



# The Rising Cost of Health Care: Causes

## COST DRIVERS

### DOCTOR & HOSPITAL COSTS:

- ♦ Doctors on average make \$200,000 - \$300,000 a year; specialists such as radiologists can earn \$400,000 or more. In Europe, doctors make \$60,000 to \$120,000. <sup>1</sup>
- ♦ Nationally, the average charge for a hospital stay involving an appendectomy increased 102% between 1997 - 2005. <sup>2</sup>
- ♦ The average charge for a hospital stay involving a routine X-ray increased 169% between 1997 - 2005. <sup>3</sup>

### FORMULARIES:

- ♦ Prescription drugs cost 30 - 50 percent more in the United States than in Europe. <sup>4</sup>
- ♦ U.S. prescription drug spending is expected to increase to \$1,537 per person by 2017, up from \$761 in 2007. <sup>5</sup>

### REGULATIONS:

- ♦ The high cost of health services regulation is responsible for more than seven million Americans lacking health insurance. <sup>6</sup>

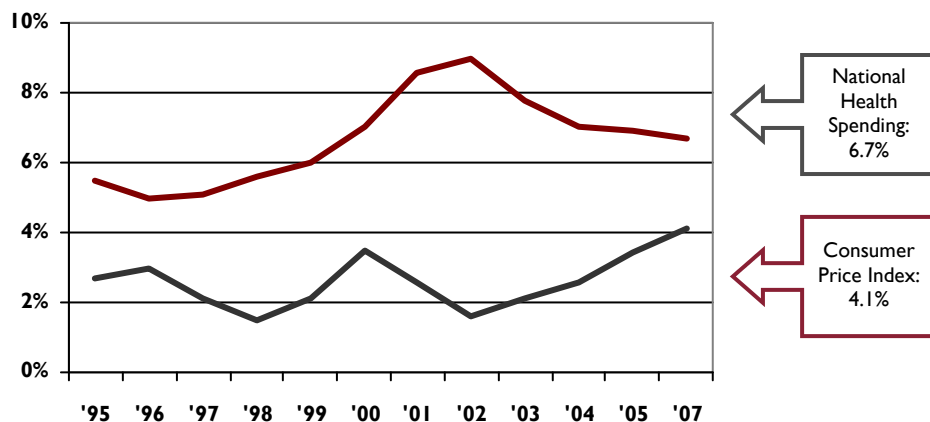
## Medical Costs Growing Faster Than the Economy

Health spending hit \$2.2 trillion in 2007 and consumed 16.3 percent of the nation's Gross Domestic Product (GDP). By 2017, health spending is expected to reach \$4.3 trillion and 19.5 percent of GDP.

The U.S. spends more than \$7,000 per person on health care each year, substantially more than any other developed country.

Health costs are rising at two-to-three times the rate of inflation, placing high-quality medical care increasingly out of the reach of American families.

### National Health Spending Has Been Increasing At a Faster Pace Than Inflation



## CAHP: Hold the Line on Medical Bills

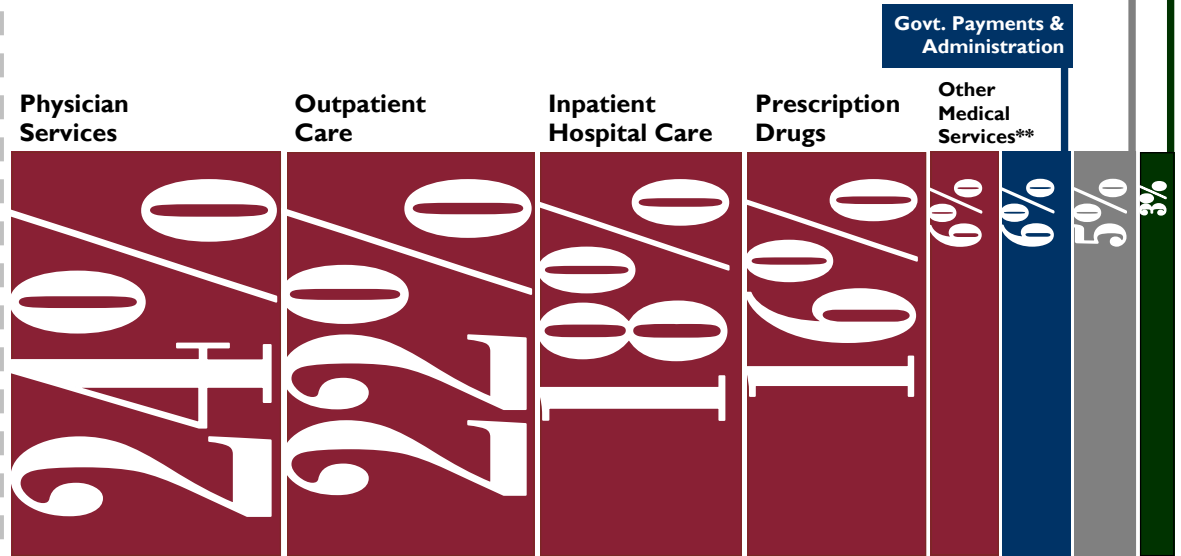
The California Association of Health Plans (CAHP) seeks to hold the line on medical bills so more Californians can afford the care they need.

Some 6.6 million Californians have no health insurance, and their numbers are expected to grow if health care costs continue to rise.

Currently, 86 cents out of every \$1 paid in health insurance premiums go to doctors, hospitals, prescription drugs and outpatient care, according to a PriceWaterhouseCoopers study conducted in 2006 for America's Health Insurance Plans (AHIP). The study's findings on how health care premiums were spent are detailed in a chart on page two.

# Health Care Premium Breakdown

Administrative costs consume 6% of private health care premiums:



\*\*Home health care, nursing homes, medical goods

Data: PriceWaterhouseCoopers

## COST DRIVERS (CONT.)

### Medical Errors:

- Experts generally believe that nearly 30% of hospital acquired infections are preventable.<sup>7</sup>
- Infections acquired at California institutions cost \$3.1 billion to treat.<sup>8</sup>
- Over 40 percent of physicians do not have a process in place to receive notifications about a potential drug dosage or interaction.<sup>9</sup>

### Unnecessary Treatments:

- Up to \$666 billion of the over \$2 trillion that we now spend annually on health care is squandered on unnecessary treatments.<sup>10</sup>

### Chronic Disease:

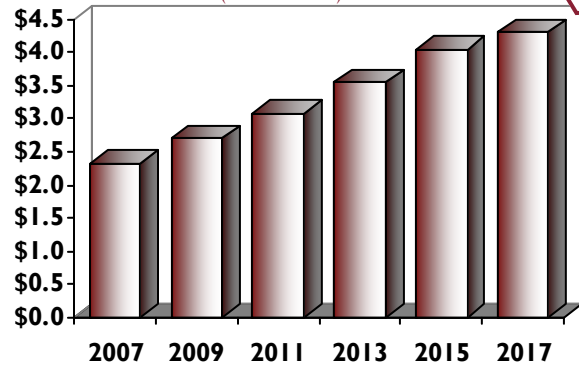
- The most common chronic diseases are costing the economy more than \$1 trillion annually.<sup>11</sup>
- Obesity increases healthcare costs 36% and prescription costs 77%.<sup>12</sup>
- Smoking results in an estimated 28% increase in medications.<sup>13</sup>

We must attack the costs driving up the price of health care so those currently insured can continue to afford their coverage and the uninsured can obtain coverage. In addition to identifying the factors that drive the cost of health care, CAHP has also developed its own

“Top 10” list of ways to cut health care costs. With these and other improvements, we can lower health care costs and ensure all Californians get the high-quality medical care they need.

## National Health Care Expenditures

(in trillions)



Double in Ten Years!

### Sidebar Sources:

<sup>1</sup> Alex Berenson, "Sending Back the Doctor's Bill," *New York Times* (Jul. 29, 2007).  
<sup>2</sup> United States Department of Health and Human Services, Agency for Health Care Research and Quality.  
<sup>3</sup> Id.  
<sup>4</sup> Alex Berenson, "Sending Back the Doctor's Bill," *New York Times* (Jul. 29, 2007).  
<sup>5</sup> "National Health Expenditures Projections 2007-2017" Centers for Medicare and Medicaid Services. February 2008.  
<sup>6</sup> "Health Care Regulation A \$169 Billion Hidden Tax," *Cato Institute*. (Oct. 4, 2004).  
<sup>7</sup> National Quality Forum, "National Voluntary Consensus Standards for the Reporting of Healthcare-Associated Infection Data." (introductory remarks on report homepage)  
<sup>8</sup> "Governor vetoes hospital disclosure proposal," *Los Angeles Times* (Oct. 14, 2007)  
<sup>9</sup> "Uncoordinated Care: A survey of Physician and Patient Experience." California Health Care Foundation (2007).  
<sup>10</sup> Maggie Mahar, "The State of the Nation's Health" *Dartmouth Medicine* (Spring 2007).  
<sup>11</sup> "An Unhealthy America: The Economic Burden of Chronic Disease -- Charting a New Course to Save Lives and Increase Productivity and Economic Growth." Milken Institute. (Oct. 2007).  
<sup>12</sup> Roland Sturm, "The Effects of Obesity, Smoking and Drinking on Medical Problems and Costs." *Health Affairs* (March/April 2002).  
<sup>13</sup> Id.

# By Examining Big-Ticket Cost Drivers, We Hope to Help Make Health Care Affordable For All Californians

## *Physician Services*

Out of every \$1 spent on health insurance premiums, 24 cents went to physician services. The cost of physician services grew by 7.8 percent in 2005 – or more than twice the rate of the consumer price index that year (3.2 percent). Physician services alone accounted for 1.9 percentage points of the 8.8 percent increase in health insurance premiums in 2005, according to AHIP. Among the factors contributing to the increased cost of physician services were:

**Medicare and Medi-Cal reimbursement rates:** Low Medicare and Medi-Cal reimbursement rates drive up health care costs because physicians make up their lost income by charging their other patients more and performing more services. Medicare reimbursement rate increases have lagged far behind the rate of inflation, rising just 13 percent from 1995 to 2003 compared to 21 percent for inflation.

**Physician Salaries:** American doctors earn two to three times as much as physicians in other industrialized countries, and their high salaries contribute to the rising cost of care in the U.S., according to the *New York Times*. Doctors in the U.S. make an average of \$200,000 to \$300,000 a year, while their counterparts in Europe made \$60,000 to \$120,000 in 2002, according to a study sponsored by the British government. In California, a Department of Finance survey found emergency room physicians earn four times more than the median income for a California family.

**Defensive Medicine:** Physicians fearful of lawsuits cost consumers more because they prescribe more tests and other costly procedures to protect themselves in case of litigation. Litigation and defensive medicine are estimated to total as much as 10 percent of the overall cost of physician services.

**More Chronic Diseases:** An aging population suffering from chronic diseases increases the cost of health care for the healthy. Nationally, 83 percent of health care spending comes from the 38 percent of our population that suffer from chronic diseases, according to the California HealthCare Foundation. An October 2, 2007, Milken Institute study found the most common chronic diseases cost the economy \$1 trillion a year, which could soar to \$6 trillion by the middle of century. A recent study published in *Health Affairs* found the U.S. spends far more on health care than any European country and cited the higher rates of chronic diseases as a major reason.

**Medical Devices:** Development of new medical devices and treatments has prolonged patients' lives but contributed to rising health care costs. Recent reports reveal doctors who have "sweetheart" deals with medical device companies tend to choose those companies' products over cheaper and equally effective models. Their decisions cost all of us.

**“American doctors earn two to three times as much as physicians in other industrialized countries”**

## *Outpatient Hospital Care*

Outpatient hospital care consumed 22 cents out of every \$1 paid in insurance premiums. These services include freestanding diagnostic centers and imaging centers, ambulatory surgical centers and hospital outpatient departments. The cost of outpatient care shot up 13.6 percent in 2005 – or more than four times faster than the consumer price index. Its rapid rise meant outpatient care accounted for 3 percentage points of the 8.8 percent growth in premiums in 2005, according to AHIP. Factors contributing to this big jump in the cost of outpatient care included:

**Unnecessary tests:** Doctors ordering unnecessary tests and other diagnostic procedures at outpatient facilities drive up health care costs for all of us. Physicians often order these unnecessary tests to protect themselves in case they're sued or in response to consumer demand fueled by medical advertising and reporting. AHIP estimates increased consumer demand added 1.2 percentage points to premium increases in 2005.



## *Inpatient Hospital Care*

Eighteen cents out of every \$1 in premiums go to inpatient hospital care. Even as hospital use declined, hospital costs continued to climb. They rose 7.5 percent in 2005 – or more than twice the rate of the consumer price index. Hospital costs accounted for 1.3 percent of the overall premium increase in 2005, according to AHIP.

Among the factors contributing to the rise in the cost of inpatient hospital care were:

**Price increases:** Hospital prices have been rising faster than the rate of inflation as hospitals have consolidated. Hospital labor costs also shot up because of an increasingly tight labor market for nurses and other hospital personnel.

**Hospital-acquired infections:** Health care-associated infections lead to 99,000 deaths each year, making them one of the biggest killers in the United States, according to federal officials. Infections acquired at California hospitals, nursing homes and similar institutions cost \$3.1 billion to treat, according to a state estimate. Infections have grown so costly to Medicare that the government will cease reimbursing hospitals for the cost of treating hospital-acquired infections October 1, 2008.

**Uninsured Care:** Insured Californians pay the bill for the uninsured through higher premiums and deductibles. The average California family pays a nearly \$1,200 “hidden tax” to fund health care for the state’s uninsured, according to the New America Foundation. Much of that health care is delivered through hospital emergency rooms.

**Balance Billing:** This abusive hospital billing practice causes costs to rise and places insured patients in the middle of health care disputes that should be handled between health plans and medical providers. More than 1.76 million insured Californians who visited emergency rooms in the last two years received balance bills from their hospitals and physicians on top of their co-pays and deductibles. The average bill was \$300. That’s a \$528 million burden on insured patients.

**Regulations:** Government regulations imposed on health care services add an estimated \$169.1 billion more per year to our medical bills, according to the Cato Institute. Health care is one of the most regulated industries within our economy, and the Cato Institute estimates these mandates cost the average household more than \$1,500 per year.

**Medical Errors:** Medical errors result in expensive complications and can cost patients their lives. The National Academy of Sciences’ Institute of Medicine estimates that 44,000 to 98,000 Americans die each year from preventable medical errors. The statistics suggest medical errors are the eighth leading cause of death among Americans.

## *Prescription Drugs*

Out of every \$1 in premiums, 16 cents is spent on prescription drugs. In past years, skyrocketing increases in prescription drugs drove up the cost of health care. These increases slowed to 8.6 percent in 2005, largely because of cost controls advanced by health plans. Prescription drugs accounted for 1.4 percentage points of the overall premium increase in 2005. Among the factors contributing to prescription drug costs were:

**Formularies:** Consumers are saving money by choosing lower-cost prescription drugs as a result of health care plans expanding the list of prescription medications that will be covered by insurance. Many health plans are shifting to two-, three- and, most recently, four-tier formularies that make beneficiaries more aware of the price of their prescribed drugs and more likely to choose a cheaper alternative, when one is available.

**Drug Development:** Drug costs are declining as more generics become available and more prescription medicines shift to “over the counter” status. Pharmaceutical companies also have developed fewer of the big-ticket blockbuster drugs in recent years, and patents have expired for many drugs, making less costly generic brands available.



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