

The Future of Health Care Financing

In most sectors of the U.S. economy, consumers control their dollars. What if that were to happen in health care?

Brandi White

In the beginning, health care financing was relatively uncomplicated. Individuals either paid for their health care in cash or they bartered for services — or they went without. It was a simple though not perfect system for simple times, and as far as historians can tell, it lasted from the beginning of man to the early 20th century, when medicine became sophisticated enough to affect clinical outcomes consistently.¹

During World War II, health care financing as we know it began to surface more rapidly when wage and price controls pushed employers into offering health insurance to attract workers.² In 1930, only 2 percent of the U.S. labor force (or 1.2 million workers and their 2 million dependents) had any health insurance. By 1958, 123 million Americans had hospital insurance, and 75 percent obtained it through their employers.³ By the 1960s, employer-based major health care coverage had become commonplace, and in 1965 Medicare was born.

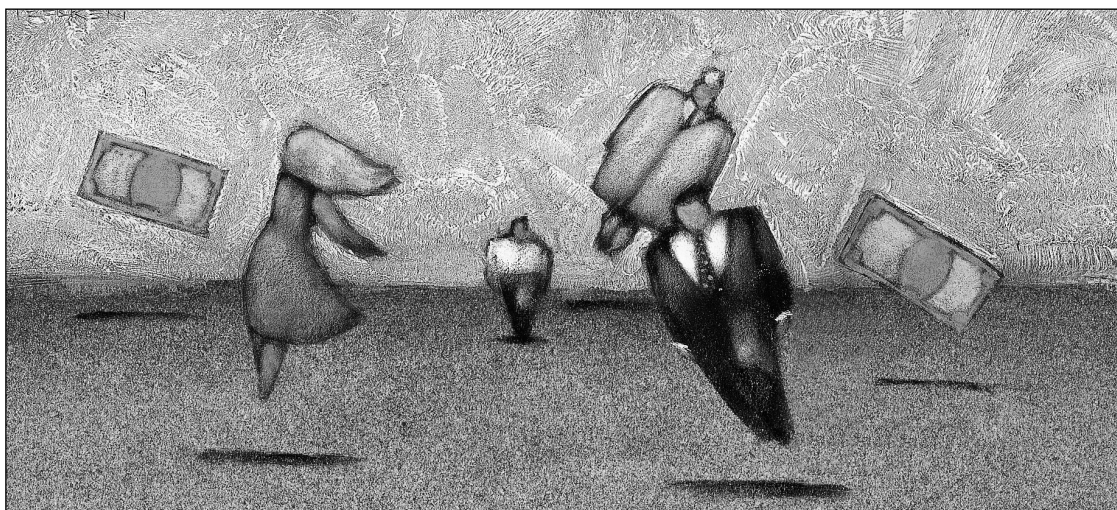
Over the next two decades, health care costs rose substantially, the increase blamed in part on a fee-for-service system that offered little incentive to manage costs and every incentive to overutilize. Looking for new solu-

KEY POINTS:

- The consumer economy, which many predict is coming to health care, will be led in part by Baby Boomers and Generation Xers who have money, are empowered by the Internet and want greater choice.
- Employers looking for new ways to reduce the administrative costs and headaches associated with managing health care benefits are eyeing “defined contribution” health plans.
- New e-health plans based on the defined contribution approach could create a financing system that finally rewards physicians who offer high-quality care and service.

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◀ Health care financing as it is known today has existed only since the mid-1900s.

◀ Rising costs and growing dissatisfaction with managed care are encouraging many to look for new models of health care financing.

➤ One alternative is a consumer-driven health care marketplace.

➤ In other industries, businesses compete for consumers' dollars by offering better quality, service, price, etc.

tions, the health care system began to embrace managed care and the HMO, a term first coined in 1970.

Since that time, managed care has proliferated, and while it has shown some success at stabilizing costs, it has had at least as many failures as successes. As patients and physicians have expressed their dissatisfaction, managed care has had to take a less managed approach. Meanwhile, costs continue to grow, with health care now exceeding 14 percent of the gross national product and growing.⁴

So where does this leave the health care financing system at the start of the 21st century? While many might argue that the United States should move toward a government-financed system or perhaps some improved version of the status quo, another theory is gaining momentum: a consumer-driven health care marketplace.

Forces at work

At some point during the past five years, many physicians may have noticed that their patients became "consumers." In some ways the change is simply semantic, but it also represents a shift in the larger economy. In other industries, con-

sumers rule. Businesses compete for their dollars by offering better quality, service, price, etc. But in health care, consumers have little or no control over their health care dollars and little or no choice among benefits and providers. In

'These folks will change the system whether it wants to change or not.'

turn, doctors who provide excellent care and service are generally reimbursed at the same rate as all others, making for a health care economy with all the wrong incentives. (See the previous articles in this series, listed below, as well as "The Emergence of Consumer-Driven Health Care," *FPM*, January 2000, page 46.)

Baby Boomers and Generation Xers are the most likely players to help usher in a new health care financing system. "They are not tolerant of paternalistic systems and will demand more involvement and decision making," says Charles M. Kilo, MD, a fellow of the Institute for Healthcare Improvement and president of Greenfield Health System, Portland, Ore. "We have only seen glimpses of this so far because most of them are healthy, but they are aging, and as they do, look out health care. These folks have money, they are more connected, they are great shoppers, and they will change the system whether it wants to change or not."

The flame of consumerism is also being fanned by the Internet, which has enabled individuals to access more and more personalized information faster than ever before. Consumers can do their banking, shopping and investing online 24 hours a day and will begin to expect the same level of information and service from health care.

"This is a movement that transcends health care," says Dave Sanders, MD, a family physician and CEO and president of MyHealthBank, an "e-health plan" based in Portland, Ore. "We're in a very advanced consumer society today, where individuals are in control of things they weren't previously in control of. Health care is just part of that overall trend toward consumerism. So whether it's one tactic or the other, the consumer is moving toward the center of the health care economy."

Series overview

This is the final article in a three-part series exploring how quality and service can pay in medical practice.

Part 1 discussed the current health care financing environment and the difficulty practices have in getting paid for quality care and exceptional customer service. The article focused on internal changes practices can make to improve quality and service while improving financial performance simultaneously. [See "Making Quality and Service Pay: Part 1, The Internal Environment," *FPM*, October 2000, page 48.]

Part 2 focused on the external environment and how practices can work with insurance plans and other financial intermediaries (e.g., health plans and IPAs) to create financial incentives for improved quality and service. [See "Making Quality and Service Pay: Part 2, The External Environment," *FPM*, November/December 2000, page 25.]

This article, part 3, explores emerging innovations in the financing system that could benefit physicians and patients alike.

Can patients handle this new responsibility?

A consumer-driven health care financing system depends on one basic idea: Individuals are the best stewards of their own health care dollars. This is a far cry from the current system, which “does not allow anyone to be a good steward,” says Charles M. Kilo, MD, a fellow of the Institute for Healthcare Improvement and president of Greenfield Health System, Portland, Ore. “The system is just not currently set up to do so. It continues to be relatively paternalistic, and with significant first-dollar coverage, there is no motivation for people to be all that engaged. They always want the latest and greatest test or drug, whether they need it or not, because they feel that they are entitled.”

The very limited literature on this subject suggests that individuals do consume less when they are given more financial responsibility.¹ “However it appears that they consume less of what is good and less of what is bad. In other words, they don’t discriminate,” says Kilo.

To discriminate appropriately, consumers will need not only financial responsibility but also incentives, information and tools, which defined contribution plans, accrual medical savings accounts and the Internet are now providing.

“I believe we should assume that people are the best stewards of their care, provide engaging assists to help them be so, but also have detailed means of identifying and supporting those who are not,” says Kilo. “Such a system is, in my opinion, much more positive and much more engaging for everyone than the current system, which assumes that no one is a good steward and does not have mechanisms that allow them to be.”

1. Rice T. *The Economics of Health Reconsidered*. Chicago: Health Administration Press; 1998.

Consumer-driven health care is getting its push not only from technology but also from those who are looking for new ways to control costs and who believe individuals are better stewards of their own health care dollars. (See “Can patients handle this new responsibility?” above.) This approach differs greatly from the current system, in which patients have no incentives and no opportunities to be prudent purchasers.

“Patients have been totally removed from the cost of care,” says Lee Newcomer, MD, executive vice president and chief medical officer of Vivius, an e-health plan based in Minneapolis, and former senior vice president of health policy for UnitedHealth Group. “As a result, we’re now in a mentality where we think if we put \$10 and an insurance card down, we should have anything we want, regardless of whether it makes sense, and that’s causing a problem.”

Defined contribution plans

Ironically, what may ultimately bring about a consumer-centric health care financing system won’t be consumers themselves. Instead,

employers looking to reduce the administrative costs and headaches associated with managing health care benefits may decide to hand over the responsibility to individuals to manage themselves. One way to do that is with a “defined contribution” approach.

Under a defined contribution model, employers would commit to a fixed dollar amount employees could use to pay for health care coverage they select, rather than the current practice of committing to a fixed health benefits package with pre-selected networks for all employees. A similar shift occurred in the 1980s on the retirement benefits front when employers began moving away from “defined benefit” (or pension) plans toward “defined contribution” (or savings) plans.

“Most health plans today are more like defined benefit plans, so it’s kind of an open-ended commitment and obligation for employers, and they would like to be able to change that,” explains Ray Werntz, president of the Consumer Health Education Council. “A defined benefit approach also puts employers in the position of trying to decide which benefits to provide populations of employees based on medical necessity. Now that doesn’t necessarily mean they’re going to pay less or

‘We think if we put \$10 and an insurance card down, we should have anything we want.’

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◀ In health care, consumers have little or no control over their health care dollars and little or no choice among benefits and providers.

◀ Baby Boomers and Generation Xers, who have money and are smart shoppers, could help usher in a consumer-centered financing system.

◀ The Internet can help empower health care consumers by giving them access to information and decision-making tools.

◀ A consumer-driven system depends on patients being good stewards of their health care dollars.

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◀ **Defined contribution health plans are piquing the interests of employers looking to reduce the burdens associated with managing health care benefits.**

► **Under a defined contribution model, employees would be able to make their own health care coverage decisions.**

► **One firm estimates that defined contribution plans will emerge rapidly in the next three to five years and will be the norm within 10 years.**

► **To facilitate a consumer-driven system, a number of alternative health care financing companies have begun to emerge.**

leave their employees hanging out to dry. They just want to have some control over their costs and distance themselves from concerns about liability.”

A defined contribution plan could take several forms. On the more conservative side, employees would simply use the defined contribution to choose among several health plans pre-selected by their employer. Or, on the more radical side, employees could take their defined contribution and head to the open market to purchase their own health insurance or care directly from providers. “While there are some vendors of defined contribution plan services in the market, I don’t know of any employer who does that yet,” says Werntz. While there may be a defined contribution mindset developing, there is “not yet a willingness on the part of employers to pull away,” he says.

Until a mature defined contribution model can emerge, says Werntz, several issues must be resolved. For example, “How do you decide how much money to give everyone?” questions Werntz. “Do you give someone who’s young less money than someone who’s

old?” He also raises caution regarding how employers put the defined contribution money into the hands of the individual. For example, if employers were to give individuals their health care dollars directly, it would raise tax issues as well as concerns that some individuals will not use the money to purchase health insurance at all. The best approach, many argue, is to give employees health care vouchers or to deposit the money earmarked for health care directly into employees’ medical savings accounts, which the employees would then be responsible for managing.

Another consideration is how defined contribution plans will affect the uninsured. Some argue that defined contribution plans would exacerbate the problem by making coverage more expensive for the elderly and those with chronic illnesses. Others say it could reduce the number of working uninsured if employers’ contributions can provide at least basic coverage without the employee contributing out of pocket. Additionally, if defined contribution plans create tax advantages that would encourage individuals without employer coverage to participate in

‘Over the next 10 years, employer-sponsored health plans will evolve en masse into defined-contribution formats.’

What does it mean for doctors?

A consumer-driven health care financing system not only promises to benefit patients but could benefit physicians as well.

The doctor-patient relationship. Perhaps most notable is the potential for returning doctors and patients to the same side in health care. For many doctors and patients, managed care has caused a rift in the relationship because of the perception that an insurance company stands between them. In contrast, these new e-health plans boast that they will re-couple doctors and patients by expanding patient choice, increasing physician freedom in medical treatment and, in some cases, establishing direct-contracting arrangements.

Quality and service. A second potential benefit is the creation of a marketplace that finally compensates physicians and other providers for their excellent performance.

“Today, no one is doing that very well, but defined contribution models will open up the possibilities of choosing physicians and hospitals based on their reputation, their performance and their service,” says Lee Newcomer, MD, executive vice president and chief medical officer of Vivius, an e-health venture based in Minneapolis.

In nearly all of these new e-health plans, patients use quality data provided by the physicians themselves, by fellow patients and by outside sources to decide where to spend their health care dollars. And under the Vivius model, physicians will actually be able to set their prices, based on the value they bring to the marketplace.

The hassle factor. Many of the new e-health plans have simplified administrative tasks and offer direct reimbursement, which can help physicians save more and make more. In fact Vivius, because it is essentially

similar programs (such as medical savings accounts), the number of uninsured could decrease.

What's clear, however, is that defined contribution health plans are piquing the interests of employers nationwide. In a survey of employers identified by *Fortune* magazine as some of the country's best companies to work for, the firm of Booz Allen & Hamilton found that "all but a few of the largest, most paternalistic respondents" anticipate a shift to defined contribution plans.⁵ "Over the next 10 years, employer-sponsored health plans will evolve en masse into defined-contribution formats, finally and irrevocably creating a consumer-driven health care system in the United States," says Gary D. Ahlquist, a senior vice president and managing partner of the firm's Health and Insurance group.

Ahlquist and his colleagues describe defined contribution health plans not as a trend but a breaking wave that will emerge rapidly as costs become more of an issue for employers. "Exactly when these forces will meet and propel us forward is impossible to say, but it's a risky gamble to bet that it is more than three to five years away," he says.

An emerging alternative

With so many dynamic forces swirling in the market (including consumerism, the Internet,

defined contribution plans and continued efforts to control costs), a number of alternative health care financing companies have begun to emerge. Although their tactics vary, what they share is a reliance on the Internet and a belief that individuals should control their health care dollars. Among the many start-ups are Definity (www.definityhealth.com), HealthSync.com, Healthmarket.com, MyHealthBank.com, Sageo.com and Vivius.com.

One of the most progressive of these companies is Minneapolis-based Vivius, which is creating a direct contracting arrangement between physicians and patients. The model is currently being pilot tested in Kansas City, Mo., and Minneapolis, with plans to enter more cities in 2001. "Think of us like a supermarket," explains Newcomer. "We have 22 aisles in our supermarket, and we're going to ask you, the patient, to go in there and make a choice from each and every aisle. When you get done you're going to have your own health plan tailored to you and you only."

In the Vivius model, each "aisle" represents either a specialty or a facility (e.g., primary care, orthopedics, cardiology, hospitals, pharmacy). Patients can either pick from the shelves themselves or can begin with one doctor they trust and build on that doctor's recommendations. Providers are allowed to set their monthly fees, and upon checkout the

direct contracting, has no pre-certification, no claims submission and no utilization review.

Better patients. A consumer-driven system also makes for better patients, argues Ray Werntz, president of the Consumer Health Education Council. When patients have financial control over their health care dollars, it affects the way they approach the clinical setting. They are more engaged, more informed, more interested in their options and less wasteful of resources because they understand "there are choices and there are consequences of those choices," says Werntz. "It's not a bad thing to have a savvy patient because then you really have two people working together to solve a problem."

The challenge. In addition to having benefits, consumerism also definitely has its challenges. "Consumers are demanding, as

they ought to be, and they're very selective and discriminating," says Dave Sanders, MD, CEO and president of MyHealthBank, an e-health venture based in Portland, Ore.

To thrive in a consumer-driven environment, physicians will have to respond to patient needs and demonstrate their value, in terms of quality, service and cost. "I think physicians will rise to the occasion when challenged by the consumer, unlike the challenges before by, say, a vehement payer," says Sanders. "The challenges consumers will bring are healthy ones for all of us."

The bottom line for FPs. A health care financing system that encourages patients to shop around for quality, service and price could be good news for family physicians in particular. Family physicians who offer high-quality services but charge less than their specialist colleagues will have a definite advantage in the consumer marketplace.

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◀ Vivius enables physicians and patients to contract directly, meaning physicians can set their own fees.

◀ MyHealthBank enables patients to select coverage based on their individual risk tolerance and to use cash for routine care.

◀ By re-focusing attention on the individual, these new companies promise to restore the doctor-patient relationship.

◀ The challenge of a consumer-driven system is that consumers are demanding.

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◀ Physicians who provide high-quality care and service will be able to charge more in a consumer-driven system.

► While traditional HMOs aren't under immediate threat of extinction, e-health plans are optimistic that they can capture a sizable share of the market.

► The health care system is changing once again, but this time physicians can feel more optimistic about the prospects.

► Ultimately, what the health care system needs is a model that encourages real partnering among physicians and patients.

consumer knows exactly how much he or she will have to pay each month to receive care from the 22 selected providers. Any additional services that are needed are covered by a traditional indemnity plan, a required purchase.

MyHealthBank, based in Portland, Ore., officially launched its defined contribution approach in October 2000 when it contracted with two Eugene, Ore., employers, representing more than 300 employees and dependents. Like other models, it funds coverage with an employer contribution to the employee's health care account. From there, an employee elects a level of coverage best suited to his or her tolerance for risk and desired benefit options. For example, a woman in her 50s might choose "gold" level coverage, spending all of her employer's contribution plus some of her own money, while a young male might opt for "bronze" level coverage, leaving money in his account to pay for health care services not covered by his insurance.

What makes this model so attractive, says Sanders, is that it lets the individual "use the insurance for things that are best covered by insurance — procedures, hospital coverage, and those sorts of needs — and it lets the individual use cash to buy primary, routine, discretionary care directly from providers and suppliers. It's a very simple approach, very feasible and very attractive to employers."

MyHealthBank considers its approach a safe but important first step. "Unless you get the dollars, we believe, in the hands of the consumer, there is no other reasonable control vehicle available today," says Sanders. He believes that ultimately a marketplace will evolve in which providers and consumers interact in a direct one-to-one economic relationship.

How will it all shake out?

Clearly the market is searching for new solutions. Many of the emerging e-health plans have secured partners such as Merrill Lynch, Chase Capital Partners, Hewitt Associates, PricewaterhouseCoopers and even the Mayo Clinic. If their hunches are right, we may now be witnessing the emergence of the next wave of health care financing.

'In the long run, what we really want are doctors and patients working together to solve problems. All of us want that.'

"Traditional HMOs aren't going to go away. I think it would be naive to say that they will. But it's a real big market out there," says Newcomer. "There are hundreds of millions of people who need insurance, and a certain segment of them are getting tired of HMOs and will probably leave. That's where you're going to see these new companies taking hold. If one of them really becomes popular, they may in fact some day replace HMOs, but that isn't going to happen in the next three to five years."

The financing paradigm does seem to be shifting, however, bringing new challenges but also opportunities to physicians and patients alike. "My sense is that physicians are going through a period of great change. Probably a year and a half ago, a lot of them were quite burnt out and had gone through the collapse of local IPAs, big major physician practice management companies had collapsed, and so on," says Sanders. "But I think we're seeing right now a great resurgence of energy and excitement on the part of physicians to look toward the future."

Although the financing system of the future remains unknown, there are reasons to be optimistic. "In the long run, what we really want are doctors and patients working together to solve problems. All of us want that," says Werntz. "I think a lot of the hostility patients have toward managed care is this feeling that they've lost control. If we can find a way to couple a more open, patient-driven approach with real patient-physician partnering, I think we'll solve a lot of the problems we're trying to solve. And I think everyone will be happier with that kind of a system." **FPM**

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