

Healthcare Cost: Impact of Trend, Reform and Recession

Over the last 20 years, the average annual healthcare cost trend has experienced significant peaks and valleys. Trend has ranged from highs of around 15% in the late 1980s and early 2000s to a low of 0% in the mid-1990s. Since the latest peak of 2002-2003, trend has once again declined, although still at a rate well above general inflation, to around 8-9% today. Preliminary forecasts indicate annual commercial cost trend will increase slightly in 2010 to 9-11%.

The following are key drivers to the somewhat higher trend levels expected in 2010.

- ❑ Adverse selection: As younger, healthier people get laid-off or opt-out of expensive healthcare coverage the average risk increases due to a disproportionate share of sick individuals retaining coverage.
- ❑ Higher reimbursement rates: Cost shifting due to expected decreases or minimal increases in Medicare and Medicaid payment rates. Provider bad debt has also escalated with the proliferation of high-deductible plans and due to a poor economy.
- ❑ Increased utilization: More individuals may be looking to get medical services completed before being laid-off or losing employer provided coverage.
- ❑ Medical advances: Specialty drugs, new procedures and new/improving infrastructure continue to add to overall trend.

Hospital outpatient facility costs are expected to trend higher than the average across all services while inpatient and physician services are expected to increase at lower than average rates. Prescription drug costs have historically trended at significantly higher levels than medical costs. Based on Milliman's Health Cost Index Report, trends on prescription drugs have declined from over 20% in 2000 to under 10% in 2008.

Drug trends can be influenced by innovation as new drugs are introduced by moving drugs from brand name to generic status as their patents expire and by becoming available over the counter. As many popular drugs have come off of

patent while few new "blockbuster" drugs have been introduced, drug trends have declined. In addition, generic drug use rates have increased to over 60%. As we look toward 2010, prescription drug trend is forecast to increase moderately (similar to the average increase in medical costs). Historical healthcare cost trends provide a context in which we make predictions about future trends. Many factors contribute to the level of healthcare costs, including an aging population, consumer demand, rising rates of conditions like obesity, diabetes and asthma, new technology and specialty drugs, high medical malpractice litigation cost, managed care programs, cost shifting impact from government healthcare programs, cost of administrative requirements and changing consumer attitudes toward healthcare. Two of the more interesting near-term elements of future healthcare cost are the impact of the current recession and pending healthcare reform.

—Jason Sciborski, Associate Actuary,
Edited by Doug Proebsting, Principal and
Consulting Actuary, Milliman, Inc.