Principle #1: Slowing Health Care Cost Growth
June 10, 2009

Slowing the growth of health care costs must be the central focus on any health care reform plan. Rapidly growing costs not only squeeze the federal budget, but put pressure on the budgets of families, businesses, and states as well, all of which contribute to the growing rolls of the uninsured.

The goals of expanding coverage, improving quality, and increasing fairness are important as well: both in their own right, and because policies to achieve these goals can be leveraged to bring down costs. At the same time, though, a failure to control health care spending growth will make any efforts to achieve these goals unsustainable, as costs will ultimately become prohibitive. The precarious fiscal position of the federal government, meanwhile, necessitates a focus on policies that would improve rather than exacerbate this situation.

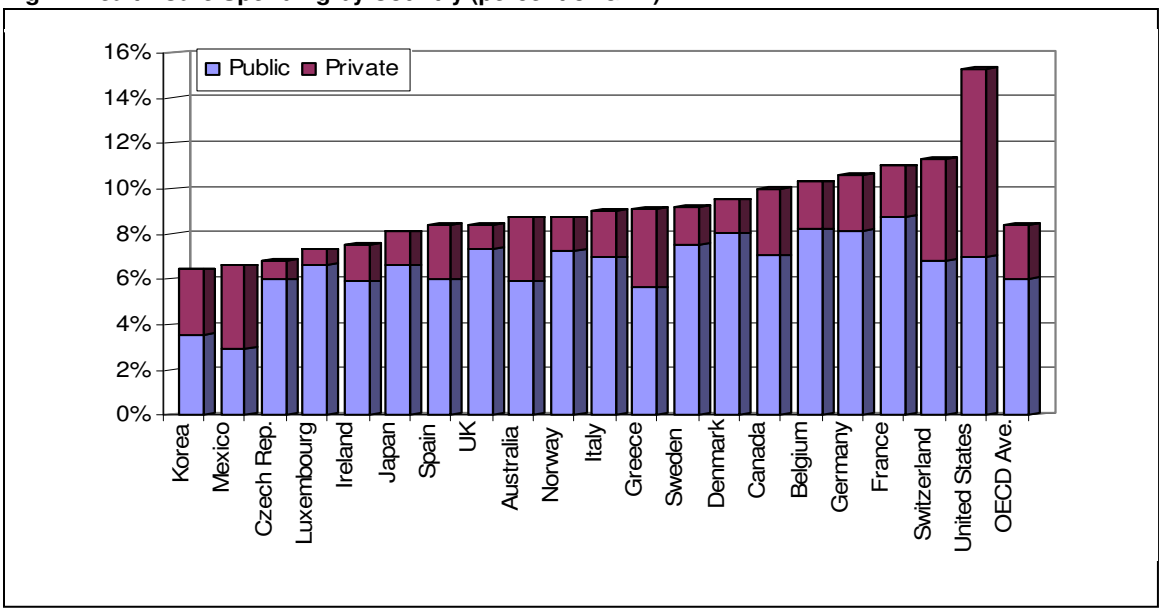
Without any change to federal policy, the Congressional Budget Office (CBO) projects that national health care costs will rise from 18 percent of GDP today to over 30 percent in 2030, and nearly 50 percent by 2080. Since nearly half of all health care spending is public – largely through Medicare and Medicaid – this growth has serious fiscal implications.

Put simply, health care costs are both high and rapidly growing in the United States. To bring them down, reform must either address the high *level* of health care costs ("shifting the curve"), the rapid *growth rate* of these costs ("bending the curve"), or both. Reform can and should also lead to more efficient delivery of care, so that the rising costs we do experience are accompanied by higher value – thus making inherent trade-offs fairer and increasing overall economic welfare.

High Health Care Costs

Health care spending in the United States is already higher than anywhere else in the world. While we spent 15 percent of our GDP on health care in 2006, the next highest spending country – Switzerland – spent only 11 percent. And the average OECD nation spent around 8.5 percent. In fact, *public* health care spending in the United States is higher than the average, even as it covers a far narrower segment of the population.

Fig. 1: Health Care Spending by Country (percent of GDP)



Source: The Organisation for Economic Co-operation and Development

No single explanation can account for this notable cost differential, although studies comparing health outcomes suggest this spending has not resulted in higher quality of care. There are a number of suggested root causes for this high spending, including:

Wealth: The United States is the richest country in the world, and as our wealth increases, we devote an increasing portion of our resources toward health care. This is reflected both in the amount of care we demand, and the prices we are willing to pay for physicians, medications, and medical technology.

Health: Compared to other countries, the U.S. is in some ways less healthy, especially with regards to obesity. High obesity rates increase the incidence of certain diseases such as diabetes and heart disease, driving up overall health care utilization and costs.

Systemic Complexity and Fragmentation: Currently, both health insurance and health care delivery are purchased in highly complex and fragmented markets which lack transparency and make normal market competition difficult. This causes both oligopolistic pricing and high administrative costs.

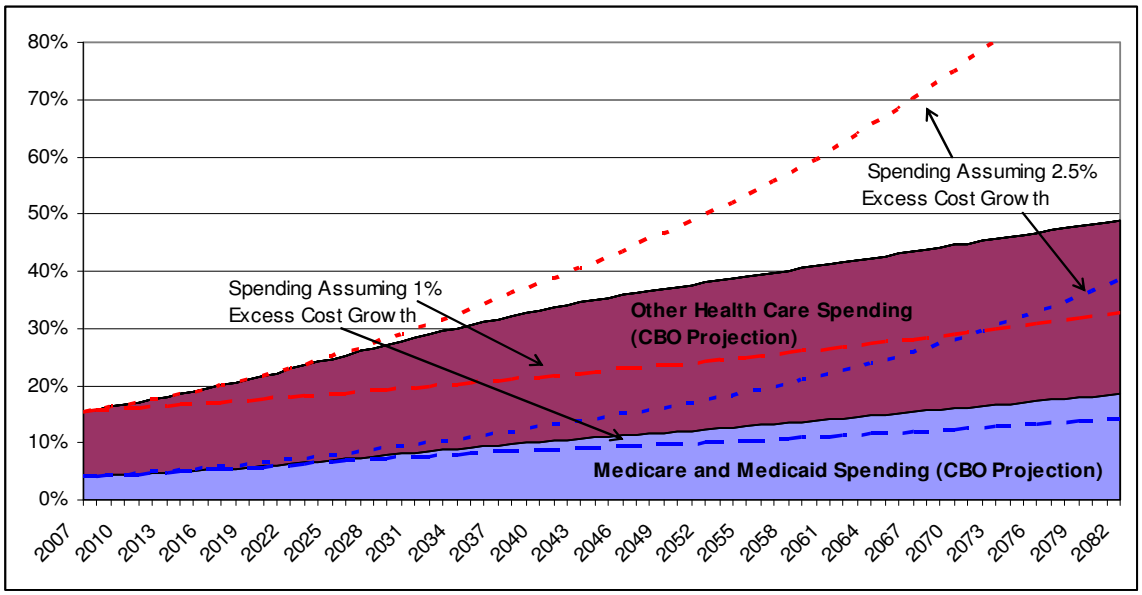
Poorly Aligned Incentives: In many ways, the U.S. health care system encourages over-spending. First, insurance hides the true costs of most health care procedures from the user, removing cost-consciousness. Second, tax incentives – mainly the tax exclusion for employer-provided insurance – obscure the full cost of health insurance in the first place. And third, payment structures laid out by insurance companies (including by Medicare and Medicaid) encourage physicians to treat more rather than treat better, and focus on acute care rather than prevention.

By addressing some of these causes, policy makers can "shift" the health care cost curve and reduce overall costs relative to their current baseline.

Rapid Health Care Cost Growth

In addition to being quite high, comparatively, health care costs are growing at an unsustainable rate. Historically, costs have grown roughly 2.5 percentage points faster than the economy each year, and if this trend continued, they would consume nearly the entire economy by 2080. Since that situation would be impossible, CBO assumes that growth will slow somewhat, but still projects that health care costs will account for nearly 50 percent of GDP by 2080 – almost 20 percent from Medicare and Medicaid.

Fig. 2: Health Care Spending Projections (percent of GDP)

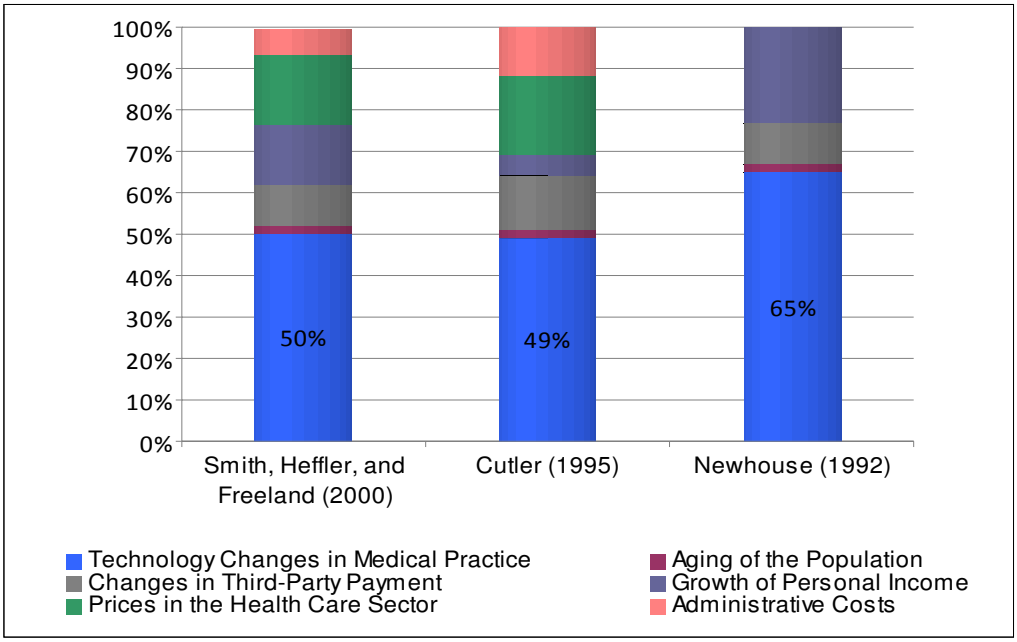


Source: Congressional Budget Office

Aggressive cost cutting measures could "bend the health care curve," slowing its growth relative to the current path. Reducing cost growth to roughly 1 percentage point above economic growth per year, for example, would hold health care costs to one third of GDP by 2080 (compared to 18 percent today), and Medicare and Medicaid costs to 14 percent of GDP (compared to under 5 percent today).

That said, significantly bending the curve is quite difficult. According to most experts, the main driver of health care cost growth is the emergence, adoption, and proliferation of new health care technology. As new drugs, equipment, procedures, and therapies are developed, they are highly demanded by doctors and patients, despite the extremely high prices.

Fig. 3: Drivers of Health Care Cost Growth between 1940 and 1990



Source: Congressional Budget Office (see http://www.cbo.gov/ftpdocs/89xx/doc8948/01-31-HealthTestimony.pdf)

Income growth and the increased prevalence of insurance have also helped drive passed cost growth, and other factors such as population aging and increased obesity are beginning to play an increasing hand. As with technological growth, though, it may be difficult or even undesirable to reverse some of these trends.

Controlling Health Care Costs

Any efforts to rein in health care costs must focus both on addressing the rate of health care spending growth and on the overall size of health care spending. In their efforts, policy makers will need to decide to what degree they are willing to get involved in private markets, and to what degree they should use existing levers – Medicare, Medicaid, and the tax code – to constrain costs.

And simply expanding coverage will not be enough. It is true that covering the uninsured can have some impact on cost by rationalizing the system – helping to address problems such as adverse selection and overuse of emergency room care. It can also be used as a political sweetener to pass cost control measures, and help expand the government's regulatory and economic arsenal for cost control. Expanding coverage, however, will inevitably mean higher health care costs for certain individuals –

specifically for those who currently choose not to buy insurance. And without enacting explicit cost control measures, covering the uninsured and subsidizing the insured will cost far more than it will save overall, especially for the government.

That said, experts have recommended a number of specific options which could legitimately address costs. Among them include conducting and utilizing comparative effectiveness research, encouraging healthier behavior, altering payment incentives, bundling or coordinating care, and changing the tax code to improve insurance price competition. Some have also suggested explicit or soft rationing to keep costs in line.

Although many of these policies can work to make the health care system cheaper and more efficient, none are free. Bending the cost curve will likely result in the slower adoption of new health care technologies. Although studies have shown that many new technologies do not add sufficient clinical benefits to be worth their costs, it is likely that more cautious technological adoption would cause some potentially valuable drugs and procedures to never be developed. Similarly, options to shift the curve will change incomes in some professions and alter the availability of care.

Fig. 4: Lewin Group Estimated Health Care Savings for Various Policies (billions)

POLICY OPTIONS	FEDERAL SAVINGS	NATIONAL SAVINGS
Fund Comparative Effectiveness Research	$12	$40
Expand Pay-for-Performance Program to All Hospitals	$41	$49
Expand Patient-Shared Decision Making Nationwide	$8	$9
Create Center for Medical Effectiveness and Realign Incentives Based on Best Practices	$114	$368
Reduce Obesity Prevalence through Tax, Regulatory, and Education Changes*	$113	$283
Increase Cigarette Tax to Fund Smoking Cessation Programs*	$68	$191
Limit Tax Exclusion by Income and Size of Plan*	$4	$279
Blend Payment Systems of Fee-for-Service and Episodic Care	$382	$229
Fund Chronic Care Initiatives to Streamline Care System	$144	$144
Institute Primary Care Case Management (PCCM) and Medicare Homes	$157	$194
Expand State Disease Management	$36	$44
Recalibrate the Reimbursement Rate to Eliminate Excess Payments	$124	$50
Allow Individuals to Purchase Insurance Across State Lines	$4	$72
Mandate Preventive Services in State Healthcare Systems	$14	$14
Allow Medicare to Directly Negotiate for Lower Prescription Drug Prices	$72	$43
Allow for the Re-importation of Prescription Drugs	$10	$43
Reform the Medical Malpractice System	$3	$12

*Excludes Revenue Raised from Provision
Source: The Lewin Group

To the extent that we as a country are not willing to accept these changes or find others, higher health costs will necessarily come at the expense of other priorities. For the federal government, in particular, this will mean raising taxes, reducing the public role in providing health coverage, and/or cutting spending elsewhere in the budget. These fundamental trade-offs cannot be avoided. However, by making the health care system more efficient and cost conscious, we can reduce health care costs relative to their current path. This is the single most important thing we can do to restore long-term fiscal stability, and it must be at the center of any health care reform plan.