

The Congressional Budget Office Reports:

**COMPARING HEALTH CARE ADMIN COST
PRIVATE SECTOR VS. GOVERNMENT
WHO'S LESS COSTLY?**

By Greg Dattilo, CEBS & Dave Racer, MLitt*

The United States Congress' Congressional Budget Office (CBO) released a two-volume health reform study in December 2008. It lays out the underlying logic, data, and arguments the Obama Administration and Congressional leaders are using to move their health reforms ahead.

We use these CBO reports to address the argument that government health care administrative cost is far less than that of private insurers. If this were a fact, of course, it would argue for a government-run health payment system. CBO's data clearly disputes that argument, and instead, shows that insurance companies spend at least 51% less on administration than government does on its health care programs.

CBO draws its spending data from the 2009 Centers for Medicare and Medicaid Services (CMS).¹ CMS projects that total health spending for 2009 will be \$2.56 trillion. (Table 1)

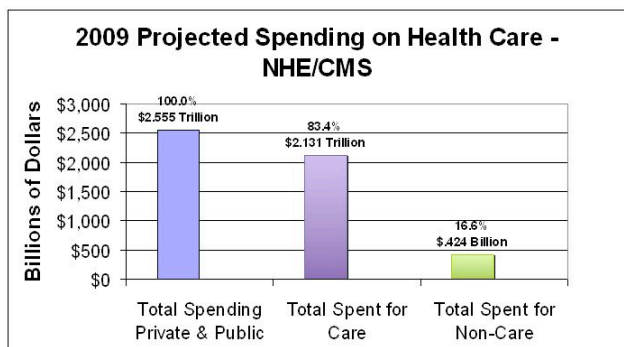
CMS divides spending data into two broad categories: Care and Non-Care. 1) The care category is money paid to providers for personal health care (physicians, hospitals, pharmacy, dental, etc.); 2) The non-care category is money paid for everything other than providing personal health care.

CMS projects 2009 spending on *care* at \$2.13 trillion – 84.4% of total spending. CMS projects spending for *non-care* at \$424 billion – 16.6% of total spending. Non-care health spending, we argue, should be labeled administrative cost.

PRIVATE AND PUBLIC HEALTH CARE PAYMENTS

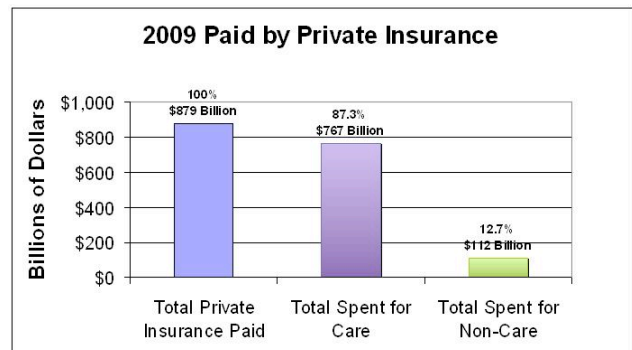
CMS breaks health care spending down into two broad categories: private and public. Private spending includes payments made outside public (government) programs. This is health care paid by private insurance, individuals (called out-of-pocket), and philanthropies.

Table 1



NHE - National Health Expenditures
CMS - Centers for Medicare and Medicaid Services

Table 2

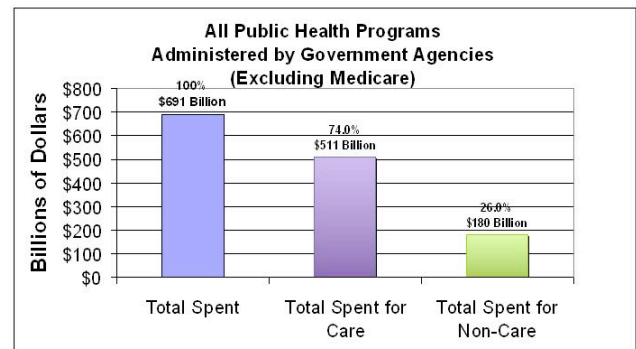


CMS projects that private insurance will spend \$879 billion. Of this, \$767 billion – 87.3% – will be paid to providers for personal health care. Some \$128 billion – 12.7% – will be spent for non-care (administrative dollars). The 12.7%, however, also includes government-mandated taxes and assessments paid by private insurance companies. (Table 2)

Now we will compare the administrative cost of private insurance programs to the administrative cost of public programs. There are two methods government uses to administer their health care programs – internally and externally.

Internal Method: This method uses government agencies at the federal, state, and local level to administer its programs. Governments use the internal method for all health care programs – Medicaid, CHIP, Veterans Administration, military, etc. – *except Medicare*.

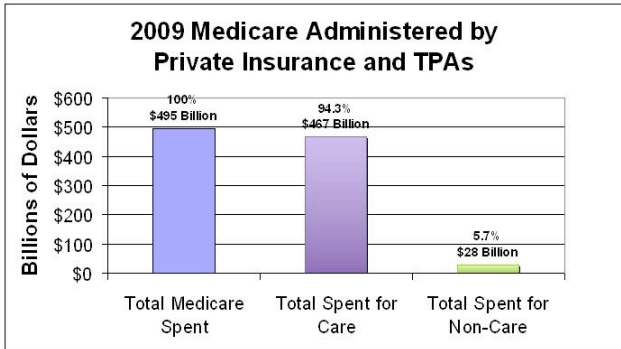
Table 3



CMS projects total spending for these *internally administered* programs in 2009 will be \$691 billion. Of that, \$511 billion will be paid to providers for personal health care. (Seventy-four cents of each dollar for these internally administered programs actually reaches providers.) The \$180 billion balance of government health care spending will go for non-care – administrative dollars. (Twenty-six cents of each dollar for these internally administered programs will be spent on non-care costs.) The administrative cost of these programs, CMS shows, is 26%. This 26% cost compares to 12.7% for privately paid health care (without adjustments for taxes and assessments). (Table 3)

Why, then, are insurance companies targeted for their “high” administrative cost? CMS data shows private insurance

Table 4



administrative cost is less than half of these government programs. Often cited, however, is the low cost of administering Medicare, but Medicare is not internally administered. It is externally administered.

External Method: This method uses *non-government* contractors. These contractors are private companies that compete with each other to process Medicare claims. Stated differently, there is no internal government agency that processes and pays Medicare claims. This work is completed by private contractors – insurance companies and third party administrators. Not one dollar of Medicare claims is paid by an internally administered government agency.

CMS projects Medicare spending for 2009 at \$495 billion. Of that, \$467 billion will be paid to providers for personal health care. The balance of \$28 billion is spent for non-care cost – administrative dollars. Of each Medicare dollar spent, 94.3% will reach health care providers; 5.7% will be spent for administration. (Table 4)

Medicare’s administrative cost is 78% less than that of other government health programs (5.7% compared to 26%). A key reason is that private companies externally administer Medicare, while other government programs are internally administered, by government agencies. The budgetary impact of this difference is astounding. If the government chose to administer Medicare internally, it would increase administrative cost by more than \$1 trillion during the next 10 years.

WHY MEDICARE’S ADMIN RATES APPEAR TO BE LOW

What is the answer as to why private companies incur only 5.7% administrative cost for Medicare while these same companies incur administrative cost of their own programs at 12.7%? There are at least six distinct reasons:

- ❑ Private insurance companies are saddled with government-imposed taxes and assessments. These vary from state to state – up to five percent of premiums. When mandatory taxes and assessments are factored out, the real net cost of private administration is less than 10%.
- ❑ CMS excludes the cost of their own employees who are directly and indirectly involved in Medicare adminis-

tration. These people enroll recipients, marketing, outreach and education, customer service, auditing, and any number of tasks. Private insurance companies include these costs as overhead, part of their 12.7% administrative cost.

- ❑ The average claim paid by Medicare is far greater than that paid for by private insurance plans. “For example, a \$10 administrative cost per insurance claim represents 10% of a \$100 claim but only 1% of a \$1,000 claim.”² If Medicare’s average claim is \$1,000, it only incurs one processing cost. If private claims average \$200, it would incur five processing costs for the same total expenditure. Therefore, Medicare administrative cost appears to be less, but it may be more.
- ❑ Insurance companies raise money through the collection of premiums. This is an administrative cost. The Federal government uses the IRS to collect Medicare premiums, and that cost is not allocated as a health care administrative expense, although it is very costly.
- ❑ Besides the IRS, the CBO shows at least seven other federal agencies, and many state agencies, are involved in the overall cost of administering government health programs. Their costs are not allocated against CMS’ administrative cost estimates.
- ❑ Medicare’s claims contractors are allowed to rubber-stamp claims without much scrutiny. Medicare’s bidding process rewards the lowest bidder. The companies that win

the bids lack the financial resources to save money for Medicare. Private insurance companies, in contrast, are very thorough in adjudicating their *own* claims, and this adds to their administrative cost: Overall, it saves them from paying ineligible, sometimes fraudulent claims. By spending three% more on adjudication

of claims, insurance companies might reduce overall spending by 10%. For certain, they would not continue doing this if it did not save them more money than it costs.

Though one has to dig for the truth, the CBO report makes the case: Competition in a private health insurance market saves tens of billions each year that government agencies would waste on administrative cost.

If the government chose to administer Medicare internally, it would increase administrative cost by more than \$1 trillion during the next 10 years.

¹ Staff. (December 2008). *Key issues in analyzing major health insurance proposals*. Congressional Budget Office. Washington, D.C. Table 1-4, p. 19.

² Staff. *Administrative costs of health care coverage*. American Medical Association. AJ:08-0368:5M:4/08 ta (5)

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