

Issue Brief

Findings from HSC



WALL STREET COMES TO WASHINGTON:

Market Watchers and Policy Analysts Evaluate the Health Care System

Consumers will pay more for health care as employers respond to a third year of double-digit insurance premium increases in 2003. Firms will shift more costs to workers through higher deductibles and copayments to protect their bottom lines and increase worker awareness of the cost of care, according to a panel of market and health policy experts at the Center for Studying Health System Change's (HSC) seventh annual Wall Street roundtable. But don't look for large employers to make radical changes to workers' health benefits. So far, most employers are cautiously eyeing new insurance products, including consumer-driven health plans and tiered hospital and physician networks. As costs continue spiraling upward, a hospital building boom is underway, raising concerns about a new medical arms race and increased costs.

Goodbye, \$10 Copayments

Despite forecasts of another round of double-digit premium increases in 2003, most large employers are unlikely to embrace major overhauls of their health benefits, but companies will take steps to make workers more aware of the costs of care. "We will see much more tweaking of existing benefit plan structures than we will moving to things that are new and different and dramatic," said Roberta Walter Goodman, a first vice president of Merrill Lynch.

In recent years, insured consumers have largely been shielded from rapidly rising health care costs. And thanks to managed care's more generous benefit structure, many people have grown accustomed to \$5 or \$10 copayments for services. With a weaker economy

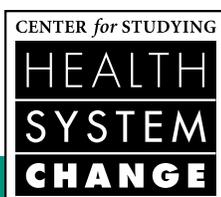
and a more uncertain job market, employers will try to increase workers' awareness of health care costs by raising deductibles and copayments and, perhaps, greater application of coinsurance, which requires patients to pay a percentage of the bill rather than a fixed-dollar amount, panelists agreed. Unlike fixed-dollar copayments, coinsurance automatically increases the amount the patient pays when prices rise.

Employers should resist the urge to increase workers' share of insurance premium contributions because such a move might tempt younger and healthier workers to decline employer-sponsored coverage. "I think premium sharing is a very dangerous tool. It's

simple for an employer to use, but it leads to tremendous adverse selection in the risk pool," Goodman said.

Increased consumer cost sharing could produce a consumer backlash, said Robert Reischauer, Ph.D., president of The Urban Institute. Increasing the cost burden on people who use more health care services through higher deductibles, coinsurance or copayments "will in fact become a political issue, and there will be a backlash," he warned.

Along with digging deeper into their pockets, consumers also are likely to have fewer health plan choices as employers reduce the number of health maintenance organizations (HMOs) and other plans offered to workers.





“As hospitals begin to build up in various markets, we’ll eventually see an overcapacity situation.”

**– Joe France,
Credit Suisse First Boston**

“You don’t want to get to the point, particularly with people of lower incomes, that cost sharing is the equivalent of being uninsured.”

– Paul Ginsburg, HSC

“I would ordinarily be hopeful that cost trends would improve somewhat, but we’re not seeing from the purchasing community the kind of dramatic action necessary to make it happen.”

**– Roberta Goodman,
Merrill Lynch**

“Many plans discontinued prospective review for hospital admissions and outpatient tests and procedures and discontinued using gatekeepers for specialty care.”

– Cara Lesser, HSC

Employers will try to focus their “business on the plans that have the largest market share, the lowest unit cost and the slowest [cost] trends,” said Joe France, director of equity research at Credit Suisse First Boston.

Tightly Managed Care Comes Undone

As managed care plans loosen restrictions on care, including referrals for specialty care and preauthorization for hospital admissions and costly outpatient tests, consumer use of services and costs have increased, especially in the most restrictive plans.

Conference moderator and HSC President Paul B. Ginsburg, Ph.D., predicted higher premium increases for more tightly managed plans “because they are being affected more by the loosening, as opposed to the plans that have traditionally been more loosely managed and haven’t had to give up as much.”

France concurred, noting that more tightly managed plans, especially HMOs, are seeing bigger increases in underlying medical costs. “The big rate increases—the 20 and 25 percent numbers—are companies going from a very tightly managed program,” he said.

Insurers Roll Out New Products

Insurers are developing new products, including so-called consumer-driven health plans that typically feature a spending account—funded by the employer but controlled by the worker—along with a high-deductible insurance policy. Proponents contend such plans give consumers more of a financial stake in care decisions. The Internal Revenue Service recently clarified that workers can roll over unused spending account balances from year to year, a move that could spur more interest in these products.

But many employers are skeptical about consumer-driven plans, which are sometimes called defined contribution plans, because cost savings may be elusive, France said. He cited the example of Hallmark where about 4,000 of the greeting card firm’s 11,000 employees fail to reach their deductibles in a given year, essentially costing the firm nothing. “Under a defined contribution

plan, I guess you’re sending them to the gym or something,” he said.

Health plans and employers have rapidly expanded the use of tiered-benefit structures for prescription drugs, giving consumers financial incentives in the form of lower copayments to use generic and preferred name-brand drugs. But insurer experimentation with tiered hospital and physician networks—which require patients to pay more out of pocket if they use more expensive providers—has progressed more slowly.

Insurers’ strategy for tiered provider networks is to “continue to offer broad provider choice but shift some of the cost of that onto consumers,” said Cara S. Lesser, HSC senior health researcher and director of site visits. The tiers are based primarily on cost, but some plans are trying to include quality measures in the equation, she noted.

Plans initially believed tiered networks would help stabilize stormy provider relationships, but the opposite has occurred as providers protested placement in the higher-cost tier. “Ironically, these products that plans viewed as a way to appease providers are now meeting a great deal of provider resistance,” Lesser said, adding that Blue Cross of California recently abandoned tiered networks after hospitals protested.

With no basis for tiering other than cost and limited ability to assess quality, France predicted an uphill battle for tiered networks.

Hospitals Gain Upper Hand

As hospitals have reduced excess capacity and consolidated through mergers, many have gained the upper hand in negotiations with health plans. “Right now, the hospitals have leverage; the last five years the insurers had leverage,” France said.

Faced with Medicare and Medicaid payment squeezes, hospitals have fought for higher rates from private managed care plans. Hospitals “engaged in really stupid pricing during the mid-1990s,” thinking they could make up lower average prices with increased volume, Goodman said. Much of the push for higher payments is a result of hospitals “trying to get rates to more rational levels.”

However, some hospital systems—especially those with local market oligopoly

or monopoly situations—have engaged in “fairly egregious behavior,” she said. “There needs to be a reaction from employers, and the employer needs to be able to say, ‘I’m going to make a tough decision. This hospital may be prominent in the market, but it’s simply too expensive, and we’re going to allow the plan to cut it out.’”

Aggressive hospitals also could face antitrust scrutiny, Goodman predicted, to see whether hospital systems came together to use their “market power to push prices and, therefore, harm consumers.”

Disease Management, Where Are You?

Using disease management techniques and evidence-based medicine to manage the care of the sickest patients can help keep costs down, Goodman said, but most health plans are only “scratching the surface” of what can be done to improve care and reduce costs.

Reischauer, however, said disease management efforts are more likely to improve

the quality of care than reduce costs. Disease management “will save some money, but the idea that this is the silver bullet and it’s going to substantially lower the trend of cost growth is largely wishful thinking.”

Noting that research shows that about “30 percent of care is either inappropriate, outright harmful or unnecessary,” Goodman said that moving medical practice to a sounder evidence base is “one of the areas in the delivery of medicine in this country that is just crying out for improvement.”

Premiums Stay Ahead of Costs

As underlying health care cost trends continue to rise, many managed care plans have been able to stay ahead of the curve with premium increases that are higher than underlying costs. But inevitably, employers will drive harder bargains with insurers and demand lower premium increases.

“The problem for the [insurers] is that they don’t know what their costs are until they’ve already priced the business, and we



“There is a whole lot more appeal among policy makers for defined contribution plans—tax credit schemes where people are given a lump sum—than there is among employers or even beneficiaries who really have to deal with these things on a day-to-day basis.”

**– Robert Reischauer,
The Urban Institute**

“Right now what we’re doing is we’re raising the copayments across the board...affecting those people who need the most services as opposed to trying to influence some people in their shopping behavior.”

**– William Scanlon,
General Accounting Office**

“Health care is considered in the tax-exempt bond arena [as] the most volatile sector, and, therefore, the sector with the highest [risk] premium, possibly next to nuclear plants.”

**– Ed Shapoff,
Goldman Sachs**

Little Hope for Medicare+Choice

Panelists were pessimistic about the outlook for Medicare+Choice, Medicare’s struggling managed care program. Even if Congress poured new money into the program, Medicare+Choice plans are facing demands for steep payment increases from providers, and government payments can’t keep up, Goodman said.

France predicted more health plans would withdraw from Medicare+Choice, adding that plans have increased premiums and reduced benefits to such a degree that the pluses for beneficiaries don’t outweigh all of the constraints of managed care. Almost all Medicare+Choice plans are HMOs, and France pointed out that the promise of HMOs to control costs and improve quality hasn’t been met in the commercial market, raising the question of whether HMOs are the “right approach” for Medicare.

Reischauer said the real question is whether Medicare+Choice can offer a better product than fee-for-service Medicare and Medigap supplemental coverage. If Medigap premiums rise 10 percent a year for a few years, there will be a “window of opportunity” for health plans to put together an attractive product, he said.

GAO’s Scanlon agreed that the outlook for Medicare+Choice plans could change if consumers’ expectations change. When Medicare+Choice was thriving, it was an unsustainable situation because plans were giving away “\$120 per month in free benefits to consumers,” he said. But if consumers understand they don’t have catastrophic coverage and a drug benefit in fee-for-service Medicare and that they are paying a lot for first-dollar coverage if they buy a Medigap policy, a Medicare+Choice plan with a reasonable premium might be a better deal for consumers.

“I don’t think we’re there yet in terms of consumers’ expectations, and whether we’ll get there and whether the plans will be willing to play is unclear,” Scanlon said.

This Issue Brief is based on a roundtable discussion, HSC's Seventh Annual Wall Street Comes to Washington: Market Watchers and Policy Analysts Evaluate the Health Care System, held June 11, 2002, in Washington, D.C.

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certainly know that there's going to be more pressure on them as an industry," France said. Using Blue Cross-Blue Shield plan margins as a proxy for the private commercial market, France said the plans have some of the highest profit margins in years. "They're not as high as they've ever been, but they're certainly getting up there, and that's usually not a prescription for a rosy outlook for the insurance industry," he said.

A New Medical Arms Race?

In many markets, hospitals are competing fiercely and building capacity to offer profitable specialty care, including cardiac, cancer and orthopedic services, raising concerns about excess hospital capacity and increased costs. HSC's Lesser pointed to Indianapolis, where the four major hospitals are investing more than \$200 million to build their own cardiac care centers. On the flip side, the public hospital in Indianapolis is struggling to raise \$12 million to upgrade its burn center—one of only two in the state.

"We see this phenomenon as a return to medical-arms-race-type behavior, competing for those high-end services," Lesser said.

While many hospitals are upgrading or building new facilities, Ed Shapoff, a vice president at Goldman Sachs who specializes in providing construction capital for non-profit hospitals, said hospitals don't have much excess cash to make "foolish investments" in new facilities.

"They don't always make the right decisions, but I don't think we're seeing the same buildup in the form of an arms race," he said. "They're taking an honest look at what they think their mission is and the population base they serve, and they're trying to provide an appropriate range of services."

But Goodman said a focus on high-profit cardiac care will crowd out investment in "mission-critical" services like burn centers, which tend to lose money. The result will be too many cardiac beds and too few burn centers.

William J. Scanlon, Ph.D., director of health care issues at the U.S. General Accounting Office (GAO), pointed out that hospitals have to balance meeting the needs of current patients and being ready to meet

the treatment needs of tomorrow's patients. "As we put pressure in terms of costs on hospitals—and some entrepreneurs have found ways to split off services that are potentially more profitable—we are potentially threatening...the capacity to serve demand in the future, and it's something we need to be concerned about."

Technology advances also will affect the need for hospital investment in bricks and mortar, and "you don't want to invest a whole lot in facilities that turn out to be unneeded," Reischauer said. "This seems to argue for some kind of regional planning rather than allowing all of these decisions to be made individually by competing hospitals."

Slower Rise in Drug Spending

While the widespread move to three-tier pharmacy benefits has helped slow drug spending, pharmaceuticals continue to be a major overall cost driver, panelists agreed. Drug patent expirations, the availability of more generic drugs and use of pharmacy benefit managers also have helped slow drug spending, they said.

Many employers are increasing copayments, moving to coinsurance and adding deductibles for drug coverage, France said, characterizing these moves as "straightforward cost shifting to workers." And some employers are looking at mandating use of generic drugs and eliminating coverage of name-brand drugs.

Even as drug copayments and other cost-shifting techniques increase, consumers' out-of-pocket costs are still relatively modest. "If you're paying a \$10 copay for a drug, that's basically the cost of going to a movie.... And moving that from \$10 to \$20 to \$30 or \$35, again, that's not a huge amount of money in the context of most people's budgets," Goodman said. ●

Go to www.hschange.org for a full transcript and webcast of the Wall Street roundtable or a summary of last year's roundtable.