal health care spending. This is what we traditionally think of with regard to spending—spending on hospital stays, visits to the physician, or on prescription drugs. In

the aggregate, 2014 personal health spending was $2,563.6 billion, 84.6 percent of total health spending.

Large categories of personal health spending are shown in Figure 1. Thirty-two percent of 2014 health care spending ($971.8 billion) was for hospital services. Spending on physician services ($480.6 billion) accounted for 15.9 percent of spending, and spending on retail outlet sales of prescription drugs ($297.7 billion) 9.8 percent. Spending on clinical services, which is often shown combined with spending on physician services, is shown separately here and accounts for 4.1 percent of spending ($123.1 billion).[1] Spending on nursing care and home health care each accounted for 5.1 percent and 2.7 percent of spending, respectively ($155.6 billion and $83.2 billion). Fifteen percent of personal health care spending ($451.6 billion) was for other services not identified separately in Figure 1.[2]

Figure 2 compares the 2005 through 2014 annual growth rates for personal health care spending in the aggregate and for four of its components. Average annual growth rates over that period are shown on the right side of the figure. Notably, the 2014 growth rates for each category except prescription drugs are below those for 2005. In contrast, prescription drug spending increased by 12.2 percent in 2014, marking an abrupt departure from growth rates of recent years. There hadn't been double digit growth in this category since 2003, and post-2006 growth rates had remained well below 6 percent. Even if all other types of spending had experienced no growth between 2013 and 2014, the increase in drug spending alone would have been enough to increase overall health spending by 1.1 percent. More than one-third of the new drug spending was from new treatments for hepatitis C. The increase in prescription drug spending in the Medicaid program was particularly large, at 24.3 percent. In addition to that of new treatments, the growth rate also reflects the impact of ACA coverage expansion.

Physician spending grew by an average annual rate of 4.1 percent over the 10-year period from 2004 to 2014, lower than the rates for the other large categories of personal health spending, and lower than the growth rate for personal health spending as a whole. The average growth rate for physician spending was 1.5 percentage points lower than the average annual growth rate for hospital spending (5.6 percent) and a full 2 percentage points lower than that for clinical spending (6.1 percent).

Spending by source of funds: who pays the bill?

Figure 3 shows the distribution of national health care spending according to its source of funds. As discussed, CMS does not show the sources for the $153.9 billion (5.1 percent of NHE) in health related investments. The remaining $2,877.4 billion in health consumption expenditures is allocated according to which program pays the bill. Each of the categories includes only those amounts actually paid by those programs. All payments made by patients—regardless of patient insurance type or whether uninsured—are part of out-of-pocket spending.

[1] Clinical spending includes that which occurs in establishments classified as outpatient care centers under the North American Industry Classification System (NAICS).
[2] The nursing home category also includes care provided in continuing care retirement communities.

Private health insurance spending in 2014 was $991.0 billion, 32.7 percent of total spending. Medicare spending, at $618.7 billion, accounted for 20.4 percent of spending, and Medicaid spending, at $495.8 billion, 16.4 percent of spending. Less than 4 percent of spending was paid for by other types of health insurance not already listed. These include CHIP, and programs under the Department of Defense and Veterans Affairs. Other sources that are not considered to be health insurance (e.g., workers compensation) paid for 8.3 percent of health care spending. The percentage paid out-of-pocket was 10.9 percent.

The last 10 years have been marked by a recession, the introduction of Medicare Part D in 2006, and the introduction of various provisions of the ACA starting in 2010. Each of these factors has had an impact on how our healthcare is paid for—that is, on the source of funds allocation. It's helpful to look at the 10-year changes in a longer-term context in order to better understand the significance of their magnitude. Figure 4 shows, in percentage terms, the contributions of each of the source of funds for health care spending over the last 50 years.[3] In each year, the percentages of spending from each of the categories sum to 100 percent. The data for 2014 are equivalent to the that in the pie chart in Figure 3. In general, the changes in shares over the most recent 10-year period are in line with, and in many cases smaller than, changes over earlier 10-year periods.

The largest change over the past 10 years was in Medicare spending, which increased by 4.0 percentage points (from 16.4 percent of spending to 20.4 percent of spending) between 2004 and 2014. This increase is related to the addition of Medicare Part D program which went into effect in 2006. In that one year alone, Medicare spending increased by 18.8 percent, and Medicare's share of total health spending shot up by almost 2 percentage points. Earlier changes in the share of health spending made by the Medicare program are also tied to program expansions as well as changes in payment policy. In its first year of implementation (1966) Medicare's share of spending was 4.0 percent. This increased to about 10 percent in the next year, where it remained through the early 1970s. Prior to 2006, Medicare's highest share of spending had been 18.5 percent in 1996 and 1997. The dip between then and 2006 was related to the Balanced Budget Act of 1997 which contained a number of provisions designed to slow the spending growth in the Medicare program.

The share of NHE paid for by private health insurance increased near continuously from 23.6 percent in 1964 to 34.8 percent in 2003. Since then, its share has decreased to 32.7 percent. The post-2003 decrease is the result of a number of contributing factors including recession-related job loss (and the subsequent loss of employer provided health insurance) and a decrease in the percentage of workers in firms that offer health insurance,

The most dramatic change over the last 50 year period has been in out-of-pocket spending. It decreased from a high of 44.1 percent of total spending in 1964 to 10.9 percent in 2014. The sharp drop in the mid-1960s is obviously linked to the introduction of Medicare and Medicaid and the related decreases in the uninsured rate. That the out-of-pocket spending percentage continued to fall continuously, even as the uninsured rates plateaued and then increased in the mid-1980s, highlights the impact of expansion in the scope of health insurance benefits and more limited cost sharing.

[3] "All other" includes other types of health insurance, other 3rd party payers, public health spending, and investment.

Changes in the share of spending paid for by the Medicaid program are, as with Medicare spending, tied to changes in program expansion and payment policy. In its initial year (1966) Medicaid accounted for 2.8 percent of health spending. This share climbed to about 10 percent in the mid-1970s and then hovered just below that rate through 1990. The effect of Medicaid expansions after that are evident as its share climbed to 15 percent by the early 2000s. Although often masked by programmatic changes, Medicaid spending also has a cyclical component. Job loss during recessions leads to the loss of employer provided health insurance, and increases in Medicaid enrollment and spending. The impact of the ACA Medicaid expansion is evident in 2014. Medicaid spending increased by 11.0 percent (the largest single year increase since 2001) and its share of spending increased from 15.5 percent to 16.4 percent.

Spending by sponsor: where does that money *really* come from?

Health spending by sponsor addresses the issue of financing. With regard to private health insurance spending, financing for premiums comes from *employee* contributions (which would be categorized under household sponsorship) and *employer* contributions (categorized under private business sponsorship). Although households with private health insurance make out-out-pocket payments for their healthcare (copayments, coinsurance, and payments before a deductible is reached), those out-of-pocket payments are not considered a financing source for private health insurance. Rather, out-of-pocket payments are a separate and distinct sponsor category.

For Medicare spending, financing sources include dedicated payroll taxes from employers and employees as well as premiums paid by individuals for Supplementary Medical Insurance (SMI). General tax revenues and trust fund expenditures also play a large role in the financing of Medicare because the dedicated financing sources are not sufficient to cover benefits and other costs. As with private health insurance spending, out-of-pocket payments made by Medicare beneficiaries are not a funding source for Medicare spending.

Figure 5 shows the breakdown of 2014 health spending by sponsor. To the far right, it has the breakdown of overall spending—20.0 percent by private business, 27.8 percent by households, 27.8 percent by the federal government, 17.0 percent from state/local governments, and 7.3 percent from other private sources. The left and middle columns of that figure show how private health insurance spending and Medicare spending are financed.

Forty-six percent of private health insurance spending was financed by private businesses through their contributions to the premiums of their enrolled employees. Thirty-two percent was financed by the household sector. This includes employee[4] contributions to premiums (23.7 percent) as well as contributions of individuals who purchase private insurance outside of their job (5.2 percent). It also includes the medical portion of premiums paid for property and casualty insurance (3.3 percent).[5]

The federal government financed 5.4 percent of private health insurance spending in 2014. 2014 was the first year in which ACA tax credits and subsidies were available to low income individuals for

[4] Employee contributions include those from privately employed individuals as well as those made by state, local, and federal government employees.
[5] In previous releases of data by CMS, property and casualty premiums were distributed between the other categories of private business and household financing.

the purchase of health insurance through exchanges. That source of federal financing amounted to 1.9 percent of private health insurance spending. Small business tax credits, which were phased in under the ACA in 2010, accounted for 0.1 percent of private health insurance spending. The retiree drug subsidy to ESI plans financed another 0.2 percent. Finally, the federal government is also an employer and, as such, makes contributions to the premiums of its employees. These contributions financed 3.3 percent of private spending.

State and local governments financed 16.1 percent of 2014 private health insurance spending. This consisted entirely of health insurance premium contributions for employees.

With respect to Medicare spending, 15.5 percent of Medicare spending was financed by private businesses through the payroll tax paid by private employers. Thirty-two percent of Medicare spending was financed by the household sector. This consists of employees' payroll taxes (21.5 percent) and premiums paid by individuals for SMI (10.2 percent).

Forty-nine percent of Medicare spending was financed by the federal government. Nearly all of this consisted of general tax revenue and trust fund expenditures (46.6 percent) although the payroll tax paid by the federal government in its role as an employer and the federal portion of Medicare buy-in premiums for dual beneficiaries also accounted for small shares (0.7 percent and 1.4 percent). State and local governments provided financing for 4.2 percent of Medicare spending through payroll tax contributions (1.9 percent), state phase down Part D payments (1.4 percent), and the state portion of Medicare buy-in payments (0.9 percent).

Figure 6 gives an overview of how the financing of health care has changed over the past 25 years. The rightmost bar—for 2014—is the same information presented for total spending in Figure 5. Here, you can see the marked decrease in the household share over this period and the commensurate increase in the federal share. The household share fell almost 10 percentage points, from 37.3 percent of spending in 1989 to 27.8 percent in 2014. The federal share increased from 16.2 percent to 27.8 percent. The decrease in the household share is due almost entirely to the relative decrease in out-of-pocket spending, which fell from 19.6 percent of health spending in 1989 to 10.9 percent in 2014. The share of health spending financed through premium contributions for private health insurance and employee payroll taxes/SMI premiums (the other components of the household share) have held relatively constant over this period.

The increase in the federal share is a result of expansions in the scope of the Medicare program as well as a shift in the financing of that program from dedicated sources such as payroll taxes and beneficiary premiums to that from general tax revenue and the trust fund. As discussed earlier, Medicare spending increased from about 10 percent of NHE in the early years of the program to just over 20 percent today (Figure 4). In 1989, only 21.2 percent of Medicare spending was financed out of general tax revenue and the trust fund. By 2004, two years prior to the addition of Part D, 34.4 percent of Medicare spending was financed from general tax revenue and the trust fund, and in 2009, three years after Part D, this share was at 46.4 percent. Since then, the share of Medicare spending financed out of general tax revenue and the trust fund has remained stable, as has the share of total health spending financed by the federal government.

Summary

NHE grew at a rate of 5.3 percent in 2014 to a level of $3,031.3 billion dollars or $9,523 on a per capita basis. While this is the first time annual growth has exceeded 5 percent since 2007, it is still a relatively low growth rate by historical standards. Important factors behind the uptick include ACA-related coverage expansions and the introduction of new drug treatments. The increase in drug spending was large enough so that even if all other types of spending had experienced no growth between 2013 and 2014, overall health spending would still have increased by 1.1 percent. Health spending grew more quickly than GDP. As a result, spending as a share of GDP increased from 17.3 percent in 2013 to 17.5 percent in 2014.

In 2014, 84.6 percent ($2,563.6 billion) of total health care spending was for personal health care—hospital services, physician services, prescription drugs, and the like. The remaining 15.4 percent of spending was for government administration, government public health activities, the net cost of health insurance and investment. Thirty-two percent ($971.8 billion) of total spending was for hospital services. Spending on physician services ($480.6 billion) accounted for 15.9 percent of spending, and spending on retail outlet sales of prescription drugs ($297.7 billion) 9.8 percent. Over the 10-year period from 2004 to 2014, physician spending grew at a lower average annual rate (4.1 percent) than did hospital or clinical spending (5.6 percent and 6.1 percent, respectively).

Looking at spending form a source of funds perspective, 10.9 percent ($329.8 billion) of 2014 health spending was paid out-of-pocket compared to 16.4 percent ($495.8 billion) from Medicaid, 20.4 percent ($618.7 billion) from Medicare, and 32.7 percent ($991.0 billion) from private health insurance spending. The share of health spending paid for out-of-pocket has decreased near continuously over the last 50 years. In 1964, it stood at 44.1 percent. Over the last 10 years the largest change in the allocation of spending by source of funds was in Medicare spending. Its share of health spending increased by 4.0 percentage points (from 16.4 percent of spending to 20.4 percent of spending) between 2004 and 2014. This increase is related to the addition of Medicare Part D program which went into effect in 2006. In that one year alone, Medicare spending increased by 18.8 percent, and Medicare's share of total health spending shot up by almost 2 percentage points.

From a financing perspective, households and the federal government each accounted for 27.8 percent of health spending in 2014. The federal share of spending was up from 16.2 percent in 1989, but has remained relatively unchanged over the past 5 years. Its longer term growth is due both the expansion of the Medicare program in general and to the increasing insufficiency of payroll taxes and SMI premiums as a funding mechanism for Medicare. In 2014, ACA tax credits and subsidies financed only a small share of spending. Together, they accounted for 1.9 percent of the financing for private health insurance.

References

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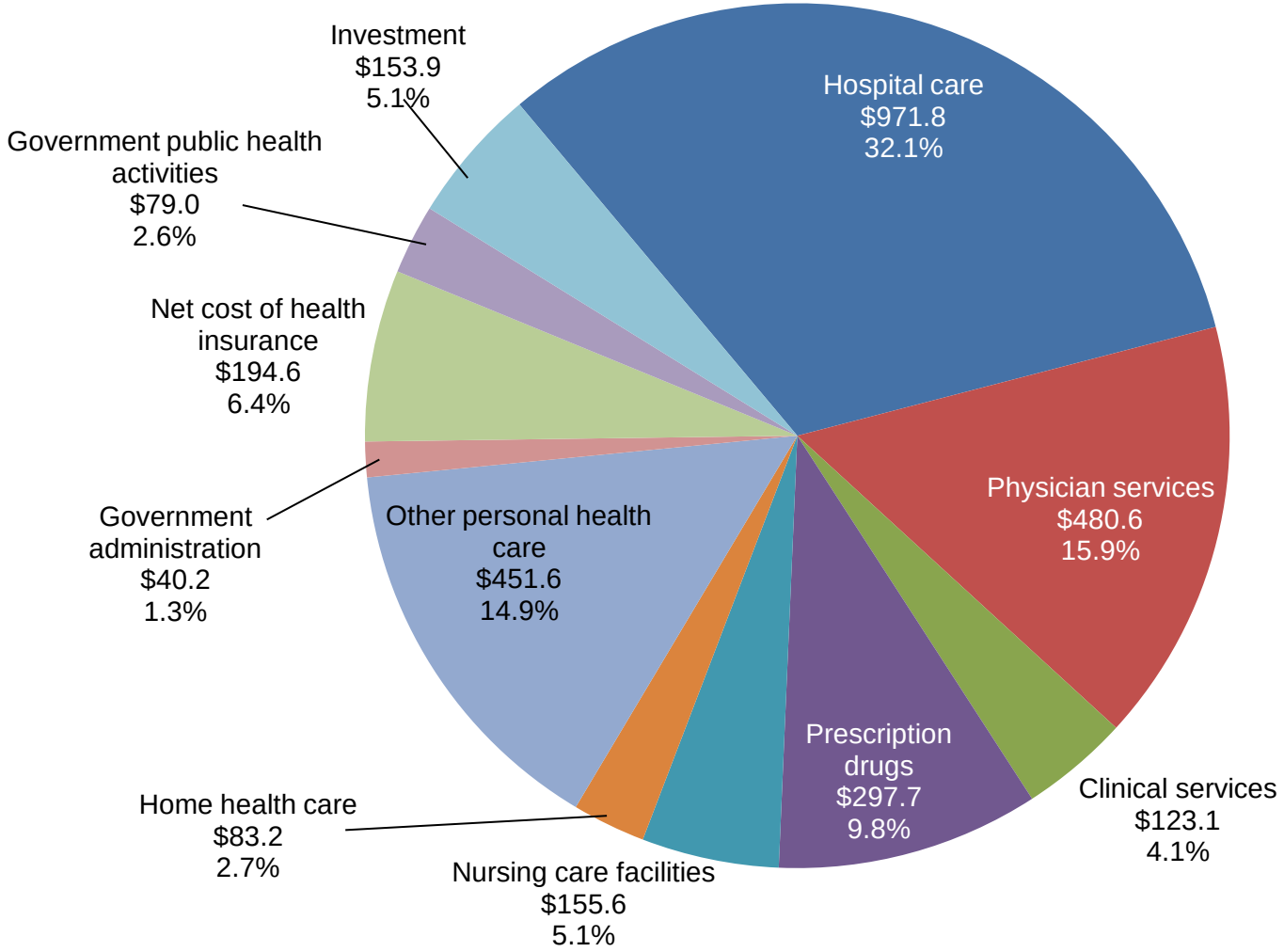
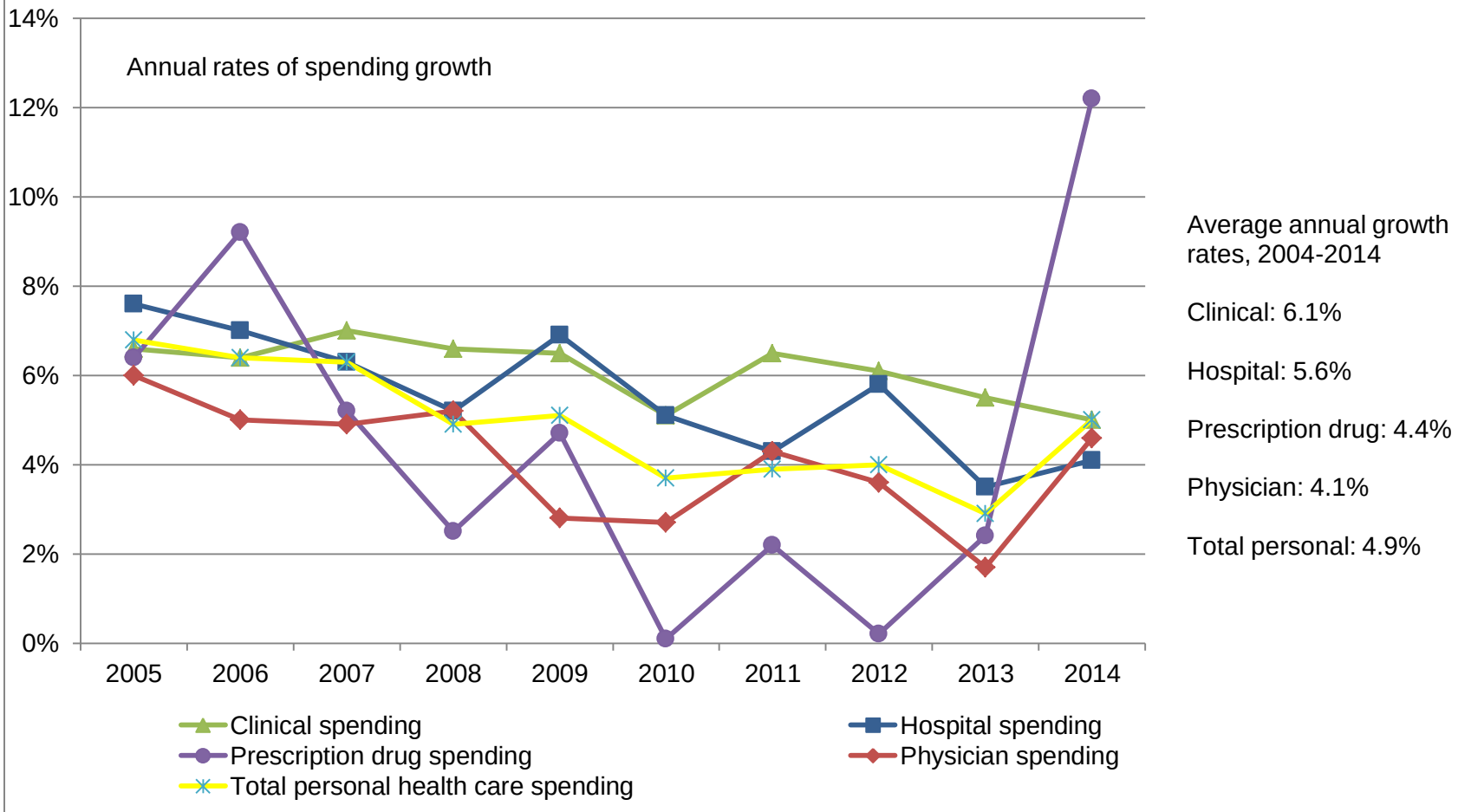
Martin, AB. et al. National health spending in 2014: faster growth driven by coverage expansion and prescription drug spending. Health Affairs (Project Hope). 2016;35(1):150-160. Available from http://content.healthaffairs.org/content/early/2015/11/25/hlthaff.2015.1194.full.pdf+html.

Figure 1. The U.S. Spent $3,031.3 Billion on Health Care in 2014 Where Did it Go?



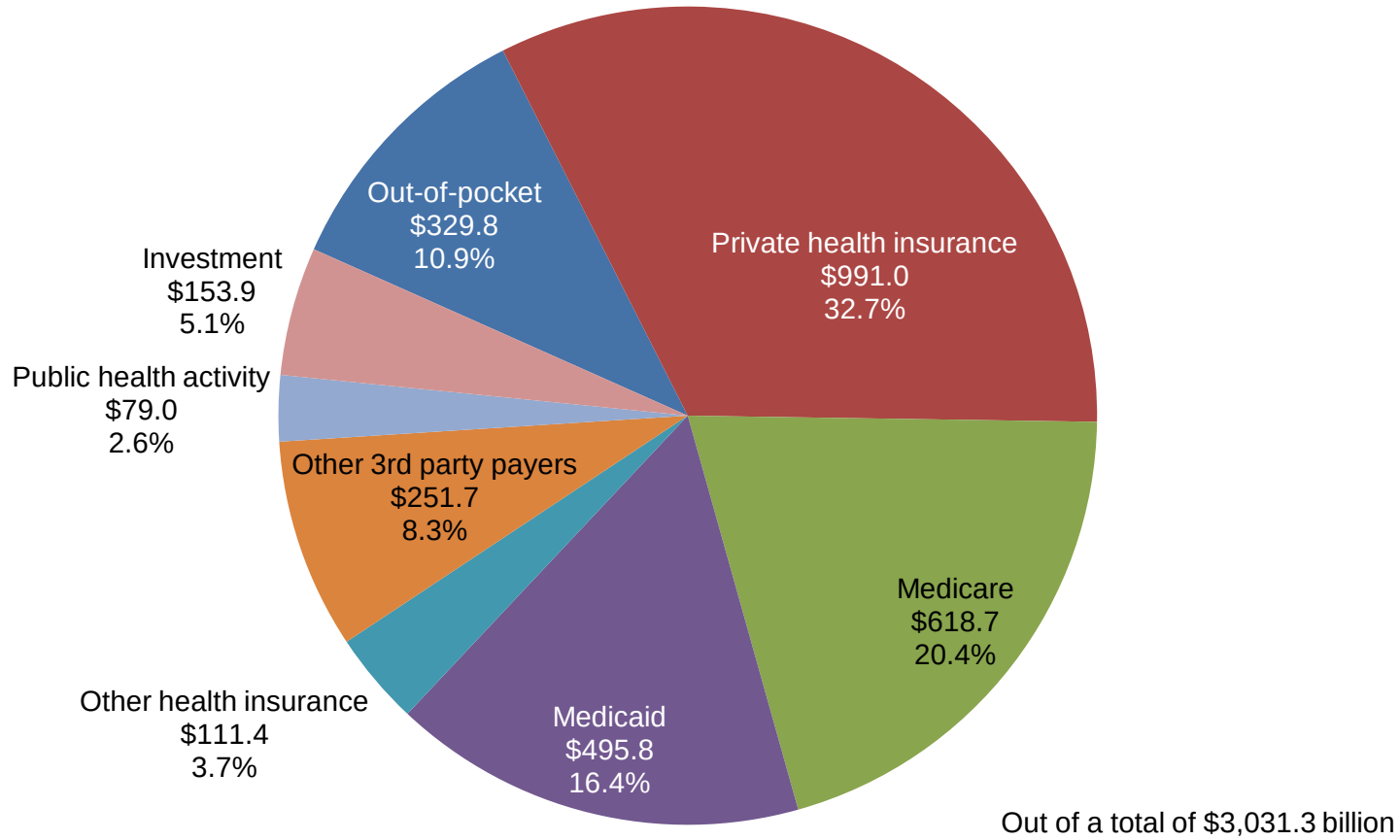
Source: https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical.html. Tables 2, 9, and 10 in NHE Tables [ZIP].

Figure 2. Spending on Physician Services Has Grown More Slowly Than Spending in Other Categories



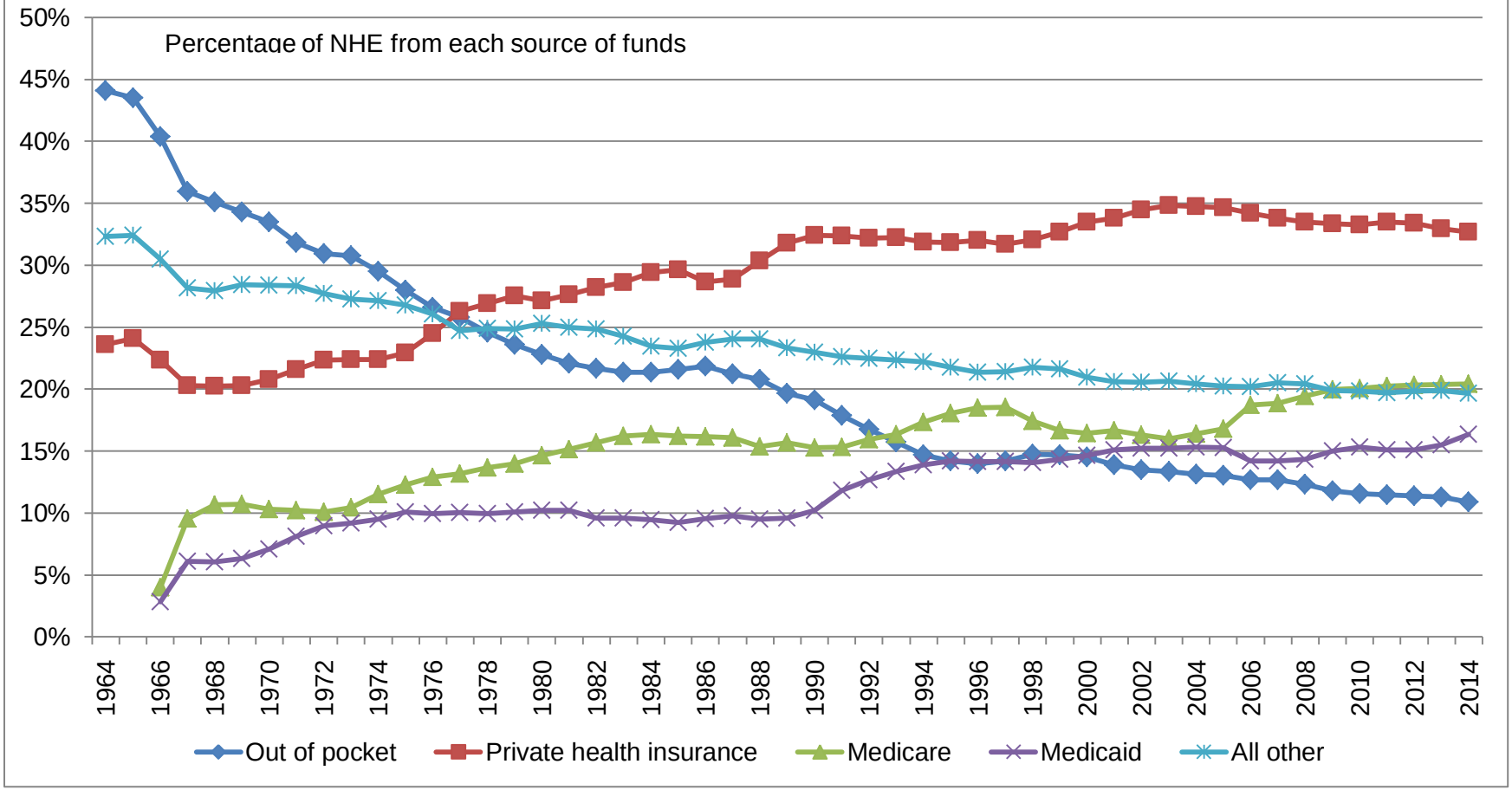
Source: https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical.html. Tables 6, 7, 9, 10, and 16 in NHE Tables [ZIP].

Figure 3. 2014 Health Care Spending by Source of Funds



Source: https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical.html. Tables 2 and 3 in NHE Tables [ZIP].

Figure 4. Distribution of NHE by Source of Funds: A 50-Year Perspective



Source: https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical.html. NHE2014.xls in National Health Expenditures by type of service and source of funds [ZIP].

Notes: "All other" includes other types of health insurance, other 3rd party payers, public health spending, and investment. In each year, the percentages sum to 100 percent.

Figure 5. The Financing of Medicare Spending, Private Health Insurance Spending, and NHE, 2014 (billions of dollars)

	PRIVATE SPENDING		MEDICARE SPENDING		NHE	
SPONSOR	Level	Percentage	Level	Percentage	Level	Percentage
Private business						
Employer contribution to employer sponsored health insurance premiums	$459.0	46.3%			$459.0	15.1%
Employer Medicare Hospital Insurance trust fund payroll taxes*			$95.8	15.5%	$95.8	3.2%
Workers compensation, temporary disability insurance, worksite health care					$51.6	1.7%
Total private business	**$459.0**	**46.3%**	**$95.8**	**15.5%**	**$606.4**	**20.0%**
Household						
Employee contribution to employer sponsored health insurance premiums	$234.7	23.7%			$234.7	7.7%
Household contribution to direct purchase health insurance	$51.3	5.2%			$51.3	1.7%
Medical portion of property and casualty	$32.4	3.3%			$32.4	1.1%
Employee/self-emp. payroll taxes and voluntary premiums paid to Medicare Hosp. Ins. trust fund*			$132.9	21.5%	$132.9	4.4%
Premiums paid by individuals to Medicare Supplementary Medical Insurance trust fund			$62.9	10.2%	$62.9	2.1%
Out-of-pocket					$329.8	10.9%
Total household	**$318.4**	**32.1%**	**$195.8**	**31.6%**	**$844.0**	**27.8%**
Other private					**$222.2**	**7.3%**

Note: *Each of these two categories includes half of self-employment contributions to the Medicare Hospital Insurance trust fund.

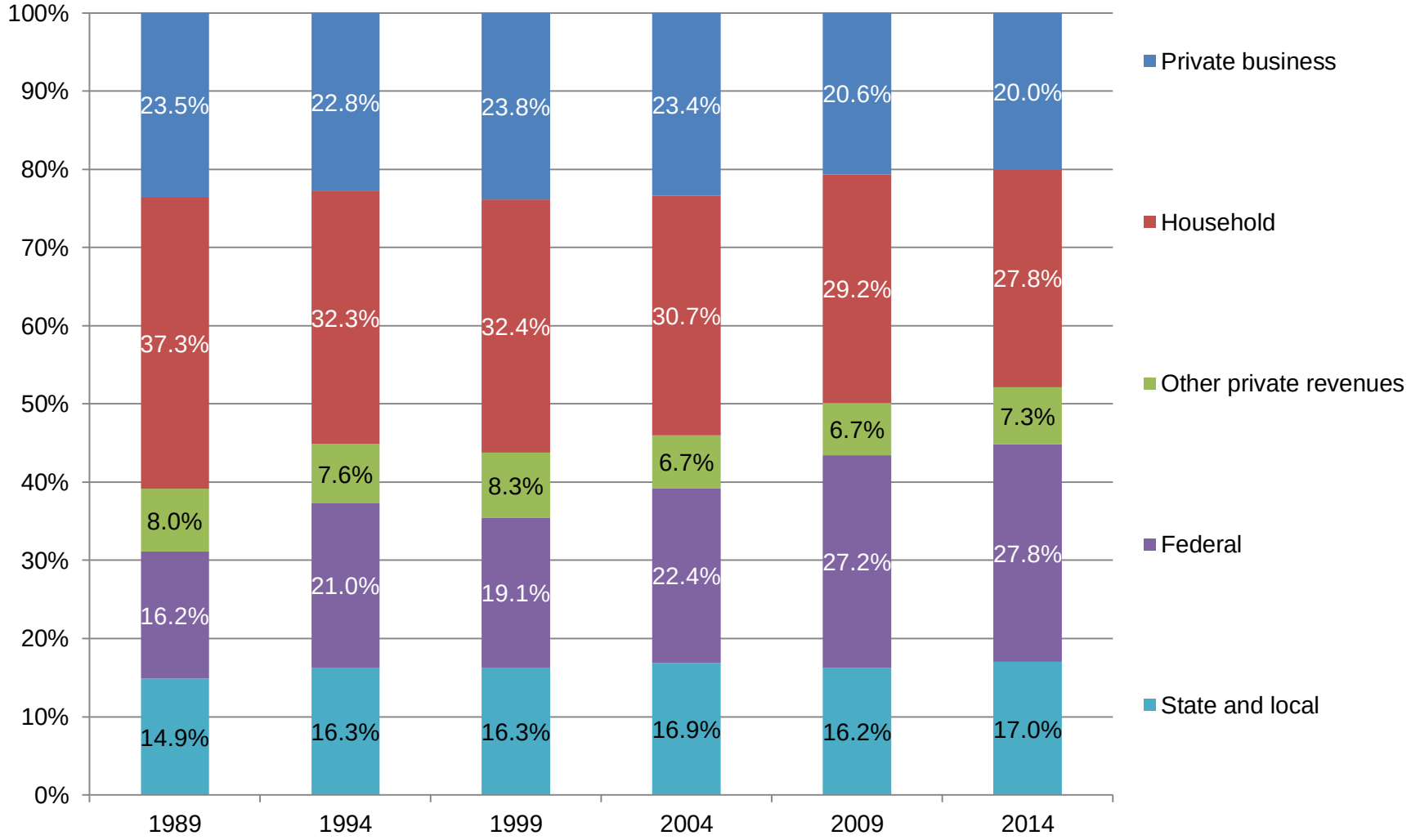
(continued on next page)

Figure 5. The Financing of Medicare Spending, Private Health Insurance Spending and NHE, 2014 (billions of dollars), continued

	PRIVATE SPENDING		MEDICARE SPENDING		NHE	
SPONSOR	Level	Percentage	Level	Percentage	Level	Percentage
Federal						
Employer contribution to employer sponsored health insurance premiums	$33.2	3.3%			$33.2	1.1%
Marketplace tax credits and subsidies	$18.5	1.9%			$18.5	0.6%
Retiree Drug Subsidy payments to employer Sponsored health insurance premiums	$1.6	0.2%			$1.6	0.1%
Small business tax credit	$0.5	0.1%			$0.5	0.0%
Employer Medicare Hospital Insurance trust fund payroll taxes			$4.0	0.7%	$4.0	0.1%
Federal general revenue and trust fund expenditures			$288.5	46.6%	$288.5	9.5%
Federal portion of Medicare buy-in premiums			$8.4	1.4%	$8.4	0.3%
Federal portion of Medicaid payments					$305.1	10.1%
Other health program expenditures					$183.8	6.1%
Total federal	**$53.8**	**5.4%**	**$300.9**	**48.6%**	**$843.7**	**27.8%**
State and Local						
Employer contribution to employer sponsored health insurance premiums	$159.8	16.1%			$159.8	5.3%
Employer Medicare Hospital Insurance trust fund payroll taxes			$11.8	1.9%	$11.8	0.4%
State portion of Medicare buy-in premiums			$5.8	0.9%	$5.8	0.2%
State phase down payments (Part D)			$8.7	1.4%	$8.7	0.3%
State portion of Medicaid payments					$190.6	6.3%
Other health program expenditures					$138.3	4.6%
Total state and local	**$159.8**	**16.1%**	**$26.2**	**4.2%**	**$515.0**	**17.0%**
TOTAL	**$991.0**	**100.0%**	**$618.7**	**100.0%**	**$3,031.3**	**100.0%**

Source: https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical.html. Tables 5, 5-1, 5-2, 5-3, 5-4, 5-5, and 5-6 in NHE Tables [ZIP].

Figure 6. The Financing of Health Care Spending Over the Last 25 Years



Source: https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/NationalHealthAccountsHistorical.html. Table 5 in NHE Tables [ZIP].