The Unsurprising Surprise Of Renewed Health Care Cost Inflation

It's easy to see why people are worried about rising health care costs. But surprised?

by Henry J. Aaron

Observers have noted that after a hiatus in the mid- and late 1990s, health care costs are once again rising fast. Like Louis Renault, the benignly corrupt police chief in Casablanca, who was “shocked, shocked!” that gambling was going on at Rick’s Café Americain, some people are similarly stunned at the reemergence of these rapid increases. Unlike Renault, whose surprise was feigned, current observers seem genuinely startled. The more sensible reaction would be that of today’s teenagers on hearing almost anything: “Well, duh!”

Health care cost inflation is not exactly new. Per capita health care expenditures have been rising 4–5 percent for half a century. Fluctuations have occurred, as Drew Altman and Larry Levitt’s exhibit shows. The recent lull was longer than others were. But the forces that have driven up costs over the long haul are, if anything, intensifying. The staggering fecundity of biomedical research is increasing, not diminishing. Rapid scientific advance always raises expenditures, even as it lowers prices. Those who think otherwise need only turn their historical eyes to automobiles, airplanes, television, and computers. In each case, massive technological advance drove down the price of services, but total outlays soared. Faulty health price statistics for many years obscured the decline in the price of achieving desired health outcomes. But recent research, well summarized by Ernst Berndt and colleagues, is on the way to removing this one anomaly.1 Nothing, of course, has obscured the almost inexorable rise in outlays.

Other countries rein in the tendency for fully insured patients to want all beneficial care, regardless of cost, by subjecting hospitals or physicians or both to politically established budget limits or their

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functional equivalent. No such controls exist in the United States. But a variety of forces became aligned in the 1990s to temporarily attenuate the underlying tendency of fully insured patients confronting a growing menu of beneficial services to spend more and more money.

The most dramatic was the massive social experiment in private regulation of health costs known as managed care. This experiment began at the most propitious of times. Private expenditures had just completed a massive growth spurt. Health insurance premiums had also jumped and were ready to repeat their cyclical slowdown. Hospital wings echoed with unoccupied beds. Doctors’ garages were filled with Mercedes Benzes. And employers were reeling under rising health care premium costs.

In this environment, managed care was well positioned to negotiate discounts from hospitals and physicians. And negotiate them they did. New pharmaceutical products and new technology shifted care from costly inpatient stays to outpatient treatments and drug therapies. And cost growth slowed.

For a few years. Meanwhile, however, new procedures continued to proliferate. New and dizzyingly costly drugs continued to emerge from clinical trials. The population continued to age. Hospitals reached their limits on discounts and struck back with demands to recontract. Managed care had picked the low-hanging fruit of easy economies. To continue holding down costs, it would have to have made palatable the denial of care that was genuinely beneficial or that patients and their physicians thought was beneficial.

Managed care couldn’t do it. Perhaps, one day managed care will learn to do it. But don’t bet on it. The problem is that managed care lacks political legitimacy. Managed care plans are private, often for-profit, entities trying to tell sick patients who want care and physicians who think the care is necessary and who profit from providing it that it is better for the cost of that care to flow to the managed care company’s bottom line than to finance medical services.

Under the best of conditions, the denial of beneficial care is difficult for employers or for their managed care agents to sustain. To make matters worse, the easy savings of managed care ended just as productivity and employment boomed. It made little sense for employers to pinch health care pennies when production dollars were abundant.
Now the situation has become genuinely nasty. The easy economies are behind us. The underlying forces driving up health care spending—biomedical advance and population aging—are intensifying. And economic growth seems to be slowing for a period of uncertain duration. Health care costs are rising fast, just as budgets, public and private, are tightening. The much-watched gross domestic product (GDP) share going to health care is likely to move up for many years to come. It is easy to see why people are worried about health cost inflation. But surprised? “Well, duh!”

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