

## policy points

**What's Driving Up Health-Care Costs?** No one will be surprised to hear that health-care spending is rising more rapidly than it has since 1993. The question is “why?” A new report shows prescription drugs and health insurance lead the way.

BY JEFF ATKINSON



The numbers are in: Health-care costs are rising at more than two

times the general rate of inflation. In 2000 (the most recent year for which comprehensive health-care statistics are available), the general rate of inflation was 3.4 percent while health-care costs climbed 6.9 percent, according to the federal Centers for Medicare and Medicaid Services (CMS).

The 6.9 percent increase is the highest rate of increase since 1993, when national health expenditures rose by

8.5 percent. In the years from 1994 to 1999, expenditures rose by an average of 5.4 percent. For a chart showing the increases over 20 years, see “**Rates of Increase in Health-Care Spending**” on page 4.

The data is available on line at [www.hcfa.gov/stats/NHE-OAct](http://www.hcfa.gov/stats/NHE-OAct)

In 2000, total health-care spending in the United States rose to \$1.3 trillion, which is 13.2 percent of the nation’s gross domestic product.

Average health-care spending per person in 2000 was \$4,637.

### Drug costs lead the way

Spending on prescription drugs increased by 17.3 percent—a higher rate than for any other health-care expenditure. This reflects multiple factors, including more drugs consumed per person and higher drug costs, particularly for new therapies.

Katharine Levit and her colleagues in the National Health Statistics Group at CMS, writing in *Health Affairs* (Jan/Feb 2002), said that increased direct advertising to consumers, along with the aging population, contributed to a rise in prescriptions from 8.3 per person in 1995 to 10.5 per person in 2000.

The drug industry says that increased use of prescription drugs actually saves health-care dollars by reducing the need for more expensive services, particularly hospitalization. Critics of the drug industry argue that the drug companies’ marketing efforts often are designed to steer consumers and their physicians to expensive new

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drugs rather than less expensive drugs which, in many cases, may be equally efficacious.

One example of a highly marketed drug is Vioxx, a medication for treating osteoarthritis, manufactured by Merck. According to a [study](#) by the National Institute for Health Care Management Research and Educational Foundation of Washington, DC, Merck spent \$161 million advertising Vioxx in 2000. This is more than PepsiCo spent advertising Pepsi (\$125 million) and Anheuser-Busch spent advertising Budweiser (\$146 million). Sales for Vioxx were \$1.5 billion in 2000, representing an increase in utilization of more than 300 percent from the prior year.

### Physicians' and hospitals' share

The amount of money going to what the government calls “physicians and clinical services” increased by 6 percent between 1999 and 2000 to a total of \$286 billion. For hospitals, the increase was 5.1 percent to \$412 billion. For a breakdown of where health-care dollars were spent, see [“Health-Care Dollars in 2000,”](#) page 4.

In the last twenty years, the proportion of physicians' income coming from private insurance has increased from 35 percent to 48 percent, while the proportion from out-of-pocket payments by patients dropped from 30 percent to 12 percent. Increased utilization of HMOs and PPOs, instead of traditional insurance (with larger deductibles), contributed to this change. Sources of physicians' payments in the years 1980 and 2000 are compared in [“Where Physicians' Money Comes From,”](#) page 4.

### Medicare, Medicaid, and SCHIP

Spending for Medicare increased 5.6 per-

cent in 2000 to a total of \$224 billion. Medicare accounted for 17 percent of overall spending on health care and 38 percent of public spending on health care. This increase was largely attributed to changes in provider payments authorized by the [Balanced Budget Refinement Act \(BBRA\)](#) and the [Benefits Improvement and Protection Act \(BIPA\)](#), both passed in 2000. The original Balanced Budget Act had slowed Medicare growth to 0.6 percent in 1998 and 1.5 percent in 1999.

Medicaid spending increased at a faster rate than Medicare, although the reimbursement rates for Medicaid generally are lower than Medicare rates. Medicaid spending increased by 8.3 percent to a total of nearly \$202 billion.

Federal and state payments for the [State Children's Health Insurance Program \(SCHIP\)](#) increased 55 percent from 1999 to 2000 to a total of \$2.8 billion. SCHIP is a program designed to provide coverage for children from families with income that is too high to qualify for Medicaid, but not high enough to afford private insurance. For a summary of government health expenditures, see [“Government Health-Care Programs in 2000,”](#) page 4.

Americans spent \$92 billion on nursing homes in 2000—an increase of 3.3 percent over the prior year. Sixty-one percent of spending on nursing home care came from public funds, primarily Medicaid. Medicare spending for nursing home care also increased when the BBRA increased reimbursement rates for certain complex patient conditions and for facilities specializing in AIDS.

### Insurance takes its bite

Premiums for private health insurance rose 8.4 percent in 2000 (to \$444 billion). That's quite a bit faster than the 6.9 percent increase in general health-care

spending. Meanwhile benefits paid by private insurers grew at a rate somewhat less (7.4 percent) than the rate of premium increase, thus creating the opportunity for higher profits for insurance companies. Comparing data from the spring of 2000 to the spring of 2001, the [Kaiser Family Foundation and Health Research and Educational Trust](#) reported that premiums increased again, this time by 11 percent. The Kaiser report on “Employer Health Benefits (2001)” said that “Increases over the past few years may be attributable to catch-up pricing by health insurers as they attempt to restore profitability after a period of intense price competition in the mid-1990s.”

The Kaiser report also tracks what it refers to as “[t]he shift in enrollment from managed care ‘heavy’ to managed care ‘light.’” In 2001, preferred provider organizations (PPOs) enrolled 48 percent of employees, up from 28 percent in 1996. The share of the market for health maintenance organizations (HMOs) has dropped to 23 percent from 32 percent in the same time period. Point of service options (POS), which are similar to HMOs, but allow patients to use non-network providers, now have 22 percent of the market. Traditional or indemnity insurance, which once was the dominant form of insurance—73 percent of the market in 1988—dropped to only 7 percent in 2001. The Kaiser report is available online at [www.kff.org/content/2001/20010906a/EHB2001\\_sof.pdf](http://www.kff.org/content/2001/20010906a/EHB2001_sof.pdf)

### More to come

This is likely to be the beginning of another round of sharply increasing health-care costs in the United States. The growth of new, expensive technologies and new drugs will add to the costs along with the larger number of

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older Americans who incur higher health-care costs than they did when they were younger. The labor market also will contribute to rising costs. The supply of nurses, for example, does not meet demand, and their wages are likely to increase at a rate faster than other workers.

The government probably will seek to control health-care costs by holding down Medicare and Medicaid reimbursement rates, particularly for hospitals and physicians. But there will be limits on the degree to which reimbursement can be set at low levels. At some point, so many hospitals will close that there will not be enough beds to care for the people who need them, and physicians may become more reluctant to care for patients in these government-sponsored insurance programs.

Meanwhile, patients have shown that they value choice, as demonstrated by the increase in the number of patients in PPOs and POS plans and the decrease in the number of patients in traditional HMOs. If the U.S. economy prospers, high quality health care with ample choices for most Americans will be possible, and Americans probably will be willing to have a growing portion of the gross domestic product devoted to health care.

If, however, the economy is sluggish or in decline, health-care spending is likely to be more limited. The government, private insurers, employers, and Americans will need to decide how much health care is affordable. ■

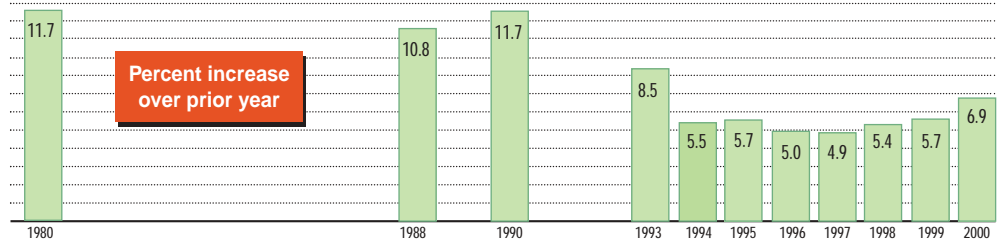
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**Rates of Increase in Health-Care Spending**

This graph shows the rate of increase in the nation's health-care spending, including both government and private payments. The years provided by the government are not at equal intervals.



**Health-Care Dollars in Year 2000**

SERVICE	DOLLARS SPENT (BILLIONS)	PERCENT OF HEALTH-CARE COSTS
Hospital care	\$412	32
Physicians / clinical services	\$286	22
Dental care	\$60	5
Nursing home care	\$92	7
Home health care	\$32	2
Prescription drugs	\$122	9
Administrative costs* (gov't and private insurance)	\$81	6
Other**	\$215	17
<b>TOTAL</b>	<b>\$1.3 trillion</b>	<b>100</b>

\* "Administrative Costs" refers only to overhead expenses; the portion of premiums paid to health-care providers is reflected in the other categories in this chart.

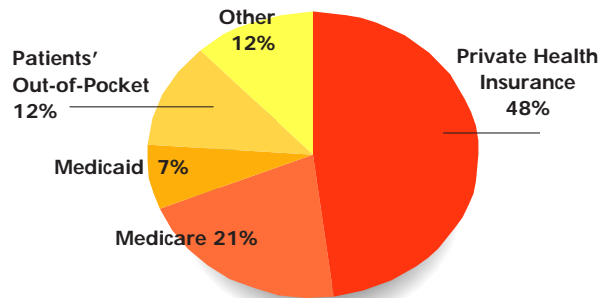
\*\* "Other" includes professional services not listed above, durable medical equipment, over-the-counter medicines, public health, research (other than for prescription drugs), and construction.

**Updated Projections**

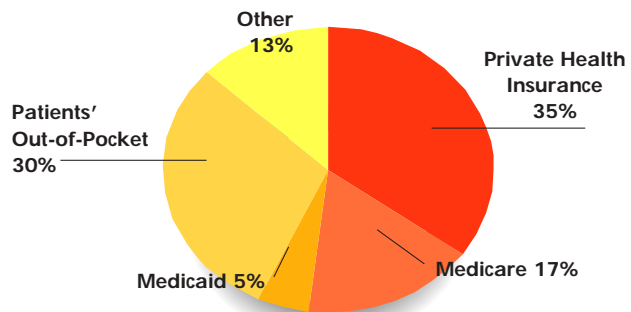
In March of this year, the Center for Medicare and Medicaid Services (CMS) issued projections for increases in health-care costs over the next 10 years. CMS projected that total health-care spending will more than double from \$1.3 trillion in 2000 to \$2.8 trillion in 2011. That will mean that the proportion of the gross domestic product (GDP) spent on health care will increase from 13.2 percent to 17 percent in that time period. CMS predicts that prescription drugs will continue to be the fastest growing health sector, although the annual rate of increase in spending on prescription drugs will drop from 17.3 percent in 2000 to 10.1 percent in 2011. ■

**Where Physicians' Money Comes From**

*In 2000* Total received: \$286 billion (U.S. population: 280 million)



*In 1980* Total received: \$47 billion (U.S. population: 230 million)



**Government Health-Care Programs in 2000**

Program	Enrollees	Expenditures	Rate of increase from prior year	% of total health-care expenditures
Medicare	39 million	\$224 billion	5.6%	17.2
Medicaid	32 million	\$202 billion	8.3%	15.5
State Children's Health Insurance Program (SCHIP)	3.3 million*	\$2.8 billion	55%	0.2

\* In 2001, SCHIP enrollment grew to 4.6 million.