



## Why are Healthcare Costs Rising?

### *Health Care Costs Series, 5<sup>th</sup> Edition*

Healthcare costs, and consequently the rates your employer pays for your employee health plan, have been rising at a rate almost double the rate of inflation over the last several years. Most employers simply cannot avoid facing vastly increasing rates for your medical plan, year after year.

Why are healthcare costs rising so high, so fast? This edition of Know Your Employee Benefits explains the factors leading to the continuing onslaught of rising healthcare costs.

#### **National Healthcare Costs**

Unpredictable and uncontrollable health insurance rate increases are having a very serious financial impact on most employers. To begin to understand why employee medical plan rates are rising so dramatically, you must first understand that the overall costs of healthcare are skyrocketing across the United States — reflecting the biggest surge in medical inflation since the early 1990s.

For example, from 1994 to 1998, average yearly healthcare cost increases hovered around 2%. From 1999 to 2000, however, costs leapt 9.4%, and increases have entered and stayed at or near double digits ever since.

As healthcare costs rise, the

amount your employer must pay for your health benefits rises. Health benefit costs continue to rise faster than the rate of inflation. This trend is expected to continue.

Do you know how much your employer pays for your health benefits? In 2007, the average cost of health benefits in the United States was \$4,479 per employee and \$12,106 for family coverage. That's in addition to salaries and hourly wages, and any other benefits the employer provides.

#### **Why are Healthcare Costs Rising?**

Why are U.S. healthcare costs skyrocketing? Several market conditions working together have lead to this onslaught of steep increases. Understanding these factors will help you be aware of the reasons behind any benefit or employee contribution (the amount you are required to pay out of your paycheck) changes your employer decides to make.

##### *The Aging of America*

It is an inescapable fact: the U.S. population is aging. While the number of older Americans is increasing, the number of children and younger people is remaining stable and even decreasing for some age groups.

According to the U.S. Census

Bureau, from 1990 to 1994 the elderly population increased 9-fold. During the same period, the number of people under the age of 65 rose only 3-fold. The growth rate of elderly persons is expected to be modest from 1990 – 2010, and is then expected to ascend dramatically from 2010 to 2030 as the Baby Boom generation enters the 65 and older category. About 1 in 5 U.S. citizens will be elderly by the year 2030.

As the American population ages, there is a subsequent rise in the occurrence of chronic diseases like asthma, heart disease, and cancer, and a resultant need for more resources to fight these diseases. This leads to elevated utilization of prescription drugs and other medical services, and an overall rise in healthcare spending.

##### *Dramatic Rise of Prescription Drug Costs*

Rising prescription drug costs are a primary cause of escalating overall spending on healthcare. Pharmaceutical research is continually providing treatment breakthroughs that should not be impeded, but the costs associated with this progress is undoubtedly having an impact on insurance companies and managed care organizations, and consequently on employers who sponsor employee health plans. Prescription drug costs have

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become a major component of health plan costs, with employers who provide managed care plans (HMOs) being hit especially hard because of the generous drug benefits those plans tend to offer.

The Centers for Medicare and Medicaid Services (CMS) report that prescription drug expenditures make up 11% of our overall national healthcare spending, and project that figure to reach 14.5% by 2012. Recognizing this trend, insurance companies and employers are moving towards more cost-effective benefit designs, such as higher copayments for prescription drugs than in previous years, or plans with three copayment levels (e.g. \$10/\$20/\$30) for various drugs, rather than the traditional two-level plan (e.g. \$10/\$20).

The reasons for the increase in spending on prescription drugs are many, and include the following:

- Introduction of new brand-name drugs to the marketplace. These new drugs are often more effective than the old ones they replace, but this kind of innovation bears a hefty price tag for insurance companies, employers, and you — the consumer.
- A general increase in the number of prescription drugs being used. Basically, more people are using more prescription drugs, thereby driving overall spending upward.
- Individuals with insurance are more likely to use prescription drugs than those without, and the growing prevalence of managed care plans — which often offer generous drug benefits — has fueled increased prescription drug use.

- With the general aging of the population, there is a higher incidence of chronic disease, and a resultant increase in the use of pharmaceuticals to treat those conditions.
- Pharmaceuticals play a primary role in increasingly aggressive diagnoses and treatment methods.
- Direct-to-consumer advertising of prescription drugs — outlawed by the FDA until 1985 — has grown by leaps and bounds over the last decade. Critics of this practice feel that promotion of drugs directly to consumers, rather than to doctors, creates inappropriate consumer demand and utilization of certain medications. In addition, many feel that drug prices could be lower if drug manufacturers did not spend huge sums of money on advertising.

## *Consolidation of Insurance Companies*

During the managed care boom of the 1990s, competition among insurance carriers and managed care companies was fierce. In order to gain market share, many large insurance companies acquired smaller, weaker firms and kept their rates low in order to stay competitive. This practice has taken its toll, leading to dips in profitability and stock prices for a large number of insurance carriers. Now, those companies that have survived are faced with much less competition and are committed to returning to profitability, which has ultimately resulted in increased rates for employers.

## *Expansion of Providers*

One of the major factors driving up the cost of healthcare is the growth of healthcare providers. Expansive healthcare systems that offer acute care hospitals,

specialty facilities, clinics, labs, physician practice groups, and other services are becoming prevalent. While these systems provide many benefits to the communities they serve, they also require a great deal of money to fuel their growth — and ultimately place upward pressure on the costs of many medical services.

## *Political Environment and Government Regulation*

Health insurance, and more specifically managed care, is one of the most regulated insurance sectors on both the state and federal levels, and has become one of the most highly debated topics in the political arena.

State and federal mandated benefits have increased 25-fold over the last three decades. Often these mandates duplicate or conflict with each other, and usually come with increased costs for the healthcare system. For example, the Health Care Portability and Accountability Act of 1996 (HIPAA) continues to influence the operations of many health plans seeking compliance. According to an April 2002 study by PricewaterhouseCoopers, HIPAA alone is responsible for adding billions of dollars of new compliance costs to the healthcare system.

Aside from HIPAA, there are over 1,500 mandated benefits at the state and federal level. Each of these has a cost associated with it, and together they have had a significant impact on healthcare costs.

## *Increased Utilization and Consumer Demand*

Utilization of many healthcare services has risen over the last decade. A number of factors such as improvements in medical technology, the influence of managed care, elevated consumer awareness and demand, and a boost in the number of practicing physicians caused health services

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like the number of surgical procedures and the number of prescription drugs dispensed to rise significantly. Other services such as breast cancer screenings, immunizations for children, and diagnostic procedures like CT and MRI have also experienced sharp utilization increases.

## *New Medical Technology*

Life expectancy and mortality rates in the U.S. are steadily improving. Developments in medical technology, including methods for early detection of disease and the introduction of new treatments and medications for acute illness have played a major role in enhancing these statistics. Old techniques are being replaced with new, often expensive treatments using new medical devices, diagnostic products, drugs, and surgical procedures. It is not surprising that these new procedures come with hefty price tags and are influential in driving overall costs of healthcare — and the cost of healthcare benefits — upward.

Your employer, like others, is undoubtedly trying to determine how to keep accelerating health plan rates from having a serious financial impact on your company. Many firms absorbed the increasing costs for years to avoid further burdening their employees. Now, most are realizing that they will have to pass portions of the costs on to employees in the form of greater contributions from their paychecks, or benefit designs that require them to pay more out-of-pocket for the medical services they use (increased coinsurance, co-payments, or deductibles). Keep the factors in this brochure in mind if your employer reduces your health benefits, or asks you to pay more. These measures will go a long way toward keeping you and your company healthy for the long term.

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