Center for American Progress

Health Care's Efficiency Dividend

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Families in today's falling economy that are lucky enough to have access to insurance find that it comes with an expensive price tag. And the latest research shows that the likely cost is higher than it needs to be due to inefficiency.[1] The Congressional Budget Office found in 2008 that $700 billion is spent every year on health care costs "that cannot be shown to improve health outcomes."[2]

Health reform is an opportunity to improve the health care system, which could produce an efficiency dividend. The government can empower physicians and patients with the best treatment possible through expanded health information technology and better comparative effectiveness research. Any reduction in needless health care spending helps improve the financial situation for families, businesses, and the government.[3] New analysis by the Center for American Progress Action Fund looks at the $12,600 cost of the average family policy in 2008 and shows that $4,270—more than 30 percent—is dedicated to spending with no understood benefit.

Inefficiency in the current system

Inefficiency and lack of transparency is part of health care today. Research by Dartmouth University Professor John Wennberg and others shows that roughly 30 percent of Medicare spending could be eliminated with no decrease in quality or access to care.[4] The CBO applied this rate to all U.S. health spending in 2008 and estimated that about $700 billion dollars will be spent on health care services this year with no proven positive health outcome. There are many reasons behind the CBO finding, such as poor use of health information technology, a lack of information on which procedures and treatments are the best in specific situations and for specific individuals, and poor care coordination—to name a few.[5] Simply put, too much of the health care system is opaque.

Families, business, and government all benefit from the efficiency dividend

The efficiency dividend is based on the idea that we have a very limited understanding of how 30 percent of annual spending on health care services actually improves health. To the extent any of that spending can be eliminated without reducing health care quality and access, as Wennberg and others have suggested, then health care costs would be reduced from the projected growth. This means premiums could grow at a slower rate as unneeded spending is eliminated—and premiums could come down over time—while benefiting families and businesses that share the cost of insurance.[6] And it also benefits the federal government's budget, which currently subsidizes the purchase of insurance through the tax code.[7] By reducing premium costs, more people will be able to afford insurance, thereby reducing the number of uninsured. At a minimum, we should develop the tools needed to understand what we are buying in the health care system everyday and what impact it has.

The federal government can take steps to capture health care's efficiency dividend. In fact, the American Reinvestment and Recovery Act has already put the health system on the path to reform with support for expanded comparative effectiveness and health information technology.[8] But it is possible to create a more efficient system by empowering physicians and patients to better understand what works best so that they can make better informed decisions. The decisions on the best care to be delivered must rest with the physician and patient, and we need a system that will support that individual process. And by promoting competition in health insurance, there will be a greater emphasis on creating an efficient health care system while ensuring that people get all the care they need.[9]

Failing to fix the problem will be expensive

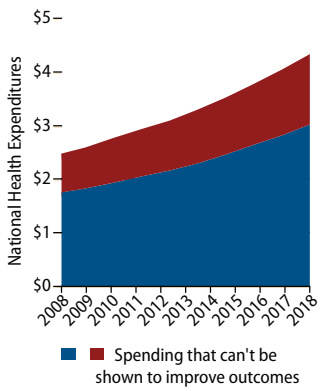
If we continue on the same path, the dollars spent on care that cannot be attributed to improved health will continue to grow from $700 billion in 2008—5 percent of GDP—to 1.3 trillion in 2018—6.1 percent of GDP.

That's a more than 40 percent increase over the next 10 years.[10] These increased costs will certainly be passed on to families and the government.

Methodology

It is reasonable to assume that CBO's estimated $700 billion in spending is evenly spread across all health care payers—private, federal, and state. According to 2008 National Health Expenditure data, 34 percent of all health spending was attributed to Private Health Insurance, meaning that the share of the $700 billion attributable to private premium spending is about $240 billion. Almost 160 million people had group coverage in

Growth in spending



Source: CBO Testimony, Dartmouth Institute For Health Policy and Clinical Practice, CMS

2008 and more than 14 million had individual insurance, meaning that 92 percent of those with private insurance were in the group market, leaving an almost $1,390-per-person share for those on the group market of the $700 billion in spending identified by the CBO.

Using a methodology for calculating the number of family policies on the group market and the number of people in those polices published by the Center for American Progress in May 2008, these data show that the average family premium of $12,600 contains $4,270 on care expenditures that cannot be attributed to improved health. The same would also be true of those on the individual market, where $1,390 of the 2008 average individual premium of $4,704 cannot be attributed to improved health.

This methodology makes a couple key assumptions:

- **The $700 billion is evenly spread across all payer types.** This assumption mirrors the basic premise of the analysis in Orszag's testimony, which is based on analysis of Medicare that shows 30 percent of the spending does not contribute to the improvement of health. The $700 billion is evenly spread across all premiums. This analysis is based on national averages. There is significant geographic variation in practice patterns, average premium levels, and insurance regulation. And it is entirely expected that care delivered by one provider could be more efficient than another—and such providers could be clustered in certain areas of the country. However, under a social insurance model, a rational insurer is reasonably expected to spread these costs evenly across their market, meaning that all families are hurt by any inefficiency. It is also worth noting that indemnity insurance is likely more susceptible to the type of spending discussed in this brief than a managed care insurance policy.

Endnotes

1 The Commonwealth Fund, "The Path to a High Performance U.S. Health System: A 2020 Vision and the Policies to Pave the Way," February 2009, available at http://www.commonwealthfund.org/Content/Publications/Fund-Reports/2009/Feb/The-Path-to-a-High-Performance-US-Health-System.aspx

2 Peter Orszag, "Increasing the Value of Federal Health Spending on Health Care," Testimony before the United States House of Representatives, Committee on the Budget, July 16, 2008.

3 According to data from Kaiser Family Foundation and the Health and Education Trust, employers pay the majority of the premium for employees, such that any reduction (or slowing in the rate of growth) in premium payments would reduce the financial burden on both employers and families. The government will also see a benefit, in the form of reduced burden from forgone revenue that accrues since private insurance premiums are not taxed.

4 John Wennberg and others, "Geography and the Debate Over Medicare Reform," Health Affairs, February 13, 2002.

5 Peter Harbage and Karen Davenport, "Containing Health Care Costs," Washington: Center for American Progress Action Fund, July 2008, available at http://wonkroom.thinkprogress.org/wp-content/uploads/2008/07/cost_containment1.pdf

6 General economic theory is that the cost of health insurance benefits is offset by employers with a reduction in employee salary/wages. In the case of a reduction in the cost of insurance, or a reduction in the rate of growth, there is a question as to where the incidence of where the savings will fall—to the benefit of the employee or the employer.

7 For every dollar spent on premiums, the federal government gives employees a tax break through their income and payroll taxes. By reducing the cost of premiums, the burden of this tax break in terms of forgone revenue to the federal government will drop.

8 U.S. Senate Finance Committee, "The American Recovery and Reinvestment Act of 2009," February 12, 2009.

9 Peter Harbage, "Competitive Health Care," Washington: Center for American Progress, Forthcoming.

10 Spending projections based on National Health Expenditure Survey, 2008-2018, available at http://www.cms.hhs.gov/NationalHealthExpendData/downloads/proj2008.pdf