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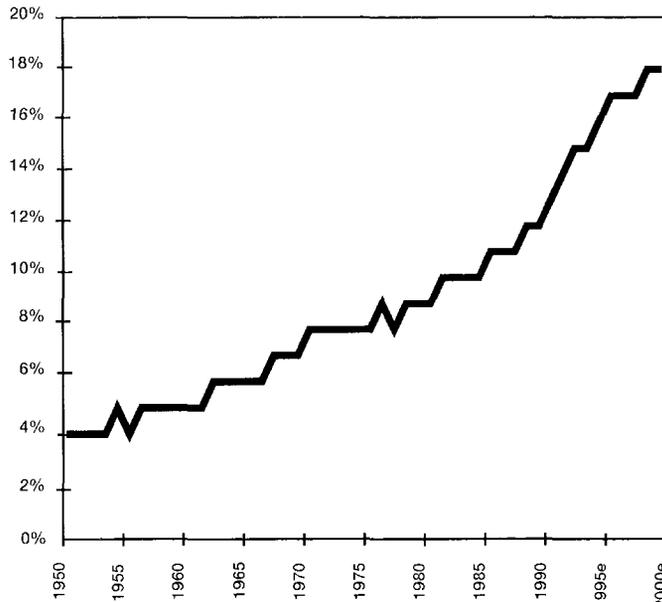
Three Decades of Government-Financed Health Care in the United States

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Congress is currently debating legislation to revamp the nation's health care system. Provisions in these bills would require that employers provide health insurance for their employees and would expand the federal Medicare and Medicaid programs. Much of the demand for reform stems from the fact that health care spending has accounted for a growing share of the nation's Gross Domestic Product (GDP) over the last several decades. *Figure 1* illustrates this trend. It graphs national health expenditures as a percent of GDP since 1950.

While talk of employer mandates, additional payroll taxes, and taxes on health insurance premiums may sound new to most Americans, the federal government's involvement in the U.S. health care system is not. Since the mid-1960s it has become increasingly involved in the nation's health care system. Today the federal government is the largest single payer of the nation's health care bills. Such obligations are putting increased pressure on the federal budget. Currently health care spending accounts for over 20 percent of all federal expenditures. By the year 2000 this figure is expected to rise to 30 percent. Federal involvement has also led to an increased reliance on third party payment of routine medical expenses, a trend many economists find disturbing.

Figure 1
National Health Expenditures as a Percent of GDP, 1950-2000



Source: Tax Foundation calculation using Commerce Department and Health Care Financing Administration data.

The Growth of Federal Involvement in Health Care Since 1965

Prior to 1965 the federal government had played a relatively minor role in financing Americans' health care. It undertook certain public health care activities, such as medical research and control of infectious disease. It also provided for the health care of certain individuals, such as federal employees, active duty military personnel, and veterans. *Figure 2* graphs national health expenditures by source since 1960. Expenditures are given in 1994 dollars so that comparisons can be made between the years. In 1960, national expenditures on health care totaled \$132.9 billion, or 5.3 percent of GDP. The bulk of these expenditures, 75.6 percent or \$100.5 billion, were paid by private sources such as individuals,

insurance companies, and philanthropic organizations. State and local governments paid \$18.1 billion, or 13.6 percent of total health expenditures. The federal government paid \$14.2 billion, or 10.7 percent of the nation's health care bill that year.

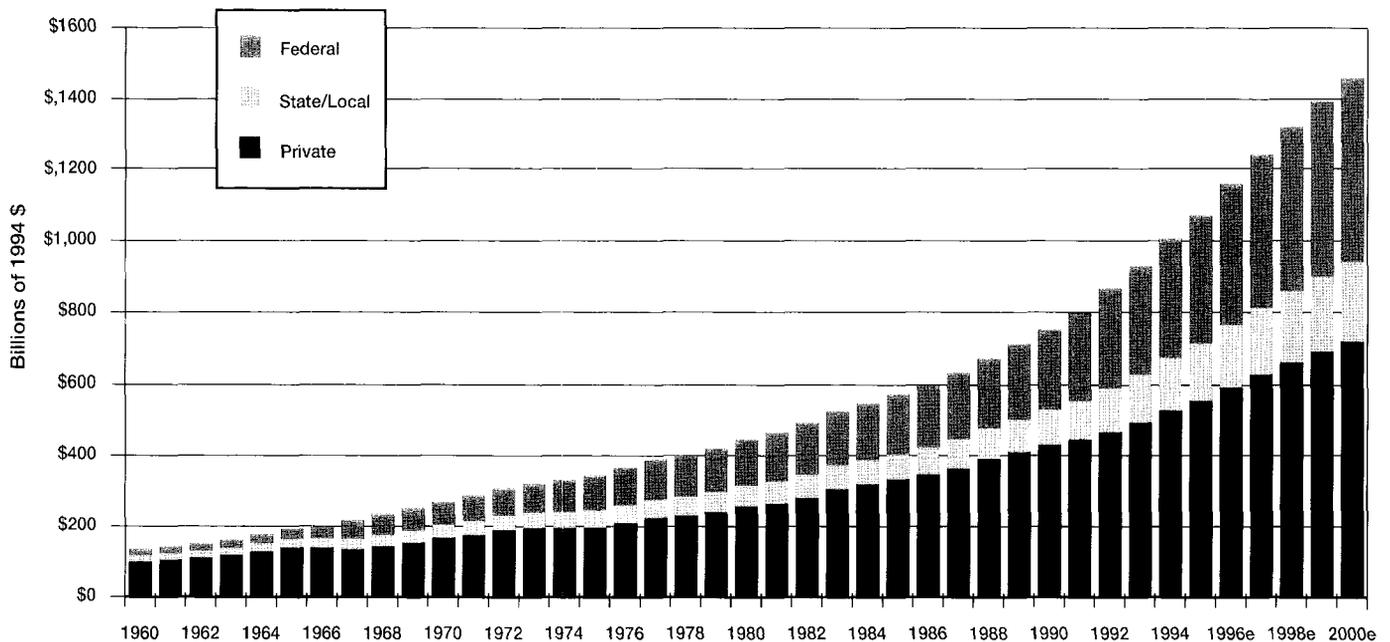
This situation remained much the same through 1965, when national health care expenditures totaled \$189.9 billion, or 6.0 percent of GDP. This was up just slightly from 5.3 percent in 1960. The bulk of these expenditures, 74 percent or \$140.5 billion, were paid by private sources. Another 13 percent, or \$24.7 billion, was paid by state and local governments. The federal government paid another \$24.7 billion.

Throughout 1965, however, the federal government laid the groundwork for what would become its growing involvement with health care over the next 25 years. By the end of that year Congress passed and President Johnson signed legislation creating Medicare and Medicaid. Medicare was originally intended to be a federal health insurance program for individuals 65 years of age and older. It is comprised of two parts, a hospital insurance program (HI) and a supplementary medical insurance program (SMI). Medicaid was intended to be a federally supported and state-administered health insurance program for certain low income individuals and families.

The creation of Medicare and Medicaid rapidly expanded the federal government's role in health care. The Medicaid program began in January of 1966. The Medicare program began six months later on July 1. Due in large part to the creation of these two programs, federal spending on health care grew from \$24.7 billion in 1965 to \$32.1 billion in 1966, a 30 percent increase. This occurred despite the fact that the much larger Medicare program was only in effect during the latter half of the year. When the full effect of Medicare was felt in 1967, federal spending on health care was more than twice its 1965 level. In these two short years federal spending went from comprising 13 percent of total health expenditures to 23.2 percent.

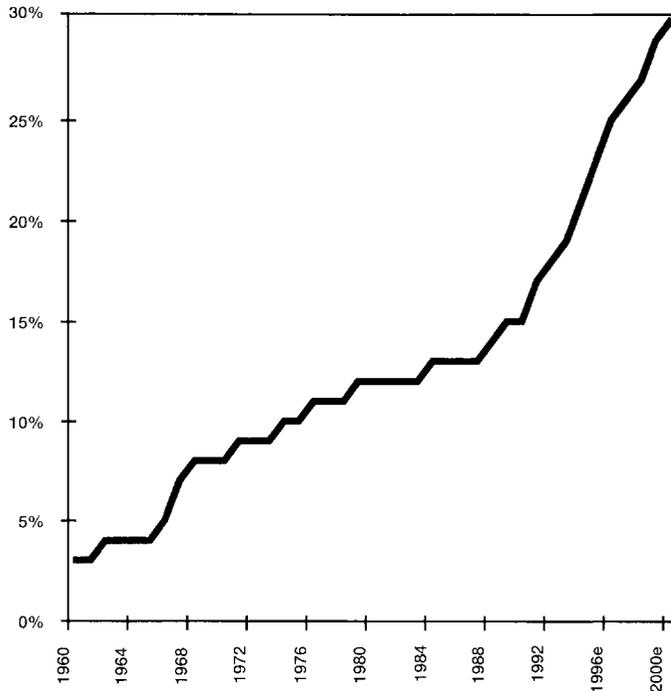
The impact of increased federal spending continued to affect national health expenditures through the end of the decade. By 1970 national health expenditures totaled \$269.1 billion, or 7.4 percent of GDP. While the bulk of these expenditures continued to be paid for by private sources, this percentage had dropped significantly from 74 percent in 1965 to 62.9 percent in 1970. Federal spending, on the other hand, rose to 23.8 percent of total health expenditures by 1970. The percentage of total health care expenditures spent by state and local governments remained constant throughout the decade at around 13.5 percent.

Figure 2
National Health Expenditures by Source of Funds, 1960-2000



Source: Tax Foundation calculation using Health Care Financing Administration data.

Figure 3
Federal Health Expenditures as a Percent of Total Federal Expenditures, 1960-2000



Source: Tax Foundation calculation using Office of Management and Budget and Health Care Financing Administration data.

By 1975 federal expenditures on health care totaled \$95.9 billion, 49.6 percent higher than their 1970 level. As a result of this rapidly rising spending, federal spending comprised an ever-increasing share of the nation's total health care bill. By 1975 federal spending accounted for 27.9 percent of national health care expenditures. This trend continued through the end of the decade. By 1980 federal expenditures for health care had grown to \$128 billion and accounted for 28.8 percent of total health care spending.

Federal health care spending rose to \$166.8 billion in 1985. During this year federal dollars accounted for 29.2 percent of national health expenditures. Health care spending made up 10.5 percent of GDP during this year. In 1990 federal health care spending rose to \$219.9 billion and accounted for 29.3 percent of national health expenditures. During this year health care spending accounted for 12.0 percent of GDP. In 1993 the federal government spent \$297.5 billion on health care, up 35.3 percent in three years. During this year federal expenditures accounted for 32.1 percent of the total. In 1993 health care spending made up 14.2 percent of GDP.

Assuming no change in the current law, national health expenditures are expected to rise to \$1.07 trillion in 1995, or 15.4 percent of GDP. It is anticipated that the federal government will pay 33.2 percent of this amount, or \$355.4 billion. In the year 2000, the nation's health bill is expected to rise to \$1.46 trillion, or 18.1 percent of GDP. It is anticipated that the federal government will pay 35.5 percent of these expenditures, or \$517.1 billion.

Pressure on the Federal Budget

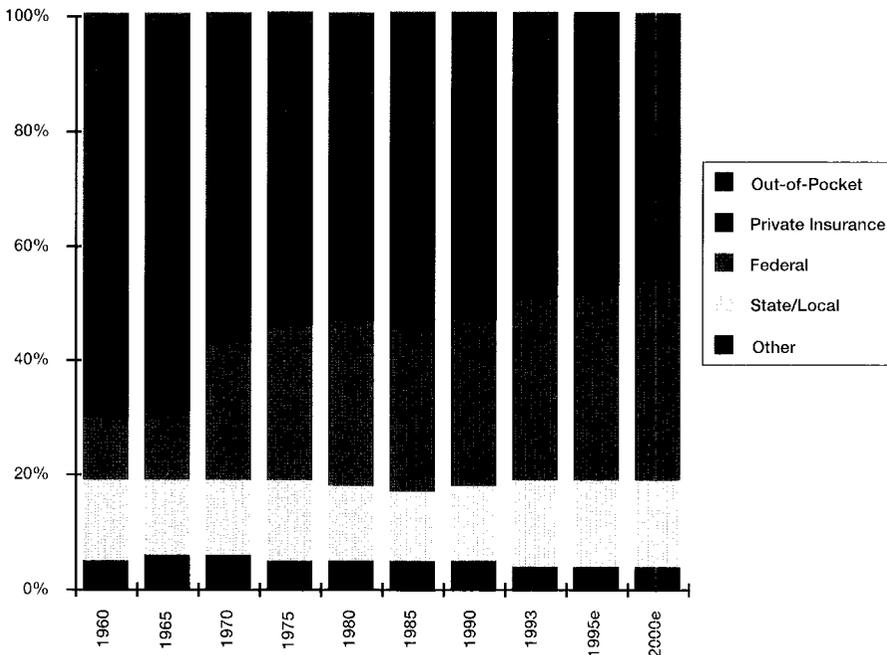
Since 1960 health care spending has consumed a growing share of the federal budget. *Figure 3* graphs federal expenditures on health care as a percent of total federal expenditures. In 1960 expenditures for health care constituted 3.1 percent of total federal spending. By 1965 this figure had risen to 4.4 percent. Following the full implementation of Medicare and Medicaid in 1967 the fraction of total federal expenditures devoted to health care climbed to 7.2 percent. By 1970 this figure had risen to 8.5 percent.

As *Figure 3* illustrates, health expenditures grew steadily as a fraction of total federal expenditures from 1970 to 1986. In 1975 health expenditures comprised 10.2 percent of total federal expenditures. This figure rose to 11.7 percent in 1980 and to 12.9 percent in 1986. Beginning in 1987, however, the share of federal expenditures devoted to health care began to grow even more rapidly. In 1990 such expenditures made up 15.3 percent of total federal expenditures. By 1993 this figure had grown to 19.4 percent. By 1995 this figure is expected to climb to 22.7. In the year 2000 spending on health care is expected to consume 30 percent of total federal expenditures.

Increased Reliance on Third Party Payers

The growing reliance on third party payment of routine medical expenses is seen as a disturbing trend by many economists. It is felt that this form of payment takes away an individual's incentive to limit on his use of health care services. The federal government promotes such reliance by both acting as a third party payer through its myriad of health programs and by providing a tax incentive for businesses to provide health insurance coverage to their employees. *Figure 4* graphs national health expenditures by type of payer since 1960. As the graph illustrates, there has been a sharp decline in individual, out-of-

Figure 4
National Health Expenditures by Type of Payer, 1960-2000



Source: Tax Foundation calculation using Health Care Financing Administration data.

pocket payment for health care since 1960. Such costs have increasingly been borne by third parties such as the federal government and private insurance companies.

In 1960 out-of-pocket payments were the largest source of funds for health care. During this year nearly one half of all health expenses were paid for out-of-pocket. The next largest source of funds was private insurance. It paid 21.8 percent of all health expenses during this year. As stated earlier, during this period, government at all levels played a relatively minor role in the provision of health care. In 1960 state and local governments paid 13.6 percent of all health care expenses. During this year the federal government paid 10.7 percent of such expenses. The remaining 4.9 percent of total health expenditures were paid for by other sources.

These numbers changed little between 1960 and 1965. Out-of-pocket payments continued to cover the bulk of all health care expenses in 1965, accounting for 45.7 percent of the total. Private insurance was the next largest source of funds, providing 24.0 percent of the total. Federal and state and local governments each provided 13 percent of total funds. Other sources contributed 4.3 percent of total funds.

The creation of Medicare and Medicaid greatly altered this balance. By 1970 the

federal government's share of national health expenditures was more than double its 1965 level at 23.8 percent. The fraction paid out-of-pocket had fallen by more than ten percentage points to 34.5 percent. The share paid by private health insurance also fell slightly to 22.5 percent. State and local governments contributed 13.3 percent of the total that year. Other sources contributed 5.9 percent.

Since 1970 there has been a steady decline in the share of total health expenditures paid for out-of-pocket as individuals have increasingly relied on third party payers. The federal government's share of total health expenditures remained steady at around 29 percent from 1980 to 1990. The share paid by private insurance rose gradually from 24.8 percent in 1975 to 32.9 percent in 1990. Throughout this period state and local government's share of total health expenditures remained constant at around 13.5 percent. Other sources continued to provide approximately 4.5 percent of funds annually.

There has been some alteration of these trends since 1990. The percentage of national health expenditures paid for out-of-pocket and by private insurance dropped to 18.8 and 30.3 percent respectively in 1993. The federal government's share of national health expenditures, meanwhile, rose to 29.1 percent in 1993. These trends are expected to continue through the end of the decade. The percentage of national health expenditures paid for out-of-pocket are expected to fall further to 18.4 percent in 1995 and to 17.4 percent in the year 2000. Similarly, the percentage of national health expenditures paid for by private insurance is anticipated to fall to 29.5 percent in 1995 and to 28.3 percent in the year 2000. Over this period the federal government's share of the nation's health bill is expected to rise to 33.2 percent in 1995 and to 35.5 percent in the year 2000.

Conclusion

The enactment of Medicare and Medicaid radically changed the way health care is financed in the United States. As these programs evolved, they have come to represent an ever-larger share of Gross Domestic Product and of total federal spending. In fact, the current health care reform was given a major push by the growing realization that current trends in federal health care spending are not sustainable. The current health care debate cannot be considered a success unless the result brings these federal expenditures under control.

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