Utah FOUNDATION Executive Summary

Report Number 677, October 2006

CONTROLLING HEALTHCARE COSTS

PART ONE: UNDERSTANDING THE FACTORS DRIVING HEALTHCARE INFLATION

A group of business leaders asked Utah Foundation to examine national research on the drivers of healthcare inflation, review data on Utah's healthcare situation, and conduct focus groups with healthcare stakeholders to better understand healthcare cost issues facing Utah. This report provides the findings of that process. A second report will examine specific reform ideas on which the group requested analysis.

Healthcare costs have risen rapidly over the last decade. As costs rise, fewer employers can afford to offer health insurance, and fewer employees can afford to pay their share of the premium when coverage is offered. Although Utah enjoys a relatively healthy and young population, it has not escaped the national trend of escalating health costs, rising premiums, and growing numbers of uninsured adults and children. Earlier this year, Utah Foundation, at the request of the Employers Healthcare Coalition, began investigating the issue of escalating health costs. Utah Foundation spoke with various sectors of the healthcare community to understand how Utah's situation compares with the nation and to explore their ideas for making health coverage more affordable for employers and employees. This report explains state and national trends in healthcare costs and summarizes the findings of focus groups with healthcare experts and stakeholders. A second report will introduce five possible areas of reform on which the Employers Healthcare Coalition requested analysis.

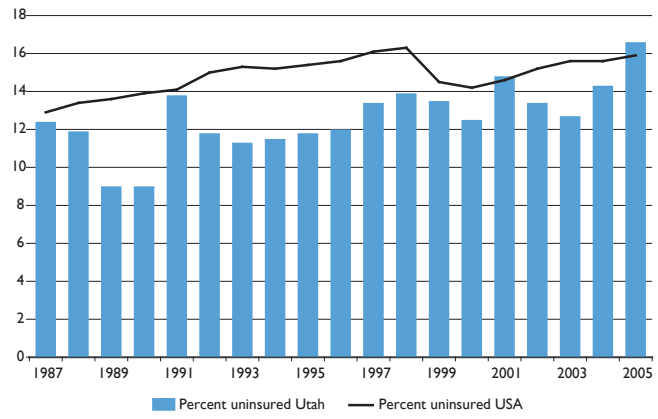
HEALTHCARE IN UTAH

Historically, Utah's uninsured rate has been below the national average (see Figure 1). In 2005, however, Utah's percentage of uninsured persons surpassed the national average for only the second time in almost twenty years. From 1995 to 2005, the uninsured rate increased by only one-half percentage point for the nation overall (15.4 to 15.9 percent) but by almost 5 percentage points for Utah (11.8 to 16.6 percent). Utah's uninsured rates for children have now also surpassed the national average for the first time since 1991.

The number of people without insurance affects the price of health insurance as uncompensated healthcare costs from the care of the uninsured are shifted to private payers. The cost of health insurance in Utah has experienced significant increases. From 1996 to 2004, the average health insurance premium for a family of four in Utah increased 46 percent after adjusting for inflation. Utah employee contributions to family premiums increased 71 percent during this period, while employees nationally faced a 59 percent increase.[1]

Most Americans with health insurance obtain it through their jobs. In 2005, 59.5 percent of people in the U.S. and 62.2 percent of Utahns had job-related coverage. A decade earlier, 61.1 percent of all Americans and 71.2 percent of Utahns had job-related coverage. Economists with the Federal Reserve recently concluded that declines in employer-based coverage "have been the driving force for overall

Figure 1: Uninsured Rates, All People: Utah and U.S.



Source: U.S. Census Bureau, Historical Health Insurance Tables, 2006.

For the complete report on this topic and other reports, please visit our website at www.utahfoundation.org

Figure 2: Employer Healthcare Coverage by Size of Firm, Utah and U.S., 2004

		Less than 10 employees	10-24 employees	25-99 employees	100-999 employees	1000 or more employees	Less than 50 employees	50 or more employees	All firms	Total number of employees
Employees by firm size	Utah	15.2%	9.0%	11.8%	17.9%	46.1%	30.7%	69.3%	100.0%	932,564
	U.S.	13.2%	8.8%	13.8%	17.7%	46.5%	29.1%	70.9%	100.0%	112,087,067
Employees in firms that offer health insurance	Utah	39.5%	57.4%	87.2%	97.3%	97.9%	54.6%	97.0%	84.0%	783,354
	U.S.	45.5%	68.4%	84.2%	94.8%	99.5%	61.0%	97.2%	86.7%	97,179,487
Employees eligible for health insurance at firms that offer health insurance	Utah	67.2%	62.2%	70.9%	64.7%	73.3%	67.2%	70.8%	70.1%	549,131
	U.S.	82.5%	77.9%	75.0%	75.3%	79.9%	78.8%	78.3%	78.4%	76,188,718
Employees who are eligible for health insurance that are enrolled in health insurance	Utah	87.0%	72.0%	77.7%	78.2%	80.4%	78.8%	79.8%	79.7%	437,657
	U.S.	81.5%	76.1%	78.1%	78.4%	81.0%	78.5%	80.2%	79.8%	60,798,597
Employees enrolled in health insurance as percent of all employees	Utah	23.1%	25.7%	48.0%	49.2%	57.7%	28.9%	54.8%	46.9%	437,657
	U.S.	30.6%	40.5%	49.3%	56.0%	64.4%	37.7%	61.0%	54.2%	60,798,597

Source: Agency for Healthcare Research and Quality,"State-level Insurance Component Summary Tables," Medical Expenditure Panel Survey, 2006.

coverage trends in recent years." Given the large proportion of people who depend on job-related coverage, employer decisions about whether or not to offer health insurance coverage to employees significantly impact the number of uninsured persons.[2]

Coverage by employer-sponsored health insurance varies greatly by size of firm as shown in Figure 2. Nationally, for larger firms (50 or more employees), 97 percent of workers are in firms that offer insurance. For smaller firms (less than 50 employees), 61 percent of workers are in firms that offer insurance. Utah employees face lower odds of obtaining employer-sponsored insurance, with only 55 percent of employees in smaller firms working for firms that offer insurance. Compared to the national average, Utah employees are much less likely to be eligible for employer-sponsored insurance, but when Utahns are eligible, they enroll in employer health plans at about the same rate as workers nationally.[3]

The fact that many small businesses do not offer their employees health insurance coverage is an important factor in the rate of uninsured in both Utah and the nation. Reforms that facilitate the offering of health benefits by small employers hold the potential to decrease both the number of uninsured and the costs of uncompensated care that are shifted to private payers.

NATIONAL TRENDS IN HEALTHCARE INFLATION

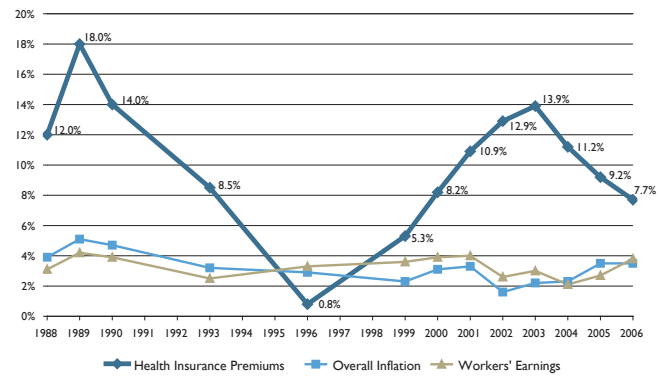
Healthcare is the largest sector of the U.S. economy. Our nation spends more on healthcare per capita than any other country. Healthcare expenditures per person increased from $944.50 in 1960 to $6,280 in 2004 (both in 2004 dollars). National spending on healthcare as a percentage of GDP has been steadily increasing since 1960, when healthcare spending accounted for just 5.2 percent of GDP. By 2004, healthcare spending represented 16 percent of GDP, and researchers estimate that by 2015 it will account for 20 percent of GDP.[4] The rapid growth rate in healthcare expenditures is not unique to the U.S. Although other nations currently have lower costs, most industrialized nations face similar challenges with accelerating healthcare costs.[5]

Healthcare spending is consuming a greater share of state budgets. Although K-12 education has historically represented the largest share of state spending, in 2003 Medicaid surpassed K-12 education and became the largest category of state spending nationally. In Utah, K-12 education continues to be the largest spending category, but while education spending as a percent of total expenditures has remained relatively flat during the last several years, the share of Utah's state budget spent on Medicaid has steadily increased.[6]

Although moderating in recent years, health insurance premium growth continues to outpace both the rate of inflation and the growth in workers' earnings (see Figure 3). The average annual premium for work-based health insurance coverage is currently $4,242 for single coverage. Coverage for a family of four now costs $11,480 annually, an increase of 87 percent since the year 2000.

Hospital care represents the largest category of private insurance expenditures, accounting for over 30 percent of all expenditures in 2004. A close second is physician and clinical services at nearly 30 percent. Administration and prescription drugs each represent approximately 14 percent of all expenditures. Although smaller categories of spending than hospital care and physician and clinical services, administration costs and spending on prescription drugs have exhibited a faster growth rate during the last several years.[7]

Figure 3: Percentage Increase in Employer-Sponsored Health Insurance Premiums Compared to Other Indicators, 1988–2006



Source: Kaiser Family Foundation,"Employer Health Benefits: 2006 Summary of Findings," 2006.

The total amount spent on prescription drugs in 2005 is more than 2.5 times spending in 1997. According to RAND researchers, about 80 percent of the increase in prescription drug expenditures over the last decade is a result of higher drug use per capita rather than higher prices. Promotional spending by pharmaceutical companies on direct-to-consumer advertising more than doubled between 1998 and 2003, increasing from $1.3 to $3.2 billion.[8]

In 2006, PricewaterhouseCoopers (PwC) published "The Factors Fueling Rising Healthcare Costs." This report attempts to attribute the 8.8 percent growth in premiums between 2004 and 2005 to particular factors, as shown in Figure 4. PwC concludes that increased utilization accounted for 3.8 percentage points of the total 8.8 percent growth in premiums between 2004 and 2005. PwC attributes increased utilization mainly to increased consumer demand, new treatments, defensive medicine, the aging of the population, and lifestyle choices such as smoking and poor nutrition.

PwC attributes 2.4 percentage points of premium inflation that year to general inflation and 2.6 percentage points to increases in healthcare prices beyond general inflation. Movement to broader-access plans, higher-priced technologies, and cost-shifting from Medicaid and the uninsured to private payers all contribute to higher healthcare prices.

New technologies are often more expensive than previous technologies and also tend to increase consumer demand and, thus, utilization. According to PwC, increases in consumer demand are "fueled by factors including the proliferation of information on medical treatments and demand pull strategies such as direct-to-consumer advertising." A 2005 RAND report on U.S. healthcare states that the real cost per hospital day (in 2002 dollars) increased from about $128 in 1965 to $1,289 in 2002. According to RAND researchers, "much of this increase reflects that we are delivering more technologically advanced care in the hospital."

It is important to note that the PwC report analyzes the attributes of premium growth, not total spending on health insurance premiums. Thus, PwC attributes three percent of premium growth to lifestyle, but research shows that lifestyle accounts for a much larger proportion of total healthcare spending. For example, the BlueCross BlueShield Association reports that 12 percent of all healthcare spending in 2002 was due to obesity alone.

A major factor in our nation's rate of growth for health expenditures is the aging of the population. Healthcare costs rise exponentially with age. Consumption of healthcare by persons 65 and older is nearly four times larger than consumption for individuals under 65. As the population of the United States continues to age, it will consume growing amounts of healthcare. In addition, public programs such as Medicare finance a large share of the elderly's healthcare. In 1999, Medicare enrollees (87 percent of whom were age 65 or older) accounted for 37 percent of national personal healthcare expenditures, although they comprised only 14.5 percent of the total population.[9]

Figure 4: Increase in Health Insurance Premiums by Component, 2004-2005

Component	Premium Growth Due to Component	Share of Premium Growth
General Inflation	**2.4%**	**27%**
Healthcare Price	**2.6%**	**30%**
Cost Shifting		6%
Higher Priced Technologies		11%
Broader-Access Plans/Provider Consolidation		13%
Increased Utilization	**3.8%**	**43%**
Aging		6%
Lifestyle		3%
New Treatments		11%
More Intensive Diagnostic Testing/Defensive Medicine		9%
Increased Consumer Demand		14%
TOTALS	**8.8%**	**100%**

Source: PricewaterhouseCoopers, "The Factors Fueling Rising Healthcare Costs 2006."

FOCUS GROUPS WITH HEALTHCARE STAKEHOLDERS

In June and July 2006, Utah Foundation conducted four focus groups with stakeholders in the healthcare system. We interviewed health insurers, hospitals, physicians, and business human resource officials who must manage and budget for health insurance for employees. The purpose of these focus groups was to gather insight into how healthcare costs are growing in Utah, the primary reasons for rapid cost growth, problems that hinder better management of healthcare costs, and ideas for reform.

Each of the four focus groups agreed on some common observations, especially that rising healthcare costs are having a significant impact on Utah's economy. Business managers told of employees canceling insurance coverage because of rising costs, while hospital leaders described how uncompensated care for the uninsured is passed on in higher prices for the insured. Insurers and doctors emphasized unhealthy lifestyles as a driver of medical cost increases. Hospitals, insurers, and doctors agreed that fear of medical malpractice liability is driving significant amounts of overutilization through defensive medicine. Hospitals, doctors, and insurers also agreed that government healthcare programs do not pay their proportionate share of costs, causing more costs to be shifted to those with health insurance.

The four focus groups spent some time defining potential reform ideas. All were interested in ways to broaden healthcare coverage in Utah. However, especially among doctors, they were leery of proposals to significantly expand government's presence in the healthcare market, feeling that such expansion would exacerbate chronic underpayment problems with federal health programs. Hospitals also suggested scaling back on optional Medicaid services so government programs could more adequately fund basic medical services for the needy. Business people and insurers asked for stronger incentives for promoting healthy living through wellness programs or other means.

Although the business managers were very interested in consumer-directed healthcare through instruments like high-deductible health plans and health savings accounts, the hospitals and doctors were hesitant to endorse this trend. These medical professionals felt that such strategies discourage utilization too much and cause patients

to avoid preventive care and necessary procedures. They also felt that moving away from protections inherent in the group insurance market would be harmful to consumers.

Each group agreed that important reforms should limit defensive medicine and overutilization, promote healthier lifestyles, make better information available on quality and costs, create incentives for greater quality, and make coverage more affordable to reduce the uninsured population.

ENDNOTES

[1] Agency for Healthcare Research and Quality, "State-level Insurance Component Summary Tables," Medical Expenditure Panel Survey, 2006.

[2] U.S. Census, Historical Health Insurance Tables, 2006; Tom Buchmeuller and Rob Valletta, "Health Insurance Costs and Declining Coverage," FRBSF Economic Letter no. 2006-25 (29 September 2006), Federal Reserve Bank of San Francisco.

[3] Agency for Healthcare Research and Quality, "State-level Insurance Component Summary Tables," Medical Expenditure Panel Survey, 2006.

[4] Centers for Medicare and Medicaid Services, U.S. Department of Health and Human Services, "National Health Expenditure Data," 2006.

[5] Dana P. Goldman and Elizabeth A. McGlynn, "U.S. Health Care: Facts About Cost, Access, and Quality," RAND Corporation, 2005.

[6] National Association of State Budget Officers, "2004 State Expenditure Report," 2005.

[7] Centers for Medicare and Medicaid Services, U.S. Department of Health and Human Services, "National Health Expenditure Data," 2006.

[8] BlueCross BlueShield Association, "Medical Cost Reference Guide," 2006.

[9] Office of the Assistant Secretary for Planning and Evaluation, U.S. Department of Health and Human Services, "Long-Term Growth of Medical Expenditures — Public and Private," 2005.

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The mission of Utah Foundation is to promote a thriving economy, a well-prepared workforce, and a high quality of life for Utahns by performing thorough, well-supported research that helps policymakers, business and community leaders, and citizens better understand complex issues and providing practical, well-reasoned recommendations for policy change. For more information, please visit www.utahfoundation.org, or call us at (801) 355-1400.

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