



## McCain's Hidden Increase in Health Care Costs

Peter Harbage, May 2008

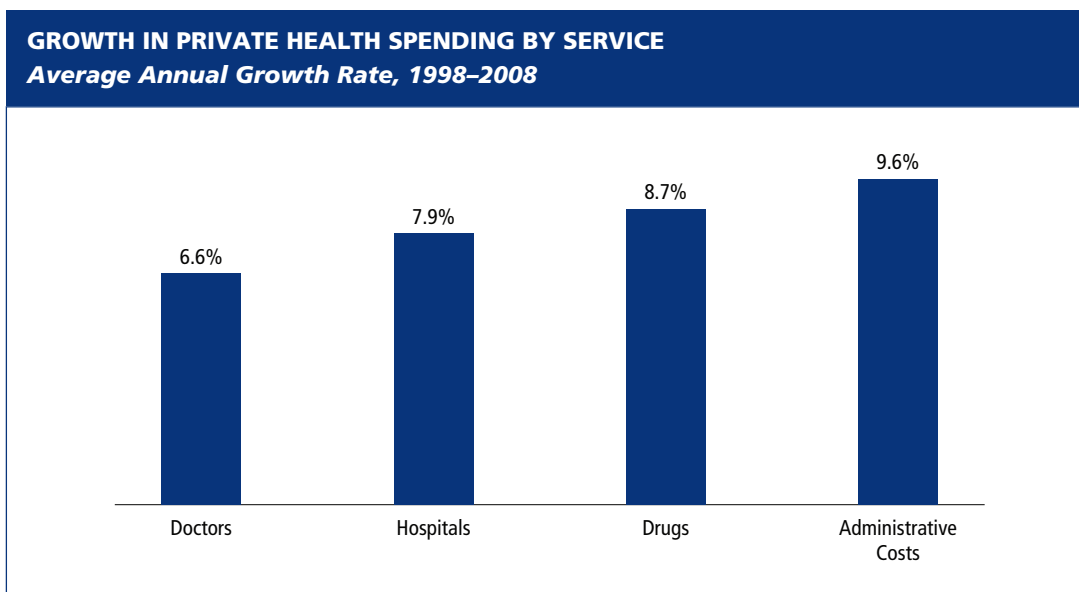
The high cost of health care is usually blamed on drug prices or new medical technology. To date, the three remaining presidential candidates have all promised to reduce health care costs with many similar goals, such as promoting the use of health information technology. However, a lesser-known reason for the rising expense of health care is the cost of running the complicated system. Billing, marketing, support staff salaries, and profits, known as administrative costs, are rising rapidly and now account for a disproportionately large portion of many Americans' health insurance premiums. In 2006, the last year for which data is available, administrative costs outgrew the increase in overall national health spending by 30 percent.<sup>1</sup> This year, it is projected that Americans will spend over \$2.3 trillion on health care, more than \$94 billion of which goes to private insurance administrative costs.<sup>2</sup>

Despite Sen. John McCain's stated support for cost control, his plan would greatly—and unnecessarily—increase the administrative costs of health care. In a speech on April 28, 2008, Sen. McCain (R-AZ) stated that, "Insurance companies should spend more on medical care and less on administration."<sup>3</sup> Yet McCain's plan focuses on expanding the individual health insurance market, where the administrative burdens are significantly higher than in the group market. In fact, shifting coverage from the group coverage market to the individual insurance market could generate as much as \$20 billion in new administrative costs—which represents an increase of more than 20 percent in 2007 dollars.

### The High Administrative Cost of the Individual Market

Most Americans obtain their insurance through the "group market" where employers either self-insure or purchase insurance from insurers. This system is more efficient than the individual market because it leverages economies of scale and allows for risk to be shared across large groups. There are many reasons why the individual market has higher administrative costs, most of which are tied to the insurer's efforts to attract the lowest risk individuals and ensure that their costs are kept low:

- **Marketing.** Insurers in the group market have a relatively limited number of customers: employers' human resources departments. The individual market requires much more hands-on marketing to a wider audience. Under the McCain plan, marketing is likely to be much more aggressive and costly as the individual market expands.
- **Underwriting.** In the group market, risk is spread across large groups, which makes an individual's health status less important in the market. In the individual market in most states, insurance companies evaluate each applicant's health status in order to price the health policy. This research is expensive and must be done by medical providers.



Source: CMS National Health Expenditures.

- **Rescission.** Individual policy holders continue to be subject to medical review once they hold a policy. Insurers typically look for evidence of pre-existing conditions in order to disallow coverage retroactively for patients with high costs. These insurance companies spend significant resources to review policy-holder files, and they can spend even more in legal fees to deny policy holders the care they need.
- **Paperwork for individuals.** Paperwork and recordkeeping can be aggregated in the group market. Yet in the individual market, paperwork and recordkeeping are significantly higher because each policy holder must be independently tracked. McCain’s Health Savings Account plans further raise the amount of paperwork and recordkeeping needed because individual out-of-pocket spending must be tracked as well. These individual accounts typically come with hefty individual administration fees from banks and insurers.

The Congressional Budget Office estimates that, on average, 29 percent of premium dollars in the individual insurance market go toward administrative costs.<sup>4</sup> This is more than double the average amount in the group market, where roughly 12 percent of employer-sponsored insurance premium dollars are spent on administrative costs.<sup>5</sup>

## The McCain Plan Promotes the Individual Market

The McCain health care plan seeks to not only increase enrollment in the individual market, but decrease enrollment in the group market.<sup>6</sup> McCain’s plan proposes to “reform the tax code to eliminate the bias toward employer-sponsored health insurance.” Under current law, workers do not pay taxes on health care premiums paid by their employers. As a result, the tax code contains an incentive for employers to offer health insurance, promoting the group market. Eliminating this incentive could cause many employers to drop their coverage, thereby causing significant coverage disruption for individuals who would be forced to seek insurance on the individual market.

## Potential Increase in Administrative Costs

Administrative costs are already the fastest growing part of the health care system. McCain's plan would greatly expand the individual market—where administrative costs are the highest.<sup>7</sup> If McCain's effort is only 20 percent successful,<sup>8</sup> meaning that one out of five people insured today through employers were to switch to the individual market, administrative costs alone would increase by more than \$4 billion per year in 2007 dollars.

If McCain's plan is completely successful in his effort and all people with employer coverage were shifted to individual health insurance, his plan could increase administrative costs by more than \$20 billion per year. To put this into perspective, the potential new insurance administrative costs could exceed the cost of the State Children's Health Insurance Program, the U.S. funding for global health, and McCain's proposed high-risk pool. Based on estimates from the Lewin Group, there is reason to believe that this analysis is conservative in the findings.<sup>9</sup>

McCain could take steps to mitigate this. For example, the bipartisan plan promoted by Senators Ron Wyden (D-OR) and Bob Bennett (R-UT) eliminates underwriting, limits marketing costs by standardizing plan information, and ensures all Americans are insured—cutting back on insurers' ability to profit by avoiding sick people. The bipartisan Massachusetts health plan uses a “connector” to ensure consumer protections and low insurer overhead costs. Yet McCain opposes such government intervention in the health market, calling it “mandating what the free market does.” Simply put, McCain's plan will create new and burdensome administrative costs.

## Methodology

To calculate the new administrative spending under the McCain health plan, the Center for American Progress relied on a multi-step calculation.

### ***Average Administrative Cost of a Policy in the Group Market: \$943***

According to the Kaiser/Health Research and Educational Trust 2007 Employer Benefits Survey, the average premium in 2007 for single beneficiaries was \$4,479, and the average family premium was \$12,106.<sup>10</sup> To determine administrative spending, we assume that an average of 12 percent of premium dollars are used for administrative costs (see footnotes). This results in an administrative cost for single plans in the group market of \$537 and family plans of \$1,453. Using national enrollment by insurance and family type,<sup>11</sup> we calculated the number of policies that exist nationally and then calculated that the weighted average of administrative costs in employer sponsored insurance is \$943.

### ***Average Administrative Cost of a Policy in the Individual Market: \$1,202***

According to the Association of Health Insurance Plans, the non-group premiums for single-beneficiary and family coverage in 2006-2007 were \$2,613 and \$5,799, respectively.<sup>12</sup> Despite the lower total premium costs, policy holders in the individual market actually pay more in administrative costs. To determine administrative spending on the individual

market, we assume an average of 29 percent of premium dollars are used for administrative costs.<sup>13</sup> This results in an administrative cost for single plans in the group market of \$758 and family plans of \$1,682. Using national enrollment by insurance and family type,<sup>14</sup> we calculated the number of policies that exist nationally and then calculated that the weighted average of administrative costs in employer sponsored insurance is \$1,202. Because the most recent data from America's Health Insurance Plans was from 2006-2007, this figure was also adjusted to reflect a 3 percent increase in health care costs.

### ***New Administrative Cost Under McCain Plan: \$4 to \$21 Billion***

In 2007, the administrative costs of insurance premiums in the individual market were an estimated \$259 more than premiums in the employer-based market. If every one of the 158 million individuals currently covered under employer-sponsored insurance had to pay the individual market's additional annual administrative cost, health expenditures in the United States would increase by more than \$21 billion. If Sen. McCain is only 20 percent successful in his effort to move people from the employer market to the individual market, the new administrative cost to the system would be more than \$4 billion.

## **Endnotes**

Note: Jeanne Lambrew contributed to the analysis.

- 1 Centers for Medicare and Medicaid Services, "National Health Expenditures by type of service and source of funds, CY 1960-2006," downloaded April 19, 2008. <http://www.cms.hhs.gov/NationalHealthExpendData/downloads/nhe2006.zip>.
- 2 Centers for Medicare and Medicaid Services, National Health Expenditure Data, Amounts by Type of Expenditure and Source of Funds: Calendar Years 1965-2017. [http://www.cms.hhs.gov/NationalHealthExpendData/03\\_NationalHealthAccountsProjected.asp#TopOfPage](http://www.cms.hhs.gov/NationalHealthExpendData/03_NationalHealthAccountsProjected.asp#TopOfPage)
- 3 John McCain for President, "Remarks By John McCain on Day One of the 'Call to Action' Tour," April 28, 2008. <http://www.johnmccain.com/Informing/News/Speeches/5e30a29e-6e89-4cb2-9035-aacd094fbd86.htm>
- 4 Congressional Budget Office, *CBO's Health Insurance Simulation Model* (Washington, DC: CBO, October 2007).
- 5 CBO estimates that administrative costs range from 9 percent for firms with > 100 workers to 27 percent for two-employee businesses. Using 2006 Census data on the distribution of covered workers by firm size and assuming firms with less than 100 have administrative costs at the midpoint of the CBO range, the average for administrative costs for employer-based coverage is 12 percent.
- 6 Kaiser08.org, 2008 Presidential Candidate Health Care Proposals: Side-by-Side, Downloaded April 18, 2008. <http://www.health08.org/sidebyside.cfm>
- 7 John McCain for President, "Straight Talk on Health System Reform," downloaded May 2, 2008. <http://www.johnmccain.com/Informing/Issues/19ba2f1c-c03f-4ac2-8cd5-5cf2edb527cf.htm>
- 8 CBO had estimated that President Bush's plan to implement a tax deduction for health insurance would only increase enrollment in the individual market by less than 10 percent. However, McCain will use a tax credit, which will make the assistance more widely available, and he would allow insurance products to be sold across state lines, thereby making insurance more available even if it is less effective.
- 9 When the Lewin Group evaluated President Bush's tax deduction proposal, which is very similar to Senator McCain's proposal, they found new administrative costs of \$6.4 billion associated with that plan, which only involved shifting 10 million persons from employer-sponsored plans to the individual market. In the 20 percent scenario under this analysis, roughly 30 million people are shifted from ESI to employer-sponsored insurance at a total administrative cost of \$4 billion.
- 10 Kaiser Family Foundation and the Health Research and Educational Trust, "2007 Employer Health Benefits Survey," September 11, 2007. <http://www.kff.org/insurance/7672/index.cfm>.
- 11 Paul Fronstin, "Sources of Health Insurance and Characteristics of the Uninsured," EBRI Issue Brief, October 2007. [http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_10-20073.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_10-20073.pdf)
- 12 AHIP Center for Policy and Research, "Individual Health Insurance 2006-2007: A Comprehensive Survey of Premiums, Availability, and Benefits." (Washington, DC: America's Health Insurance Plans, December 2007).
- 13 Congressional Budget Office, *CBO's Health Insurance Simulation Model*.
- 14 Fronstin, "Sources of Health Insurance and Characteristics of the Uninsured."