

# Improving Incentives in Health Insurance and Health Care Spending

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# U. S. Health Care Spending Growing Rapidly

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- National Health Expenditures are projected to grow from 16% of GDP to more than 20% of GDP by 2015
- Public and private spending both rising
  - Federal Medicaid and Medicare spending projected to consume 9.4% of GDP in 2050
  - Private health insurance premiums increasing at more than 3 times the rate of inflation in recent years
  - Tax expenditures also consume public resources

# Can Our Spending Go Further?

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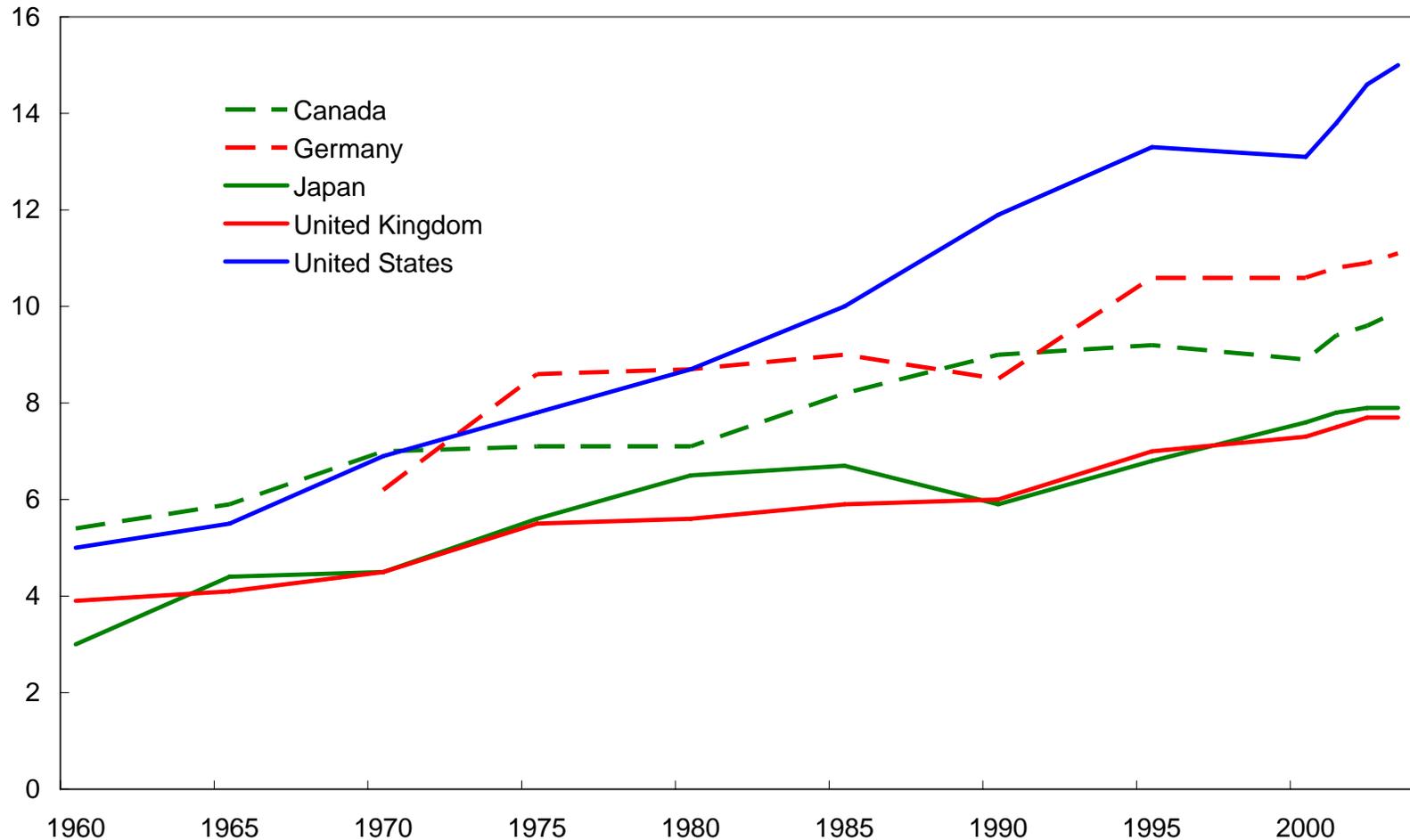
- America is home to the world's premier health care. We generate medical advances and lifesaving therapies, but . . .
  - We spend roughly twice as much per capita as many developed countries, but many outcomes lag
  - Within the US, higher spending does not necessarily translate to better outcomes
  - Millions of Americans do not have health insurance

# Health Expenditures as a Share of GDP

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International Comparison  
Health Expenditures as a Share of GDP

Percentage of GDP

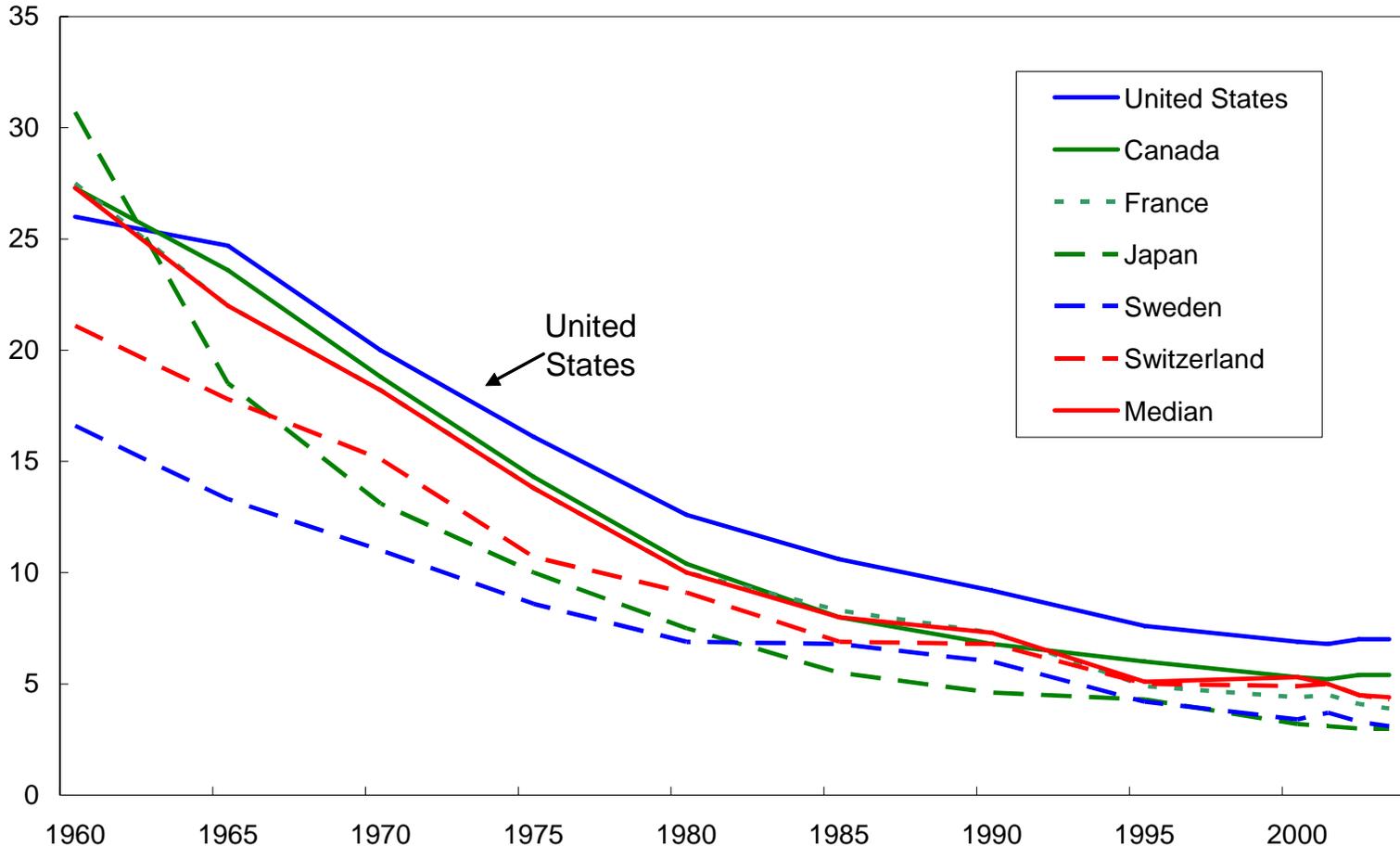


Source: OECD

# U.S. Infant Mortality Above OECD Median

Infant Mortality Rates (per 1,000 Live Births) by OECD Country, 1960-2003

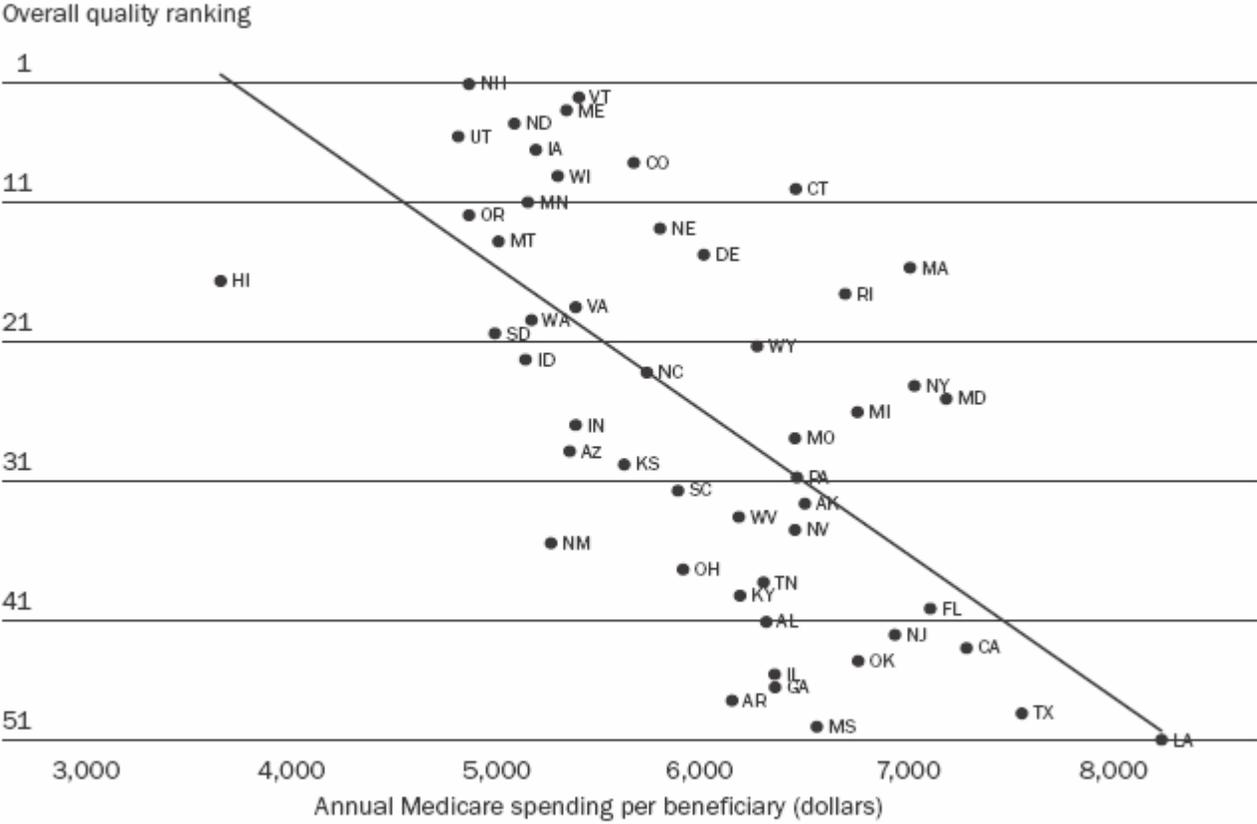
Deaths per 1,000 Live Births



Source: OECD

# Higher Spending Does Not Necessarily Lead to Higher Quality

**EXHIBIT 1**  
**Relationship Between Quality And Medicare Spending, As Expressed By Overall Quality Ranking, 2000-2001**



**SOURCES:** Medicare claims data; and S.F. Jencks et al., "Change in the Quality of Care Delivered to Medicare Beneficiaries, 1998-1999 to 2000-2001," *Journal of the American Medical Association* 289, no. 3 (2003): 305-312.

**NOTE:** For quality ranking, smaller values equal higher quality.

# Consequences of Inefficient Spending

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- Health care dollars not allocated to highest value uses
- Wage growth is slowed and consumers have fewer resources for other goods and services
- Health insurance increasingly unaffordable, raising uninsurance rates
- Increasing pressure on taxpayers to finance government-provided insurance

# Policy Goals

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- Get higher-value care
  - Spending decisions based on evaluation of costs versus benefits, not just what is covered by insurance
  - Continued promotion of innovation
- Ensure that care is widely available and affordable

# Why Health Care Spending Has Grown

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- Not changes in number of physician visits or hospitalizations, but intensity of treatment when there
- New technologies are life-saving, but little incentive to develop technologies that are cost-saving
- Most consumers not in a position to evaluate costs versus benefits of care

# Barriers to Informed Decision-Making

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- Private side: Tax treatment creates an unbalanced playing field
  - Premiums for employer-provided insurance tax-preferred
  - Out-of-pocket health spending mostly not tax-preferred
  - ⇒ Promotes first-dollar coverage
- Public side: Medicare reimbursement based on quantity, not quality or value
  - ⇒ Promotes more intensive care
- Information on prices and quality is often not available

# Improving Incentives

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- Private side:
  - Remove bias against consumer-directed care: Level the playing field between insurance and out of pocket spending and make basic insurance more affordable
- Public side:
  - Medicare: give seniors information, choices, and financial protection (example: Part D)
- Provide more information on price and quality

# Building on Health Savings Accounts (HSAs)

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- HSAs allow out-of-pocket health care spending to be tax-free when accompanied by high deductible policy
- First offered in 2004, enrollment up to more than 3 million in early 2006 and rising rapidly

# Current HSA Rules

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- Must have high deductible insurance:
  - Deductible of at least \$1,050 single / \$2,100 family, but preventive care can be first-dollar
  - Out of pocket limit of at most \$5,250 / \$10,500
- HSA contribution max:
  - Lesser of deductible or \$2,700 / \$5,450
  - Balances roll-over indefinitely, tax-free

# Advantages of HSAs

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- No tax penalty for choosing to have catastrophic insurance coverage but pay for routine care out-of-pocket
- Incentive for consumption of high-value care – which can lead to competition and the development of more cost-effective technology
- Proposals to make HSAs more attractive and affordable
  - Tax-free contributions up to OOP limit, premium tax exclusion for individual purchases, tax credit for low-income enrollees, flexibility for employer contributions to chronically-ill
- Combined with other proposals to expand access and improve affordability
  - Better access to information, ability to purchase insurance across state lines, allowing small firms to band together

# Potential Issues

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- Effect on overall spending
- Affordability for poor or sick
- Effect on number of uninsured
- Effect on risk-pooling
- Ability of patients to make informed decisions

# HSAs Can Rein in Overall Health Spending

- Premiums for consumer-directed health plans like HSAs are rising much more slowly than other plans
- Around half of spending is by people who would likely face some cost-sharing under a typical HSA-based plan
- Only about 20 percent of spending is done in emergency situations – so people usually do have time to shop
- People with HSAs still get the discounts negotiated by insurers, and insurers still provide disease management
- On margin, HSAs do not favor health spending relative to spending on other things

# HSA's Can Encourage Cost-Effective Health Spending

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- Case of preventive care:
  - Study of Federal health plans found HDHPs at least as likely to cover preventive care as PPOs, often with lower copays
- Case of generic drugs:
  - Study of Aetna CDHPs saw 6.5% decline in pharmacy costs, driven by 12.8% increase in utilization of generics
  - 44% of enrollees in CDHPs request information about cheaper generic alternatives (compared with 27% in comprehensive plans)
  - More broadly, drug spending 25% lower in CDHPs than PPOs; doubling copays reduces drug spending by a quarter or more
  - Which drugs are preventive? Could expand flexibility of HDHPs (to allow more plan innovation, improve compliance, etc.)

# HSAs Can Make Health Care More Affordable for Low-Income and Uninsured

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- Policies more affordable than typical PPOs
  - Higher deductibles largely offset by lower premiums
  - Families can save money even with substantial medical bills
- New enrollees representative of wide pool
  - More than a third of individual purchasers had income under \$50,000
  - Around a third of people purchasing HSAs on their own were previously uninsured
- Firms more likely to continue offering insurance if cost growth contained
  - Firm offering decreased from 69% in 2000 to 61% in 2006, driven by rising premiums
  - More than a third of firms starting to offer HSAs did not offer any insurance before
- Expansion proposals have provisions that target resources to lower-income enrollees
  - Tax credit, payroll tax relief, tax parity for individual purchase
  - Increased flexibility for employers to contribute more for chronically ill employees

# Families can save money even with high medical bills

- Family of 4 in Columbus, OH earning \$50,000 gets quotes for 2 family policies from same insurer:
  - Traditional PPO plan:
    - \$5,800 premium
    - \$1,000 deductible
    - 10% copay up to \$2,000 out-of-pocket max
  - HSA:
    - \$3,750 premium
    - \$3,000 deductible
    - 20% copay up to \$5,000 out-of-pocket max
- How much family would save by choosing the HSA:
  - If they had \$1,000 in medical bills:
    - save \$1,900 under current law, and \$3,200 under proposed expansions
  - If they had \$5,000 in medical bills:
    - save \$100 under current law, and \$1,800 under proposed expansions
  - If they had \$10,000 in medical bills:
    - \$400 worse under current law, but save \$1,600 under proposed expansions
  - If they had \$25,000 in medical bills:
    - \$800 worse under current law, but save \$1,250 under proposed expansions

# Better Information is Crucial

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- Patients can make choices that are best for them in consultation with physicians
- Physicians can be more effective patient advocates
- Federal government can lead the way

# Towards Efficient Use of Health Care Resources

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Price-sensitive consumers armed with information are likely to increase competition, promote development of cost-effective technology, and make health care dollars go further