National Health Spending In 2007: Slower Drug Spending Contributes To Lowest Rate Of Overall Growth Since 1998

Health spending growth outpaced a slowing economy and increased as a share of gross domestic product.

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ABSTRACT: In 2007, U.S. health care spending growth slowed to its lowest rate since 1998, increasing 6.1 percent to $2.2 trillion, or $7,421 per person. The health care portion of gross domestic product reached 16.2 percent, up from 16.0 percent in 2006. Slower growth in 2007 was largely attributed to retail prescription drug spending and government administration. With the exception of prescription drugs, most other health care services grew at about the same rate as or faster than in 2006. Spending growth from private sources accelerated in 2007 as public spending slowed; however, public spending growth has continued to outpace private sources since 2002. [*Health Affairs* 28, no. 1 (2009): 246–261; 10.1377/hlthaff.28.1.246]

HEALTH CARE SPENDING IN THE UNITED STATES grew 6.1 percent to $2.2 trillion, or $7,421 per person, in 2007 (Exhibits 1 and 2). The health spending share of gross domestic product (GDP) reached 16.2 percent—an increase over the 16.0 percent share in 2006. This paper presents national health expenditure (NHE) estimates through 2007, with a focus on recent trends in the health care goods and services purchased, the sources of funds used to pay for those purchases, and the sponsors of U.S. health care spending. The NHE estimates measure the total annual spending for health care goods and services in the United States as well as spending for program administration; the net cost of private health insurance; government public health; and the amount invested in

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EXHIBIT 1
National Health Expenditures (NHE), Aggregate And Per Capita Amounts, And Share Of Gross Domestic Product (GDP), Selected Calendar Years 1970–2007

Spending category	1970	1980	1990	2000	2004	2005	2006	2007
NHE, billions	$74.9	$253.4	$714.1	$1,353.2	$1,854.8	$1,980.6	$2,112.7	$2,241.2
Health services and supplies	67.1	233.4	666.8	1,264.4	1,733.1	1,850.4	1,976.1	2,098.1
Personal health care (PHC)	62.9	214.8	607.6	1,139.2	1,550.2	1,655.1	1,765.5	1,878.3
Hospital care	27.6	101.0	251.6	416.9	566.8	607.5	649.3	696.5
Professional services	20.6	67.3	216.8	426.8	581.2	621.5	661.4	702.1
Phys. and clinical services	14.0	47.1	157.6	288.6	393.6	422.2	449.7	478.8
Other prof. services	0.7	3.6	18.2	39.1	52.9	56.0	58.7	62.0
Dental services	4.7	13.3	31.5	62.0	81.5	86.4	90.5	95.2
Other PHC	1.2	3.3	9.6	37.1	53.3	56.9	62.5	66.2
Home health and nursing home care	4.3	20.9	65.2	125.8	157.9	168.7	178.4	190.4
Home health care[a]	0.2	2.4	12.6	30.5	42.7	48.1	53.0	59.0
Nursing home care[a]	4.0	18.5	52.6	95.3	115.2	120.6	125.4	131.3
Retail outlet sales of medical products	10.5	25.7	74.0	169.8	244.3	257.5	276.4	289.3
Prescription drugs	5.5	12.0	40.3	120.6	188.8	199.7	216.8	227.5
Durable medical equipment	1.6	3.8	11.3	19.4	22.8	23.8	24.2	24.5
Other nondurable medical products	3.3	9.8	22.5	29.8	32.7	34.0	35.3	37.4
Program administration and net cost of private health insurance	2.8	12.2	39.2	81.8	128.8	138.7	150.4	155.7
Government public health activities	1.4	6.4	20.0	43.4	54.0	56.6	60.2	64.1
Investment	7.8	19.9	47.3	88.8	121.7	130.2	136.6	143.1
Research[b]	2.0	5.4	12.7	25.6	38.8	40.2	41.3	42.4
Structures and equipment	5.8	14.5	34.7	63.2	83.0	90.0	95.2	100.7
Population (millions)	210.2	230.4	253.8	282.5	293.5	296.2	299.1	302.0
NHE per capita	$356	$1,100	$2,814	$4,789	$6,319	$6,687	$7,062	$7,421
GDP, billions of dollars	$1,039	$2,790	$5,803	$9,817	$11,686	$12,422	$13,178	$13,808
NHE as percent of GDP	7.2%	9.1%	12.3%	13.8%	15.9%	15.9%	16.0%	16.2%
Implicit price deflator for GDP	27.5	54.0	81.6	100.0	109.5	113.0	116.7	119.8
Real GDP, billions of chained dollars	$3,772	$5,162	$7,113	$9,817	$10,676	$10,990	$11,295	$11,524
Real NHE, billions of 2000 dollars[c]	$272	$469	$875	$1,353	$1,695	$1,752	$1,811	$1,871
PHC deflator[d]	16.0	34.5	70.4	100.0	116.3	120.5	124.6	128.8

SOURCES: Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group; and U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census.

[a] Freestanding facilities only. Additional services of this type are provided in hospital-based facilities and counted as hospital care.

[b] Research and development expenditures of drug companies and other manufacturers and providers of medical equipment and supplies are excluded from "research expenditures" but are included in the expenditure class in which the product falls.

[c] Deflated using the implicit price deflator for GDP (2000 = 100.0).

[d] PHC implicit price deflator is constructed from the Producer Price Index for hospital care, Nursing Home Input Price Index for nursing home care, and Consumer Price Indices specific to each of the remaining PHC components.

structures, equipment, and noncommercial research. These estimates are developed using data and information from a variety of sources such as Medicare and Medicaid program data, the Census Bureau's quinquennial Economic Census and Service Annual Survey, provider-based surveys, private health insurance filings with state insurance commissioners, and other sources.[1]

The 2007 rate of growth in NHE was the slowest since 1998, and 0.6 of a per-

EXHIBIT 2
National Health Expenditures (NHE), Average Annual Growth From Prior Year Shown, Selected Calendar Years 1970–2007

Spending category	1970[a]	1980	1990	2000	2004	2005	2006	2007
NHE	10.5%	13.0%	10.9%	6.6%	8.2%	6.8%	6.7%	6.1%
Health services and supplies	10.4	13.3	11.1	6.6	8.2	6.8	6.8	6.2
Personal health care (PHC)	10.4	13.1	11.0	6.5	8.0	6.8	6.7	6.4
Hospital care	11.6	13.9	9.6	5.2	8.0	7.2	6.9	7.3
Professional services	9.5	12.5	12.4	7.0	8.0	6.9	6.4	6.2
Phys. and clinical services	10.1	12.9	12.8	6.2	8.1	7.3	6.5	6.5
Other prof. services	6.6	17.1	17.5	8.0	7.9	6.0	4.8	5.6
Dental services	9.1	11.1	9.0	7.0	7.1	6.0	4.7	5.2
Other PHC	7.3	10.1	11.4	14.5	9.5	6.8	9.8	5.9
Home health and nursing home care	17.2	17.2	12.1	6.8	5.8	6.9	5.8	6.7
Home health care[b]	14.5	26.9	18.1	9.3	8.8	12.6	10.3	11.3
Nursing home care[b]	17.4	16.4	11.0	6.1	4.9	4.7	4.0	4.8
Retail outlet sales of medical products	7.8	9.4	11.2	8.7	9.5	5.4	7.4	4.6
Prescription drugs	7.5	8.2	12.8	11.6	11.9	5.8	8.6	4.9
Durable medical equipment	9.7	8.9	11.5	5.6	4.1	4.2	2.0	0.9
Other nondurable medical products	7.4	11.4	8.6	2.9	2.4	3.9	4.0	5.7
Program administration and net cost of private health insurance	8.6	16.0	12.4	7.6	12.0	7.6	8.4	3.6
Government public health activities	12.8	16.5	12.0	8.1	5.6	4.7	6.5	6.4
Investment	11.7	9.9	9.0	6.5	8.2	7.0	4.9	4.8
Research[c]	10.9	10.8	8.9	7.3	10.9	3.8	2.7	2.7
Structures and equipment	11.9	9.5	9.1	6.2	7.0	8.5	5.8	5.7
Population	1.2	0.9	1.0	1.1	1.0	0.9	1.0	1.0
NHE per capita	9.2	11.9	9.9	5.5	7.2	5.8	5.6	5.1
GDP	7.0	10.4	7.6	5.4	4.5	6.3	6.1	4.8
Implicit price deflator for GDP	2.7	7.0	4.2	2.1	2.3	3.3	3.2	2.7
Real GDP, billions of chained dollars	4.2	3.2	3.3	3.3	2.1	2.9	2.8	2.0
Real NHE, billions of 2000 dollars[d]	7.6	5.6	6.4	4.5	5.8	3.4	3.3	3.3
PHC deflator[e]	4.1	8.0	7.4	3.6	3.9	3.6	3.4	3.4

SOURCES: Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group; and U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census.

[a] Average annual growth, 1960–1970.

[b] Freestanding facilities only. Additional services of this type are provided in hospital-based facilities and counted as hospital care.

[c] Research and development expenditures of drug companies and other manufacturers and providers of medical equipment and supplies are excluded from "research expenditures" but are included in the expenditure class in which the product falls.

[d] Deflated using the implicit price deflator for GDP (2000 = 100.0).

[e] PHC implicit price deflator is constructed from the Producer Price Index for hospital care, Nursing Home Input Price Index for nursing home care, and Consumer Price Indices specific to each of the remaining PHC components.

centage point lower than the 6.7 percent growth in 2006 (Exhibit 2). The deceleration in 2007 was attributed mostly to slower growth in both retail prescription drug spending and Medicare spending associated with administering the Medicare benefit. Retail prescription drug spending grew 4.9 percent in 2007, the slowest rate of growth since 1963, accounting for more than half of the 2007 slowdown in overall NHE growth. For retail prescription drugs, the deceleration in 2007 resulted from several factors, including a further increase in the generic dispensing

rate, slower growth in prescription drug prices, and growing consumer safety concerns.[2] Growth in administrative spending for the Medicare program accounted for most of the remainder of the overall slowdown in 2007. Medicare administration spending growth slowed to 10.7 percent, from 62.5 percent in 2006 associated with the one-time impact of the implementation of Medicare Part D.

When viewed more broadly, slower growth in NHE between 2002 and 2007 can be divided into two periods for analysis. From 2002 to 2004, growth in NHE decelerated rapidly, from 9.0 percent to 6.9 percent, with slower growth in the net cost of private insurance and retail prescription drug spending as well as smaller slowdowns in several other categories such as hospital and government public health. From 2004 to 2007, NHE growth slowed much less rapidly, from 6.9 percent to 6.1 percent. While growth in prescription drug and physician and clinic spending contributed to the deceleration over the period, the relative stability of growth in hospital spending, which constituted just over 30 percent of total NHE, contributed to the moderation in the overall trend.

Between 2004 and 2007, public spending for health care grew at an average annual rate of 7.2 percent, compared with 5.9 percent for private spending. This recent spending trend is consistent with the longer-run experience, which shows an average annual growth of 10.5 percent for public spending and 9.5 percent for private spending between 1970 and 2004. As a result, the share of total NHE spending paid for by public sources increased from 37.6 percent in 1970 to 45.3 percent in 2004, and then to 46.2 percent in 2007.

Recent faster growth in public spending was attributable in part to health-related legislation, most notably the Medicare Prescription Drug, Improvement, and Modernization Act (MMA) of 2003. Under this legislation, Medicare beneficiaries gained access to Part D prescription drug coverage in 2006, adding $40.5 billion to Medicare expenditures (this increase in public spending was partially offset by lower Medicaid drug spending for Medicare beneficiaries; Exhibit 3). Additionally, MMA authorized higher payments to Medicare Advantage (MA) plans, which created incentives for those plans to expand enrollment by increasing their areas of coverage and expanding the benefits offered.[3] Since the MA provisions of MMA were implemented in 2004, enrollment in MA plans has increased, on average, 17.0 percent annually. The main drivers of slower growth in private spending from 2004 to 2007 were slower growth in prescription drug spending and the net cost of private health insurance. Slower growth in retail prescription drug spending had a larger impact on private spending than on public spending, as private sources accounted for a majority (approximately two-thirds) of drug spending.

Retail Prescription Drugs

In 2007, retail prescription drug spending increased 4.9 percent to $227.5 billion; this was a deceleration from 8.6 percent growth in 2006. As mentioned ear-

EXHIBIT 3
Medicare Prescription Drug And Part D Expenditures, Calendar Years 2006 And 2007

	2007			2006		
	Total	FFS/PDP[a]	MA/MA-PD[b]	Total	FFS/PDP[a]	MA/MA-PD[b]
Medicare Rx drugs ($ millions)	$47,019	$36,224	$10,795	$39,516	$31,075	$8,441
Part B Rx drugs	4,787	1,747	3,040	3,773	1,575	2,197
Part D Rx drugs	42,233	34,477	7,755	35,743	29,500	6,244
Part D spending ($ millions)	47,612	38,584	9,028	40,511	32,766	7,745
Part D Rx drugs	42,233	34,477	7,755	35,743	29,500	6,244
Part D administration[c]	5,379	4,107	1,272	4,767	3,266	1,501
Part D enrollment[d] (millions)	24.2	16.9	7.3	20.3	14.3	6.0
Dual eligibles[e]	5.9	5.2	0.7	5.7	5.1	0.6
Other low income	3.3	2.6	0.6	2.6	2.1	0.5
All other[f]	15.0	9.0	6.0	12.1	7.1	5.0
Percent distribution of enrollment	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Dual eligibles[e]	24.4	31.1	9.0	28.0	35.8	9.4
Other low income	13.5	15.6	8.7	12.6	14.6	7.9
All other[f]	62.1	53.3	82.3	59.4	49.6	82.7
Part D Rx drugs						
Spending per enrollee	$1,745	$2,045	$1,057	$1,758	$2,064	$1,034
Spending growth per enrollee	−0.7%	−0.9%	2.2%	–[g]	–[g]	–[g]

SOURCE: Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group.

NOTES: Numbers presented are rounded; therefore, per enrollee calculations derived from rounded figures may not match data presented. FFS is fee-for-service. PDP is prescription drug plan. MA is Medicare Advantage. MA-PD is MA prescription drug plan.

[a] Stand-alone prescription drug plans; pertains to Part D prescription drug spending only.

[b] Pertains to Part D prescription drug spending only.

[c] Includes federal administrative costs as well as the administrative costs, profits or losses, and other nonbenefit factors for private Part D drug insurance plans.

[d] Enrollment totals exclude Medicare beneficiaries in employer-sponsored retiree health plans that qualify for the Part D employer subsidies.

[e] Medicare beneficiaries who also qualify for full Medicaid coverage.

[f] Includes plans for beneficiaries who are not qualified for the low-income subsidy.

[g] Not applicable.

lier, the factors that contributed to slower growth in 2007 included an increase in the generic dispensing rate, slower growth in prescription drug prices, and growing consumer safety concerns.

■ **Generic dispensing rate.** The generic dispensing rate increased to 67 percent in 2007, up from 63 percent in 2006 and 60 percent in 2005.[4] Because generic drugs cost, on average, 30–80 percent less than brand-name drugs, increases in the generic dispensing rate contribute to slower spending growth.[5] The loss of patent exclusivity for several major blockbuster medications in 2006, including Flonase, Pravachol, Zocor, and Zoloft, had a large impact on the 2007 prescription drug trend, as six-month generic exclusivities expired for some of these drugs and additional generic medications became available.[6] Additionally, the impact of the loss of patent exclusivity for some major blockbusters in 2007, most notably Norvasc, Ambien, Lotrel, Coreg, and Toprol-XL, also contributed to increased use of generic drugs and slower

"The loss of patent exclusivity for several major blockbuster medications in 2006 had a large impact on the 2007 trend."

growth in total drug spending in 2007.[7]

■ **Drug prices and growing safety concerns.** Prescription drug prices, as reflected in the National Health Expenditure Accounts (NHEA), grew 1.4 percent in 2007, much slower than the 3.5 percent growth in 2006.[8] This lower price growth was driven in part by increased use of generics and the introduction of generic drug discount programs by large retail chain stores.[9] Increased safety concerns for certain prescription drugs in 2007 also likely influenced the drug spending trend, as the Food and Drug Administration (FDA) issued sixty-eight "black box" warnings, compared to fifty-eight in 2006 and twenty-one in 2003.[10]

■ **Medicare prescription drug spending.** Not surprisingly, Medicare retail prescription drug benefit spending (including both Parts B and D) grew more slowly in 2007 than in 2006, which included the one-time growth effect of adding the new drug benefit. However, Medicare retail prescription drug spending still increased at a robust rate of 19.0 percent—faster than growth in any other source of funds that paid for prescription drugs in 2007. Total Medicare Part D spending in 2007 amounted to $47.6 billion, of which $42.2 billion was spent on benefits and $5.4 billion on administrative costs (including payments to private plans that administer the Part D benefit). This was an increase of 17.5 percent over the 2006 level of $40.5 billion, with benefits (which represent almost 90 percent of all Medicare Part D spending) growing 18.2 percent and administrative spending growing 12.8 percent.

The increase in Part D spending was influenced primarily by increased enrollment in stand-alone prescription drug plans (PDPs) and MA prescription drug (MA-PD) plans. Total person-year-equivalent enrollment in Part D plans increased 19 percent in 2007 to 24.2 million, up from 20.3 million in 2006.[11] When Part D was introduced, beneficiaries were given until 15 May 2006 to enroll in a prescription drug plan; as a result, some beneficiaries delayed enrollment and therefore were not included for the full year in 2006. For 2007, however, beneficiaries were required to enroll in a Medicare Part D plan by 31 December 2006. The significant increase in enrollment in 2007 reflects these different enrollment cutoff dates, which would not have occurred had both years included enrollees over the full twelve-month period.

Although Part D spending and enrollment increased just under 20 percent in 2007, Part D benefit spending per enrollee actually declined 0.7 percent, from $1,758 in 2006 to $1,745 in 2007. This was largely the result of the initial open enrollment period ending 15 May 2006. Beneficiaries who were enrolled for the full year in 2006 tended to be more costly than average, while those enrolling toward the end of the open enrollment period tended to be less costly than average.[12] This resulted in a somewhat inflated per enrollee cost in 2006. Additionally, other fac-

tors that may explain the slower per enrollee growth in Part D spending were (1) a reduction in plan bid levels, on average, as a result of the availability of later data on drug costs, as well as (2) plans' efforts to control costs by negotiating discounts and rebates with drug companies and (3) by monitoring utilization management.[13]

Trends In Major Services

■ **Hospitals.** Hospital spending growth increased 7.3 percent in 2007, to $696.5 billion. This marks the third straight year of relatively stable growth in the range of 6.9–7.3 percent after an average annual rate of 8.0 percent from 2000 through 2004. By comparison, the average annual growth for hospital services was 5.2 percent between 1990 and 2000, a period greatly influenced by more tightly managed care.[14] The slight up-tick in hospital spending in 2007 (from 6.9 percent in 2006) was influenced by strong growth in Medicaid hospital spending. In contrast, Medicare hospital spending growth remained relatively stable at 4.6 percent in 2007, reflecting slower growth in fee-for-service (FFS) inpatient and outpatient use together with strong growth in managed care hospital spending as additional beneficiaries enrolled in MA plans.[15] Growth in total inpatient days, as reported by the American Hospital Association, was flat or declining from 2003 through 2006.[16] Inpatient revenue accounted for $6 out of every $10 for the average community hospital in 2006.[17]

Hospital price growth, as measured by the Producer Price Index (PPI) for hospitals, slowed from 4.4 percent in 2006 to 3.5 percent in 2007.[18] Price growth accounted for about half of the total growth in hospital spending, while utilization, service intensity, and population growth accounted for the remainder. Input price growth slowed slightly as well, from 4.0 percent in 2006 to 3.5 percent in 2007.[19]

■ **Physicians and clinics.** Spending for physician and clinical services grew 6.5 percent in 2007 to $478.8 billion, the same rate of growth as 2006. However, when viewed separately, rates of spending growth for physicians compared to clinics reveal disparate trends. Spending for physician services, which slowed from 6.4 percent in 2006 to 5.9 percent in 2007, accounts for around 80 percent of this category. Some of this slowdown can be explained by a legislated reduction in Medicare payments to physicians for imaging services that took effect in 2007.[20]

From 2004 through 2007, clinic spending outpaced physician spending, growing at an average annual rate of 8.5 percent versus 6.4 percent, respectively. Spending for outpatient services performed in stand-alone clinics and urgent care centers continued to increase, contributing to the trend between 2004 and 2007.[21]

Price growth for physician services, as measured by the Consumer Price Index (CPI) for physicians services, increased 3.9 percent in 2007, up from 1.8 percent in 2006.[22] This acceleration in price, combined with relatively stable overall spending growth, indicates a sharp decrease in nonprice factors such as the use or intensity of services paid for in 2007. Recent survey data indicate that the number of physician office visits declined from the end of 2006 through 2007.[23]

■ **Nursing homes and home health.** Spending growth for freestanding nursing home care accelerated a bit in 2007, increasing 4.8 percent to $131.3 billion from 4.0 percent in 2006.[24] A major factor underlying the trend in 2007 was faster growth in prices, 4.7 percent in 2007, following slower growth of 3.0 percent in 2006, as reported in the PPI for nursing care facilities.[25] Private spending increased 6.8 percent in 2007 following 4.1 percent growth in 2006, while public spending growth remained roughly unchanged at 3.6 percent in 2007. Medicaid accounted for 42 percent of all nursing home spending in 2007; however, with a growth rate of only 0.4 percent in 2007, it did not contribute to the acceleration in overall nursing home spending. Medicare spending growth for nursing home services remained roughly the same at 10.2 percent in 2007, down from 10.5 percent in 2006.

Spending growth for freestanding home health care services increased 11.3 percent, reaching $59.0 billion in 2007. Home health care price growth, as measured by the PPI for home health care services, grew faster in 2007, increasing 1.8 percent compared to 0.6 percent in 2006.[26] Much of the growth in home health spending continues to be influenced by nonprice factors, such as use and intensity.

Spending for freestanding hospice services, included in home health in the NHEA, increased on average 20 percent annually from 2000 to 2007, as the Balanced Budget Refinement Act (BBRA) of 1999 and the Benefits Improvement and Protection Act (BIPA) of 2000 increased payments to various providers, including hospice. In addition, use of the hospice benefit and the supply of hospice providers have increased, both contributing to strong growth in hospice spending.[27] Medicaid spending for home health care increased rapidly between 2000 and 2007 (averaging 17.2 percent annually), in part as a result of states' continued focus on providing care to Medicaid enrollees in their homes as an alternative to high-cost institutions.[28]

Trends In Major Payers

■ **Medicare.** Medicare spending increased 7.2 percent in 2007, to $431.2 billion, more in line with the average annual growth of 6.3 percent observed from 1995 to 2005, following the 18.5 percent increase in 2006 that resulted from the one-time impact of the implementation of Medicare Part D (Exhibit 4). Spending growth for FFS Medicare, which accounted for about 80 percent of total Medicare spending in 2007, slowed significantly to 3.6 percent in 2007 (data not shown). As beneficiaries switched from traditional FFS to MA plans, FFS enrollment declined (−2.3 percent in 2006 and −0.8 percent in 2007) while MA enrollment grew (28.8 percent in 2006 and 16.3 percent in 2007). In 2003, MA spending growth declined 0.3 percent; however, since then it has grown strongly, increasing 23.3 percent in 2007. This increase in MA spending accounted for almost 60 percent of the total change in Medicare spending in 2007, largely because of the shift in enrollment.

Spending growth for MA is heavily influenced by increases or decreases in enrollment, as payments are based on plan-specific per member per month capitated

EXHIBIT 4
National Health Expenditures (NHE), Amounts And Average Annual Growth From Previous Year Shown, By Source Of Funds, Selected Calendar Years 1970–2007

Source of funds	1970[a]	1980	1990	2000	2004	2005	2006	2007
NHE, billions	$74.9	$253.4	$714.1	$1,353.2	$1,854.8	$1,980.6	$2,112.7	$2,241.2
Private funds	46.8	147.0	427.4	756.4	1,014.9	1,081.6	1,139.7	1,205.5
Consumer payments	40.4	127.0	369.9	647.4	880.8	937.0	986.3	1,043.5
Out-of-pocket payments	24.9	58.1	136.2	192.6	234.9	247.0	255.0	268.6
Private health insurance	15.5	68.8	233.7	454.7	645.9	690.0	731.3	775.0
Other private funds	6.4	20.0	57.5	109.0	134.2	144.6	153.4	162.0
Public funds	28.1	106.3	286.8	596.8	839.9	899.0	973.0	1,035.7
Federal	17.7	71.6	193.9	417.7	599.5	640.3	707.6	754.4
Medicare	7.7	37.2	109.5	224.4	311.2	339.4	402.3	431.2
Medicaid	2.8	14.5	42.5	117.3	171.1	177.8	174.9	186.1
Other federal[b]	7.2	19.9	41.9	76.1	117.3	123.1	130.4	137.0
State and local	10.4	34.8	92.8	179.0	240.4	258.7	265.4	281.3
Medicaid	2.4	11.5	31.1	83.3	119.4	133.7	134.5	143.3
Other state and local[c]	7.9	23.2	61.7	95.8	121.0	125.0	130.8	138.1
Total Medicaid[d]	5.3	26.0	73.7	200.5	290.5	311.5	309.4	329.4
Average annual growth from prior year shown								
NHE	10.5%	13.0%	10.9%	6.6%	8.2%	6.8%	6.7%	6.1%
Private funds	8.5	12.1	11.3	5.9	7.6	6.6	5.4	5.8
Consumer payments	8.0	12.1	11.3	5.8	8.0	6.4	5.3	5.8
Out-of-pocket payments	6.8	8.8	8.9	3.5	5.1	5.2	3.3	5.3
Private health insurance	10.2	16.1	13.0	6.9	9.2	6.8	6.0	6.0
Other private funds	12.2	12.2	11.1	6.6	5.3	7.8	6.1	5.6
Public funds	15.3	14.2	10.4	7.6	8.9	7.0	8.2	6.4
Federal	20.0	15.0	10.5	8.0	9.5	6.8	10.5	6.6
Medicare	–[e]	17.1	11.4	7.4	8.5	9.1	18.5	7.2
Medicaid	–[e]	17.7	11.4	10.7	9.9	4.0	−1.6	6.4
Other federal[b]	9.7	10.7	7.7	6.2	11.4	5.0	5.9	5.1
State and local	10.2	12.8	10.3	6.8	7.6	7.6	2.6	6.0
Medicaid	–[e]	16.8	10.4	10.3	9.4	12.0	0.6	6.5
Other state and local[c]	7.3	11.3	10.3	4.5	6.0	3.3	4.7	5.5
Total Medicaid[d]	–[e]	17.3	11.0	10.5	9.7	7.2	−0.7	6.4

SOURCE: Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group.

NOTE: Numbers might not add to totals because of rounding.

[a] Average annual growth, 1960–1970.

[b] Includes State Children's Health Insurance Program (SCHIP), maternal and child health, vocational rehabilitation, Substance Abuse and Mental Health Services Administration, Indian Health Service, federal workers' compensation, public health activities, Department of Defense, Department of Veterans Affairs, and other miscellaneous general hospital and medical programs.

[c] Includes SCHIP, maternal and child health, public and general assistance, vocational rehabilitation, state/local hospital subsidies, public health activities, and other miscellaneous medical programs.

[d] Subset of public funds; includes both the federal and the state and local portion of Medicaid.

[e] Not applicable; Medicare and Medicaid became effective in July 1966.

rates. Beginning in 2006, as mandated by MMA, payments are based on amounts "bid" by private MA plans. In addition, under MMA, payment rates to these plans were increased, which led to higher enrollment because plans could offer expanded coverage and provide additional benefits.[29] As such, per enrollee MA spending increased 15.5 percent in 2006 (including the introduction of Part D) , followed by 6.0 percent in 2007.

The slowdown in total Medicare spending growth in 2007 was most dramatic for prescription drugs and administration. In addition, the slowdown was broadly

"Many states reported continued widespread use of pharmacy cost containment strategies in 2007."

based across many other services, including physician and clinical services as well as smaller contributions from durable medical equipment, home health care, nursing home care, and other nondurable medical products. Medicare spending for physician and clinic services decelerated, from 6.3 percent in 2006 to 4.6 percent in 2007, as growth in volume and intensity slowed and the Deficit Reduction Act (DRA) of 2005 reduced payments to physicians for imaging services.[30]

■ **Medicaid.** Medicaid spending grew 6.4 percent in 2007 to $329.4 billion, following the first decrease (−0.7 percent) in program history in 2006. The 2007 increase marks the return to a more "normal" growth trend following implementation of Medicare Part D, which shifted drug funding for dual eligibles from Medicaid to Medicare. Growth in Medicaid spending averaged 8.0 percent annually between 1995 and 2005.

When prescription drug spending is excluded, the year-to-year change between 2006 and 2007 in all other Medicaid spending is less dramatic: 5.8 percent in 2006 and 7.1 percent in 2007. Medicaid spending growth for hospital services contributed greatly to this increase. Spending for hospital care, which makes up more than one-third of all Medicaid spending, grew 8.9 percent in 2007, much faster than in 2006 (4.9 percent). This acceleration was largely attributable to increases in inpatient and outpatient payments as states provided additional supplemental payments to hospitals.[31] Other personal health care and home health care also contributed to the increase in Medicaid spending in 2007, as states continued to use home and community-based services (HCBS) waivers and home health services as an alternative to institutional care. Medicaid spending for dental care (less than 2 percent of total Medicaid spending) increased 13.9 percent in 2007, a significant acceleration from growth of 2.7 percent in 2006. Recently, some states have taken steps to increase access to dental care by increasing provider payments and streamlining billing practices.[32]

At the same time, Medicaid spending for prescription drugs and other professional services declined in 2007. Historically, drug spending has been one of the fastest-growing categories of Medicaid spending, doubling its share of Medicaid spending from 6.3 percent in 1993 to 12.5 percent in 2004. Following the most recent peak in Medicaid prescription drug spending growth—in 1999, when spending increased 20.8 percent—many states aggressively pursued policies that slowed the rate of spending growth for prescription drugs.[33]

In 2007, Medicaid prescription drug spending decreased 1.8 percent, following a larger decline of 48.6 percent in 2006 (associated with the implementation of Medicare Part D). The decline in 2007 was widespread, with thirty-one states reporting spending less in 2007 than in 2006 (data not shown). Many states re-

ported continued widespread use of pharmacy cost containment strategies in 2007, including prior authorization, preferred drug lists, supplemental rebate programs, Maximum Allowable Cost programs, and multistate purchasing pools.[34]

Medicaid spending for other professional services also declined, falling 1.2 percent in 2007 after a decline of 0.6 percent in 2006. These types of services, which include providers such as podiatrists and chiropractors, are not mandatory in Medicaid and continue to be subject to state cuts and increases in copayments.[35]

■ **Private health insurance spending.** Private health insurance premiums increased 6.0 percent to $775.0 billion in 2007—the same rate as in 2006 but much lower than the recent peak of 10.7 percent in 2002. Some factors that explain the slower growth trend are a reduction in small employers' offer rates for insurance, a decline in the share of population covered by private insurance (from 68 percent in 2002 to 65 percent in 2007; data not shown), and the recent increased take-up rates of high-deductible plans (HDPs) and health savings accounts (HSAs).[36] The net cost of private health insurance (the difference between premiums and benefits) grew just 1.4 percent in 2007. Since 2004, spending for private health insurance premiums has grown at the same rate as or slower than spending for benefits, reducing the share of premiums accounted for by the net cost of private insurance from 13.2 percent in 2004 to 12.2 percent in 2007. Although more muted than in past decades, this trend is typical of a downturn in the underwriting cycle.[37]

Private health insurance benefit payments accounted for 87.8 percent of premiums in 2007, and benefit growth slowed from a rate of 9.4 percent in 2002 to 6.6 percent in 2007. As noted earlier, an important factor was the slower growth in private health insurance payments for prescription drugs.

In 2007, premiums for employment-based insurance continued to account for the vast majority (95 percent) of total private health insurance premiums. Employers' proportions of these premiums fell very slightly, from 73.1 percent in 2006 to 72.9 percent in 2007. The lower share in employer spending was due in part to the Medicare Part D retiree drug subsidy ($3.8 billion in 2006 and $4.0 billion in 2007), which is provided to employers that offer qualifying drug coverage to retired Medicare-eligible employees. This subsidy can be used to help offset the cost increases faced by both private businesses and state and local governments.

■ **Out-of-pocket spending.** In 2007, out-of-pocket health spending grew 5.3 percent to $268.6 billion, after increasing 3.3 percent in 2006. This acceleration was mainly due to increased out-of-pocket spending for retail prescription drugs, nursing home services, and nondurable medical supplies. Out-of-pocket drug spending rebounded to a growth rate of 1.8 percent following a −4.0 percent decline in 2006 that was a result of the implementation of Medicare Part D, which shifted some out-of-pocket spending for Medicare beneficiaries without drug coverage to Medicare Part D.

Analysis Of Spending By Sponsor

The relative shares of financing for the health services and supplies sponsored by businesses, households, government entities, and other private sources remained steady at both an aggregate and an underlying-detail level in 2007.[38] This stability is in contrast to the movements observed in 2006, when Medicare Part D caused noticeable shifts in the shares of the underlying-sponsor categories.

■ **Business sector.** Business-sector financing reached $518.0 billion in 2007, increasing 5.6 percent over 2006 (Exhibits 5 and 6). Business-sector health spending remained at 25 percent of health services and supplies spending; this share has been roughly unchanged since 1987. Private employers' contributions to private health insurance premiums constituted the majority of business financing (77 percent), and in 2007 these costs rose 6.1 percent—faster than the 3.6 percent rate in 2006.

■ **Households.** Household spending growth slowed in 2007 to 5.9 percent after growing 7.9 percent in 2006 (the largest rate of growth since 2002). The growth in payments for the employee share of employer-based plan premiums, taxes for Medicare Hospital Insurance (Part A), and premiums paid for Medicare Supplementary

EXHIBIT 5
Expenditures For Health Services And Supplies, By Type Of Service, Type Of Sponsor, And Source Of Funds, Billions Of Dollars, Calendar Year 2007

		Private funds			Public funds			
							Federal and state	
Spending category	Total ($)	Total[a]	Out of pocket	Private health insurance	Total	Medicare	Medicaid	Other public[b]
Health services and supplies	$2,098.1	$1,123.9	$268.6	$775.0	$974.2	$431.2	$329.4	$213.6
Type of service								
Personal health care (PHC)	$1,878.3	$1,027.7	$268.6	$680.3	$850.6	$409.6	$303.9	$137.0
Hospital care	696.5	312.2	23.2	256.9	384.3	196.2	120.0	68.0
Professional services	702.1	454.5	107.6	306.1	247.6	110.0	89.9	47.7
Phys. and clinical services	478.8	317.4	49.6	236.5	161.3	96.1	33.2	32.0
Other professional services	62.0	41.7	15.9	22.6	20.3	13.7	3.5	3.1
Dental services	95.2	89.1	42.1	46.9	6.1	0.2	5.0	0.9
Other PHC	66.2	6.3	–[d]	–[d]	59.8	–[d]	48.2	11.6
Nursing home and home health	190.4	62.4	41.3	15.3	128.0	47.0	75.3	5.7
Home health care[c]	59.0	12.6	6.0	5.6	46.4	23.8	20.5	2.1
Nursing home care[c]	131.3	49.7	35.3	9.8	81.6	23.2	54.8	3.6
Retail outlet sales of medical products	289.3	198.6	96.5	102.1	90.7	56.3	18.8	15.6
Prescription drugs	227.5	146.6	47.6	99.1	80.8	47.0	18.8	15.0
Durable medical equipment	24.5	16.9	14.0	3.0	7.5	7.0	0.0	0.5
Other nondurable medical products	37.4	35.0	35.0	–[d]	2.3	2.3	–[d]	0.0
Program administration and net cost of private health insurance	155.7	96.2	–[d]	94.6	59.5	21.6	25.4	12.5
Government public health activities	64.1	–[d]	–[d]	–[d]	64.1	–[d]	–[d]	64.1

EXHIBIT 5
Expenditures For Health Services And Supplies, By Type Of Service, Type Of Sponsor, And Source Of Funds, Billions Of Dollars, Calendar Year 2007 (cont.)

		Private funds			Public funds			
							Federal and state	
Sponsors of health care[e]	Total ($)	Total[a]	Out of pocket	Private health insurance	Total	Medicare	Medicaid	Other public[b]
Health services and supplies	$2,098.1	$1,119.9	$268.6	$771.0	$978.2	$417.9	$339.8	$220.5
Private	1,252.3	985.9	268.6	636.9	266.4	234.8	–[d]	31.7
Private business	518.0	404.7	–[d]	398.4	113.3	81.6	–[d]	31.7
Household	660.3	507.1	268.6	238.6	153.1	153.1	–[d]	–[d]
Other private revenues	74.1	74.1	–[d]	–[d]	–[d]	–[d]	–[d]	–[d]
Public	845.8	134.0	–[d]	134.0	711.8	183.1	339.8	188.8
Federal government[f]	485.9	25.5	–[d]	25.5	460.4	172.6	192.2	95.6
State and local government	359.9	108.5	–[d]	108.5	251.4	10.5	147.6	93.2

SOURCE: Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group.

NOTE: Numbers might not add to totals because of rounding.

[a] Includes other private funds.

[b] Includes State Children's Health Insurance Program (SCHIP), maternal and child health, vocational rehabilitation, Substance Abuse and Mental Health Services Administration, Indian Health Service, federal workers' compensation, public health activities, Department of Defense, Department of Veterans Affairs, public and general assistance, state/local hospital subsidies, and other miscellaneous general hospital and medical programs.

[c] Freestanding facilities only. Additional services of this type are provided in hospital-based facilities and are counted as hospital care.

[d] Not applicable.

[e] Medicaid buy-ins for Medicare eligibles ($10.4 billion) are allocated to Medicaid. In the traditional National Health Expenditure Accounts (NHEA), they are included with Medicare. Differences in total private health insurance and total public funds are due to the reallocation of the retiree drug subsidy ($4.0 billion) from private health insurance to Medicare. The "other public" difference is due to the reallocation of the state phase-down payment ($6.9 billion) from Medicare to state and local governments.

[f] The data for federal government Medicare equal Trust Fund interest income and federal general revenue contributions to Medicare less the net change in the Trust Fund balance.

Medical Insurance (Part B) slowed in 2007 as growth in out-of-pocket spending accelerated. Household income available to pay for health care services has not grown as quickly over the past few years, resulting in a slight increase in the share of income devoted to health care, to 6.0 percent, in 2007 from 5.4 percent in 2001 (data not shown).

■ **Federal and state and local government.** Federal government financing for health care slowed significantly in 2007, growing 7.0 percent, down from 10.1 percent in 2006 (reflecting the introduction of Part D). As a share of total revenue collected, federal health care financing remained stable in 2006 and 2007 at roughly 28 percent (not shown). Growth in state and local governments' financing increased 6.3 percent in 2007. The Medicaid program, which accounted for 41 percent of all state and local government health spending, increased from growth of 1.0 percent in 2006 (again reflecting the impact of Part D) to 6.6 percent in 2007; it was the main driver of the increase in overall state and local financing. State and local governments spent approximately 24 percent of their revenues on health care in 2007.

EXHIBIT 6
Expenditure Levels For, And Average Annual Growth In, Health Services And Supplies, By Type Of Sponsor, Selected Calendar Years 1987–2007

	Spending (billions of dollars)				Average annual growth from previous period shown		
Type of sponsor	**1987**	**2005**	**2006**	**2007**	**2005**	**2006**	**2007**
Health services and supplies	$447.8	$1,850.4	$1,976.1	$2,098.1	7.8%	6.8%	6.2%
Business, households, and other private	333.4	1,114.9	1,183.2	1,252.3	6.9	6.1	5.8
Private business	122.1	472.2	490.4	518.0	7.8	3.9	5.6
Employer contributions to private health insurance premiums	84.2	362.1	375.4	398.4	8.4	3.6	6.1
Other[a]	37.9	110.1	115.1	119.6	6.1	4.5	4.0
Household	188.9	577.9	623.4	660.3	6.4	7.9	5.9
Household private health insurance premiums[b]	43.9	205.2	224.5	238.6	8.9	9.4	6.2
Medicare payroll taxes and premiums[c]	35.7	125.7	143.9	153.1	7.2	14.5	6.4
Out-of-pocket health spending	109.2	247.0	255.0	268.6	4.6	3.3	5.3
Other private revenues	22.4	64.8	69.4	74.1	6.1	7.0	6.8
Government	144.4	735.5	792.9	845.8	9.5	7.8	6.7
Federal government	73.9	412.6	454.3	485.9	10.0	10.1	7.0
Employer contributions to private health insurance premiums	4.9	23.1	24.3	25.5	9.1	5.0	5.0
Employer payroll taxes paid to Medicare HI Trust Fund	1.7	3.3	3.4	3.6	3.8	2.3	4.1
Medicare[d]	16.9	119.7	156.4	169.0	11.5	30.6	8.1
Medicaid[e]	28.1	182.8	180.5	192.2	11.0	−1.2	6.5
Other programs[f]	22.3	83.6	89.7	95.6	7.6	7.3	6.6
State and local government	70.5	322.9	338.6	359.9	8.8	4.9	6.3
Employer contributions to private health insurance premiums	16.0	99.5	103.3	108.5	10.7	3.8	5.1
Employer payroll taxes paid to Medicare HI Trust Fund	3.1	9.4	9.9	10.5	6.3	4.9	6.7
Medicaid[e]	22.8	137.2	138.5	147.6	10.5	1.0	6.6
Other programs[g]	28.6	76.8	86.9	93.2	5.6	13.2	7.3

SOURCE: Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group.

NOTE: HI is hospital insurance (Part A).

[a] Includes employer Medicare Part A payroll taxes, temporary disability insurance, workers' compensation, and industrial in-plant.

[b] Includes employee contributions to employer-sponsored health insurance and individually purchased health insurance.

[c] Includes employee and self-employment payroll taxes and premiums paid to Medicare HI and Supplementary Medical Insurance (SMI, Part B) Trust Funds.

[d] The data for federal government Medicare equals Trust Fund interest income and federal general revenue contributions to Medicare less the net change in the Trust Fund balance.

[e] Includes Medicaid buy-ins for Medicare premiums for the dually eligible.

[f] Includes State Children's Health Insurance Program (SCHIP), maternal and child health, vocational rehabilitation, Substance Abuse and Mental Health Services Administration, Indian Health Service, federal workers' compensation, public health activities, Department of Defense, and Department of Veterans Affairs and other miscellaneous general hospital and medical programs.

[g] Includes state phase-down payments, SCHIP, maternal and child health, public and general assistance, vocational rehabilitation, state/local hospital subsidies, and public health activities.

Concluding Remarks

In 2007, health spending growth decelerated to 6.1 percent, the slowest rate since 1998, in part because of a forty-five-year low in the growth rate for prescription drug spending and slower growth in administrative spending associated with

the Medicare benefit. At the same time, overall nominal economic growth decelerated from 6.1 percent in 2006 to 4.8 percent in 2007. The most recent economic data indicate that the economy is growing at a slower rate through the third quarter of 2008 and likely into 2009. Recent history has shown that through the downturns, health spending has remained somewhat insulated from the effects of a slowing economy and has increased as a share of GDP. With the uncertain economic climate and recent shifting of payment responsibilities in the health care system, the interaction between the economy and the share of it devoted to health spending will continue to be closely watched.

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