

Why Are Health Care Costs So High?

Health care premiums have generally increased year after year due to complex factors. As a business owner, you can still take action to lighten health care costs now for your employees. With payment reform and delivery system reform, small businesses are beginning to see a way to bring down costs. We will discuss these strategies more in the next couple of blog posts.

The average annual premium for single coverage in an employer-sponsored health plan in 2011 was \$5,429 (\$15,073 for family coverage). That represents an 8 percent increase for single coverage and a 9 percent increase for family coverage from 2010 (inflation based on the Consumer Price Index was only 3.2 percent in 2011).¹

Why are costs so high? It is a complicated question to which there is no single or simple answer. Here are some reasons that help to explain what's driving the continual rising cost of your health coverage.

Fee-for-service

The basis for health care in most instances in the U.S. is the “fee-for-service” model. Health care providers — doctors and hospitals — are paid for the services they perform. Under this model, the more tests, procedures and exams that are performed, the more the providers get paid.

What's more, there is little incentive for patients to decline any offered medical services because they don't pay for the services out of pocket. Insurance or a government program, such as Medicare or Medicaid, fully or mostly covers the services. Based on its current structure, the fee-for-service model is a key contributor to a number of issues driving increased costs.

Lack of preventive care

For the most part, the health care system is set up to treat medical conditions as they occur. The system is not structured to support preventive actions that could bring down costs in the future. For example, providing overweight pre-diabetic people with weight-loss programs likely would avoid the medical costs associated with those people developing diabetes and spending the rest of their lives being treated for the condition and its associated maladies.

There is significant movement toward more support for preventive care, especially under the Affordable Care Act. Insurers must now cover the cost of smoking cessation programs, dietician counseling and many other preventive care costs. But the system as a whole is not yet fully geared toward prevention of health problems.

As such, the Los Angeles Area Chamber of Commerce educates its members on the importance of wellness programs and preventive measures to help reduce employee costs for health care and improve the health and productivity of the workplace.

Delivery of services

In the U.S., physicians are the primary health care providers, with hospital and medical staff taking supporting roles. For the most part, the physicians write prescriptions, set broken legs and direct the performance of other medical actions. Overall, doctors in the U.S. provide exceptional care and are well paid for their services. The fees charged by doctors under the fee- for-service model are impacted by factors, in addition to the quantity of services and procedures performed, including:

- Legal risks
- A shortage of doctors and an increase in demand
- More patient request for tests and medications
- Higher demand generated by pharmaceutical advertising
- The mistaken belief that more services equals better care

This equation of having most medical actions performed by highly compensated personnel translates into high medical costs. What's more, under the fee-for-service model, this compensation is largely dependent on the amount of services provided. In contrast, when the fee-for-service model is not used, doctors are on a fixed salary and are not incentivized for the quantity but rather the quality of care they provide.

Technology

In medicine, technology is an important contributor to better care through prevention and disease management, and may enable doctors to catch health problems before they get worse. But the cost of medical technology devices and medications is high.

For example, an MRI machine ranges between \$1 and \$3 million, with an additional half a million dollars needed to build the appropriate suite in which to house the machine² and these costs need to be recovered through patient usage (which may even lead to overprescribing MRI tests). Another growing, but expensive, trend contributing to higher health care costs is robotic surgery.

Overall, in part because of the fee-for-service model, there is more use of high-tech equipment and procedures in the U.S. than in any other country. Yet even with a focus on heavy equipment, many providers still lack the full use of electronic medical records — resulting in repetitive, costly tests.

Litigation

The U.S. is known as a litigious society. When something goes wrong medically, often the patient or patient's family blames the health care provider and sues. This state of affairs adds to the cost of health care in two ways:

- Defensive medicine. Because of the fear of being sued, doctors may prescribe tests and other procedures to cover all their bases with the hopes of avoiding future litigation.
- Malpractice premiums. Insurers, for the most part, are on the hook for multimillion-dollar malpractice actions. The cost of professional liability coverage for doctors has risen to help keep pace with the malpractice action payouts. The doctors (or hospitals that cover doctors) pass along the cost of the premiums to patients.

In California in particular, compliance costs for the State's main bill regulating patient malpractice rights, MICRA, are very high. Doctors and hospitals often practice defensive medicine by overprescribing tests. Efforts to raise the maximum fees patients may recoup from malpractice lawsuits and how trial lawyers are paid to pursue such cases have been broadly opposed by business groups, including the L.A. Area Chamber, in order to avoid dramatic health care cost increases.

Regulatory compliance

Good intentions don't always lead to good results. The government wants to protect patients (e.g., the Health Insurance Portability and Accountability Act, or HIPAA, and concerns about patient privacy) and has created rules — and massive paperwork — toward this end. The cost of compliance with government regulations has added dramatically to the cost of health care, with some estimates putting administrative costs at 14 percent of total health care spending.³

To maintain continuity of care and control costs, the Chamber has actively opposed burdening the health care system with additional regulatory compliance costs, especially at a time when it is taking in millions of newly insured patients. To continue to ensure California's national leadership role in health care reform implementation, it is critical that our state health care infrastructure have an opportunity to adjust and grow under the weight of the massive expansion it is undergoing, without taking on additional regulatory burdens and limitations which could drive up costs and increase business climate uncertainty.

Cost Pressures

Chronic government underpayment for public health care programs such as Medicare and Medicaid have contributed to rising costs to individuals and businesses who must compensate for the very low government provider rates for millions of patients.

California has the nation's lowest Medicaid provider rates, with some primary care doctors providing services at less than what it costs to furnish them. Without

adequate provider rates, our health care system can neither accommodate nor sustain the increased demand it faces.. In order to achieve long-term decreases in the uninsured, which will drive down system costs overall, government must make the proper investments to raise provider rates to adequate levels and avoid cost-shifts to private health care recipients.

Additionally, new high-priced prescription specialty drugs, used to treat certain chronic or complex conditions, could lead to skyrocketing health care costs. According to the California Association of Health Plans, “Specialty drugs account for fewer than one percent of all prescriptions in the U.S., but consume a hefty 28 percent of prescription spending.” Such added cost pressures for specialty drugs are leading to ballooning pharmacy budgets for health insurance plans, particularly for publicly funded programs such as Medi-Cal.

Conclusion

There are many suggestions for fixing the current high cost of health care. Many experts agree that one of the main obstacles — the fee-for services model — should be revised or reformed for meaningful cost reduction. To that end, many health plans and hospitals are experimenting with payment reform pilots which redesign the payment system for services to measure how efficiencies, quality of care, and cost savings change. The Affordable Care Act incentivizes some of these pilots but the industry itself is going further to test new ways to contain costs while maintaining or improving care.

An incentive system that rewards results would likely go a long way toward containing costs and lowering premiums, though there will arguably be challenges in implementation, measurement, and trade-offs. Addressing the other factors responsible for high costs can also be helpful in lowering premiums. It’s up to consumers who ultimately bear the cost of the system to demand the type of reform that will keep the delivery of quality health care up but drive health care costs down.

¹According to Employer Health Benefits 2011 Annual Survey
<<http://ehbs.kff.org/pdf/8226.pdf>>

²eHow Health “How Much Do MRI Machines Cost?”
<www.ehow.com/about_4731161_much-do-mri-machines-cost.html>

³Center for American Progress.
<www.americanprogress.org/issues/2012/06/paper_cuts.html>