

MEMORANDUM

December 1, 2009

To: Senator Tom Coburn
Attention: Evan Feinberg

From: Thomas L. Hungerford
Specialist in Public Finance
7-6422

Subject: **Public and Private Expenditures for Health Care, 2007**

This memorandum responds to your request for information on total national health expenditures for health care and the proportion funded by the federal, state and local governments. In particular you are interested in incorporating tax expenditures into the estimate of the proportion of national health expenditures coming from public sources. It can be argued that some private health expenditures should be attributed to the public sector because of tax subsidies available for health care spending.

Table 1 reports the breakdown of national health expenditures by source of funds. In 2007, national expenditures amounted to \$2.24 trillion, of which 53.8% came from private sources such as private health insurance and 46.8% came from public (federal, state, and local government) sources. This breakdown, however, does not take into consideration the tax subsidies for private funding for health care. For example, the exclusion of employer provided health care provides a subsidy for private health insurance, which could be counted as public funds rather than private funds.

Incorporating tax expenditures into the breakdown of health expenditures into public and private sources will change the results that are reported in **Table 1**. The intuition behind the analysis is fairly simple. For example, take a dollar an employer pays for a premium for an employee's health insurance. This dollar is part of the employee's compensation, but it is not taxed like other income (at an average federal, state, and local tax rate of 15%); it is excluded from income for income tax purposes. In essence, the employee receives a 15 cent government subsidy for this dollar spent on health insurance—the government pays 15 cents and the employee pays 85 cents.¹ This suggests that some funds that are classified as private in **Table 1** could arguably be classified as public funds.

¹ Most economists agree that the costs of employer provided fringe benefits are passed on to employees. See, for example, Katherine Baicker and Amitabh Chandra, "The Labor Market Effects of Rising Health Insurance Premiums," *Journal of Labor Economics*, vol. 24, no. 3 (2006), pp. 609-634; and Dana Goldman, Neeraj Sood, and Arleen Leibowitz, "Wage and Benefit Changes in Response to Rising Health Insurance Costs," *Forum for Health Economics and Policy*, vol. 8, article 3 (2005).

Table 1. National Health Expenditures by Funding Source, 2007

Source of Funds	Amount (billions)
Total National Expenditures	\$2,241.2
Private Funds	\$1,205.5
Out-of-pocket payments	\$268.6
Private Health Insurance	\$775.0
Other Private Funds	\$162.0
Public Funds	\$1,035.7
Medicare	\$431.2
Medicaid (federal, state and local)	\$329.4
Other Federal	\$137.0
Other state and local	\$138.1

Source: Center for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group, National Health Expenditure Data, table 3, available at <http://www.cms.hhs.gov/NationalHealthExpndData/downloads/tables.pdf>.

Table 2 reports the results of applying this reasoning to total national health expenditures. The table shows the funding sources and public/private breakdown as reported by the Center for Medicare and Medicaid Services (CMS) in the first column. The two columns of numbers show the revised split between public and private funds based on applying the reasoning described above to tax expenditures (the method is described below).

Table 2. Revised National Health Expenditures by Funding Source, 2007

(billions of dollars)

Source of Funds	Private	Public
Private (CMS definition)	\$894.8	\$310.7 ^a
Out-of-pocket payments	\$257.1	\$11.5 ^a
Private Health Insurance	\$482.1	\$292.9 ^a
Other Private Funds	\$155.7	\$6.3 ^a
Public Funds (CMS definition)		\$1,035.7
Medicare		\$431.2
Medicaid		\$329.4
Other Federal		\$137.0
Other State and local		\$138.1
Total	\$894.8	\$1,346.4

Source: CRS analysis of CMS data.

Note: ^aThe public portion is due to tax expenditures.

CMS attributes \$268.6 billion of out-of-pocket expenditures to private sources. However, taxpayers are allowed to deduct out-of-pocket medical expenditures exceeding 7.5% of adjusted gross income on their federal and state tax forms. The Joint Committee on Taxation estimates that the federal government lost \$8.7 billion in tax revenue in 2007 from this deduction.² Other tax expenditures for out-of-pocket expenses amount to \$0.3 billion. State and local income tax revenues are about 28% of federal income tax revenues; it is assumed that state and local revenue losses from tax expenditures will also be 28% of federal revenue loss estimates. Consequently, it is estimated that state and local governments lost \$2.5 billion from these tax expenditures. The total tax subsidy for out-of-pocket health expenditures is \$11.5 billion.

The Joint Committee on Taxation estimates that federal government forgoes \$251.0 billion in income and payroll tax revenue due to the exclusion of employer provided health insurance and other health insurance deductions.³ State and local government lose \$41.9 billion in income tax revenue because of these exclusions and deductions. Consequently, \$292.9 billion of the \$775.0 billion for health insurance is classified as coming from public funds. Other private funds for health expenditures include charitable contributions to hospitals and other providers. These charitable contributions are deductible and reduce federal, state, and local tax revenues by \$6.3 billion.⁴ This analysis estimates that \$310.7 billion of health expenditures that CMS attributes to private funds could be considered public funds.

The last row of **Table 2** reports the revised breakdown of national health care expenditures between private and public sources. It is estimated that public funding sources account for \$1,346.4 billion—60% of national health expenditures can be attributed to public sources.

² U.S. Congress, Joint Committee on Taxation, *Tax Expenditures for Health Care*, 110th Cong., 2nd sess., July 31, 2008, JCX-66-08, p. 2.

³ For example, the self-employed are allowed to deduct their health insurance.

⁴ Federal tax revenue losses were estimated to be \$4.9 billion in 2007. See U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2007-2011*, 110th Cong., 1st sess., September 24, 2007, JCS-3-07 (Washington: GPO, 2007). State and local 2007 tax expenditures are estimated to \$1.4 billion.
