TAX FOUNDATION

The Spiraling Cost of Federal Healthcare Subsidies and Carveouts

September 2026

Will McBride Chief Economist & Stephen J. Entin Fellow in Economics
Guy Cardwell Research Assistant

Key Findings

- The US federal government faces several fiscal challenges in the coming decades, including the growing burden of federal healthcare programs and tax preferences.
- Healthcare spending has grown rapidly for decades and is approaching one-third of the federal budget as of 2025.
- In addition, the health sector receives more than $500 billion annually in federal tax preferences, making it the most heavily tax-favored sector in the economy.
- In total, the fiscal cost of federal tax expenditures and spending for health care is nearly $2.7 trillion, or 8.9 percent of GDP, as of 2025 and will grow to about 9.7 percent of GDP by 2035.
- Through fiscal measures alone, the federal government plays an increasingly dominant role in health care with nearly half of all national health spending flowing through federal programs or tax preferences as of 2025.

Introduction

The federal government's finances are on an unsustainable trajectory, due in large part to a long pattern of growing subsidies and tax preferences for health care. The Congressional Budget Office (CBO) projects that, under current law, deficits as a share of GDP will rise from 5.8 percent in 2026 to 6.7 percent in 2036 (all years are fiscal years unless otherwise noted), representing the largest sustained deficits in the country's history. Deficits will continue rising to 9.1 percent in 2056. Debt held by the public will top 100 percent of GDP in 2026 and is expected to reach a new record high of 106 percent within the next four years. It will continue rising to 120 percent in 2036 and 175 percent in 2056.[1]

The imbalances are driven by rapid growth in spending that exceeds growth in the economy and tax revenues. The CBO's latest projection indicates spending will grow from 23.3 percent of GDP in 2026 to 24.4 percent in 2036 and 27.9 percent by 2056. This is far above the average spending level over the last 50 years of 21.1 percent.[2] Meanwhile, revenues are projected to grow from 17.5 percent of GDP in 2026 to 17.8 percent in 2036 and 18.8 percent in 2056.

The largest and fastest-growing category of federal spending is major healthcare programs, including Medicare, Medicaid, Affordable Care Act (ACA) subsidies, and the Children's Health Insurance Program (CHIP).[3] As this report shows, total federal healthcare spending, including smaller programs scattered across various agencies, is now nearly one-third of the federal budget.

In addition to direct spending, the health sector receives a disproportionate share of federal tax preferences, the largest of which is the exclusion for employer-sponsored health insurance (ESI), according to the US Treasury Department and the Joint Committee on Taxation.[4] Treasury's latest tally of federal tax expenditures—which measures the estimated loss of income and payroll tax revenues from credits, deductions, exclusions and other special carveouts—indicates that healthcare preferences cost more than $500 billion annually, making it the most heavily tax-favored sector in the economy.

In total, the fiscal cost of federal tax expenditures and spending for health care, as of 2025, is nearly $2.7 trillion, or 8.9 percent of GDP. Furthermore, the cost is projected to continue growing faster than the overall economy, making reforms to healthcare policy essential to achieve a sustainable fiscal trajectory.

Another reason to be concerned about these subsidies and carveouts is the resulting lack of neutrality and economic distortions that come from picking winners and losers on such a grand scale. For instance, the exclusion for ESI distorts the labor market and the healthcare market by leading employers to divert compensation to tax-free ESI benefits rather than taxable cash, and favoring costly insurance coverage tied to employment rather than portable coverage or direct payments to healthcare providers.[5] This report demonstrates that, through fiscal measures alone, the federal government plays an increasingly dominant role in health care, with nearly half of all national health spending flowing through federal programs or tax preferences.

1 Congressional Budget Office, "The Budget and Economic Outlook: 2026 to 2036," Feb. 11, 2026, https://www.cbo.gov/publication/61882.
2 Congressional Budget Office, "Historical Budget Data," https://www.cbo.gov/data/budget-economic-data#2.
3 Congressional Budget Office, "The Budget and Economic Outlook: 2026 to 2036," Feb. 11, 2026, https://www.cbo.gov/publication/61882; Congressional Budget Office, "Historical Budget Data," https://www.cbo.gov/data/budget-economic-data#2; William McBride, "Can Tax Reform Solve the Debt Problem—or Just Slow It?," Tax Foundation, Apr. 30, 2026, https://taxfoundation.org/research/all/federal/can-tax-increases-fix-the-national-debt/.
4 US Treasury Department, "Tax Expenditures," https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures; Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2025-2029," JCX-45-25, Dec. 3 2025, https://www.jct.gov/publications/2025/jcx-45-25/; William McBride, "A Brief History of Tax Expenditures," Tax Foundation, Aug. 22, 2013, https://taxfoundation.org/research/all/federal/brief-history-tax-expenditures/.
5 William McBride and Alex Durante, "Federal Revenue and Distributional Impacts of Limiting the Tax Exclusion for Employer-Sponsored Health Insurance Premiums," Tax Foundation, Oct. 2, 2025, https://taxfoundation.org/research/all/federal/employer-sponsored-health-insurance-premiums-tax-affordable-care-act/.

Federal Budget Increasingly Dominated by Healthcare Spending

Federal healthcare spending far exceeds spending on national defense or any other industry or category of spending, according to the latest data from the Office of Management and Budget (OMB).[6] In 2025, the federal government spent $2.18 trillion on health care, amounting to 31.2 percent of the federal budget and 7.2 percent of GDP. Healthcare spending, including programs like Medicare and Medicaid, was more than one-third of non-interest federal spending last year (36.2 percent) and more than twice the size of the defense budget (which totaled $855 billion in 2025, excluding the Defense Health Program, or 12.2 percent of the federal budget).

Healthcare spending far exceeded other sector-specific spending, such as agriculture and food assistance ($197 billion or 2.8 percent of the budget), transportation ($145 billion or 2.1 percent), education and training ($88 billion or 1.3 percent), housing ($78 billion or 1.1 percent), and energy ($21 billion or 0.3 percent).

Federal healthcare spending has grown at a staggering rate over the last several decades, mainly through expansions of Medicare and Medicaid beginning in the 1960s that increased benefits and eligibility for those programs, but also due to an aging population, increased income and ability to pay for health care, and rising healthcare costs. In 1962, prior to the advent of Medicare and Medicaid, the federal government spent $2.3 billion for health programs, representing about 2.1 percent of the budget and about 0.4 percent of GDP.

Back then, healthcare spending from all sources, including state and local governments as well as private spending, was 5.4 percent of GDP, and the federal government's share of that spending was 7.2 percent. Since that time, overall healthcare spending has grown to 18.4 percent of GDP, as of 2025, and the federal share has grown to 39.3 percent.[7]

As of 2025, Medicare spending reached more than $996 billion (net of premiums), nearly 3.3 percent of GDP, while Medicaid surpassed $668 billion, or 2.2 percent of GDP. The next largest category of healthcare spending is veterans' medical care, costing over $148 billion, or about 0.5 percent of GDP, followed by health insurance assistance, made up primarily of ACA premium tax credits (PTCs), costing $129 billion, or about 0.4 percent of GDP in 2025. While run through the IRS, the federal government counts about 90 percent of the cost of PTCs as outlays (spending) because of the refundable portion that exceeds tax liability.[8]

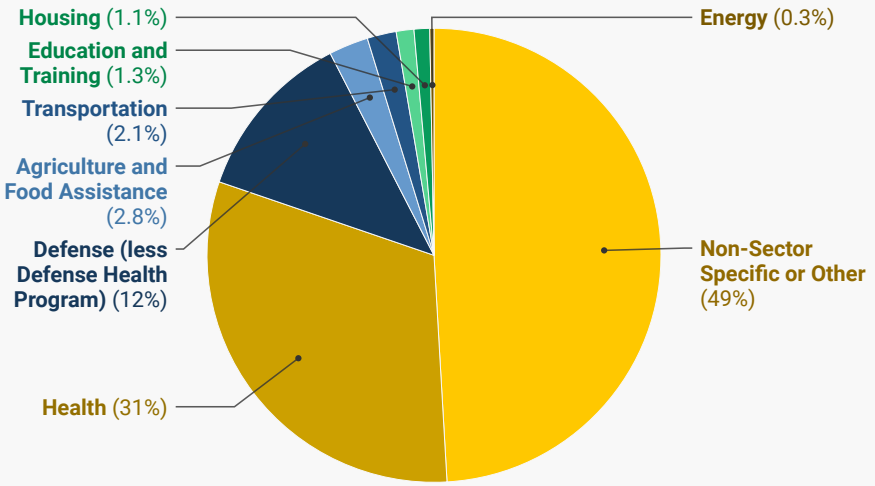
The cost of federal health insurance assistance has more than doubled since the pandemic, from $52 billion in 2020 to $129 billion in 2025, following enhancements that were made to PTCs as part of the American Rescue Plan Act of 2021, which were later extended through the end of 2025 as part of the Inflation Reduction Act of 2022. The expired enhancements reduced the maximum amount eligible enrollees were

6 US Office of Management and Budget, "Historical Tables," https://www.whitehouse.gov/omb/information-resources/budget/historical-tables/.
7 Centers for Medicare and Medicaid Services, "National Health Expenditure Data," https://www.cms.gov/data-research/statistics-trends-and-reports/national-health-expenditure-data.
8 William McBride, "Cleaning Up the Tax Code Could Raise Trillions for Tax Reform," Tax Foundation, Feb. 6, 2025, https://taxfoundation.org/blog/tax-credits-expenditures-spending-offset-tax-cuts/.

Figure 1.

Healthcare Spending Approaching One-Third of the Federal Budget

Share of US Government Outlays by Sector, Fiscal Year 2025



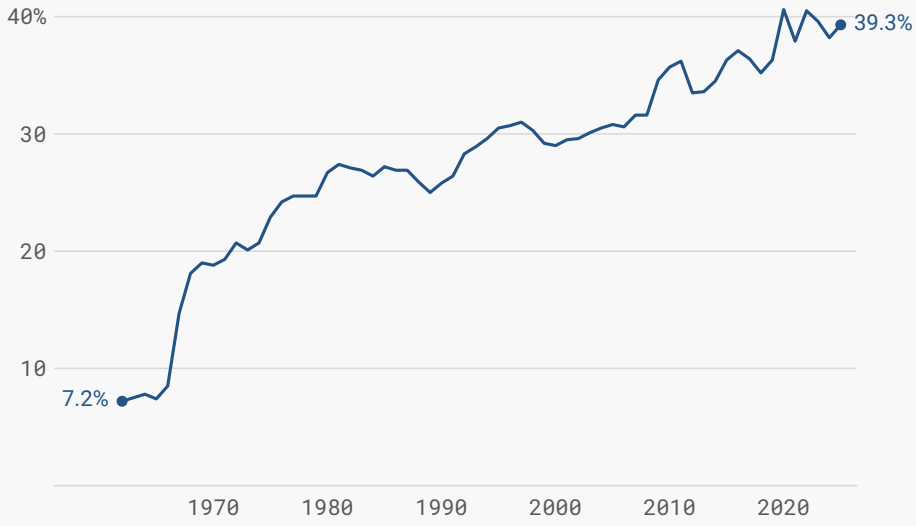
Source: US Office of Management and Budget, "Historical Tables: Table 3.2—Outlays by Function and Subfunction: 1962–2031, Table 15.1—Total Outlays for Health Programs: 1962–2031"; Authors' calculations.

TAX FOUNDATION

Figure 2.

Federal Government Plays an Increasing Role in Health Care

Federal Outlays for Health Programs as a Share of National Health Spending from All Sources, 1962 to 2025



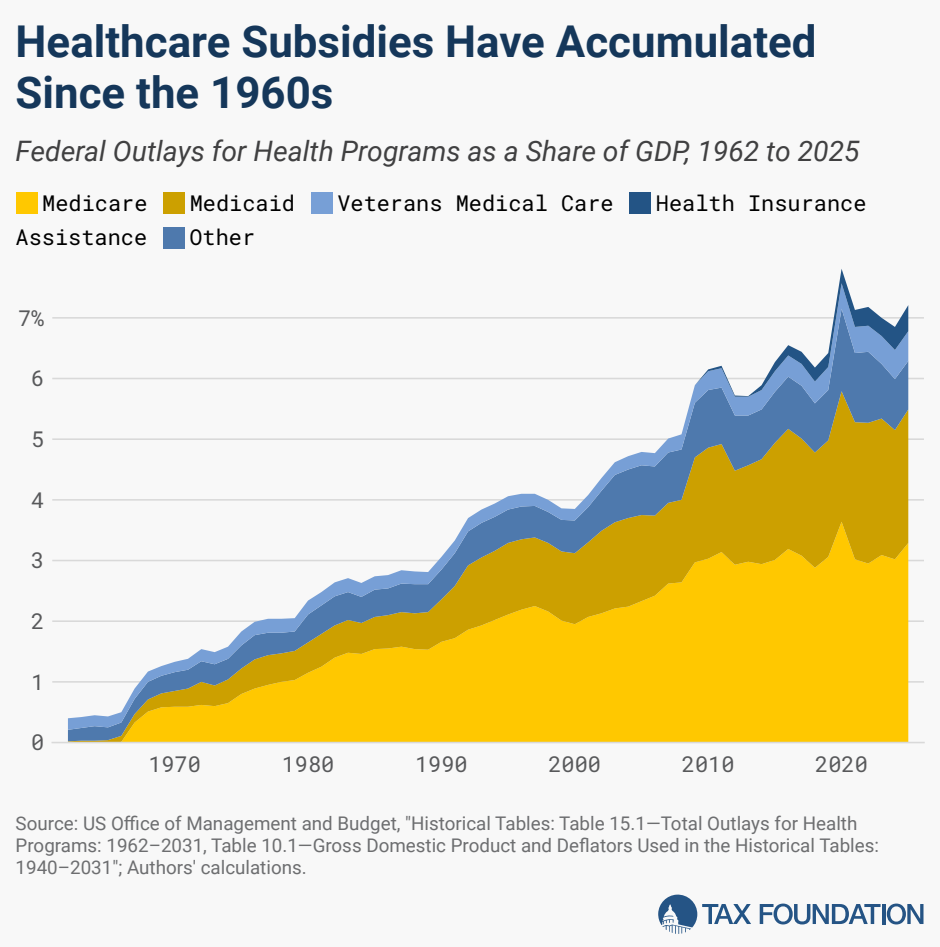
Source: US Office of Management and Budget, "Historical Tables: Table 15.1—Total Outlays for Health Programs: 1962–2031"; Centers for Medicare and Medicaid Services, "National Health Expenditure Data"; Authors' calculations.

TAX FOUNDATION

required to contribute toward premiums for health insurance purchased through the ACA exchanges. They also extended eligibility to people whose income was above 400 percent of the poverty level.

Other health programs, totaling $242 billion, or 0.8 percent of GDP, in 2025, include the Defense Health Program, which has grown steadily in recent years from $53 billion in 2020 to $61 billion in 2025, and various smaller programs that received a surge of funding during the pandemic reaching $238 billion in 2020 before falling to $181 billion in 2025.

Figure 3.



Fiscal Cost Compounded by Tax Preferences for Health Care

In addition to federal healthcare spending, the federal tax code provides several tax preferences for health care. PTCs were the largest tax credit in the tax code in 2025, which, in addition to the outlay effects described above, also reduced income tax revenue by about $12 billion in 2025, according to Treasury's estimates.[9]

9 US Treasury Department, "Tax Expenditures Fiscal Year 2027," Dec. 16, 2025, https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures.

Far and away the largest healthcare tax preference is the exclusion for employer-sponsored health insurance (ESI) premiums, which reduced federal income tax revenue by $279 billion and federal payroll tax revenue by $171 billion in 2025. Other major health tax preferences include health savings accounts, the deductibility of medical expenses, the deductibility of charitable contributions to health institutions, and the deductibility of self-employed medical insurance premiums, which together cost about $50 billion in 2025. Treasury's estimate for all health sector tax expenditures totaled $512 billion in 2025, but this does not account for the tax exemption for hospitals, which costs about $12 billion as of 2021.[10] Treasury's health tax expenditures amount to about 9 percent of all US healthcare spending from all sources.

ESI and other tax expenditures make health care the most favored sector in the tax code. Treasury's estimate of $512 billion for the health sector is about 26 percent of all tax expenditures, which total about $2 trillion in 2025. By comparison, tax expenditures for housing totaled $309 billion (16 percent of Treasury's tax expenditure budget), education and training $111 billion (6 percent), and energy $64 billion (3 percent) in 2025.

However, a large portion (about 40 percent by dollar amount) of Treasury's tax expenditures are provisions that broadly move the tax code in the direction of neutrality with respect to saving and consumption decisions and thus would not be considered subsidies or preferences under an ideal consumption tax base.[11] These provisions, such as individual retirement accounts and expensing for capital investment, substantially reduce the double taxation of saving and investment inherent in the income tax.

Removing those neutral provisions leaves $1.2 trillion of non-neutral tax expenditures in 2025 by Treasury's estimates, $512 billion or 43 percent of which goes to the health sector (none of the official health tax expenditures are neutral). By comparison, non-neutral tax expenditures for housing totaled $154 billion (13 percent of Treasury's non-neutral tax expenditures), education and training $111 billion (9 percent), and energy $63 billion (5 percent) in 2025.

The fiscal cost of federal healthcare tax preferences has grown at a slower rate than federal healthcare spending, and though the cost has increased faster than GDP, it has not matched growth in overall US healthcare spending from all sources. As a share of GDP, federal healthcare tax preferences have increased from 1.4 percent in 1994 (the earliest available year of data) to 1.7 percent in 2025, with about 90 percent of the cost coming from ESI. In contrast, over the same period, all other non-neutral tax expenditures have shrunk from about 3.3 percent of GDP in 1994 to 2.3 percent in 2025. In total, all non-neutral tax expenditures have shrunk from 4.6 percent of GDP in 1994 to 4.0 percent in 2025, with the largest drop following 2017's Tax Cuts and Jobs Act.[12] Health care's share of all non-neutral tax expenditures has grown from 29 percent in 1994 to 43 percent in 2025.

10 Elizabeth Plummer, Mariana P. Socal, and Ge Bai, "Estimation of Tax Benefit of US Nonprofit Hospitals," *JAMA* 332:20 (September 2024), https://pmc.ncbi.nlm.nih.gov/articles/PMC11428023/; Scott Hodge, "Reining in America's $3.3 Trillion Tax-Exempt Economy," Tax Foundation, Jun. 18, 2024, https://taxfoundation.org/research/all/federal/501c3-nonprofit-organization-tax-exempt/.

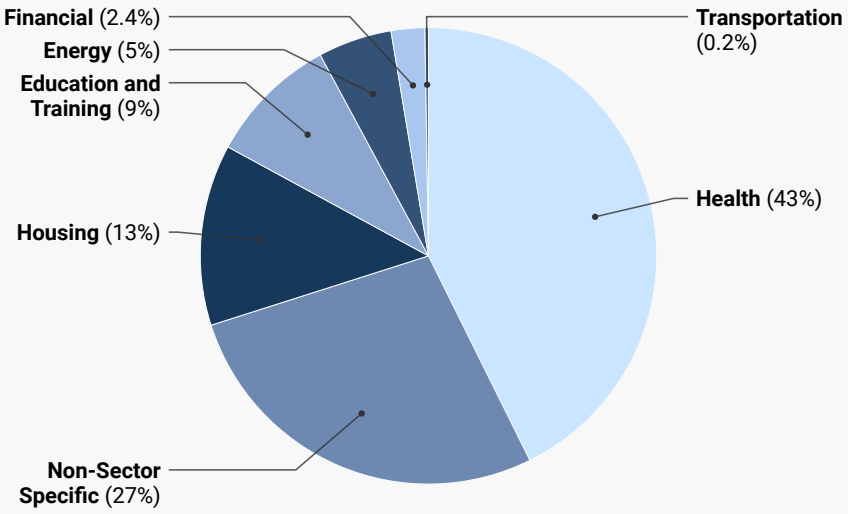
11 William McBride, "A Brief History of Tax Expenditures," Tax Foundation, Aug. 22, 2013, https://taxfoundation.org/research/all/federal/brief-history-tax-expenditures/.

12 Robert Bellafiore, "Tax Expenditures Before and After the Tax Cuts and Jobs Act," Tax Foundation, Dec. 18, 2018, https://taxfoundation.org/data/all/federal/tax-expenditures-pre-post-tcja/.

Figure 4.

Health Care Is the Most Favored Sector in the Tax Code

Share of Estimated Value of Non-Neutral Federal Tax Expenditures by Sector (Including Income and Payroll Tax Effects but Excluding Outlay Effects), Fiscal Year 2025



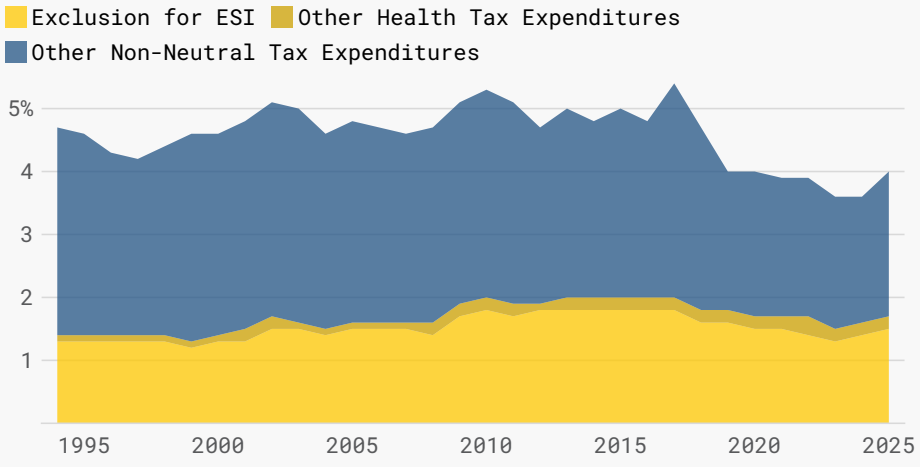
Source: US Treasury Department, "Tax Expenditures Fiscal Year 2027," Dec. 16, 2025; Authors' calculations.

TAX FOUNDATION

Figure 5.

Health Tax Preferences Keep Climbing

Estimated Value of Non-Neutral Federal Tax Expenditures (Including Income and Payroll Tax Effects but Excluding Outlay Effects) as a Share of GDP, 1994 to 2025



Note: ESI payroll tax effect imputed for years 1994 to 2007 based on Treasury's reported estimates in subsequent years.
Source: US Treasury Department, "Tax Expenditures [Fiscal Years 1996 to 2027]"; Authors' calculations.

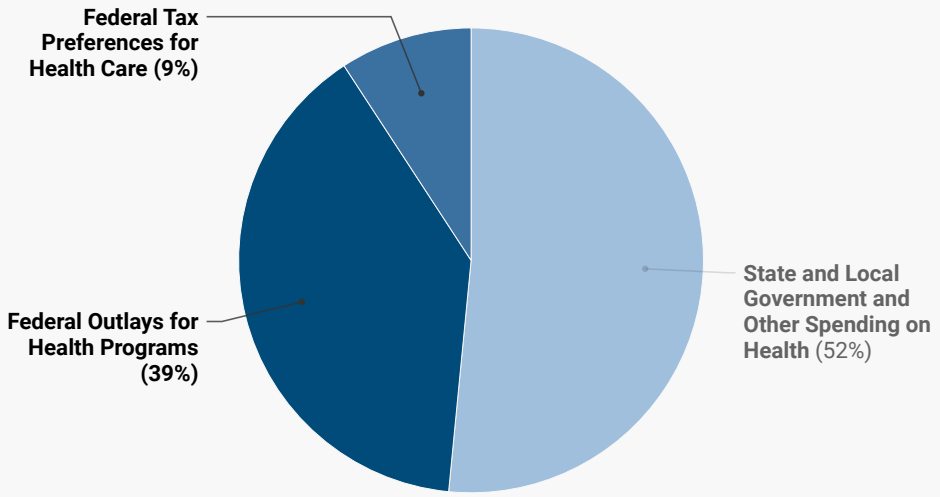
TAX FOUNDATION

Combining health sector tax expenditures with federal healthcare spending, the total fiscal cost of federal healthcare subsidies and carveouts was nearly $2.7 trillion in 2025, or 8.9 percent of GDP, amounting to 48.5 percent of all US healthcare spending from all sources.[13]

Figure 6.

Federal Subsidies and Carveouts Comprise Nearly Half of National Health Spending

Federal Health Tax Preferences and Outlays for Health Programs as a Share of National Health Spending from All Sources, 2025



Source: US Treasury Department, "Tax Expenditures Fiscal Year 2027," Dec. 16, 2025; US Office of Management and Budget, "Historical Tables"; Centers for Medicare and Medicaid Services, "National Health Expenditure Data"; Authors' calculations.

TAX FOUNDATION

Healthcare Subsidies Projected to Continue Growing Under Current Law

Federal healthcare spending as a share of GDP has been on a remarkably steady trend upward, growing slightly more than one percentage point per decade on average over the last six decades. Spending growth was on course to continue at that rate until Congress passed the One Big Beautiful Bill Act (OBBBA), which tightened rules and reduced eligibility for Medicaid and PTCs. Beyond the OBBBA, the Trump administration and Congress limited growth in healthcare spending by allowing the more generous subsidies for ACA plans to expire in 2025.

More recently, the Trump administration has denied an extension of subsidies for Medicare Part D prescription drug plans, but any savings there may be offset by unanticipated growth in Medicare Part D

13 An alternative analysis that includes state and local government sources indicates that about two-thirds of US healthcare spending comes from government. See David U. Himmelstein and Steffie Woolhandler, "The Current and Projected Taxpayer Share of US Health Costs," *American Journal of Public Health* 106:3 (March 2016), https://ajph.aphapublications.org/doi/full/10.2105/AJPH.2015.302997; Congressional Budget Office, "Federal Subsidies for Health Insurance, 2026 to 2036," Jul. 23, 2026, https://www.cbo.gov/publication/62539.

spending following the changes made as part of the Inflation Reduction Act of 2022.[14] Needless to say, the complexity of the health sector and health policy makes projections difficult and uncertain. However, the trend remains up despite recent reforms. Based on the CBO's projections under current law—which, among other things, assume the PTC enhancements are not extended—the OBBBA will reduce federal healthcare spending by about $1 trillion over the next decade. As a result, growth in these programs will fall to about half the historical rate, so they rise from 7.2 percent of GDP in 2025 to about 7.8 percent in 2035.[15]

Healthcare tax expenditures are projected to grow from 1.7 percent of GDP in 2025 to about 1.9 percent in 2035, while health care's share of non-neutral tax expenditures is set to rise from 43 percent in 2025 to more than 49 percent in 2035.[16] Combined with federal healthcare spending, the total fiscal cost of federal healthcare subsidies and carveouts is set to rise from 8.9 percent of GDP in 2025 to about 9.7 percent of GDP in 2035.

How Sustainable Are Healthcare Subsidies and What Options Are There for Reform?

Lawmakers must weigh a wide range of issues and goals when they design healthcare policy—including improving affordability, access, and quality—but a primary concern should be the sustainability of federal healthcare subsidies.[17]

Interest costs on the federal debt, for instance, are projected to reach an all-time high of more than $1 trillion, or 3.3 percent of GDP this fiscal year, before growing to more than 4.5 percent of GDP over the next decade. The primary deficit, which excludes interest costs, is set to average more than 2 percent over the next decade, pushing the total deficit to levels that have never been sustained in peacetime.[18]

Tax Foundation has modeled options to cap or eliminate the largest healthcare tax expenditure, the exclusion for employer-sponsored health insurance. We estimate that eliminating the income tax exclusion would raise about $2.4 trillion over the next decade (on a dynamic basis, accounting for the policy's macroeconomic effects) and eliminating the payroll tax exclusion would raise about $1.6 trillion.[19] While other tax expenditures could be limited, the spending side offers far more scope for savings through reforms to the major healthcare programs, including Medicare, Medicaid, and the ACA exchanges.

14 Anna Wilde Mathews, "Trump Administration to End Medicare Drug Plan Subsidy," *The Wall Street Journal*, Jul. 28, 2026, https://www.wsj.com/health/healthcare/trump-administration-to-end-medicare-drug-plan-subsidy-76d255d1; Benedic N. Ippolito, "Ending Temporary Part D Subsidies Makes Sense," American Enterprise Institute, Jul. 29, 2026, https://www.aei.org/economics/ending-temporary-part-d-subsidies-makes-sense/; Congressional Budget Office, "Developments in CBO's Projections for Medicare Part D," Jul. 29, 2026, https://www.cbo.gov/publication/62549; Douglas Holtz-Eakin, "How 'Bout Them Price Controls?," American Action Forum, Jul. 30, 2026, https://www.americanactionforum.org/daily-dish/how-bout-them-price-controls/.

15 Congressional Budget Office, "The Budget and Economic Outlook: 2026 to 2036," Feb. 11, 2026, https://www.cbo.gov/publication/61882.

16 US Treasury Department, "Tax Expenditures Fiscal Year 2027," Dec. 16, 2025, https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures.

17 William McBride, "Can Tax Reform Solve the Debt Problem—or Just Slow It?," Tax Foundation, Apr. 30, 2026, https://taxfoundation.org/research/all/federal/can-tax-increases-fix-the-national-debt/.

18 Congressional Budget Office, "The Budget and Economic Outlook: 2026 to 2036," Feb. 11, 2026, https://www.cbo.gov/publication/61882.

19 Tax Foundation, "Options for Reforming America's Tax Code 3.0: A Policymaker's Guide to Tax Reform Trade-Offs," July 2026, https://taxfoundation.org/tax-reform-guide/; William McBride and Alex Durante, "Federal Revenue and Distributional Impacts of Limiting the Tax Exclusion for Employer-Sponsored Health Insurance Premiums," Tax Foundation, Oct. 2, 2025, https://taxfoundation.org/research/all/federal/employer-sponsored-health-insurance-premiums-tax-affordable-care-act/.

For instance, the CBO has estimated several options to reduce Medicare and Medicaid spending that could save trillions of dollars over the next decade. Some reforms would build on the OBBBA, including capping federal spending on Medicaid, limiting state taxes on healthcare providers, reducing federal Medicaid matching rates, increasing premiums paid for Medicare, and requiring site-neutral payments.[20] Reform efforts should aim to reduce waste in healthcare spending, improve efficiency, and ease cost pressures.[21] Rather than continuing to subsidize inefficient healthcare programs, lawmakers should change course and institute market reforms, allowing more competition, innovation, and consumer choice to finally "bend the cost curve" in health care downward.

20 Congressional Budget Office, "Options for Reducing the Deficit: 2025 to 2034," Dec. 12, 2024, https://www.cbo.gov/publication/60557.

21 William McBride, Erica York, Alex Durante, and Garrett Watson, "The Unsustainable US Debt Course and Impacts of Potential Tax Changes," Tax Foundation, Jan. 14, 2025, https://taxfoundation.org/research/all/federal/us-debt-budget-taxes-spending-social-security-medicare/; James C. Capretta, "Health Care Subsidies Are a Political Shortcut, Not a Lasting Policy Solution," American Enterprise Institute, Sep. 30, 2025, https://www.aei.org/commentary/health-care-subsidies-are-a-political-shortcut-not-a-lasting-policy-solution/; Peter G. Peterson Foundation, "Almost 25% of Healthcare Spending is Considered Wasteful, Here's Why," Apr. 3, 2023, https://www.pgpf.org/article/almost-25-percent-of-healthcare-spending-is-considered-wasteful-heres-why/; Mark Pauly, Scott Harrington and Adam Leive, "'Sticker Shock' in Individual Insurance under Health Reform," NBER Working Paper 20223, June 2014, https://www.nber.org/papers/w20223; Maria Polyakova and Stephen P. Ryan, "Subsidy Targeting with Market Power," NBER Working Paper 26367, August 2021, https://www.nber.org/papers/w26367; John C. Goodman, "Reform Obamacare Instead of Spending More Money On It," Forbes, Sep. 28, 2025, https://www.forbes.com/sites/johngoodman/2025/09/27/reform-obamacare-instead-of-spending-more-money-on-it/; Marika Cabral, Michael Geruso, and Neale Mahoney, "Do Larger Health Insurance Subsidies Benefit Patients or Producers? Evidence from Medicare Advantage," *American Economic Review* 108:8 (August 2018), https://www.aeaweb.org/articles?id=10.1257/aer.20151362.