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Viewpoints: When patients become consumers, health care costs can be tamed

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As the nation frets about unaffordable health care costs and ponders which drastic remedies are called for, economists are reporting a surprising finding: Health care is becoming more affordable. The rate of growth in health care expenditures is slowing dramatically. It now is near historical lows, with only 3 percent annual growth between 2009 and 2011 compared with twice that rate in the previous decade. What is going on? And will it continue?

The most obvious explanation is that the economic slowdown is discouraging consumers from using health care services. Much of the reduction in health care inflation is due to job-related loss of insurance and the insecurities felt even by those who retain coverage. People are postponing doctor visits, prescription refills and elective surgeries. Utilization of health care, and the expenditures it entails, will rebound in the coming few years as the economy recovers and people regain insurance. This will be accelerated by the insurance expansions that begin next year due to the Affordable Care Act.

But what is causing the remaining part of the cost slowdown? One very significant change in the underlying economics of health care has been the growth of consumer cost-sharing requirements. Almost everyone now expects to pay part of the cost of the drugs he or she uses. Employers have been raising the deductibles that consumers must pay prior to receiving any benefit; one-third of individuals with job-related health insurance now face an annual deductible of at least $1,000.

When spending their own money, patients become consumers, shopping for what they perceive to be the best value for their money. Do the providers and producers of health services understand this? The pharmaceutical industry knows it only too well; years of expensive direct-to-consumer brand promotion prove impotent when non-advertised but cheaper generics enter the market.

Now it appears that hospitals are coming to understand that consumers care about prices.

Several years ago CalPERS, the largest purchaser of health insurance in California, introduced a new cost-sharing structure for PPO members needing knee or hip replacement surgery. Distress by the five-fold variation in what it was being charged for these procedures by hospitals across the state, CalPERS said: enough. It would pay up to $30,000 toward joint replacement, and enrollees would pay the rest.

The CalPERS contribution equaled or exceeded the prices charged by 41 hospitals, including market leaders such the medical centers at Stanford University and University of California, San Francisco,

but fell short of the prices charged by 76 others (some had been charging up to $120,000).

What happened? CalPERS enrollees did vote with their feet toward the lower-priced hospitals. Lower-priced facilities experienced a 21 percent greater volume of CalPERS patients for joint replacement surgery. But the bigger response was in the prices charged by the hospitals. More than half of the expensive hospitals reduced their prices, many by a substantial margin. The target was obvious. They wanted to be at or below $30,000, and they got there. Prices fell by an average of 20 percent across all hospitals and by 34 percent across the more expensive facilities. The state of California and other public employers using CalPERS saved almost $6 million in two years from these two procedures alone. Their employees saved another $600,000 in lower coinsurance payments.

This needs to be put into perspective. CalPERS is a big buyer, but does not account for a large portion of any one hospital's admissions. Most hospitals have merged into regionally dominant systems that encompass multiple inpatient facilities and ambulatory clinics. They are not afraid of insurance companies. They can negotiate high prices. But employers do not need to negotiate consumer cost-sharing requirements with hospitals. They can impose them unilaterally. And hospitals are afraid of consumers, once they starting shopping for value.

The defining characteristic of the health care industry has been that everyone is spending someone else's money. Hospitals have never had to consider the economic value of their services to their customers, defined as how much patients are willing to pay to use Facility A compared to Facility B.

This now is changing. Hospitals are beginning to look at what the payers are willing to pay, setting their prices accordingly, and then working to bring costs in line with revenues. Just like everywhere else in the economy.

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