SESSION OBJECTIVE

• Understand the main components and issues in financing personal health services.

2013 US Healthcare Expenditures

• $2.9 trillion = $2,900,000,000,000
• $9,255 per person average
• IOM report: estimated one-third of health expenditures was wasted expense

Source: cms.gov; National Health Expenditures 2013 Highlights

Gross Domestic Product 2010

United States 17.9%
Germany 11.6%
Canada 11.3%
United Kingdom 9.6%
United States (if the one-third in waste could be eliminated) 11.9%

Source: The World Bank
http://data.worldbank.org/indicator/SH.XPD.TOTL.ZS

U.S. Health Expenditures

National health exp:
Private
Public
Federal
State and local

Source: Centers for Medicare & Medicaid Services
http://www.cms.gov/NationalHealthExpendData/02_NationalHealthAccountsHistorical.asp

Private vs. Public

Distribution of Personal Health Expenditures by Source of Payment, 1980-2009
Funding of Health Care 1850-1930

- Funding Sources
  - Cash - patients paid per agreement with physician
  - Donations - hospital patients poor, most hospital funds came from other sources
- Early 1900s - Insurance Emerges
  - Focus - replaced lost wages
  - Did not pay medical bills

Origin of Employer-Sponsored Health Insurance

- Hospitals becoming the center of care following improvements in medicine
- Hospitals following Great Depression of 1929
  - Weakened financial stability of voluntary hospitals
  - Average hospital receipts per person fell from $236 to $59
- Insurance products created to prevent the potential collapse of voluntary hospitals

Baylor University Health Plan 1929

- Origin - Baylor University Hospital provided insurance to 1,500 school teachers
- Up to 21 days of hospital care a year
- Annual cost of $6 per person
- Lead to Blue Cross plans

HEALTH INSURANCE DESIGN

Why offer health insurance through employers?
Expansion of Employer-Sponsored Insurance

• During World War II - freeze imposed on wages and salaries
• Resulted in development of pensions, disability programs, and private health insurance
• Post WW II – growth in private health insurance plans
• 20% covered by some health insurance at WW II conclusion grew to 70% by early 1960s

INSURANCE CONCEPTS

• Risk
  – Central to concept in insurance
  – Adverse deviation from desired outcome
  – Probability of incurring a loss

INSURANCE

• Shift risk from individual to group
  – Loss is unaffordable to individuals
  – Share losses on some equitable basis
  – Law of large numbers

HEALTH INSURANCE EVOLUTION

• First employer-sponsored plans similar to auto insurance
  – Cover against expensive loss
• Unique Characteristics for Insurance
  – Covers services that are normal events (office visits)
  – Cover services that can be budgeted by individuals (pharmaceuticals)
  – Claims are not independent (e.g., epidemics)

Health Reform

• Some employers do not fund health insurance plans for employees
• Often, individuals cannot afford to purchase health insurance coverage
• Small businesses experience insurance premiums increases when one worker incurs significant health care costs
  – Causes some small businesses to discontinue coverage
• Many employees lack health insurance coverage

MORAL HAZARD OF HEALTH INSURANCE

• Derived from fire insurance industry
  – Insured buildings more likely to burn
• Patients utilize more health care services if paid with "someone else’s" money
• No incentives to contain costs
  – Sickness not always a well-defined condition
  – Utilization (costs) partly controlled by hospitals & physicians who profit from additional services
• Prices increase as ability to pay increases
INSURANCE COST SHARING

• Deductible
  – Portion of a subscriber's health care expenses that must be paid out-of-pocket before any insurance coverage applies

• Co-Insurance
  – Limits the amount of coverage paid by the plan to a fixed percentage (e.g., 80%)

• Co-Payment
  – Medical expenses paid by member out-of-pocket as a fixed amount ($25 for office visit)

INSURANCE PREMIUMS

• Varies with amount & type of insurance

• Calculated based on:
  – Events insured against
  – Prediction of occurrence
  – Cost of occurrence

Cost of Healthcare for Typical U.S. Family of Four

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Cost</th>
<th>Cost to Employer</th>
<th>Total Cost to Family</th>
<th>Deduction from Payroll</th>
<th>Cost Sharing</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>$8,414</td>
<td></td>
<td></td>
<td>$1,428</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>$9,235</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>2003</td>
<td>$10,168</td>
<td></td>
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<tr>
<td>2004</td>
<td>$11,192</td>
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<tr>
<td>2005</td>
<td>$12,214</td>
<td></td>
<td></td>
<td>$2,035</td>
<td>$2,035</td>
</tr>
<tr>
<td>2006</td>
<td>$13,382</td>
<td>$8,362</td>
<td>$5,020</td>
<td>$2,810</td>
<td>$2,210</td>
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<tr>
<td>2007</td>
<td>$14,500</td>
<td>$8,909</td>
<td>$5,591</td>
<td>$3,171</td>
<td>$2,420</td>
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<tr>
<td>2008</td>
<td>$15,609</td>
<td>$9,442</td>
<td>$6,167</td>
<td>$3,492</td>
<td>$2,675</td>
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<tr>
<td>2009</td>
<td>$16,771</td>
<td>$9,947</td>
<td>$6,824</td>
<td>$4,004</td>
<td>$2,820</td>
</tr>
</tbody>
</table>

Sources: Survey conducted by Milliman, Inc. an actuarial firm

2008 Milliman Medical Index (MMI), May 2009

MMI measures the average spending by such family of four if covered by an employer-sponsored PPO program.

U.S. Health Expenditures

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research &amp; Construction</td>
<td>8%</td>
</tr>
<tr>
<td>Health Services &amp; Supplies</td>
<td>84%</td>
</tr>
<tr>
<td>Personal Health Services</td>
<td></td>
</tr>
<tr>
<td>Adm. of Health Insurance</td>
<td>5%</td>
</tr>
<tr>
<td>Government Public Health</td>
<td>3%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
</tr>
</tbody>
</table>

2013 Health Care Expenditures

Source: cms.gov; National Health Expenditures 2013 Highlights;
Personal Health Care Expenditures: Where It Came From

- Medicare, 22%
- Medicaid, 16%
- Private Insurance, 36%
- Out of Pocket, 15%
- Other Private, 4%
- Other Public, 7%
- Other Public, 7%
- Private Insurance, 30%
- Medicaid, 16%

Part 1 Session Questions

1. In general, how does US health spending compare with other developed nations?
2. About what percent of US health expenditures are paid from public sources?
3. What motivated the development of hospital insurance?
4. In insurance, what are the concepts of risk and moral hazard?
5. What types of patient cost sharing methods are used and why?
6. What general factors determine the price of a health insurance policy?
7. What are the largest categories of US health expenditures?