AMERICAN ACADEMY *of* ACTUARIES

Public Hearing: Rising Health Care Costs
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Thank you Commissioner McRaith and distinguished committee members for holding this hearing to address the rising costs of health care. My name is Shari Westerfield, and I serve as the chairperson of the American Academy of Actuaries'[1] State Health Committee. The Academy is the non-partisan, public policy organization representing actuaries of all specialties in the United States.

On behalf of the Academy's Health Practice Council, I appreciate the opportunity to provide this testimony today. My remarks will focus on the problem of rising health care costs in the context of current reform proposals designed to address the problem of the uninsured, a discussion of a few drivers of health care costs, and considerations necessary to assess the impact of any potential cost control measure.

Background

The number of uninsured Americans has been climbing steadily, reaching nearly 47 million in 2006, according to the U.S. Census Bureau. State and federal policymakers have been pursuing various approaches to expanding health insurance coverage. Generally, the most prominent are comprehensive proposals that would rely on the private insurance market as well as expansions of public coverage.

Attempts to expand health coverage, either through the states or as part of national reform, deserve serious consideration. However, even if efforts to achieve universal coverage are successful, they would address only part of the uninsured problem. In general, these various proposals don't address the root of the problem—the rising costs of health care.

Recent National Health Expenditure data reveal that health care spending increased 6.7 percent in 2006, slightly higher than the 6.5 percent growth rate in 2005. Although these growth rates are lower relative to those earlier in the decade, they nevertheless exceed the overall growth in the economy. As a result, health care spending has continued to grow as a share of the economy, reaching 16 percent of the gross domestic product (GDP) in 2006. If the growth in health care spending does not slow, attempts to achieve universal coverage will fall short. Many people will find insurance premiums, even subsidized premiums, too expensive.

[1] The American Academy of Actuaries is a national organization formed in 1965 to bring together, in a single entity, actuaries of all specializations within the United States. A major purpose of the Academy is to act as a public information organization for the profession. Academy committees, task forces and work groups regularly prepare testimony and provide information to Congress and senior federal policy-makers, comment on proposed federal and state regulations, and work closely with the National Association of Insurance Commissioners and state officials on issues related to insurance, pensions and other forms of risk financing. The Academy establishes qualification standards for the actuarial profession in the United States and supports two independent boards. The Actuarial Standards Board promulgates standards of practice for the profession, and the Actuarial Board for Counseling and Discipline helps to ensure high standards of professional conduct are met. The Academy also supports the Joint Committee for the Code of Professional Conduct, which develops standards of conduct for the U.S. actuarial profession.

This is a problem in the individual market and group markets. The Kaiser Family Foundation and the Health Research and Education Trust found that since 2001, employer-sponsored health insurance premiums increased 78 percent, or 10 percent per year on average. These increases are not only higher than the rate of inflation, but higher than wage growth rates as well. Higher premiums make it less likely that employers will offer health insurance to their workers and, even when they do, workers are less likely to be able to afford their share of the premiums.

Rising health care costs also mean that costs to the government for public health insurance coverage will rise, putting a strain on state and federal budgets. Medicaid now rivals elementary and secondary education spending as the largest budget item for states. Similarly, Medicare is becoming a larger component of the federal budget. In 2005, nearly one out of every seven federal revenue dollars was used for Medicare. By 2050, this could increase to one out of every two dollars. Although some of this increase is due to the aging of the population, rising health care costs play an even larger role.

If the growth in health care costs does not slow, attempts to achieve universal coverage will likely be in vain. Any health reform proposals, therefore, must focus seriously on controlling health spending.

Drivers of Health Care Costs

In order to control spending, it is important to have an understanding of the major causes of health spending growth. The Academy is currently developing an issue brief that outlines drivers of health care costs, as well as discussing various options for addressing those drivers. There are drivers that increase per unit costs, such as general inflation, broader access provider networks, and provider consolidation. There are also drivers that increase utilization, such as new technology and treatments, lifestyle factors, and more generous benefit packages. In addition, there are some factors that have a particular impact on the increase in private health insurance spending, such as cost shifting and adverse selection.

I will focus my discussion today on three factors that increase utilization—new technology and treatments, lifestyle factors, and more generous benefit packages. I will also briefly discuss cost shifting and adverse selection and how they can increase private health insurance spending.

First, the introduction of new technology and treatments can increase health care spending by increasing utilization and the utilization of higher intensity services in particular. While advances in technology and pharmaceuticals have brought breakthroughs that have increased life expectancy, many new advancements are additive and supplement existing treatments, rather than replacing prior treatments. As a result, improvements in longevity and quality of life have come with tremendous costs. In addition, new technology and treatments may not always be better or more cost effective than prior treatments. More comparative effectiveness research, especially that which compares new technologies to existing treatments, along with the implementation of evidence-based medicine, may help not only improve the quality of care, but also do so through more cost-effective means.

Second, lifestyle choices can also increase health care costs. For instance, increases in obesity rates have led to increases in the prevalence of diabetes; smoking leads to lung cancer and heart disease. Such lifestyle choices increase the need for and utilization of medical services to deal with chronic conditions. Indeed, the onset of many chronic conditions could be prevented or at least delayed or made less severe by better nutrition, more exercise, and smoking cessation. As a result, many insurers and employers have developed wellness and disease management programs to encourage and facilitate changes in many

of these common lifestyle choices. The programs aim to reduce the development of chronic conditions and subsequent utilization of health care services – essentially imposing higher short-term costs with the hope of higher quality of life and lower costs in the long term. Most of these programs are relatively new, so it is unclear the extent to which the upfront costs will be offset by any future savings.

Third, most health coverage programs in use today cover a fairly comprehensive set of medical services. This comprehensiveness lowers the cost of care to the insured and results in increased utilization of services. Comprehensive benefits can also help encourage the development of new technologies and treatments. Benefit design features such as cost sharing requirements options can be used to discourage more effective use of health care services. However, any incentives to make insureds more sensitive to benefit costs should be balanced with the need to not discourage people from seeking needed care. A relatively new concept in insurance benefit design is the Value Based Insurance Design (VBID), which attempts to set cost sharing requirements so they better provide incentives to seek needed care, while discouraging care that is not necessary.

New technology and treatments, lifestyle choices, and the generosity of benefits contribute to health spending growth overall. There are also two factors that affect spending among those with private insurance coverage—cost shifting and adverse selection. Cost shifting refers to the phenomenon in which health care providers charge higher rates to private payers to compensate for below-cost payments received public insurance programs and free care provided to uninsured patients. Adverse selection refers to the phenomenon in which individuals who are more likely to be at risk of high health spending are more likely to purchase insurance coverage. This can drive up the premiums for the privately insured population. It is important that any potential measures to address rising costs, as well as attempt universal coverage, not encourage or exacerbate cost shifting or adverse selection.

Conclusion

There is no easy answer or magic bullet to reducing spending growth. However, when potential options are assessed, several factors should be considered. First, it is important to consider not only the magnitude of any cost savings, but also whether they are one-time or permanent in nature. Second, it should be determined whether the cost savings will accrue in the short-term or the long-term. Third, any associated implementation expenses must be recognized. Fourth, the impact on health care quality should be considered.

I again commend Commissioner McGraith and this committee for focusing on the important issue of health care spending growth. Thank you again for the opportunity to testify. I am happy to answer any questions.