

US Healthcare Costs Background Brief

Background

Healthcare costs have been rising for several years. Expenditures in the United States on health care reached \$2 trillion in 2005, almost 3 times the \$696 billion spent in 1990, and over 8 times the \$246 billion spent in 1980. Stemming this growth has become a major policy priority, as the government, employers, and consumers increasingly struggle to keep up with healthcare costs.¹ Spending on health care in the US reached \$2 trillion in 2005, and accounted for 16% of the nation's Gross Domestic Product (GDP). Total healthcare expenditures grew at an annual rate of 6.9% in 2005, slower than the past several years, but still significantly outpacing inflation and the growth in national income.²

Although Americans benefit from this increasing investment in health care, the recent rapid cost growth, coupled with an overall economic slowdown and rising federal deficit, is placing great strains on the systems we use to finance health care, including private employer-sponsored health insurance coverage and public insurance programs such as Medicare and Medicaid. Since 2001, employer-sponsored health coverage premiums have increased by 68%.³ Employers are increasingly shifting costs to their employees in the form of higher premiums, de-

ductibles, and co-payments. With workers' wages growing at a much slower pace than healthcare costs, many face difficulty in affording this growth in out-of-pocket spending.

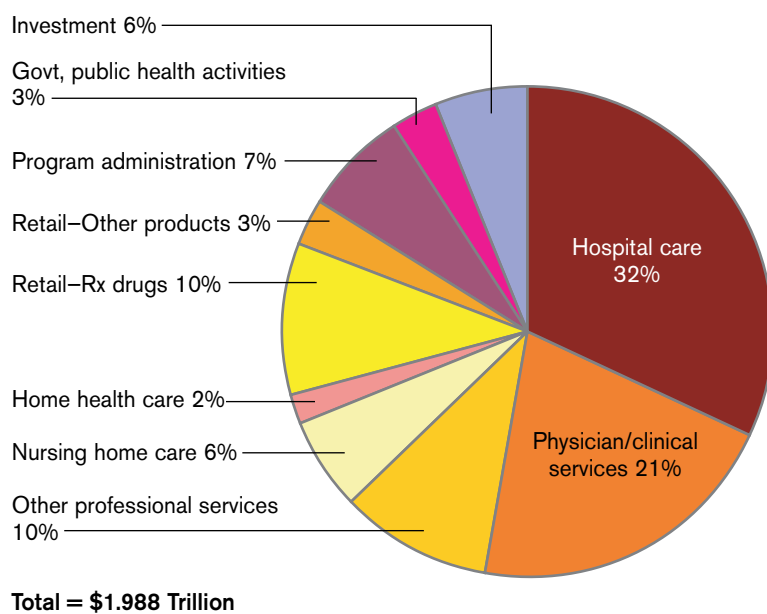
Medicare and Medicaid program spending have also been rising, but at lower rates than private employer plan premiums. Medicare spending has increased since the implementation of the prescription drug benefit in January 2006. Spending in the Medicaid program has also been rising steadily. It now comprises one of

the largest items in state budgets, and many states have had to make cuts in eligibility or benefits to help reduce program spending.

How is the US healthcare dollar spent?

As shown in Figure 1, hospital care accounts for the largest share (32%) of health expenditures. Physician services are the next largest items, comprising one-fifth of national health spending. Prescription drugs, while accounting for only 10% of total expenditures, has been one of the biggest

Figure 1. National Health Expenditures, 2005²



contributors to the growth in spending, doubling as a share of expenditures over the past decade.²

What is driving healthcare costs?

Controlling healthcare expenditures requires a solid understanding of the factors that are driving the growth in spending. Some of the major factors to consider are:

- Intensity of services—The nature of health care in the US has changed dramatically over the past century with longer life spans and greater prevalence of chronic illnesses. This has placed tremendous demands on the healthcare system, particularly an increased need for treatment of ongoing illnesses and long-term care services such as nursing homes.
- Prescription drugs and technology—Spending on prescription drugs and the major advancements in healthcare technology have been cited as major contributors to the increase in overall health spending. Growth in prescription drugs expenditures has outpaced the spending growth in other services. The effect of spending on technology, such as devices, is harder to estimate. Some analysts state that the availability of more expensive, state-of-the-art drugs and technological services fuels healthcare spending not only because the development costs of these products must be recouped by industry but also because they generate consumer demand for more intense, costly services even if they are not necessarily cost-effective.

Prescription drugs, while accounting for only 10% of total expenditures, has been one of the biggest contributors to the growth in spending, doubling as a share of expenditures over the past decade.²

- Aging of the population—Health expenses rise with age and as the baby boomers are now in their middle years, some say that caring for this growing population has raised costs. This trend will continue as the baby boomers will begin qualifying for Medicare in 2011 and many of the costs are shifted to the public sector.
- Administrative costs—7% of healthcare expenditures are for administrative costs (eg, marketing, billing, actuarial expenses) and this portion is much lower in the Medicare program (<2%), which is operated by the federal government.⁴ Some argue that the mixed public-private system creates overhead costs that are fueling healthcare spending. Some groups have also suggested that administrative costs, primarily actuarial expenses, result in excessive profits for private insurance companies.

What are the major proposals to contain costs?

Since the 1960s, the nation's efforts to control healthcare costs have not had much long-term effect.⁵ One of the most recent efforts, the advent of "managed care," which represented a shift towards greater control over utilization of services, did initially seem to generate savings as managed care practices became widespread throughout the late 1980s and 1990s. However, spending has since rebounded sharply as the health sector seems to have exhausted one-time savings and a backlash loosened many managed care policies, particularly restrictions on consumer choice. The different proposals currently in the policy arena are divided broadly by debate over a stronger role for government negotiation or market-based models relying on competitive forces.

- Increasing consumer involvement in purchasing—Supporters of new "consumer-driven" health plans believe that greater price transparency would make consumers more price sensitive and more prudent purchasers and thus save consumers and employers money. One of the major forms currently is tax-favored "health reimbursement accounts (HRA)," to which employers contribute funds that are managed by the employee to spend on primary health care as she or he directs. Once the account is exhausted, a catastrophic insurance plan begins covering at least a portion of expenses beyond a high annual deductible (a portion of which an employee may have to pay out-of-pocket depending

on how much money is in the HRA). Critics of the consumer-directed approach raise concerns about the potential impacts that the higher cost-sharing would have on lower income people and about the potential for these new arrangements to be disproportionately used by healthy people, shifting sicker groups to more expensive forms of insurance, and the risk that patients will not obtain important healthcare services, particularly preventive and primary care services in order to retain money in their accounts. While most prevalent in the private sector, elements of consumer-directed plans have started entering various state Medicaid programs as well.

- Government regulation—Citing the success of the Medicare program in controlling per capita spending over its history and warning that market-based approaches combined with greater individual financial responsibility can disadvantage those with limited financial resources and

Seven percent of healthcare expenditures are for administrative costs (less than 2% for Medicare programs).

create barriers to needed care, some policymakers favor more government involvement in the healthcare sector. Supporters of a single-payer program administered by the federal government, similar to Medicare, point to significantly lower administrative costs in other such systems and argue that industry profits would play less of a role in rising prices. Critics argue that such regulation stifles innovation and that market-based approaches are more cost-effective and will provide consumers with a wider range of choices.

- Improving quality and efficiency—There are a number of initiatives in play that aim to help make the healthcare system more efficient and higher quality, and consequently more cost-effective. Disease management strives to improve and streamline the treatment regimen for certain common, chronic health conditions. Bulk purchasing of drugs, similar to the current VA system, has been proposed for the State Pharmaceutical Assistance Programs. Greater use of technology, such as electronic medical records, is also being researched in several demonstration projects around the country for its potential to more efficiently share information and reduce overhead costs. **MPM**

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DISCUSSION QUESTIONS

- What are the major drivers of the rise in healthcare spending?
- How can health care be made more affordable without limiting access to necessary care?
- What role should government play in controlling increases in the cost of care and the cost of health coverage? What different choices do state and federal policymakers have in containing costs.
- What is the responsibility of individuals in the cost of their care? Are health savings accounts and high deductible insurance policies an approach that should be expanded? What are the concerns for low-income individuals?
- How does the rise in costs affect efforts to expand coverage to the nation's 45 million uninsured?