Rising health insurance costs are a mystery to many people. Questions like: what causes premiums to increase? Why do premiums increase at rates higher than the general rate of inflation? Why do my premiums increase when I don't use many healthcare services? To answer these questions it's important to have an understanding of the factors that impact health insurance premiums. Price, utilization, intensity, selection, and leveraging. Let's start with price. Price or the cost of health care services is a main driver of health insurance premiums. Price includes what insurers pay out in benefits on behalf of their members to hospitals, physicians, and other healthcare providers for services and prescription drugs. As costs for health care services rise, so do premiums, and ultimately the price everyone must pay for health insurance, even those who don't use many healthcare services. Let's use a simple analogy to explain how price affects health insurance premiums. We've all gone out for dinner with a group of people and shared in the expense of the meal by splitting the bill equally. Each person in the group orders different menu items at various prices. If the group splits the bill evenly, the people ordering the most expensive meals pay less than the value of their dinner that people who eat lightly will pay more than the value of their meal, and the selection or action of any one person in the group will affect the amount everyone pays. For example, Susan's meal costs $10 David's meal costs $15 Chris's meal costs $20 John's meal costs $25 katie's meal costs $30. The total cost of the food adds up to $100 divided equally each person will pay $20. Let's take it one step further What happens when the restaurant needs to raise its price for food items due to inflation or supply costs? That cost must eventually be passed on to their customers. If menu prices increased by 5% the total cost of the five meals becomes $105. Each person must pay $21 of the total bill regardless of what each individual ordered. Each person is responsible for an equal share of the total bill. The same principle holds true when it comes to increases in health insurance. A group of people that are insured under the same health insurance plan require different medical services all at varying prices. For example $188 for an office visit with lab tests $3560 for an inpatient hospital stay for a newborn after delivery 1273 dollars for an emergency room visit $225 for a thirty-day brand-name prescription, and so on. Regardless of the charges for the services each person receives, the entire group will be subject to the overall cost. If there is an increase in health care costs or the charges for those services, health insurance premiums will be impacted. Utilization is the number of health care products and services provided. Think of it as the volume factor. More doctors office visits more tests or treatments and more prescription drugs are just a few examples of the increasing volume of services in health care. In addition, people are living longer and require more health care services than ever before. All these factors drive utilization for the volume of services upward as the use of health care services increases health insurance premiums rise, and ultimately so does the price everyone must pay for health insurance. Let's use
the group dining analogy again to describe how this works. An increase in utilization is represented when David adds a $5 dessert to his meal he's receiving an additional food item which increases the total cost of the food for the group to $110. Only David receives the benefit of the dessert, but the entire group shares in the cost. Each person's portion of the bill has increased $1 to $22. This principle also applies to health insurance premiums. Some people require more medical services than others. The total number of services delivered to the entire group may increase from year to year. For illustrative purposes let's say a group of people had 800 doctor's office visits last year. This year the number of visits for that same group of people increases to 1,000 office visits. Their utilization increased causing an increase in the amount of benefits paid, which contributes to rising health insurance premiums for everyone, not just those who went to the doctor more. Intensity is the impact to overall cost when a product or service is replaced by a more expensive one. In many cases new technologies new procedures and new therapies can be more accurate or less invasive, and deliver a higher quality of care to the patient, but these new health care services all come with an increasing cost. As the use of more expensive services increases health insurance premiums rise and ultimately so does the price everyone must pay for health insurance. So how do more expensive products and services impact the overall cost in our dinner analogy? Let's say the restaurant enhances their lobster entree to include a six-ounce steak. Katie's lobster entree is no longer available, and is now replaced by a surf and turf entree. The new entree costs $5 more. The intensity factor's at play here because a less expensive item has been replaced with a more expensive item. Now the total bill for the group is $115, and each person will pay $23. In healthcare, the intensity of services such as advances in technology, new diagnostics, and new, more expensive drug therapies are a leading driver in escalating healthcare costs. For example, MRI's with an average cost of around $1,557 are increasingly used instead of, or in addition to less expensive X-rays that cost an average of $90. The newer more expensive diagnostic is replacing the old or adding another layer of testing. As health care services and procedures become more expensive overall health care costs increase, and the amount of health insurance benefit dollars increase. We all pay for these increases through increasing health insurance premiums. Health insurance premiums are based largely on the average benefit expense for a group of people. Selection impacts overall costs when someone with lower than average benefit expenses leaves the group. The broader the cross-section of people in the group, the lower the expenses for everyone, so the risk can be spread across more people. When individuals that use fewer services leave the group, premiums rise and ultimately so does the cost everyone must pay for health insurance. If susan decides to drop out of the group and not dine with them anymore, the total food bill goes down from $115 to $105, but since only four people remained to split the bill, each person will now pay $26.25. This concept also applies to health
insurance premiums. If several people who rarely use their benefits leave the group, premiums will go up for those people who remain in the group. Why? Because the risk is now spread among the less diverse cross-section of people in the group. Each remaining member will be expected to pay more in premiums to cover overall expenses. When a member's co-pay stays the same but health care costs increase, members receive a richer benefit. The resulting increase in expense may be absorbed by the employer or the health plan in the form of a higher premium, but not passed on to the consumer with a raise in the copay. The impact is called leveraging. Health plan members are often insulated from rising health care costs and don't feel the immediate impact of increasing costs. This is largely because most of us are only responsible for our out of pocket expenses. Co-insurance co-payments or deductibles amounts which are a small portion of our overall health care expenses. Let's use our dining analogy to illustrate the leveraging impact. It's sort of like having a discount coupon. A popular one is buy one dinner at full price and get a second meal for $10. Over time the restaurant may raise the price of their standard menu items, but the value of the coupon remains the same, just $10 for the second dinner. When prices increase, but customers still pay the same amount, the business needs to recoup costs somewhere. The restaurant may need to add a little cost to other menu items to compensate for redeemed coupons. The same principle applies when it comes to health care costs. Someone has to absorb the cost increases. Let's look at the cost of prescription drugs as an example. In recent years, health plan members co-payments have not kept pace proportionately with the true cost of prescriptions. For example, if a prescription costs $50, and a member's copayment is $15, the benefit expense would be $35. The $35 is paid by the health insurance plan as a benefit expense. What happens though when the cost of the drug increases? In our example, the drug's price increases by 30% to $65, but the members still pay $15 out of pocket. The benefit expense is now $50. That's a 42% benefit increase that has to be absorbed by the health insurance plan or the employer sponsored plan. A 30% increase in price has a 42% effect on the amount of benefits paid. That's a 12% leveraging effect. Because of proportionality, the members co-payment has not kept pace with the overall cost. The members percentage of the prescription costs actually dropped from 30% to 23%. That's the impact of leveraging.

In the dinner analogy the price increase was only five percent from $20, to $21 per person. As we've seen however, price is only one part of the picture. When all the factors; price, utilization, intensity, selection, and leveraging come into play, the total increase in the dinner bill is 31% from $20 per person to $26.25 per person. When it comes to health insurance premiums, these combined factors produced much the same result. That's why many times premium increases are higher than the general rate of inflation. So what can consumers do to help control rising premiums? Here are a few suggestions. Track prices, choose generics over brand-name drugs. Managed utilization,
take an active role in your care. Work with a primary care doctor to manage all of your health care needs. Monitor intensity. Be cost conscious and know what treatments cost and whether alternatives are available. Reduced disease risk. Take the time to take care of yourself. Eat right, stay active, don’t smoke, stay up to date on your preventive exams and procedures. When it comes to making a difference in health care costs, your decisions count.