

Cost Drivers in Health Care



Overview

This issue brief catalogues cost drivers in health care. It is not a formal review of the literature, or evaluative in any sense; it simply attempts to capture and catalogue the variety of factors that have been identified without comment on the merits, the interactions, or in some cases, the conflicting views about the factors cited. It identifies factors within three broad categories that drive spending, starting with overall societal factors, then the determinants of health, and finally factors within the health care system itself.

There are several caveats to keep in mind. There is no “right” level of spending or rate of increase, but it is clear that the United States is at levels and future growth rates that are viewed by most observers as too high. While inventories and research on cost drivers, including this catalogue, tend to isolate individual factors, it is the interactions among them that yield the total health spending result.

Aggregate factors

There are several aggregate, societal factors that are cited as top-line drivers of total health spending in a nation.

National per capita income: higher national income is associated with relatively higher health spending. The U.S spending level and growth rates are comparatively high even when adjusting for the nation’s higher per capita income.

Summary

This Issue Brief catalogues factors that are cited as cost drivers in health care, without making any assessment of the relative merits of the factors. It presents the factors within three broad categories, recognizing that it is the interactions that are critical, and that any categorization is dependent on judgments about placement.

Aggregate national demographic and economic factors

Per capita income
Age
Disease prevalence.

Determinants of health of individuals and societies

Individual characteristics (genetics) and personal behaviors
The physical environment in which individuals live and work
The social and economic environment in the community

Health system factors

Demand-side issues: the prevalence of insurance coverage; insurance coverage shortfalls; and the information gaps in health care;

Supply-side issues: overall supply and mix of services; the development, diffusion and pricing of new technology;

Systemic, crosscutting issues:

- Marketplace structures;
- Payment incentives: driving volume, especially of higher cost services;
- Fragmented delivery and financing systems
- Insufficient evidence-base on multiple aspects of care and costs;
- Regulatory issues
- Quality and safety
- Malpractice litigation risks

The selected bibliography lists a number of sources.

Age: as a population ages, its average health needs and health spending increase.

Disease prevalence: the relative health and the prevalence of diseases in a population, and changes in those diseases, is a driver of health spending.

Determinants of health

Public health research focuses on a range of personal, social, economic and environmental factors outside what is typically seen as the “health system.” These are seen as critical

factors that influence health status, the demand for health care and health costs, as well as a broader set of economic consequences of excess morbidity and shorter lifespans, such as the impact on productivity.

Individual characteristics and behaviors: a number of individual determinants of health are cited.

- **Genetics:** individuals inherit tendencies to health and health risks, such as the likelihood of developing particular conditions, that affect life expectancy.

- **Gender:** women and men experience different health care risks over their lifetimes.
- **Individual behaviors:** a person's diet, physical activity, smoking, alcohol or other substance use, all contribute to an individual's health status and need for health services.

Physical environment: the physical environment in which individuals and families live and work is cited as having an impact on health status. This includes factors such as the availability of clean water and sanitation, climate, exposure to contagious disease and toxic hazards, the working environment, exposure to violence, and overall public safety in a community.

Social and economic environment: income and educational disparities are cited as determinants of health, as are the norms and cultures of communities and families, including the norms and culture of the medical community itself.

Health system factors

Finally, there are health care and health system factors that affect costs and cost increases. Cost drivers within the health system can be characterized in different ways, and it is essential to note again that it is the interaction among these factors, and those above, that yield the result. The following categorizes factors into demand-side issues, supply-side issues, and systemic issues.

Demand-side issues: Several features of the health care system are cited as having an important effect on the demand for services.

- **Insurance effect:** private and public health insurance coverage, and changes in the scope of that coverage, has an impact on the use of services by lowering the effective price paid at the point of service by consumers. At the same time, the lack of comprehensive insurance coverage is cited as a factor driving some cost increases due to delayed care and treatment for those who

are uninsured and those with coverage that is inadequate.

- **Information shortfalls:** a second factor, sometimes listed as a demand-side effect, is a lack of information. One problem cited is that of “asymmetrical information” – a marketplace problem in which the consumer/patient simply does not have the expertise to fully evaluate the clinical situation and risks, and defaults to the professional expertise and judgment of the physician or other health professional. In addition, there is a lack of pricing transparency and quality information that consumers can rely on to make choices.

Supply-side issues: Supply-side issues are also cited as having an important effect on the volume, mix and price of services.

- **Overall service capacity:** the overall supply of health professionals, largely physicians, and of hospitals and other facilities, affects the level of spending. Communities with greater supply appear to have greater spending, which is described as the phenomenon of “supply-induced demand.”
- **Mix of service capacity:** the mix of services, in particular the mix of physician specialties, affects the level and distribution of spending. The relative share of subspecialty providers versus primary care providers is, in particular, cited as a factor that affects total health spending.
- **Technology development, diffusion:** technology development and diffusion is most frequently cited as the most significant contributor to the level of and growth in health spending. This includes a number of features.
 - the rate of development and introduction of new technologies;
 - the substitution of more expensive technologies for less expensive technologies for the same clinical problem;

- the diffusion or expansion of new technologies, and in particular, diffusion beyond the specific evidence-based indicators of clinical value;
- the pricing power of the developers of technology. This includes the relatively higher prices paid for technologies in the U.S. compared with other nations, and the maintenance of relatively high prices even as technologies are broadly diffused beyond the initial stage of innovation.
- **Compensation levels:** compensation at multiple levels in health care, ranging from physician income levels to administrative compensation, is cited as a factor for higher spending in the U.S.

Systemic issues

In addition to the intersection of the demand- and supply-side issues in driving health spending, there are a variety of other systemic issues in health care that are cited, in combination with other factors, as influencers of health spending.

- **Marketplace issues:** different and conflicting views about overall market factors are cited. These include—
 - the absence of free-market principles operating in health care drives up costs, due to insurance coverage, government regulation, lack of individual choice, and lack of pricing transparency;
 - alternatively, an unfettered commercial marketplace drives up utilization and pricing in the absence of appropriate regulatory constraints;
 - marketplace consolidation and the absence of countervailing marketplace power or regulatory pressures allow entities to raise prices in local markets; these price increases have been a recent focus of attention.

- **Payment incentives:** payment in the still dominant fee-for-service payment system remains a frequently cited factor. It is viewed as:
 - providing incentives for multiple interventions and increasing volume of services, rather than promoting value;
 - favoring relatively more expensive specialty care and interventions compared with primary care services;
 - supporting and rewarding a fragmented delivery system.
- **Fragmented delivery and financing system:** this system, which is both a cause and effect of other issues—
 - does not have the capacity for the care coordination that is necessary for care or total cost management;
 - leads to the inefficiencies that arise from less than optimal use of duplicative resources;
 - leads to higher administrative costs for payers, providers and patients.
- **Insufficient evidence base:** there is not a sufficient evidence base, nor a willingness to use available evidence, in making clinical, coverage and payment decisions.
 - there is not a clear evidence-base for many health care interventions, or comparisons among alternative interventions for similar conditions;
 - there is not a clear evidence base on costs, or comparisons of the total costs of alternative interventions;
 - there is not a clear evidence-base for the development and rapid diffusion of improved approaches to providing care, lowering costs and improving value; and
 - there is not a clear pathway in either the public or private sectors to develop and use such a range of comparative evidence on interventions, costs, and value to support appropriate differentiation in care, coverage and payment.
- **Quality and safety:** quality problems, including overuse, underuse, and misuse, and safety problems with consequences for mortality and morbidity, are viewed as driving up total spending and lessening value.
- **Malpractice litigation:** the risk of exposure to malpractice litigation is cited as a factor driving up costs in part due to the price of malpractice coverage itself, and in part as a driver of the unnecessary provision of services arising from “defensive medicine.”
- **Regulation:** the degree and type of regulation is cited in multiple and conflicting ways.
 - regulation stifles innovation and limits entry of competing entities and products, with the consequence of higher prices;
 - regulation increases the administrative costs of compliance;
 - a lack of regulation and regulatory enforcement allows entities to engage in anti-competitive behavior, allowing ineffective products on the market, raising prices or allowing inappropriate utilization to continue.

Draft prepared by Health Policy
Alternatives
Washington, DC

Commissioned by the Alliance for
Health Reform
© April 2012

Lilly

Substantially supported by a grant
from Eli Lilly

Selected bibliography

National health spending, historical data and projections, as well as the Medicare Trustees reports, are available through Centers for Medicare & Medicaid Services (CMS) website: <http://www.cms.gov/NationalHealthExpendData/>

Sean P. Keehan, et. al., "National Health Spending Projections Through 2020: Economic Recovery and Reform Drive Faster Spending Growth," *Health Affairs*, August, 2011. <http://content.healthaffairs.org/content/early/2011/07/27/hlthaff.2011.0662.abstract>

Congressional Budget Office: extensive publication series at <http://www.cbo.gov/browse/publications/164>, including:

- "The Long-Term Outlook for Health Care Spending," November, 2007.
- "A Federal Perspective on Health Care Policy and Costs," Presentation by Peter Orszag, September 18, 2008.

International health spending data are available through the Organization for Economic Cooperation and Development (OECD) website: http://www.oecd.org/document/16/0,3746,en_2649_33929_2085200_1_1_1_1,00.html

Gerard F. Anderson and Bianca K Frogner, "Health Spending in OECD Countries: Obtaining Value Per Dollar," *Health Affairs*, November/December 2008. <http://content.healthaffairs.org/content/27/6/1718.fullpdf+html?sid=8ab-1b5a4-c853-45a2-94c9-9d90af884e3d>

Kaiser Family Foundation, "Health Care Spending in the United States and Selected OECD Countries, April 2011." <http://www.kff.org/insurance/snapshot/oecd042111.cfm>

McKinsey Global Institute: http://www.mckinsey.com/Client_Service/Healthcare_Systems_and_Services

- "Accounting for the cost of U.S. health care: A new look at why Americans spend more," December, 2008.
- "Accounting for the cost of U.S. health care: Pre-reform trends and the impact of the recession," December, 2011.

World Health Organization, Social Determinants of Health http://www.who.int/social_determinants/thecommission/en/

U.S. Department of Health and Human Services, "Determinants of Health," <http://www.healthypeople.gov/2020/about/DOHAbout.aspx>

Gail R. Wilensky and David Satcher, "Don't Forget about the Social Determinants of Health," *Health Affairs*, 16 January, 2009.

Paul B. Ginsburg, "High and rising health care costs: Demystifying U.S. health care spending," The Synthesis Project, Research Synthesis Report No. 16, October, 2008, Robert Wood Johnson Foundation. <http://www.rwjf.org/pr/product.jsp?id=35368>

Michael F. Cannon and Michael D. Tanner, "Healthy Competition: What's Holding Back Health Care and How to Free It, Cato Institute, 2007. <http://www.cato.org/store/books/healthy-competition-whats-holding-back-health-care-how-free-it-paperback>

Victor R. Fuchs, "Major Trends in the U.S. Health Economy Since 1950," *The New England Journal of Medicine*, March 15, 2012.

Donald M. Berwick and Andrew D. Hackbarth, "Eliminating Waste in US Health Care," *Journal of the American Medical Association*, March 14, 2012.

Bernadette Fernandez, "Drivers of Premium Increases and Review of Health Insurance Rates," Congressional Research Service, U.S. Library of Congress, January 20, 2012.