



## GFOA Recommended Practice

### Health Care Cost Containment - 2004

**Background.** Health care cost inflation is a growing concern confronting state and local governments who provide health care benefits for their retirees and employees. Nearly all governments offer some type of health care coverage to their employees. However, governments face a challenge in maintaining these benefits because of past and projected health care inflation. Allowing public employees and retirees the flexibility and tools necessary to save for retirement and to pay for health care expenditures is essential.

For most of the past twenty years, health care inflation has been extremely high relative to a variety of benchmarks, so that it currently occupies a significant part of a government's overall operating budget. In particular, it is growing much faster than general inflation and government general revenues. As a result, it constrains the ability to fund other government services (without raising taxes or fees). It also hampers the ability to provide other compensation (e.g., ability to provide salary increases) and other retirement enhancements that employees value.

From an employer perspective, health care costs are predominantly measured in terms of:

1. Premiums, for governments that obtain coverage through insurance carriers, and
2. "Premium-equivalents," for governments that self-insure.

Self-insured governments incur costs for claims, claims administration, and stop-loss insurance which are converted into a premium-equivalent cost that is comparable to premiums.

In general, health care costs are simply a function of the unit cost of a health care service multiplied by the number of units used (utilization). Therefore, factors driving rapid health care inflation include, but are not limited to, the following:

1. Unit costs
  - Technology
  - Litigation and malpractice insurance
  - Failure to limit increases in the supply of new facilities ("certificates of need")
  - Extending drug patents through loopholes in federal patent law
  - Limited ability to provide generic drug alternatives
2. Units (utilization)
  - "Defensive" health care

- Direct to consumer advertising
- Demographics
- Chronic diseases

In addition, other factors that drive health care inflation include administrative costs associated with the decentralized, market-based health care delivery system in the United States. In particular, the industry structure, increasingly consolidated among larger insurance carriers, larger physician groups and larger provider networks, has brought about greater market power to these groups. The limited availability of providers and carriers in particular regions may drive up costs further.

Finally, governments incur additional costs due to cost-shifting. For example, the federal government has shifted costs to private, state, and local plans by setting Medicaid and Medicare reimbursement levels below market costs. Hospitals' mandatory provision of indigent care also shifts cost to employer-based plans.

**Recommendation.** Health care cost containment covering active and, where applicable, retired employees, is a critical component of long-term financial planning and budgeting. Cost containment is necessary to maintain the provision of government service levels, particularly in jurisdictions subject to tax limitations.

GFOA recommends that governments institute a number of efforts to contain costs. As a preliminary step in establishing a cost containment program, governments should perform a cost analysis that utilizes historical trend data on costs and utilization experienced by the employer so as to highlight areas for remedial action. Once a baseline of cost and utilization data is established, governments should consider the following strategies:

#### 1. Plan design

These are incremental or major initiatives to provide employee coverage through a more efficient and effective plan structure. Major initiatives include the movement from indemnity plans to managed care organizations, such as Preferred Provider Organizations, Exclusive Provider Organizations, or Health Maintenance Organizations, as well as recent "consumer-driven health care plans." It also entails the establishment of eligibility criteria that determine whether part-time or temporary employees are covered as well as vesting for retiree health care coverage. Incremental changes include adjusting co-payment and co-insurance levels to influence individual behavior with respect to network/out of network services, brand/generic prescriptions and over the counter medication, inpatient/outpatient services, and other decisions.

#### 2. Vendor management

Management of vendors encompasses activities designed to operate a plan more effectively, by making optimal use of health care vendors. This includes such steps as (a) audits of claims to ensure that carriers or third-party administrators pay benefits according to plan rules, (b) verification of enrolled participants ("positive re-enrollment"), and (c) coordination of benefits. Vendor management includes sound procurement practices, such as periodic rebidding of the health care plan vendors, setting appropriate compensation for consultants/brokers, and ensuring

that vendor interests are aligned with the government's. Additionally, governments should consider available quality measures for the effectiveness of treatment outcomes and costs.

### 3. Individual health management

Health care costs are driven to a significant extent by the behavior and lifestyle choices of individuals. Thus, targeted efforts to encourage lifestyle changes may be effective financially, such as:

- Wellness programs
- Disease management (for at-risk employees or employees undergoing initial treatment)
- Financial incentives for behavior /lifestyle modification
- Employee education on healthcare matters
- Greater cost awareness by making provider costs more "visible" to participants (e.g., providing incentives to employees who discover inaccurate billing)

### 4. Aggregation

In order to obtain better pricing and market leverage, governments should evaluate whether to aggregate their purchasing power. This includes (where allowed by law) formation of health care insurance pools, intergovernmental agreements for procurement of prescription drugs, partnerships with private sector organizations, or local government participation in state master agreements. Aggregation can also be achieved simply by using fewer insurance carriers or vendors to deliver benefits.

### 5. Cost sharing

As employers, governments may realize savings by sharing certain costs with employees. Cost-sharing can be implemented through joint payment of premiums, co-payments, and co-insurance. Cost-sharing initiatives can be augmented through the use of tax-advantaged savings accounts that allow employees to save and pay for health costs or future retiree health insurance. Additionally, some governments provide incentives to encourage employees to use spousal health care plans.

For certain governments, self-funding may be a more efficient financing method than the use of insurance carriers. However, governments would need to analyze factors such as number of employees, ability to accept risk, and availability of stop-loss coverage before pursuing self-insurance.

Approved by the GFOA Executive Board, October 15, 2004.