

Getting the most for our health care dollars

Administrative costs of health care coverage

Reducing administrative and other nonclinical costs that do not contribute value to patient care needs to be included as one of several broad strategies to address rising health care costs. Such administrative costs and unnecessary burdens are imposed by complex procedures for filing insurance claims and countless Medicare, Medicaid and state insurance regulations.

The AMA supports: developing and adopting a consistent format for defining, estimating and reporting administrative costs; achieving greater national uniformity of health insurance market regulation; encouraging the continued development of patient- and physician-friendly electronic systems; pressing the insurance industry to adopt more standardized claims-filing processes; and instituting broader reforms to promote value-based decision-making.

Administrative costs are frequently cited in debates about health system reform. There is widespread agreement that excessive costs and unnecessary burdens are imposed by complex procedures for filing insurance claims; countless Medicare, Medicaid and state insurance regulations; and new cottage industries that assist third-party payers with billing, repricing payments to physicians and hospitals, managing pharmaceutical benefits and other nonclinical activities. The American Medical Association (AMA) advocates reducing administrative and other nonclinical costs that do not contribute value to patient care as one of several broad strategies to address rising health care costs.

The AMA believes that excessive administrative costs are secondary to—and symptomatic of—fundamental flaws in the way health insurance is currently provided and paid for. Many people have been unfairly shut out of the health insurance system because of ill-conceived government policies—specifically, health insurance tax subsidies that don't help the poor, and health insurance regulations that don't protect the sick. Flawed tax and regulatory policies are also blamed for driving up administrative costs by imposing 51 arbitrarily different sets of insurance rules from states and the District of Columbia, which, in turn, drive all but the largest insurers out of many markets, often giving them excessive market power. Therefore, to expand coverage and curb administrative costs, the AMA supports redesigning health insurance tax breaks, market rules and safeguards so that health insurance markets work properly, and so that coverage is affordable for everyone, regardless of income or health status. The AMA is hopeful that the implementation of the Patient Protection and Affordable Care Act, the health system reform legislation that was enacted into law in March 2010 (Public Law 111-148), will address many of these key concerns.

Background

Given the wide variation in administrative cost estimates, government data provide a natural reference point. The annual National Health Expenditures Accounts (NHEA) report administrative expenditures approaching \$160 billion in 2008. This amounts to 6.8 percent of total U.S. health care spending, broken out as 11.7 percent for private insurers and 6.3 percent for public programs. NHEA data also show more rapid growth of administrative expenditures for public programs than for private insurance in recent years.

By comparison, industry estimates of administrative costs of private health plans generally are somewhat lower than NHEA because they do not count insurer profits as part of administrative costs. Such inconsistencies in how administrative costs are defined make it difficult to determine the extent to which differences in estimates reflect differences in health plan efficiency.

Unlike industry or NHEA estimates, other measures supported by single-payer advocates include a broader array of administrative costs not limited to those incurred by insurers, such as maintaining medical records and administering employee health benefits, yielding estimates that are orders of magnitude higher. Using these measures, single-payer advocates are of the position that administrative expenses associated with private insurance are much higher than those of Medicare. On the whole, the argument is made that the bulk of these administrative costs could be avoided if the United States were to adopt a Canadian-style health care system.

A closer look at administrative costs

These frequently cited estimates have been criticized for incorrectly measuring and reporting administrative costs in various ways that, together, exaggerate differences between private and public insurance. Major shortcomings of administrative cost estimates include the following:

- **Ignoring unreported administrative costs of government programs.** Perhaps the most obvious shortcoming of many estimates is that they ignore unreported spending on administration of government programs. Such uncounted administrative costs are especially evident in the Medicare program and include:
 - Tax collection to fund Medicare, analogous to premium collection by private insurers. Although premium collection expenses of private insurers are rightly counted as administrative costs, tax collection expenses incurred by employers and the Internal Revenue Service do not appear in the official Medicare or NHEA accounting systems, and so are usually overlooked
 - Medicare program marketing, outreach and education
 - Medicare program customer service

- Medicare program auditing by the Office of the Inspector General
 - Medicare program contract negotiation
 - Staff salaries for CMS personnel with Medicare program responsibilities
- **Reporting administrative costs as percentages rather than dollars.** Presenting administrative costs as a percentage of total health care costs gives a misleading impression of Medicare's efficiency relative to private insurance. Medicare patients are an expensive population, with much higher medical costs per person and per claim relative to the general privately insured population. Thus, an identical dollar amount of administrative cost per enrollee or per claim in the two sectors would make Medicare administrative costs appear lower. For example, a \$10 administrative cost per insurance claim represents 10 percent of a \$100 claim but only 1 percent of a \$1,000 claim. Similarly, rising medical costs of Medicare enrollees create the appearance that Medicare is becoming administratively more efficient over time.
- **Confusing costs of regulatory compliance with health plan inefficiency.** Private insurers face administrative costs not imposed on public programs, such as the need to comply with multiple sets of state and federal regulations. Both overregulation and arbitrary differences in regulation create unnecessary administrative costs and prevent cost-savings from economies of scale. Private insurers also must pay premium taxes, usually counted as an administrative expense, driving up administrative costs as a percentage of total costs and creating the appearance of reduced efficiency.
- **Failing to recognize indirect costs not reflected on an accountant's ledger.** Tallying up dollars spent on all administrative activities for public and private insurance alike, along with addressing the other issues just discussed, would greatly improve administrative cost estimates and comparisons—but still would not capture indirect, hidden costs of insurance administration. These indirect costs depend on how basic administrative functions are accomplished, functions that are necessary for both private and public insurance, including collecting revenues, managing use of services, and paying physicians and hospitals.

Toward fairer comparisons

Several analyses have sought to make fair comparisons between private and public insurance by addressing common shortcomings of administrative cost estimates. A pair of studies of Medicare administrative costs that included unreported expenditures on the program made by numerous government agencies concluded that Medicare administrative expenditures were at least three times the amount reported in the federal budget in 2003—\$15.0 billion vs. \$5.2 billion.^{1,2} Another administrative cost analysis—possibly the most comprehensive and methodologically rigorous to date—examined a wide array of costs borne by insurers, health care providers, and patients in the United States and Canada, paying particular attention to indirect costs of carrying out basic administrative functions.³

The study calculated costs, net of associated benefits, of explicit and implicit methods of collecting revenues, curbing use of services and paying providers. For example, longer waiting times in Canada implicitly keep utilization of health care services in check, generating indirect costs to patients from delayed treatment and missed work. The study found that indirect, hidden administrative costs dwarfed monetary expenditures, concluding that true administrative costs are many times higher in Canada than in the United States.

How to get the most for our health care dollars

The AMA believes that usual methods of estimating administrative costs ignore important facts, thereby overstating differences between private and public insurance, and that administrative costs are actually lower than generally reported in the private sector and higher than generally reported in the public sector. As a next step to address health care costs following the passage of health system reform legislation, the AMA supports the following specific measures to simplify needlessly complex administrative procedures and regulations:

- Develop and adopt a consistent format for defining, estimating and reporting administrative costs, in order to facilitate unbiased comparisons across different types of insurance and health care systems.
- Achieve greater national uniformity of market regulation across health insurance markets, regardless of type of submarket (e.g., large group, small group, individual), geographic location or type of health plan.
- Encourage the continued development of patient- and physician-friendly electronic systems to efficiently handle pricing, billing and claims processing at the point of service.
- Press the insurance industry to adopt more standardized claims-filing processes.
- Reduce nonclinical health system costs that do not add value to patient care.
- Institute broader reforms to promote value-based decision-making so that decisions of insurers, patients, physicians and others take both costs and benefits into consideration. As described in "Strategies to address rising health care costs" in this series, decision-making can be improved through increased market competition, greater availability and transparency of information, and incentives.

References

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