

Reducing Administrative Costs in U.S. Health Care

A Hamilton Project proposal by David Cutler of Harvard University offers several reforms to reduce excessive administrative costs in health care. Administrative expenses amount to roughly one quarter to one third of health-care spending, and a substantial portion of this expense could be eliminated with better policies and practices. Cutler's proposal would do the following:

- **Establish a clearinghouse for bill submission** that allows for standardized and efficient health-care payments.
- **Simplify prior authorization** by applying it more selectively and implementing it more automatically.
- **Harmonize quality reporting**, providing calculations at the practice level that are based on electronic medical records.
- **Enhance data interoperability** by requiring payers and providers to provide access to data.

Issue Overview

- **Administrative costs refer to the *non-clinical* costs of running a medical system.** Billing- and insurance-related expenditures represent the largest administrative costs; other administrative costs include marketing and enrollment, credentialing, and quality measurement and assessment costs.
- **Health-care spending on administrative costs far exceeds the amount necessary to deliver effective health care.** Administrative costs account for one quarter to one third of total health-care spending in the United States.
- **Improving the coordination of information exchange between payers and providers** can help reduce excessive administrative costs, potentially saving more than \$50 billion annually.

The Challenge

Excessive administrative costs impose an undue burden on insurers, physicians, and their patients. When health-care providers spend more than is necessary on health-care administration, this results in higher prices for insurers, which are passed onto businesses and their employees in the form of higher insurance premiums. Unnecessary administrative hurdles may also discourage patients from seeking health care and detract from the time health-care providers could spend caring for patients, and the lack of data interoperability raises costs for all.

Government intervention in health-care markets is warranted to address excess administrative expenses. Health care is both a major expense for households and firms and a core part of the economy. In addition, as major health-care payers, governments at all levels have a vested interest in reducing the administrative health-care costs they face; nearly half of health-care spending is paid for by federal, state, and local governments.

The Path Forward

In response to these challenges, Cutler proposes reforms to reduce administrative health-care costs:

- 1. Establish a clearinghouse for bill submission.** Standardizing the electronic transmission of billing and claims submissions would improve consistency in the information required across payers and improve administrative efficiency.
- 2. Simplify prior authorization.** Applying prior authorization rules selectively, attaching a price to prior authorization, and automating prior authorization could help reduce the high costs associated with implementing prior authorization.
- 3. Harmonize quality reporting.** Quality metrics should be meaningful to clinicians and patients, harmonized across payers, and developed using information gathered in electronic medical records.
- 4. Enhance data interoperability.** Easing the exchange of health information not only aids decision-making by clinicians, but also reduces administrative costs associated with information coordination between providers, patients, and insurers.

While some amount of administrative cost is necessary for a functioning health-care system, the U.S. currently spends more on administrative costs than comparable multi-payer systems. If adopted, Cutler's proposed reforms to health-care administration could save \$50 billion annually, or approximately \$150 per person per year.

Cutting administrative health-care costs is advantageous to physicians, insurers, and patients. Lower administrative costs would reduce prices, enable physicians to spend more time caring for patients, and diminish patient burdens that may discourage them from accessing health care.

About the Author

David Cutler is the Otto Eckstein Professor of Applied Economics at Harvard University.