Center for American Progress

The Math Is Clear

Reducing Our Long-Term Federal Budget Deficit Means Enacting Comprehensive Health Care Reform Now

Michael Linden March 10, 2010

Introduction and summary

Our nation's long-term federal budget deficit problem is almost entirely a health care problem. Ten years ago, 17 percent of the federal budget was devoted to the two largest health care entitlement programs, Medicare and Medicaid. Over the past decade, that share climbed to 21 percent and is expected to reach 25 percent by the end of this one.

After that point, if we do nothing, Medicare and Medicaid will continue to swallow up a larger and larger proportion of the federal budget, while simultaneously pushing overall government spending to new and unsustainable heights. The Congressional Budget Office projects that, under current policies, spending on Medicare and Medicaid in 2030 will exceed $3 trillion, close to four times as much as is spent today. The health care path that we find ourselves on will lead to a budget that is permanently and dangerously unbalanced.[1]

The health care reform plans that are currently before Congress take the first step toward getting off of our current path and onto a more sustainable one. They do not solve the entire problem, but the plans do offer tens of billions of dollars worth of direct deficit reduction plus the promise of billions of dollars more in savings as the efficiency and modernization provisions kick in.

Anyone concerned about our long-term budget situation but opposed to the current health reform effort must answer this simple question: In the absence of health care reform, what other policies do you support that will reduce the deficit by at least $1 trillion over the next two decades?

The following memo illustrates just how difficult a question that will be to answer. After first demonstrating that our future budgetary problems are driven primarily by health care spending, this memo describes the Herculean nature of trying to balance the budget without reforming the health care system. Finally, after briefly reviewing some estimates of actual deficit reduction that the health care reform legislation offers, the memo closes by comparing some other "options" for achieving similar levels of deficit reduction, but without health care reform.

Some of these options include cutting defense spending by about one-sixth, or completely eliminating every program in the Department of Homeland Security along with the National Institutes of Health, NASA, and all foreign embassies. Reviewing these other "options" makes it clear just how substantial the savings from health care reform really are.

Our deficit problem is a health care problem

Three years ago, before the Great Recession began, federal spending, excluding interest payments on the debt, was 18.3 percent of the gross domestic product. By the end of this decade, federal spending is expected to swell by nearly 2 full percentage points of GDP, to 20.1 percent. But all of that increase will come from just three programs—Social Security, Medicare, and Medicaid—all of which are expected to grow, as a share of GDP, over the next 10 years. The rest of the budget is actually projected to shrink.

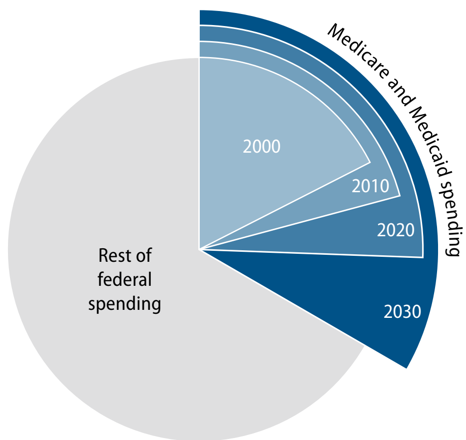
Here are the numbers. Spending on all programs, benefits, and services except for Medicare, Medicaid, and Social Security amounted to 9.9 percent of GDP in 2007, and is expected to fall to 9.2 percent of GDP in 2020, a decrease of 0.7 percentage points of GDP. Growth in Social Security nearly offsets that decline in other government spending, with the government retirement program growing to 5 percent of GDP by 2020, up from 4.3 percent of GDP in 2007.[2]

Since the decline in other spending areas is offset by an increase in Social Security, that means that the nearly 2 percentage-point increase in overall government spending between now and 2020 is due entirely to the increase in spending on Medicare and Medicaid. In fact, spending on those two health programs is expected to hit 6 percent of GDP by 2020, up from 4.1 percent of GDP in 2007.

Or looked at another way, if spending on Medicare and Medicaid were to experience no increase, then the overall size of federal spending would actually decline somewhat from 2007 levels.[3] With no change in policy for Medicare and Medicaid, however, spending will grow by three times as much as Social Security spending will from 2020 to 2030, according to long-term projections by the Congressional Budget Office.[4]

Of course, the full budgetary effect of an unmitigated rise in health care spending is not limited to the direct outlays for Medicare and Medicaid.

By 2030, more than a third of the entire budget will be devoted to Medicare and Medicaid

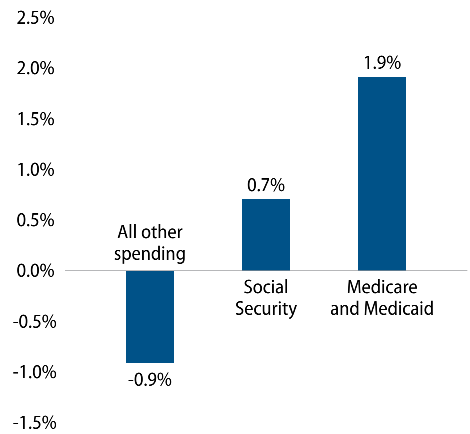


Because health care spending is such a massive contributor to our current and future federal budget deficits, the ongoing interest payments on the debt that we will incur to cover those health care expenses is another added cost going forward. Indeed, interest payments on the debt are expected to nearly triple over the next 10 years.

Put simply, our deficit challenge is, at its core, a health care challenge. Trying to balance the budget without reforming health care is a surefire recipe for failure.

Health care costs drive government spending

Change in spending, as a share of GDP, from 2007 to 2020



Balancing the federal budget without health care reform

If we do nothing to address the rising cost of health care, if we do not pass fundamental health care reform, what would it take to balance the budget? On our current path, by 2025 the deficit is projected to exceed 9 percent of GDP. In that year, Medicare and Medicaid would consume nearly one-third of all federal noninterest spending. The rest of the budget would amount to 16.1 percent of GDP.

So in order to get to a balanced budget in 2025 without health care reform, all other federal spending would have to be reduced by 56 percent. That means Social Security benefits would need to be cut in half, as would spending on national defense, on veterans' benefits, on homeland security, on education, and on everything else.

Alternatively, one could propose closing that budget gap by increasing taxes instead of cutting the entire budget in half. But raising another 9 percentage points of GDP in tax revenue would mean an overall increase in taxes of around 45 percent—clearly an unwise policy.[5] Even if a future Congress and president decided to split the difference in 2025 and get half of the deficit reduction from spending cuts and half from tax increases, the result is still utterly unrealistic: cut all spending by 25 percent and raise everyone's taxes by 22 percent.

The math reveals the stark reality. Getting back to a sustainable federal budget requires health care reform now. We simply cannot allow ourselves to arrive at the future as it is currently projected.

Deficit reduction with health care reform

The health care reform package currently under consideration by Congress offers both tangible direct deficit reduction as well as the very real potential to significantly reduce overall health care costs over the next several decades. Both will be required to substantially alter our present budgetary course.

Estimates vary as to the precise amount of deficit reduction that we can expect from health care reform. On the low end is the estimate from the Congressional Budget Office, which does not take into account any efficiency improvements stemming from the legislation. CBO's "score" (budget lingo for an evaluation of the budgetary costs of a piece of legislation), which only includes direct changes in spending and revenues, has health care reform reducing the deficit by between $920 billion and $1.7 trillion over the next two decades.[6]

Harvard University health economist David Cutler suggests, however, that the savings are likely to be much larger than that once the efficiency and modernization improvements contained in the bill take hold. He estimates that the total budgetary savings from now until 2030 will total around $6.5 trillion.[7]

The scope of our budget problems is such that even $6.5 trillion in deficit reduction over 20 years is not enough to fully solve them. There is no question that passing health care reform right now is only the first step in addressing the long-term budget gap. But the fact remains that the plan currently on the table is the largest deficit reduction measure Congress has seen in more than a decade.

Replacing the savings from health care reform if it fails

What's more, that savings cannot be easily found elsewhere if Congress fails to enact meaningful health care reform. Take the year 2025 as an example. CBO estimates that passing health care reform now will reduce the deficit in fiscal year 2025 by between $70 and $140 billion.[8] Cutler's estimates suggest it will save closer to $480 billion that year.

For the sake of simplicity, assume for the moment that CBO's higher estimate is the most accurate. If health care reform fails, is there some other way to achieve $140 billion in deficit reduction? Here are some "options" that would result in the same level of deficit reduction, $140 billon in 2025, as passing health care reform:

- A 9 percent reduction in Social Security benefits that year
- Cut defense spending by 16 percent
- Completely eliminate the food stamp program, as well as the school lunch and breakfast program
- End health care benefits for veterans plus eliminate all aid to states and school districts for elementary, secondary, and vocational education
- Abolish the Department of Homeland Security, NASA, and the National Institutes of Health, and shutter all embassies, and fire all ambassadors and foreign service staff
- Cut the home mortgage interest deduction in half
- Raise income taxes on everyone so that everyone pays about 5 percent more

See the appendix below for how these numbers were calculated.

Of course, these policies assume that health care reform will only deliver the $140 billion in direct deficit reduction for 2025. If we take account of the potential efficiency savings that reform will likely introduce, as Professor Cutler argues, then the savings will be much larger. In that case, the policies needed to replace those savings, should health care reform fail, would also need to be much larger. Getting $480 billion of savings in 2025 would, for example, would require slashing Social Security benefits by 30 percent, or cutting the Pentagon's budget fully in half!

The health care reform package now before Congress will not get us all of the way to a balanced budget, but it will deliver substantial savings over the long run. In fact, the savings are so substantial that trying to replace them by cutting other parts of the budget or by raising additional taxes would be difficult and extremely painful. The simple budgetary truth we face is that any path to a sustainable budget begins with health care reform.

Reform now or pay later

The health care reform bill would reduce the deficit by $140 billion in 2025. That's the same as abolishing the Department of Homeland Security, the National Institutes of Health, and NASA and closing all embassies.

Reform health care **$140 billion**	OR	**Cut the Department of Homeland Security** **$55 billion** + **Cut the National Institutes of Health** **$38 billion** + **Cut NASA** **$25 billion** + **Close all embassies** **$20 billion** = **$138 billion**

Appendix

Neither the Congressional Budget Office nor the Office of Management and Budget publishes projections of most specific programs beyond 2020 or, in some cases, 2015. What follows is an explanation of how we constructed our 2025 projections.

Gross Domestic Product in 2025

The Congressional Budget Office, in its most recent long-term budget outlook, projects that in 2025 real GDP, which factors in the rate of inflation, will be $17.4 trillion in 2000 dollars. In nominal dollars, using CBO's inflation and real growth assumptions, that translates to $28.5 trillion.

A 10 percent reduction in Social Security benefits

According to the Congressional Budget Office's most recent long-term budget projections, Social Security spending will amount to 5.6 percent of GDP in 2025, a bit less than $1.6 trillion. Benefits make up more than 95 percent of total Social Security expenses, so $140 billion in savings would mean a cut in benefits of more than 9 percent.

Cut defense spending by 16 percent

The Congressional Budget Office, in its latest budget and economic outlook, projects that defense spending will be $813 billion in 2020. Defense spending is discretionary and CBO assumes that discretionary spending will grow with inflation. Applying the inflation assumptions for 2020 through 2025 from CBO's latest long-term budget outlook to the $813 billion yields a 2025 estimate of $897 billion. $140 billion in savings would therefore translate into a 15.6 percent cut.

Eliminate the food stamp, school lunch, and school breakfast programs

The Congressional Budget Office, in its latest budget and economic outlook, projects that 2020 outlays for the Supplemental Nutrition Assistance Program will be $61 billion, and outlays for all child nutrition programs will be $25 billion. CBO's long-term budget outlook does not include specific projections of these programs. In order to estimate their cost in 2025, we applied the share of total non-Medicare, Medicaid, and Social Security spending going to these programs over the next 10 years (as projected by CBO) to the projection of that same spending category for 2025.

From 2010 to 2020, CBO projects that outlays for food stamp and the child nutrition programs will equal 4.7 percent of spending excluding Medicare, Medicaid, Social Security, and net interest payments on the debt. CBO projects that category of spending to be approximately $3 trillion in 2025. 4.7 percent of that equals $141 billion.

End health care benefits for veterans and educations aid to states and localities

According to the Office of Management and Budget's most recent projections, budget authority for the Veteran's Health Administration will be $60 billion in 2015. Discretionary budget authority for function 501 (elementary, secondary, and vocational education) will be $46 billion in 2015. Applying CBO's assumption that discretionary spending will grow at the rate of inflation yields a 2025 cost of $129 billion.

Abolish the Department of Homeland Security, NASA, and NIH, and close all embassies

According to the Office of Management and Budget's most recent projections, discretionary budget authority for the Department of Homeland Security will be $45.2 billion in 2015, discretionary budget authority for the National Aeronautics and Space Administration will be $21 billion in 2015, discretionary budget authority for the National Institutes of Health will be $31.1 billion in 2015, and discretionary budget authority for the conduct of foreign affairs, will be $16.2 billion. Applying CBO's assumption that discretionary spending will grow at the rate of inflation yields a 2025 cost of $138 billion.

Cut the home mortgage interest deduction in half

According to the Office of Management and Budget, the home mortgage interest deduction will reduce tax revenues in 2015 by $149.6 billion. Unfortunately, OMB does not project its costs out beyond that. Between 2009 and 2015, however, the cost of the home mortgage interest deduction grew by about $14 billion per year. Applying that growth rate to the next 10 years yields a total cost of $290 billion in 2025. $140 billion in savings would mean reducing the overall value of the deduction by about half.

Raise income taxes on everyone so that everyone pays about 5 percent more

In their latest long-term budget outlook, CBO projects that total income tax revenues in 2025 will equal approximately $2.8 trillion (under their alternative fiscal scenario). Raising $140 billion from the income tax system would mean an overall increase of about 5 percent.

Endnotes

1 Congressional Budget Office, "The Long-Term Budget Outlook" (2009).

2 The projections of federal spending in 2020 are based on current policies as estimated by the Office of Management and Budget.

3 Ibid.

4 Congressional Budget Office, "The Long-Term Budget Outlook" (2009).

5 Under the Congressional Budget Office's alternative fiscal scenario, total tax revenues in 2025 will equal 18.8 percent of GDP. The alternative fiscal scenario assumes that the entirety of the tax cuts passed in 2001 and 2003, which are scheduled to expire in 2010, will be made permanent. It also assumes that the Alternative Minimum Tax is permanently indexed to inflation.

6 The Congressional Budget Office estimates that in the first 10 years, the Patient Protection and Affordable Care Act, which was passed by the United States Senate, will reduce the deficit by $130 billion. In the following decade, they estimate that the bill will reduce the deficit by between 0.25 percent and 0.5 percent of GDP. Applying those percentages to estimates of nominal GDP from 2020 to 2030 (based on CBO's real GDP estimates contained in their long-term budget outlook) yields totals of close to $800 billion and $1.6 trillion respectively. Adding the $130 billion in savings from the first decade results in the final estimate of total savings over two decades.

7 These estimates were provided by David Cutler, and were the basis for his recent piece: David Cutler, Karen Davis, and Kristof Stremikis, "Why Health Reform will Bend the Cost Curve" (Washington: The Commonwealth Fund and the Center for American Progress, 2009).

8 This estimate uses a projection of nominal GDP for 2025 based on the real GDP projection in CBO's long-term budget outlook. See note 6.