



The Association of Washington Healthcare Plans

## **Rising Health Care Costs** *What Factors are Driving Increases?*

Rising health care costs and access to affordable coverage are prominent issues for Washington employers, health care providers, purchasers, and legislators, as well as in the daily lives of millions of its residents. The driving forces behind rising health care costs, however, are often misunderstood. Although increasing premiums are often blamed for driving up the cost of health care, premiums actually rise in direct response to health care costs. Instead, there are several other key cost drivers that combine together to drive up the cost of health care. Understanding why health care coverage costs are increasing is crucial for us to work effectively together to address these issues.

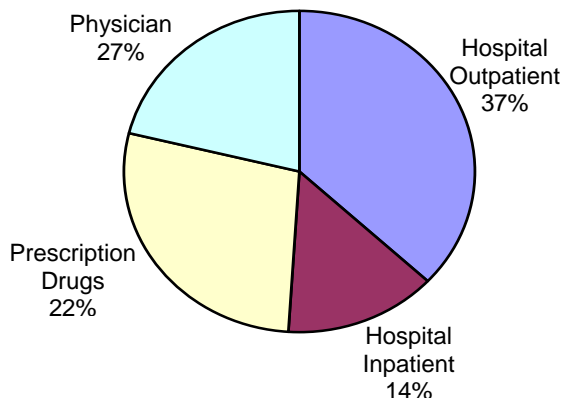
### **Understanding the Relationship between Health Care Costs & Premiums** *Premiums rise in response to health care cost increases*

The cost of health care has been continually rising for several decades, and continues to affect people's ability to afford health coverage. From 1990 through 2000, combined public and private spending in the United States nearly doubled from about \$696 billion to about 1.3 trillion, according to the General Accounting Office (GAO)<sup>1</sup>. Rapid growth is expected again to double spending from 2000 through 2010.

Health care spending now represents 15 percent of our nation's GDP<sup>2</sup>. For most states, including Washington, health care spending is one of the fastest growing components of the state budget.

Hospital outpatient and inpatient costs are the largest component of health care spending. Their growth accounted for half the total increase in health care costs between 2000 and 2001.

Contributions to Private Insurance Spending Growth, 2002<sup>3</sup>



The relationship between health care costs and premiums is often misunderstood. Health care premiums are not responsible for rising health care costs, but rather premiums rise in response to increases in the cost of providing health care services. Health care cost inflation causes increases in benefit payments made by insurers for services rendered on behalf of their enrollees. Benefit payments are the single largest component of health insurance premiums; on average, almost 90 cents of every premium dollar are paid back to providers for health care services<sup>4</sup>. So, when the cost of health care services goes up, insurance premiums must rise to keep pace.

A recent Kaiser Family Foundation employer health benefits survey found that premiums for employer-based health benefits rose by 13.9 percent in 2003. This is the third consecutive year of double-digit premium increases, and a higher rate of growth than any year since 1990. Premium increases in 2003 exceeded the overall rate of inflation by nearly 12 percentage points. The cost of coverage for a family of four is now nearly \$9,100 per year<sup>5</sup>. Cost is the most commonly cited reason for why individuals do not take up or buy coverage or why employers do not offer coverage<sup>6</sup>.

After experiencing moderate growth in the 1990's, employer health insurance expenditures have increased substantially over the last few years. A slowdown in the rate of health care premiums increase is expected this year, however health care costs continue on the rise.

## **Cost Drivers**

*Several key factors are impacting cost*

Both nationally and in Washington State, there are several factors contributing to the increasing cost of health care services, and in turn, health care premiums. Cost drivers include:

- Greater Demand for Services
- New Technology
- Prescription Drugs
- Cost Shift Due to Under-Funded Public Programs
- Government Regulation & Mandates
- Medical Malpractice Liability

### Greater Demand for Services

*A growing population, aging baby-boomers, and disease management*

The dual pressure of increased numbers of elderly and an increasing population in general will continue to exert tremendous stress on our health care system. Since 1980, Washington's population has grown to a current level of 6,068,996. 11.2 percent of our population is now over 65 years old. By 2020, Washington's population is expected to grow by an additional 2 million residents.

In addition, the state's population is aging. More than 1.2 million Washington residents will be age 65 or over by 2020. People over 50 use twice as much health care as those in their twenties, and almost four times as much by the time they are 60. Such growth requires more physicians, nurses, and other health care providers just to keep pace with service demands.

It is also important to note that a substantial share of total health care spending goes not only for acute care, such as trauma victims and certain newborns, but chronic health conditions as well. Ongoing chronic care for conditions such as asthma and diabetes --- diseases on the rise --- are placing continuing demands on the health care system.

Medical Directors representing AWHP member plans recently sponsored a forum on enhancing chronic care management, and actively participate in related community-wide efforts.

### New Technology

#### *The demand for state-of-the-art treatment*

Medical technology is a major driver of health care costs. Technological advances are unquestionably providing important break-throughs in saving lives and improving care, but they come with significant cost. The estimated \$150 - \$200 billion<sup>7</sup> medical technology market encompasses a wide range of innovations, led by diagnostic imaging, cardiovascular procedures, and in-vitro (laboratory) diagnostic tests.

New technology often increases health care costs, even if it succeeds in lowering the unit cost of service. For example, several new procedures are revolutionizing care for heart disease. As a result, many cardiac procedures are now done without a hospital stay and with lower risks, thus increasing their availability to patients. The greater availability, however, greatly increases the number of times they are used each year. Recent GAO report findings, therefore, have concluded that the utilization resulting from these technology advances has generally offset any potential savings<sup>8</sup>. In other instances, new technologies may offer only marginal improvements over existing treatments, but with dramatically higher price tags. And may be additive rather than replace or reduce present modalities of care.

In response to increasing demands for access to cutting edge technology, AWHP member health care plans are working with physicians to develop treatment protocols and evidence-based standards of care to guide the introduction and use of new technology.

### Prescription Drugs

#### *More drugs, used more frequently, at higher costs*

Dramatic increases in the cost, frequency of use, and demand for prescription drugs directly affects the costs of private and public insurance coverage. Over the last decade, national spending on prescription drugs by both public and private payers has more than tripled as total drug expenditures climbed from \$40 billion in 1990 to \$141 billion in 2001<sup>9</sup>. Private insurance pays the largest share of rising prescription drug costs, absorbing 47 percent of the national cost in 2001 --- a sizable increase from 24 percent covered by private insurers in 1990<sup>10</sup>. This means that health insurers spent an average of \$24.70 per member per month on prescription drugs in 2001<sup>11</sup>. Consumer's share of paying prescription drug expenditures "out-of-pocket" decreased from 59 percent in 1990 to 31 percent in 2001<sup>12</sup>.

Three main factors are driving this dramatic increase in prescription drug costs: more prescriptions being written, price inflation, and a shift towards use of higher-cost drugs.

- In 2001, 3.1 billion prescriptions were dispensed in the United States, compared to 1.9 billion in 1993<sup>13</sup>.
- Promotional spending by pharmaceutical companies has grown dramatically. “Direct-to-consumer” advertising introduces newer drugs, which are more costly than older drugs.
- According to the National Institute for Health Care Management, sales for the 50 most heavily advertised drugs grew by 31.9 percent from 1999 - 2000, compared to 13.6 percent for all other drugs<sup>14</sup>.

On the positive side, the increased use of generic drugs provides an opportunity for slowing the growth in costs, while preserving health care quality. The average difference between generic (\$22.79) and brand name (\$76.29) prescription drugs is about \$50<sup>15</sup>.

AWHP member plans encourage use of generic drugs whenever appropriate, as part of their prescription drug benefit designs.

#### Cost Shift Due to Under-Funded Public Programs

*Cost-burdens are being shifted to private insurers*

The under-funding of state and federal government programs, like Medicaid and Medicare is of serious concern when understanding the rising costs of health care coverage. Because public program reimbursements often do not cover the actual cost of care, health care providers are putting more and more pressure on health insurers to make-up for public program payment shortfalls. As insurers respond to this pressure, a cost shift occurs from the lower reimbursement rate in the public program to a higher reimbursement rate in the private market. These higher rates are then reflected in employer premiums. This type of cost shifting from the public market to the private will continue until reimbursement rates from the government fully fund the cost of services provided to individuals in public health coverage programs.

In addition to cost shifting, the poor public program reimbursements are also affecting basic access to primary care for Washingtonians. A recent State report demonstrates that as of 2002, a majority of physicians in most rural counties were no longer accepting new Medicaid and Medicare patients<sup>16</sup>. As private providers are no longer able to afford to serve the publicly insured, these patients must either avoid care or fall back on Washington's safety net --- which is already stretched. Washington's community and migrant health centers, which make up the primary safety net, have experienced a 10 percent increase in total patients, and a 26 percent increase in uninsured patients since 2001<sup>17</sup>.

Washington health insurers also subsidize funding for the Washington State Health Insurance Pool (WSHIP), which makes available comprehensive coverage for individuals with serious medical conditions. Unlike high-risk pools in other states, however, Washington's also extends eligibility to many individuals who would otherwise be covered by state programs, thus shifting additional cost risks to private insurers.

AWHP is an active advocate for adequate funding of state government programs and elimination of cost shifting to private purchasers.

## Government Regulation & Mandates

### *Regulatory burdens create a costly environment*

Increasing government regulations and new mandates are also contributing to increases in the cost of health care. Currently, in Washington, four state and two federal agencies regulate health care insurers. There are literally hundreds of state statute and code regulations, and hundreds of more contract compliance requirements for those participating in public programs.

Requirements are often highly complex and overlapping, and in some cases, contradict each other. In other cases, health insurers are required to provide state agencies with information they could obtain directly from another state agency. This regulatory environment creates an administrative burden for insurers, which impacts premium costs, but delivers little value to consumers.

AWHP member plans are actively working with representatives from state agencies to simplify administratively burdensome state regulatory requirements, and help free valuable health care dollars for patient care and services.

On top of state regulations and requirements, the federal government has passed over 100 new laws regulating health care plans, since 1996. One, the Health Insurance Portability and Accountability Act (HIPAA), is adding tremendous costs to our health care system. The American Hospital Association estimates costs to the hospital system alone will exceed \$22 billion during the first ten years<sup>18</sup>.

In addition to regulatory compliance costs, recent Washington State benefit mandates --- such as every category of provider, direct access to certain providers, and chemical dependency coverage --- are also contributing to health care cost increases. Washington currently mandates coverage of 47 particular services and provider types, including optometry, chiropractic care, registered nurses, reconstructive breast surgery, mammograms, temporomandibular joint disorders, podiatry, and foot care services. While all these mandated benefits seem noble and are certainly appreciated by those who need these services, they help drive up the cost of health coverage.

AWHP plans are working with legislators and community leaders to develop innovative solutions to meet employer and employee health needs, and provide them with expanded choices of health plans, while at the same time mitigating cost increases and protecting consumers.

## Medical Malpractice Liability

### *Malpractice insurance costs are skyrocketing*

Jury awards in medical lawsuits have more than doubled since 1994<sup>19</sup>, leading to increased malpractice insurance premiums, health care provider costs, and an increase in the practice of defensive medicine. Awards account for only part of the problem --- since most cases never result in a judgment, but cost millions of dollars to defend. Existing incentives for frivolous litigation not only fuels rising costs, but also hinders efforts to reduce medical errors and improve quality.

Rising malpractice insurance premiums are driving up practitioner fees, especially for OB/GYN and surgical services. Nationally, it is estimated that about \$108 billion is added each year to the

cost of health care because physicians feel compelled to practice defensive medicine --- ordering unnecessary tests and making unnecessary referrals --- to avoid future litigation<sup>20</sup>.

AWHP member plans have joined a broad coalition of business, government, and non-profit organizations seeking to resolve the current medical liability crisis in our state.

## **What Can Legislators Do to Help Control Rising Health Care Costs?**

*Together we can make a difference...*

- Assure full funding of state government programs
- Carefully evaluate requests for additional health care mandates
- Advocate for regulatory simplification efforts
- Evaluate the cumulative effect of additional regulation prior to implementation
- Support reasonable limits on non-economic damages in medical malpractice lawsuits

*The Association of Washington Healthcare Plans (AWHP) is an alliance of licensed health care service contractors and health maintenance organizations that provide health coverage to over 4 million residents in Washington State. AWHP member plans are committed to working together to assure Washington residents access to affordable, quality health care choices.*

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<sup>1</sup> GAO, *Comptroller General's FORUM HEALTH CARE*, "Health Care Expenditures Are Escalating", GAO-04-793sp, May, 2004

<sup>2</sup> GDP stands for gross domestic product. Katharine Levit, et al, "Health Spending Rebound Continues in 2002", *Health Affairs*, Jan/Feb 2004: 147-159

<sup>3</sup> Center for Studying Health System Change, "Tracking Health Care Costs", 2003

<sup>4</sup> Centers for Medicare and Medicaid Services, Office of the Actuary, National Statistics Group, as reported in Health Insurance Association of America, *Chartbook on Health Care Cost Trends*

<sup>5</sup> Kaiser Family Foundation *Employer Health Benefits 2003 Annual Survey*, retrieved April 11, 2004 from: <<http://www.kff.org/insurance/ehbs2003-3-set.cfm>>

<sup>6</sup> Robert Woods Johnson, *State Coverage Initiatives*, "Why are People Uninsured?", retrieved Jun. 24, 2004 from: <<http://www.statecoverage.net/why.htm>>

<sup>7</sup> *Medical and Health care Marketplace Guide*, 2000 data as reported by Booz Allen Hamilton, 2003

<sup>8</sup> GAO, *Comptroller General's FORUM HEALTH CARE*, "Health Care Expenditures Are Escalating", GAO-04-793sp, May, 2004

<sup>9</sup> U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, *National Health Expenditure Amounts by Type of Expenditure and Source of Funds: Calendar Years 1965 - 2001*, 2002

<sup>10</sup> U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, *National Health Expenditure Amounts by Type of Expenditure and Source of Funds: Calendar Years 1965 - 2001*, 2002

<sup>11</sup> Milliman USA, *2001HMO Intercompany Rate Survey*, Aug. 2002

<sup>12</sup> U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, Office of the Actuary, National Health Statistics Group, *Expenditures for Prescription Drugs, by Source of Funds*, (chart), U.S. Health Care System Chartbook Series, June 2002 edition

<sup>13</sup> National Institute for Health Care Management, 2002; U.S. Census Bureau, 2002. Blue Cross Blue Shield Association analysis, as reported in *Medical Cost Reference Guide*, Jun. 23. 2003

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<sup>14</sup> National Institute for Health Care Management, 2002; U.S. Census Bureau, 2002. Blue Cross Blue Shield Association analysis, as reported in *Medical Cost Reference Guide*, Jun. 23. 2003

<sup>15</sup> Verispan (Scott-Lewin), as reported by Generic Pharmaceutical Association, 2003; National Association of Chain Drug Stores, 2002

<sup>16</sup> "Access to Primary Health Care Services", Washington Rural Health Assessment Project, the office of the Community and Rural Health. July 2003, retrieved July.12.2004, from <<http://www.doh.wa.gov/hsqa/ocrh/har/hcresrch.htm>>

<sup>17</sup> Data collected by the State Health Care Authority, received through correspondence with the Community Health Network of Washington, July 2004

<sup>18</sup> "Who Will Care for You?" Washington State Hospital Association, 2001

<sup>19</sup> Jury Verdict Research. *Current Award Trends*, 2001 Edition, as reported in *Medical Cost Reference Guide*, Jun. 23. 2003

<sup>20</sup> Liability Reform Coalition. "What is at Stake", retrieved May. 25.2003, from: <<http://www.walrc.org/resources/talking-points.html>>