ECONOMIC AND BUDGET ISSUE BRIEF
CBO
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Growth in Medical Spending by the Department of Defense

The Department of Defense (DoD) faces a growing burden in providing peacetime health care for military personnel, retirees, and their dependents and survivors—who all together number over 8 million. Adjusted for the overall rate of inflation in the U.S. economy, the department's annual spending on medical care almost doubled from 1988 to 2003, rising from $14.6 billion to $27.2 billion. Furthermore, because DoD cut the size of the active-duty force by 38 percent over that same period, medical spending per active-duty service member nearly tripled, rising from $6,600 to $19,600.[1] Medical spending rose from one-quarter to more than one-half of the level of cash compensation (defined as basic pay, the housing allowance, and the subsistence allowance), and it is likely to continue to increase.

DoD views many of its medical costs as unavoidable. The department argues that it must operate its own in-house system of health care providers and military medical treatment facilities to ensure that U.S. forces will have reliable, high-quality medical care in time of war. Moreover, DoD believes that in peacetime, it needs that in-house system, together with care purchased from the private sector, to provide the health care benefits necessary to attract and retain high-quality active-duty and reserve forces.

CBO's analysis addresses some of the questions raised by the trends in spending growth. What factors explain the historical growth in DoD's medical costs? If policies do not change, what levels of spending might be seen in the future? What are the implications of current trends in military medical costs for the total costs of military personnel? How might various policy changes work either to suppress or accelerate growth in DoD's medical spending?

Factors Underlying Past Growth

Over half (56 percent) of the total growth in spending per active-duty service member from 1988 to 2003 can be attributed to national changes in health care costs generally—owing to greater use of technology, changes in the utilization of health care services, and higher medical prices (*see Figure 1*). That growth reflects a trend that could continue. Another 41 percent of the observed growth can be attributed to events that are unlikely to recur. One was a shift in the mix of DoD's beneficiary population: the number of active-duty service members and their dependents fell substantially during the military drawdown after the Cold War while the number of retirees and their dependents grew—pushing up spending per active-duty service member. Another unique event was the introduction of accrual budgeting for the medical benefits of military retirees and their dependents who were eligible for Medicare. That accounting change (aimed at better capturing the full cost of labor) did not affect benefits but did raise DoD's budgets.

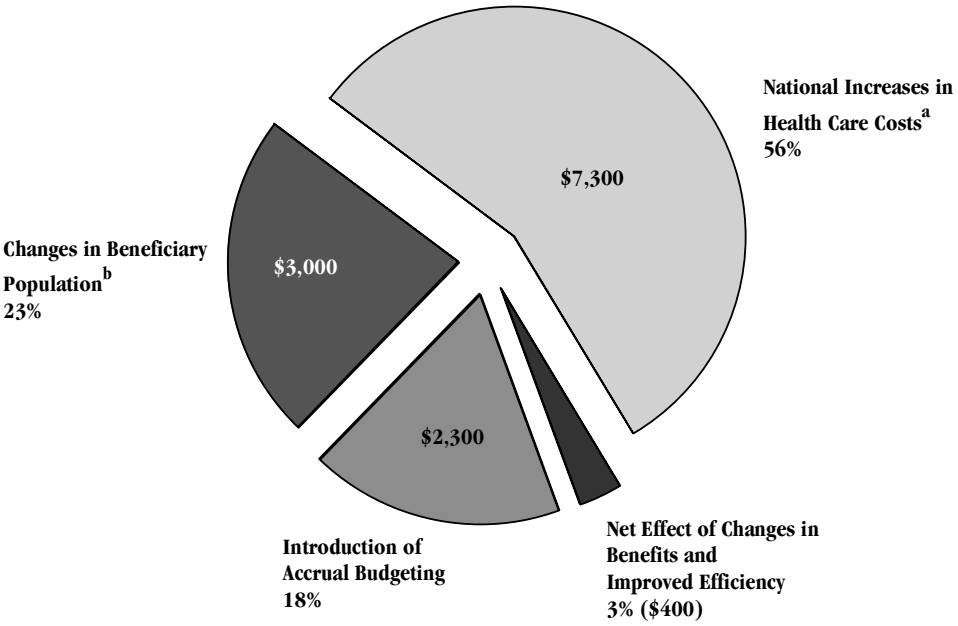
The remaining 3 percent of growth in spending derived from other changes within DoD's medical system. Although small, that figure derives from the net effect of several more substantial offsetting factors, including reduced access to care at military medical treatment facilities in the 1990s, improved efficiency with the introduction of the TRICARE program, and new medical benefits provided since 2000. The most significant of those new benefits was the TRICARE For Life plan for Medicare-eligible retirees introduced in fiscal year 2002. CBO estimates that that program added $3.0 billion to military health care spending in 2003.

1. These figures are calculated as medical spending on all beneficiaries divided by the number of active-duty service members.

Figure 1.

Factors Contributing to the Growth in the Department of Defense's Medical Spending per Active-Duty Service Member, 1988 to 2003

(2002 dollars)



Source: Congressional Budget Office.

Note: The Department of Defense's medical spending increased from $6,600 per active-duty service member in 1988 to $19,600 in 2003, or by a total of $13,000.

a. Owing to the greater use of technology, changes in the utilization of health care services, and higher medical prices.

b. Consisting of a decrease in the number of active-duty military personnel and their dependents and an increase in the number of retirees and their dependents and survivors.

Projections of Future Growth Under Current Policies

Because DoD is subject to many of the same factors that drive growth in per capita health care spending in the United States as a whole, CBO began its projections of the department's future medical spending by incorporating just those general influences—extending the department's current policies, including the current size of the military. If DoD's medical spending (adjusted for projected shifts in the number and mix of beneficiaries) increases at the same rate as per capita medical spending (similarly adjusted) in the United States as a whole, it could grow from $27 billion today to between $40 billion and $52 billion by 2020 (in 2002 dollars). That range translates to between $29,000 and $38,000 a year for each active-duty service member.

Medical spending is already substantially higher per dollar of cash compensation for members of the military than it is for federal civilian employees or private-sector workers. Although that fact is due in part to the early age at which military service members retire, it also reflects the high rate at which DoD's beneficiaries utilize health care services. Unlike beneficiaries of health care plans offered by private employers, most of DoD's face few, if any, premiums, deductibles, or copayments.

If current policies remain unchanged, DoD's spending on health care per dollar of cash compensation could grow from 55 cents to between 64 cents and 84 cents by 2020 (*see Figure 2*). To the extent that military members might prefer a compensation package that placed more emphasis on cash relative to medical benefits, that mix of compensation could reduce the quality of the force that DoD could attract and retain for a given compensation budget and increase the cost of military personnel relative to contractors and civilians.

Policy Changes and Future Spending

Although the same factors underlying national trends are likely to put pressure on DoD to increase its medical spending, that spending may not continue to rise in line with that in the United States as a whole. DoD's medical spending grew more slowly than national trends from 1988 to 2000 and much more quickly from 2000 to 2003. The markedly different rates of growth seen during those two periods illustrate the impact that changes in policies and benefits can have.

This analysis examines four policy changes and their potential effect on DoD's future medical spending. Two of the policies, drawn from trends in private-sector health care and a change in the military retirement system that introduced an element of choice, would slow the rate of growth by offering beneficiaries the opportunity to choose less-generous health coverage and receive some of the savings in cash.

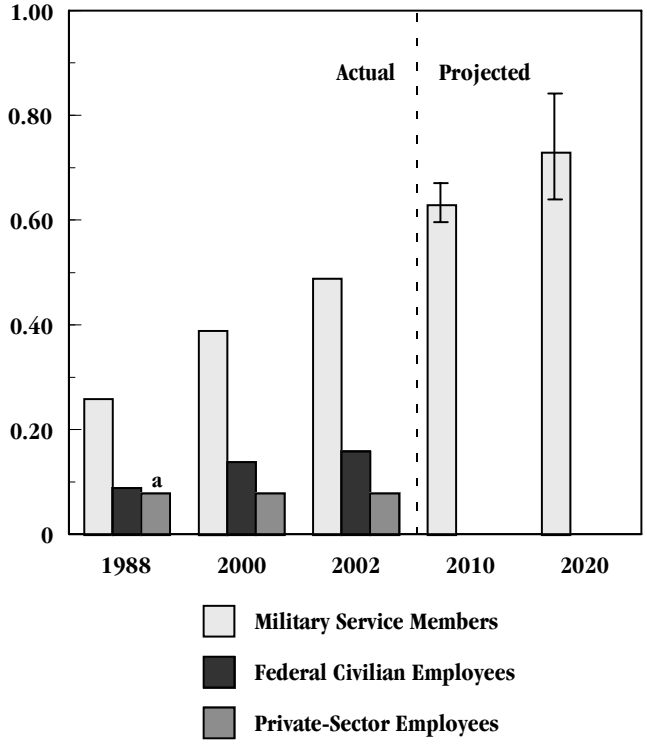
The first would allow retiring service members to choose a cash bonus instead of TRICARE For Life coverage after age 65. The present discounted cost of TRICARE For Life at retirement for an individual who retires this year is $172,000, a figure that rises to $319,000 for someone who will retire in 2020. Even if service members received a bonus of only half of the present discounted value, many might prefer to take the cash in place of the benefit. The second policy change would create a "cafeteria plan" that would provide family members of active-duty personnel with a cash allowance that they could use to pay for any current TRICARE plan, a new low-option TRICARE plan, or coverage by a civilian employer. By 2020, those policy changes together would reduce DoD's annual medical spending by 3 percent, or $1.5 billion, CBO estimates. At the same time, they would increase the options available to service members and their families.

However, such options that offer choice cannot by themselves halt the shift in the compensation package away from cash and toward health care. Even if both of the options were adopted, DoD's spending on health care per dollar of cash compensation could still rise from 55 cents today to 70 cents by 2020. Maintaining the current ratio could require far-reaching changes, such as the introduction of premiums (which could reduce DoD's costs by encouraging families with access to plans offered by private employers to choose those plans) and imposing more copayments (which would bring down utilization rates). In the private sector, employers have relied on changes in health care benefits and on premiums, deductibles, and copayments to hold medical spending below nine cents per dollar of salaries and wages (as shown in Figure 2).

Figure 2.

Medical Spending per Dollar of Cash Compensation for Service Members and for Federal and Private-Sector Employees, 1988 to 2020

(Dollars)



Source: Congressional Budget Office using information from the Department of Defense (for military service members), the Office of Personnel Management (for federal civilian employees' salaries and Federal Employees Health Benefits program premiums), and the Bureau of Labor Statistics (for comparable data on private-sector employees).

Note: Error bars represent high and low estimates.

a. Based on 1991 data because earlier data are not available.

The third and fourth policies examined in this study would increase the rate of growth in DoD's health budget by implementing new benefits that have been proposed (by lawmakers in current legislation and by advocacy groups) for reservists and for retirees under age 65. If DoD offered

reservists full-time access to the TRICARE program, as considered in the third option, and expanded benefits for retirees under age 65, as described in the fourth option, DoD's medical spending could increase by 15 percent, or $7 billion per year, by 2020. However, the size of the increase would depend crucially on the design of the benefits. If DoD simply helped the families of reservists pay the costs of maintaining their civilian coverage during mobilizations, spending would increase by only $9 million per year by 2020 under peacetime conditions.

Related CBO Publications: This brief is based on *Growth in Medical Spending by the Department of Defense* (September 2003), prepared by Allison Percy. It and the following related CBO publications are available at the agency's Web site (www.cbo.gov): *Accrual Budgeting for Military Retirees' Health Care* (March 2002) and *The Long-Term Implications of Current Defense Plans: Summary Update for Fiscal Year 2004* (July 2003).

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