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Report RL31374

Health Expenditures in 2004

Paulette C. Morgan, Domestic Social Policy Division

January 26, 2006

Abstract. In 2004, the most recent year for which data are available, approximately \$1.9 trillion was spent on health care and health-related activities. This amount represents a 7.9% increase over 2003 spending. The majority of health spending (83%) went towards paying for health care goods and services provided directly to individuals. These goods and services are referred to as personal health care. The remaining amount covered administrative expenses, public health activities, health research, construction of health facilities and offices and medical capital equipment. Table 1 indicates how much was spent on various categories of health care goods and services in 2004 and how much these amounts increased over 2003 levels.

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CRS Report for Congress

Health Expenditures in 2005

Updated September 26, 2007

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Prepared for Members and
Committees of Congress

Health Expenditures in 2005

Summary

In 2005, the most recent year for which data are available, just under \$2 trillion was spent on health care and health-related activities. This amount represents a 6.9% increase over 2004 spending. The majority of health spending (84%) went towards paying for health care goods and services provided directly to individuals. These goods and services are referred to as personal health care. The remaining 16% of health spending covered research, public health activities, administrative costs, structures, and equipment.

Personal health care expenditures grew 7.1% in 2005, continuing a downward trend in the growth of expenditures that peaked in recent times in 2001 at 8.7%. From the beginning of 1992 to the end of 2000, personal health expenditures grew at an average annual rate of 5.8%, historically low levels not seen since 1960. Compared with spending increases over the past 40 years, the 7.1% increase that occurred in 2005 is relatively moderate. In particular, the years 1979 through 1981 experienced growth rates between 13.8% and 15.9%.

Relative to the overall economy, personal health expenditures increased in 2005. In 2005, personal health expenditures accounted for 13.3% of gross domestic product (GDP), up from 13.2% of GDP in 2004 and 2003, 12.8% of GDP in 2002, and 12.2% in 2001. For the nine years prior to 2001, health spending as a percentage of GDP was relatively constant. From 1992 to 2000, personal health expenditures, as a percentage of GDP, stayed between 11.5% and 11.7%. During the three decades prior to the 1990s, personal health expenditures, as a percentage of GDP, increased almost every year.

Home health care spending was the fastest growing category of personal health care in 2005. Home health care spending in 2005 was 11.1% higher than the amount spent in 2004. Yet, because home health care represents about 3% of personal health expenditures, it was one of the smallest contributors to overall growth in personal health spending. Hospital care, which grew 7.9% in 2005 and accounts for more than one-third of personal health expenditures, contributed the most to overall growth in personal health spending. Spending on physician and clinical services, which grew at 7.0% in 2005 and accounts for one-fourth of personal health expenditures, was the second largest contributor to overall growth in personal health spending.

Over 85% of personal health expenditures in 2005 were financed by third-party payers. The largest payer, private health insurance, financed 36% of all personal health expenditures. The second-largest payer, the federal government, accounted for 34% of all personal health spending. Certain categories of health care are funded primarily by third-party payers, whereas other categories are financed almost entirely out-of-pocket. The federal government is the largest payer of hospital care and nursing home and home health care. Private health insurance is the largest payer of dental services and prescription drugs. Out-of-pocket expenditures are the largest source of funding for non-durable medical goods (which include over-the-counter drugs) and durable medical goods (which include eyeglasses).

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Health Expenditures in 2005

In 2005, the most recent year for which data are available, approximately \$2.0 trillion was spent on health care and health-related activities. This amount represents a 6.9% increase over 2004 spending. The majority of health spending (84%) went towards paying for health care goods and services provided directly to individuals. These goods and services are referred to as personal health care. The remaining amount covered administrative expenses, public health activities, health research, construction of health facilities and offices and medical capital equipment.¹ **Table 1** indicates how much was spent on various categories of health care goods and services in 2005 and how much these amounts increased over 2004 levels.

Table 1. 2005 Health Expenditures

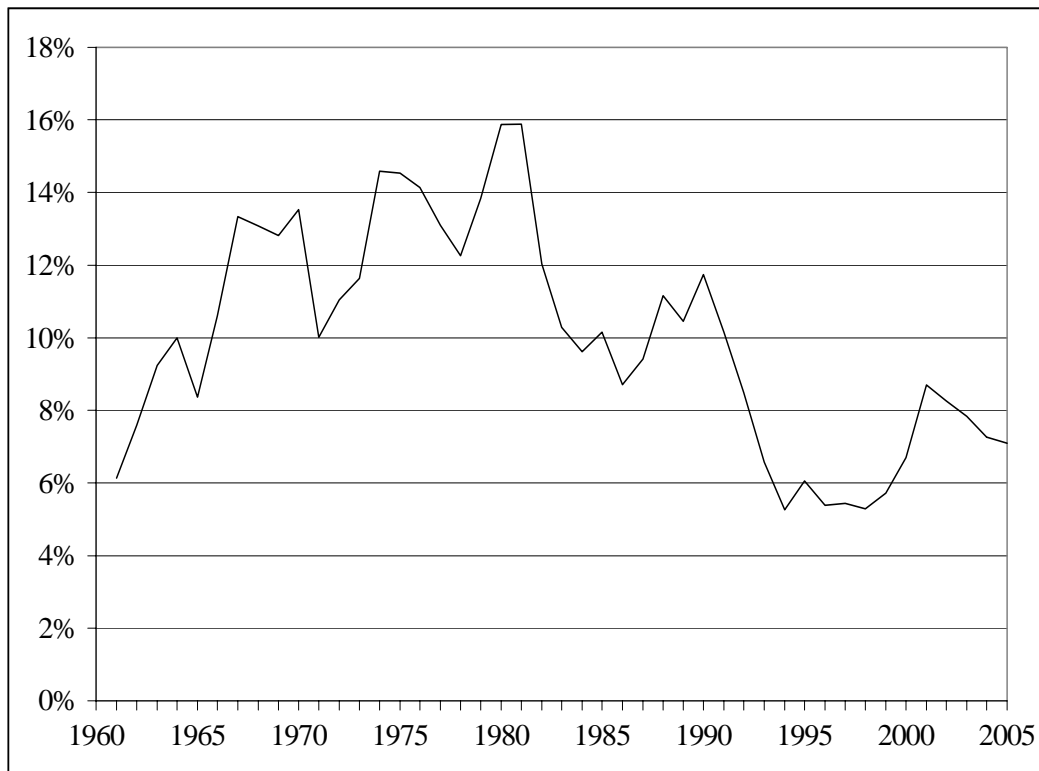
Type of Expenditure	Amount (\$ billions)	Increase over 2004 spending (\$ billions)	Percent increase over 2004 spending
Personal health care expenditures:			
Hospital care	\$611.6	\$44.7	7.9%
Physician and clinical services	\$421.2	\$27.5	7.0%
Long-term care:			
Nursing home care	\$121.9	\$6.8	6.0%
Home health care	\$47.5	\$4.7	11.1%
Prescription drugs	\$200.7	\$11.1	5.8%
Dental services	\$86.6	\$5.2	6.3%
Other professional services	\$56.7	\$4.1	7.8%
Non-durable medical goods (excluding prescription drugs)	\$34.1	\$1.3	4.1%
Durable medical goods	\$24.0	\$0.8	3.7%
Other personal health care	\$57.2	\$3.9	7.3%
Total personal health care expenditures	\$1,661.4	\$110.1	7.1%
Government administration and net cost of private health insurance	\$143.0	\$7.8	5.7%
Government public health activities	\$56.6	\$4.1	7.7%
Research	\$40.0	\$1.8	4.6%
Structures and Equipment	\$86.8	\$5.1	6.3%
Total national health expenditures	\$1,987.7	\$128.8	6.9%

Source: Prepared by the Congressional Research Service (CRS) based on data from the Centers for Medicare and Medicaid Services, Office of the Actuary.

¹ Research excludes amounts spent by pharmaceutical companies and medical equipment suppliers.

This report focuses on expenditures for personal health care, since these goods and services constitute most spending on health-related activities. The latter half of the 1990s experienced historically low growth in personal health care spending. From the beginning of 1994 to the end of 1999, health spending increased at an average annual rate of 5.6%. This low growth is attributable to changes in both the private and public sectors. In the private sector, the increased use of managed care limited cost growth during the mid-1990s. Vigorous fraud-and-abuse investigation and the Balanced Budget Act of 1997 (which slowed growth in hospital, home health, and nursing home payments) constrained health expenditures in the late 1990s.² The effect of these changes in public and private sector have subsided; in 2000, personal health expenditures grew at 6.7%, 1.1 percentage points higher than the average rate over the previous six years. Personal health expenditures grew at even higher rates in 2001 (8.7%) but have fallen steadily since then. Looking from a broader historical perspective, spending growth in recent years is still much lower than that in most years since 1960 (see **Figure 1**). In particular, the years 1979 through 1981 experienced growth rates between 13.8% and 15.9%.

Figure 1. Growth in Nominal Personal Health Expenditures



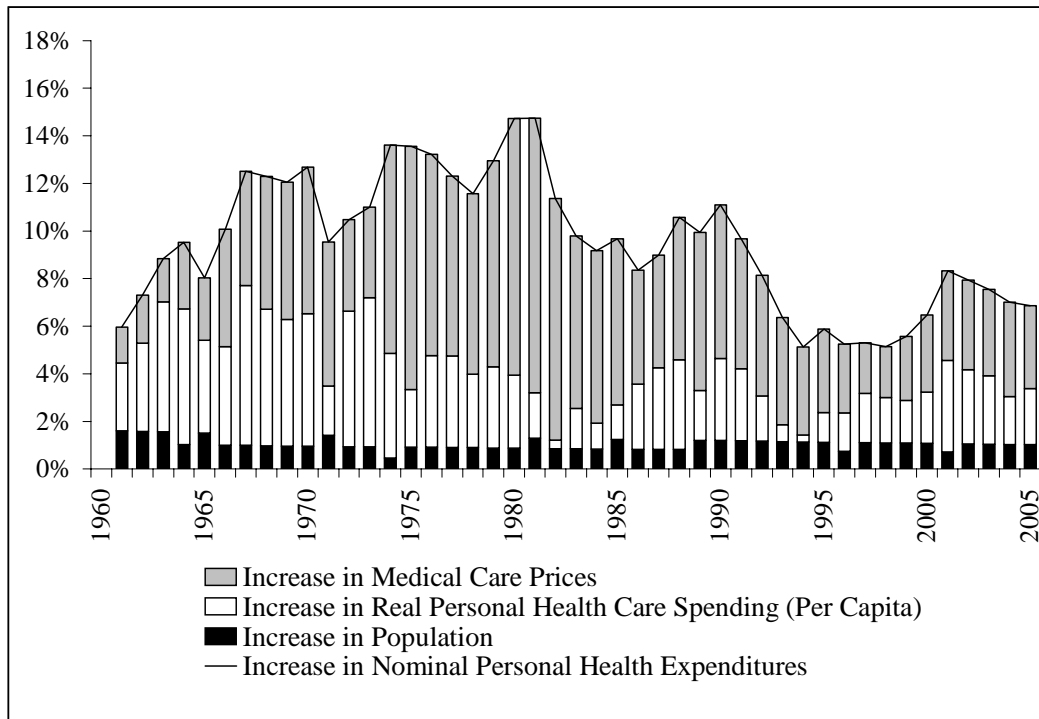
Source: Congressional Research Service (CRS) calculations using data from the Centers for Medicare and Medicaid Services, Office of the Actuary.

² Levit, Katharine, Cynthia Smith, Cathy Cowan, Helen Lazenby, and Anne Martin, "Inflation Spurs Spending in 2000," *Health Affairs*, vol. 21, no. 1, January/February 2002.

Real Growth in Personal Health Expenditures

Figure 1 depicts growth in nominal personal health expenditures.³ Three factors contribute to growth in nominal health spending: higher population, higher prices, and higher real per capita expenditures, which some experts label the “intensity” of care. Real per capita expenditures indicate qualitative and quantitative increases in the amount of care received by individuals. **Figure 2** depicts the role of population, prices, and real per capita expenditures in nominal health expenditure growth. Caution should be used when interpreting data on real health expenditures, however. Real expenditures are estimated using price indexes for medical care goods and services, but such price indexes are imperfect.⁴ As a result of these imperfections, it is difficult to isolate prices and real per capita health expenditures from nominal health spending.

Figure 2. Factors Influencing Growth in Nominal Personal Health Expenditures



Source: Congressional Research Service calculations using data from the U.S. Census Bureau and the Centers for Medicare and Medicaid Services, Office of the Actuary.

Note: To make component factors additive, percentages in this figure represent continuous growth rates rather than discrete annual changes. A supporting table for this figure is provided in the appendix.

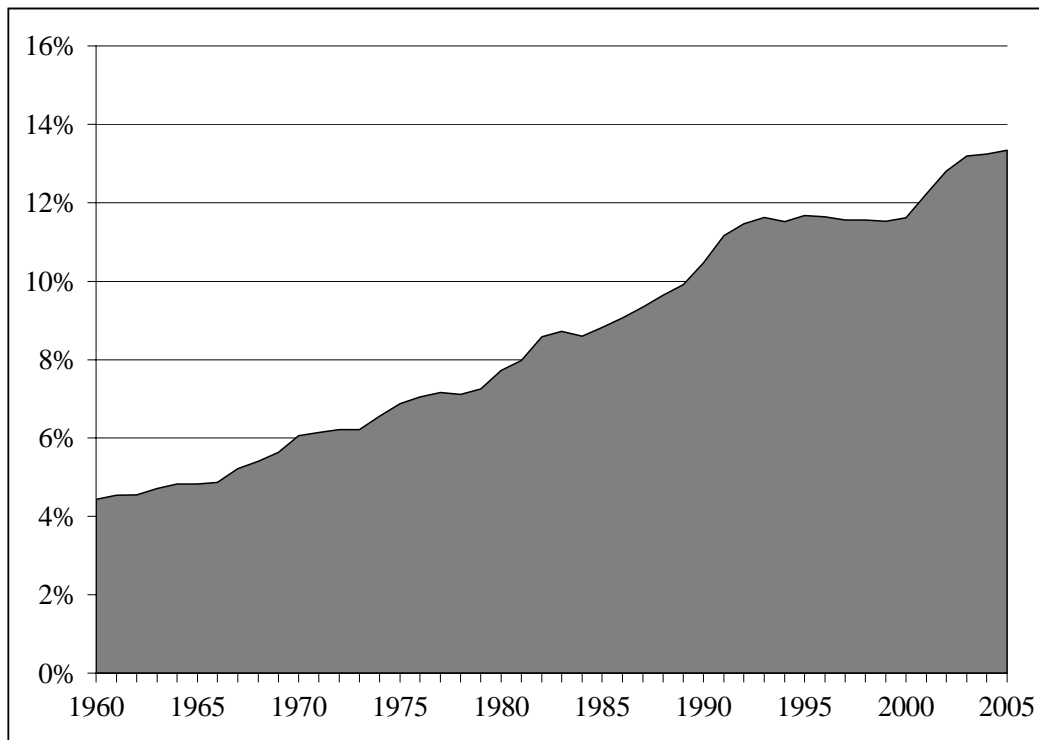
³ Nominal describes expenditures which are not adjusted for inflation.

⁴ For more information, see Berndt, Ernst R., et al., “Price Indexes for Medical Care Goods and Services: An Overview of Measurement Issues,” in David M. Cutler and Ernst R. Berndt, eds., *Medical Care Output and Productivity* (Chicago: The University of Chicago Press, 2001).

Health Spending and Gross Domestic Product

Spending on personal health care in 2005 increased relative to the overall economy. In 2005, personal health care expenditures accounted for 13.3% of gross domestic product (GDP), up from 13.2% of GDP in 2003 and 2004, 12.8% of GDP in 2002 and 12.2% of GDP in 2001. These increases mark a departure from the experience of the previous nine years, when health spending as a percent of GDP was relatively constant. Between 1992 and 2000, personal health care expenditures averaged 11.6% of GDP (see **Figure 3**).

Figure 3. Personal Health Care Spending as a Percent of Gross Domestic Product (GDP)



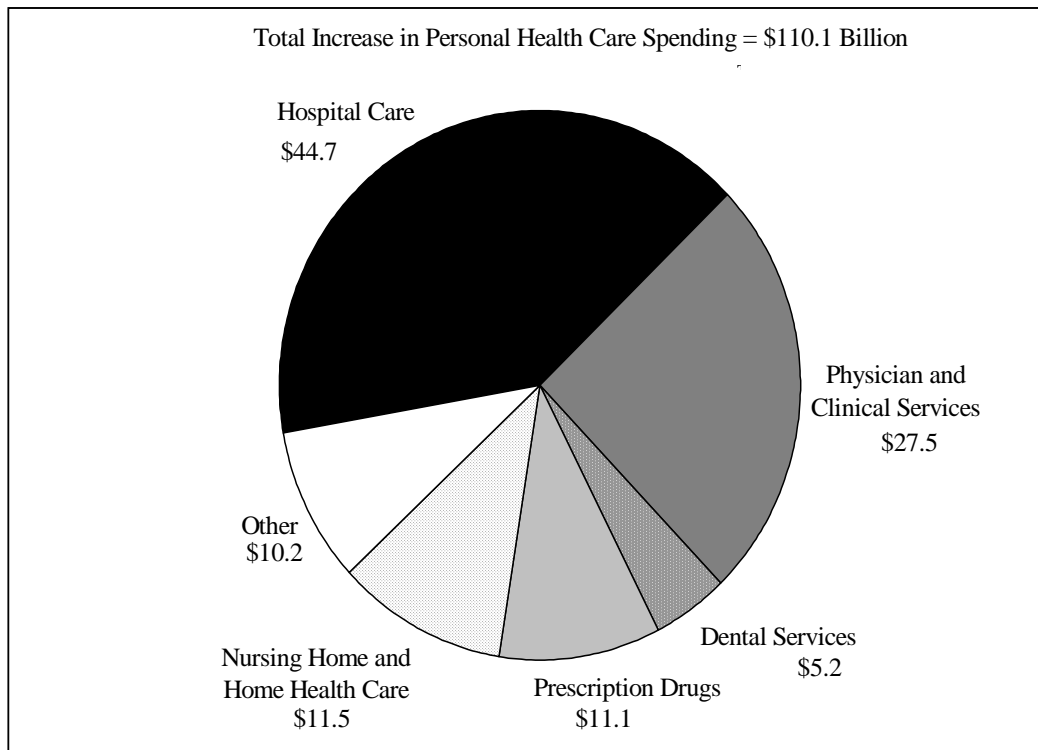
Source: The Congressional Research Service (CRS) calculations using data from the Centers for Medicare and Medicaid Services, Office of the Actuary.

Growth in Categories of Medical Care

Four categories of medical goods and services compose more than 84% of personal health care expenditures: hospital care, physician and clinical services, prescription drugs, and long-term care (which includes nursing home and home health care). In 2005, home health care was the fastest growing category of health expenditures, increasing 11.1% above 2004 expenditures (see **Table 1**).

However, growth rates of individual categories of services can be deceptive at indicating how much a particular category of medical care contributed to overall spending growth. As indicated in **Table 1**, the category with the largest *dollar* increase was hospital care. In 2005, spending on hospital care was \$44.7 billion higher than in 2004, an increase of 7.9%.⁵ Home health care expenditures were \$4.7 billion higher in 2005 than they were in 2004, an increase of 11.1%. Thus, even though home health care increased more than hospital care in terms of percentage growth, hospital care grew more than home health care in dollar terms. That is, growth in hospital care contributed most to increased personal health care expenditures in 2005. The \$44.7 billion increase in hospital expenditures in 2005 accounted for 41% of the \$110.1 billion increase in overall personal health care spending. **Figure 4** shows how much dollar growth in each category of personal health care contributed to total growth in personal health expenditures.

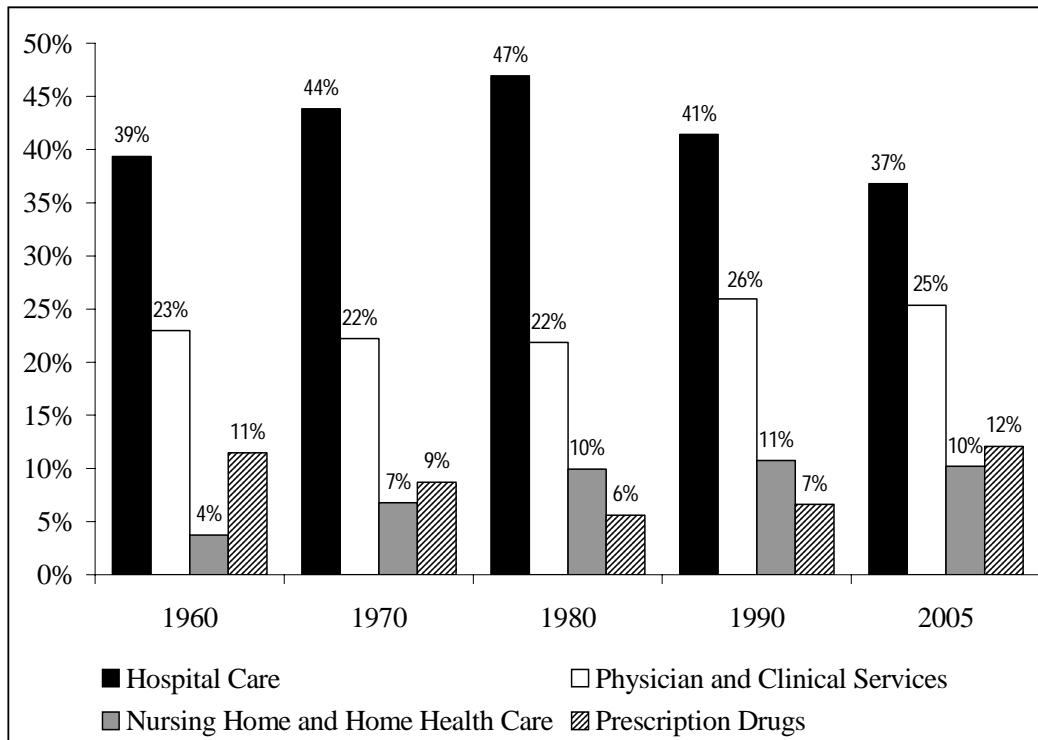
Figure 4. Contribution of Various Types of Medical Care to Total Personal Health Care Growth, 2005 (amount in billions)



Source: The Congressional Research Service (CRS) calculations using data from the Centers for Medicare and Medicaid Services, Office of the Actuary.

⁵ That hospital care can exhibit large dollar growth, yet moderate percentage growth, is attributable to the fact that hospital care constitutes a relatively large share of total personal health expenditures.

Figure 5. Share of Personal health Expenditures Devoted to Major Categories of Medical Care, 1960-2005



Source: The Congressional Research Service (CRS) calculations using data from the Centers for Medicare and Medicaid Services, Office of the Actuary.

Much attention has been directed at spending on prescription drugs. The share of personal health expenditures devoted to prescription drugs has more than doubled since 1981, when drugs accounted for only 5.4% of personal health expenditures. Yet, 1981 represented the trough of a 20-year decline in spending on prescription drugs, as a share of personal health expenditures. While the percent of personal health expenditures spent on prescription drugs has grown significantly over the past two decades, prescription drug spending represented only a slightly greater share of personal health expenditures in 2005 as it did in 1960. This trend is illustrated in **Figure 5**.⁶

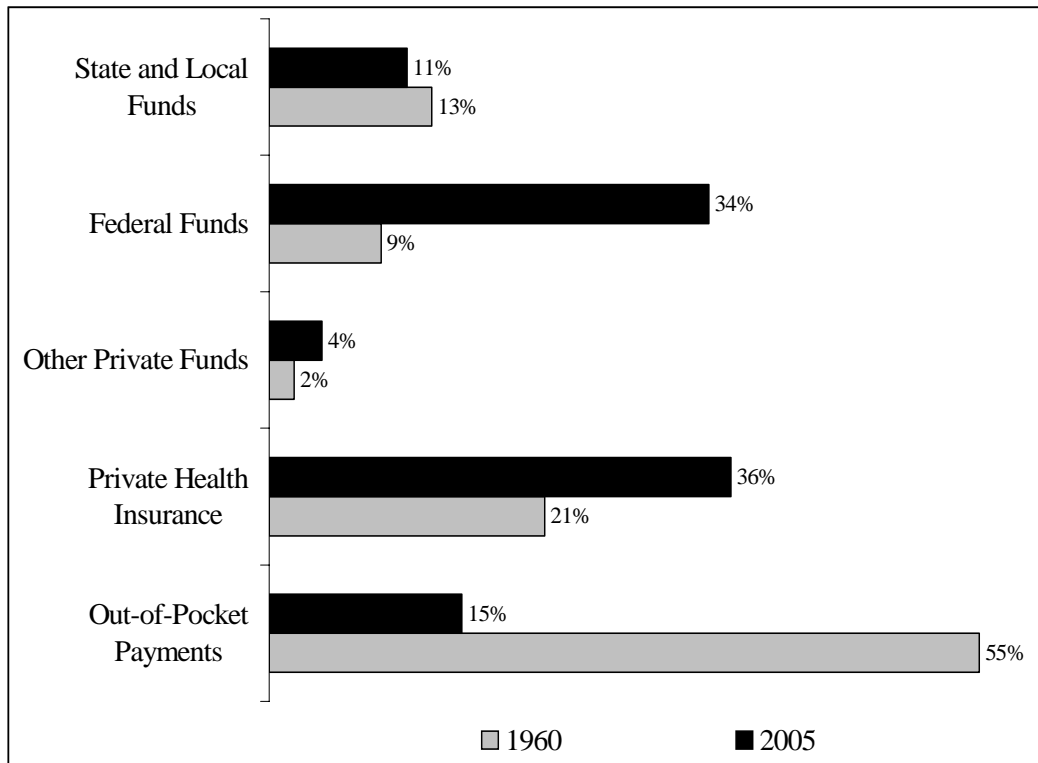
Long-term care, which includes nursing home and home health care, composes a larger share of health care than in the past. In 1960, about 4% of personal health care expenditures were spent on nursing home and home health care. In 2005, about 10% of personal health spending was directed towards providing nursing home and home health care.

⁶ It is worth noting that data on prescription drug spending include only those drugs received in non-institutional establishments. Spending on drugs dispensed in nursing homes or hospitals is considered spending on those respective categories. Consequently, data on prescription drug expenditures are likely to be understated.

Financing Health Care

In 2005, 85% of personal health expenditures were in the form of third-party payments. Private health insurance was the largest payer of personal health care in 2005; it paid 36% of personal health expenditures. The federal government, the second largest payer, accounted for 34% of all personal health spending. The health care system underwent a shift over the last four decades from one financed primarily by out-of-pocket expenditures to one financed primarily by private insurance. **Figure 6** shows how the funding of personal health care has changed from 1960 to 2005. Ultimately, all health care is funded by individuals through out-of-pocket expenditures (including insurance deductibles and co-payments), insurance premiums, taxes, and charitable contributions.⁷

Figure 6. Source of Funding for Personal Health Expenditures, 1960-2005

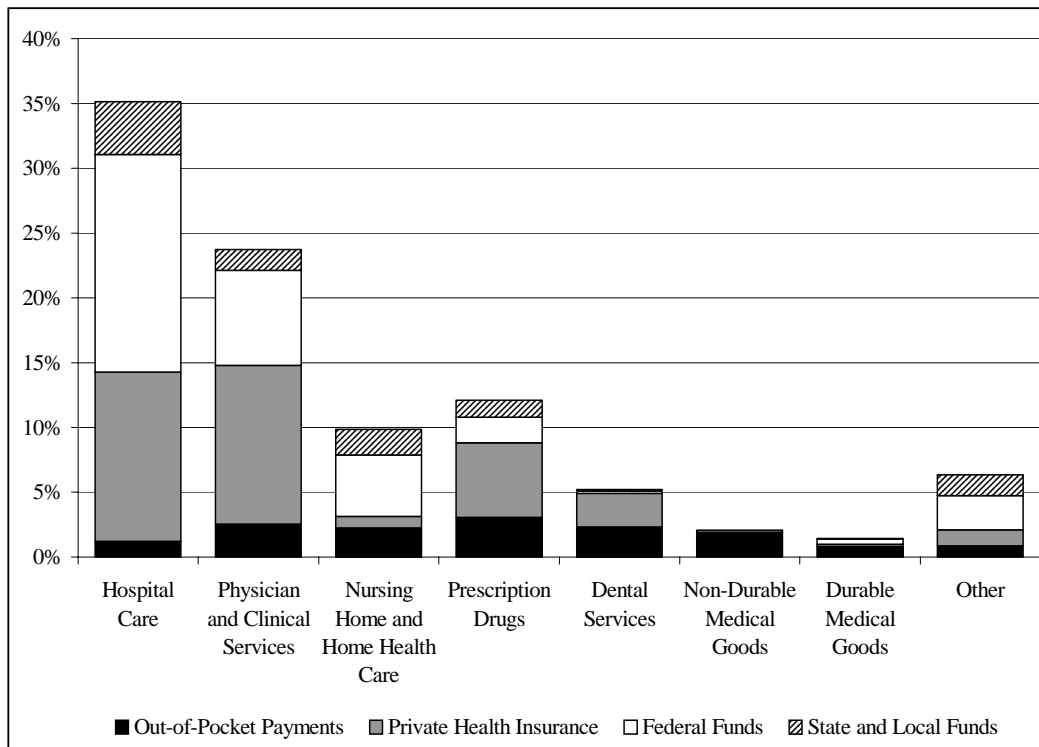


Source: The Congressional Research Service (CRS) calculations using data from the Centers for Medicare and Medicaid Services, Office of the Actuary.

⁷ Even when an individual's employer contributes part of the insurance premium, economic theory suggests that the individual accepts a lower wage in exchange for this benefit. Thus, individuals pay for all insurance premiums, either directly or in the form of forgone wages.

Although private insurance and the federal government are the largest payers of overall personal health expenditures, their role in financing health care varies by type of medical care. **Figure 7** illustrates how major categories of health care were funded in 2005 (detailed numbers for **Figure 7** are provided in **Table 2**). The two largest categories of personal health care, hospital care and physician services, were financed primarily by private insurance and the federal government. A small share of these services were paid out-of-pocket. Conversely, almost all expenditures on non-durable medical goods (which includes mostly over-the-counter drugs) were paid out-of-pocket, although this category represents only a small share of all personal health care expenditures. Private insurance plays a relatively small role in financing nursing home and home health care. These services were funded mostly by the federal government and out-of-pocket expenditures. Dental services and prescription drugs are funded mostly by private insurance and out-of-pocket expenditures; the federal government plays a relatively small role in the financing of these services. State and local funds account for a small share of expenditures in all categories. The contribution of these funds is largest in nursing home and home health care, and in hospital care.

Figure 7. Source of Funding for Major Categories of Personal Health Care Expenditures, 2005



Source: The Congressional Research Service (CRS) calculations using data from the Centers for Medicare and Medicaid Services, Office of the Actuary.

Table 2. Sources of Funding for Major Categories of Personal Health Care Expenditures, 2005
(amounts in billions)

Category of health care	Source of funding					Total
	Out-of-Pocket	Private health insurance	Federal funds	State and local funds	Other private funds	
Hospital care	\$20.1	\$217.0	\$279.4	\$67.7	\$27.4	\$611.6
Physician and clinical services	\$42.5	\$203.3	\$121.8	\$26.7	\$26.8	\$421.2
Prescription drugs	\$50.9	\$95.2	\$32.9	\$21.7	\$0.0	\$200.7
Nursing home and home health care	\$37.4	\$14.9	\$78.5	\$32.9	\$5.6	\$163.3
Dental services	\$38.3	\$43.1	\$3.1	\$2.1	\$0.1	\$86.6
Non-durable medical goods	\$32.0	\$0.0	\$2.1	\$0.0	\$0.0	\$34.1
Durable medical goods	\$13.7	\$2.9	\$7.0	\$0.4	\$0.0	\$24.0
Other	\$14.5	\$20.2	\$43.9	\$26.8	\$8.5	\$113.9
Total	\$249.4	\$596.7	\$568.5	\$178.4	\$68.4	\$1,661.4

Source: Centers for Medicare and Medicaid Services, Office of the Actuary.

Note: Numbers may not add up to total due to rounding.

Appendix

Table 3. Factors Influencing Growth in Nominal Personal Health Expenditures

Year	Increase in population	Increase in medical care prices	Increase in real per capita personal health care expenditures	Total increase in nominal personal health care expenditures (continuous growth rates)	Total increase in nominal personal health care expenditures (yearly growth rates)
1966	1.0%	4.9%	4.1%	10.1%	10.6%
1967	1.0%	4.8%	6.7%	12.5%	13.3%
1968	1.0%	5.6%	5.7%	12.3%	13.1%
1969	1.0%	5.8%	5.3%	12.1%	12.8%
1970	1.0%	6.2%	5.6%	12.7%	13.5%
1971	1.4%	6.0%	2.1%	9.5%	10.0%
1972	0.9%	3.9%	5.7%	10.5%	11.0%
1973	0.9%	3.8%	6.3%	11.0%	11.6%
1974	0.5%	8.8%	4.4%	13.6%	14.6%
1975	0.9%	10.2%	2.4%	13.6%	14.5%
1976	0.9%	8.5%	3.9%	13.2%	14.1%
1977	0.9%	7.6%	3.9%	12.3%	13.1%
1978	0.9%	7.6%	3.1%	11.6%	12.3%
1979	0.9%	8.7%	3.4%	13.0%	13.8%
1980	0.9%	10.8%	3.1%	14.7%	15.9%
1981	1.3%	11.5%	1.9%	14.7%	15.9%
1982	0.9%	10.2%	0.4%	11.4%	12.0%
1983	0.8%	7.2%	1.7%	9.8%	10.3%
1984	0.8%	7.3%	1.1%	9.2%	9.6%
1985	1.2%	7.0%	1.4%	9.7%	10.2%
1986	0.8%	4.8%	2.7%	8.4%	8.7%
1987	0.8%	4.7%	3.4%	9.0%	9.4%
1988	0.8%	6.0%	3.8%	10.6%	11.2%
1989	1.2%	6.6%	2.1%	9.9%	10.5%
1990	1.2%	6.5%	3.5%	11.1%	11.7%
1991	1.2%	5.5%	3.0%	9.7%	10.2%
1992	1.2%	5.1%	1.9%	8.1%	8.5%
1993	1.1%	4.5%	0.7%	6.4%	6.6%
1994	1.1%	3.7%	0.3%	5.1%	5.3%
1995	1.1%	3.5%	1.2%	5.9%	6.1%
1996	0.7%	2.9%	1.6%	5.3%	5.4%
1997	1.1%	2.1%	2.1%	5.3%	5.4%
1998	1.1%	2.1%	1.9%	5.1%	5.3%
1999	1.1%	2.7%	1.8%	5.6%	5.7%
2000	1.1%	3.3%	2.2%	6.5%	6.7%
2001	0.7%	3.8%	3.9%	8.3%	8.7%
2002	1.0%	3.8%	3.1%	7.9%	8.3%
2003	1.0%	3.6%	2.9%	7.5%	7.8%
2004	1.0%	4.0%	2.0%	7.0%	7.3%
2005	1.0%	3.5%	2.4%	6.9%	7.1%

Source: The Congressional Research Service (CRS) calculations using data from the U.S. Census Bureau and the Centers for Medicare and Medicaid Services, Office of the Actuary.

Note: Totals may not equal the sum of the parts due to rounding. Continuous growth rates can be converted to discrete yearly changes using the formula: [(annual change)=exp(continuous rate)-1].