



Economics of Health Care

Understanding health care cost drivers

In the series *Economics of Health Care*, Blue Cross and Blue Shield of New Mexico (BCBSNM), a Division of Health Care Service Corporation, a Mutual Legal Reserve Company, addresses the many components of health care costs, explaining how the average health insurance premium dollar is spent. These costs continue to climb—some at higher rates than others. But what costs are rising the fastest? And why?

While 83 percent of American adults utilize health insurance,¹ few stop to consider that their \$30 prescription drug or office visit copayments are only a small fraction of the total charges. Many people assume “it’s covered.” But that’s not the whole story. Even if a person’s copayments remain the same, the cost of health care services may continue to rise at a rapid rate. In fact, growth in medical care costs is projected to outpace inflation and increases in employee earnings. As health care costs continue to rise, New Mexicans are faced with increased health care premiums and out-of-pocket expenses.

Average health care premium dollar breakdown²

35¢	Hospital costs (inpatient/outpatient)
33¢	Physician services
14¢	Drugs
5¢	Other medical services
6¢	Government payments, compliance, claims processing
4¢	Consumer services
+ 3¢	Insurer margin
\$1.00	



The rising costs of health care

What are some common drivers of health care costs?

- + Prescription drugs
- + Overuse and misuse
- + Defensive medicine
- + Medical advances
- + Personal behaviors
- + Chronic conditions
- + Preventable injuries
- + Health care fraud
- + Cost shifting
- + Uninsured individuals
- + Inflation

Prescription drug spending is one of the fastest growing costs, followed closely by hospital care and physician services. Three main factors influence prescription drug costs—consumption, price fluctuations and drug types.

Americans continue to use more prescription drugs to manage their health. As billions of dollars are spent on promoting brand name drugs, both the cost and demand for these drugs continue to rise. Generic drugs (on average) are 20 percent less expensive than brand name drugs.³

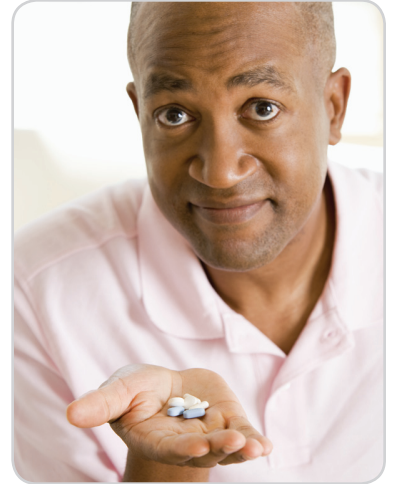
Our country is spending more on health care because we are consuming more health care services. This includes the **overuse and misuse of health**

care, which is a major contributor to rising health care costs. For example, some people may visit the emergency room when an urgent care clinic or doctor's office visit could sufficiently meet their needs at a much lower cost.

Another significant cost driver is a result of doctors practicing **defensive medicine**. The act of over-testing patients is a precaution that many doctors take to protect themselves from malpractice lawsuits. Nearly three-quarters of U.S. doctors practice defensive medicine at an annual estimated cost of \$650 billion.⁴

Medical advances are another significant cost driver. While new technology can be life-saving, there is a cost involved in making such treatments available. In comparison to Canada, the United States has nearly three times as many CT scanners and four times as many MRI units per person.⁵ Both machines cost hundreds of thousands of dollars each.

A pack of cigarettes sold in New Mexico costs our economy an average of **\$10.47**⁶ in medical costs and lost productivity as a result of premature death and disease. The average smoker misses **50 percent** more workdays than non-smokers. Sadly, nearly **one in five** New Mexicans currently smokes.⁷



The amount spent on **prescription drugs** in 2008 was **\$234.1 billion**, which is nearly six times the amount spent in 1990.³



Bicycle-related injuries are a leading cause of nonfatal traumatic brain injuries among elementary school-aged children across the United States. Helmet use could save at least **\$70 million annually**.⁸



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Approximately 70 percent of all health care costs are directly related to **personal behavior**. In addition, nearly three-quarters of all costs can be traced to cardiovascular disease, cancer,

diabetes and obesity. Each of these costly conditions are preventable the majority of the time.⁹

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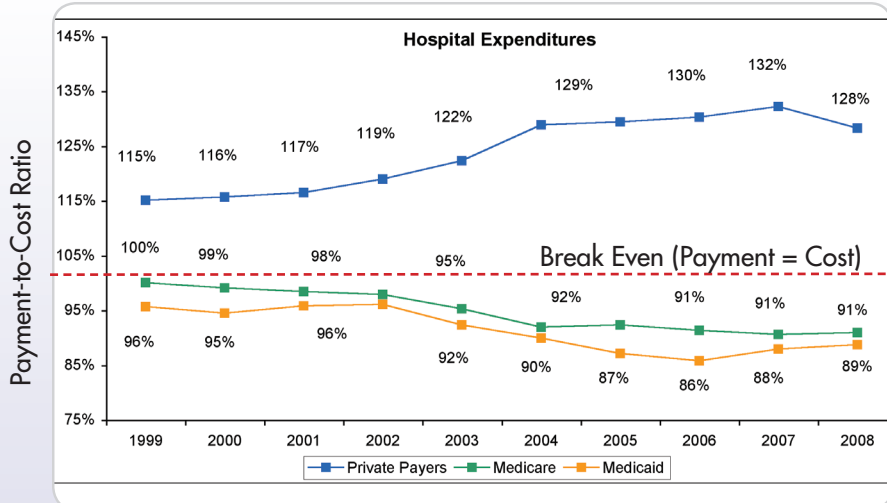
Unhealthy behaviors can result in costly **chronic conditions**. For example, while smoking is harmful to the

user, children also can become asthmatic from being around an adult's secondhand smoke. Research shows that people with chronic conditions generally use more health care services, which include doctor visits, hospital care and prescription drugs. Insurance works by spreading costs across the sick and healthy—so an individual's chronic condition affects everyone's health insurance premiums.

Each year, thousands of New Mexicans rush to emergency rooms to receive treatment for **preventable injuries**. During the period April 2009 through March 2010, Blue Cross and Blue Shield of New Mexico members incurred charges that averaged \$1,982 per emergency room visit. For children and adolescents alone, medical costs for preventable injuries in the U.S. are \$17 billion annually.¹² Simple actions—such as buckling seatbelts and consistently using bicycle helmets—can help prevent injuries and reduce costs for everyone.

Many consumers forget that ultimately we all pay for the activities of those who abuse the system.

It's probably no surprise that **health care fraud** is a key driver of rising health care costs. Approximately 3 percent of all health care spending—or \$68 billion annually—is lost to health care fraud.¹³ This type of fraud comes in many forms and is committed by people who *provide* health care services and by those who *receive* services. Many consumers forget that ultimately we all pay for the activities of those who abuse the system.



Cost Shifting

The health care industry is also experiencing displaced costs. Private insurers' payments to health care providers have traditionally increased since 1999, while payments by Medicare and Medicaid have decreased over this same time. This process is shifting the costs from Medicare and Medicaid to private insurers, requiring private insurers to pay increasingly more and resulting in increased private insurance costs.¹⁴



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Approximately 46.3 million Americans do not have health insurance¹⁵, and this growing number contributes to the increasing cost of health care for everyone. It is not unusual for people without health insurance coverage to wait to seek medical care. This can complicate a simple health problem, making it more costly to treat. In addition, people without health insurance coverage often seek treatment for non-emergency ailments in the emergency room—an expensive alternative to visiting the doctor's office.



Imagine sitting in a movie theater that seats **350** people. Suppose one person needs a liver transplant, and everyone else in the theater has no health problems. At **\$1,500** per year, an insurer would need the premiums of all **349** others in that theater just to cover the cost of one person's **\$523,400** liver transplant.¹⁶

Another challenge to affordable health care coverage is maintaining a balance between relatively healthy people and those who experience more health issues. The sustainability of health insurance coverage is based on having a variety of people in a collective pool—both healthy and unhealthy—to share the risk of the group.

The future of health care

After looking at the many factors that influence health care costs, it becomes clear that controlling health care costs will take a lot of effort from all stakeholders—health insurers, health care providers, the government and consumers. In future issues of *Economics of Health Care*, we will look at ways we can all be a part of the solution.

For more information, check out the other messages in our *Economics of Health Care* series.

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