

Healthcare Spending and the Affordable Care Act

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The media have recently reported a decline in American health-care spending.

Over the last three years, the growth rate in national health expenditures has flattened to about 3.9% – a significant reduction from the 6.2% – 9.7% rate of the preceding decade. And on June 18th the U.S. Department of Labor released its medical care price index for May 2013. The index, which measures personal spending on medical appointments, hospitalizations, insurance and supplies, was down 0.1% for the month, largely due to a 0.6% reduction in prescription-drug outlays.

Several studies attempt to explain the changes.

- Prescription prices are now slightly lower due to patent expirations and cheaper generics coming into the market.
- The still-shaky U.S. economy is a contributor, as financially stressed families postpone non-essential procedures and shift to lower-cost health plans. This argument is supported by a Kaiser Family Foundation and Altarum Institute finding that 77% of declining health spending is the result of economic conditions.
- Employers have for some time been shifting more health-care costs to their workers. Because they are now paying a greater share out of their own pockets, the workers are incited to shop for more affordable options, thereby pressuring health care providers to lower their costs.
- The Affordable Care Act is responsible for the health spending slowdown. In its 2013 report to Congress, the President's Council of Economic Advisers argued that the economy explains 18% of recent health cost reductions, and the balance is driven largely by the Act.

Lower prescription drug prices reflect pharmaceutical market conditions, and are likely short-lived. And if the past is any indicator, the improving economy will foster consumers' return to their prior spending patterns. Employer cost shifting will be eliminated under the Affordable Care Act. But the Act's role in health cost reductions is an open question.

By some estimates, provisions of the Affordable Care Act could

result in significant cost reductions. Melinda Beeuwkes Buntin and David Cutler have projected a 1.5-percentage-point reduction in annual cost increases from the Act's health care reforms – more than \$700 billion over ten years. The savings would arise from provider expense reductions through the use of electronic medical records; fewer recurring illnesses through better coordination of care; and improved care management through bundled payments, incentives for higher quality, and shared cost savings. This seems optimistic.

When Michael Chernew, et al., looked into the recent slowdown in health care spending, they concluded that it resulted from greater competition and broader consumer choice. Looking at large firm insurance plans over the period 2008-2011, the Chernew study found that the firms' workers bore more of their health care costs as a result of higher deductibles, co-pays, and changed plan provisions. According to the authors, this increased responsibility for health spending accounted for "approximately 20% of the observed slowdown" in spending.

Despite provider quality incentives and electronic medical records, the impact of the Affordable Care Act on U.S. health spending will be determined largely by the extent to which the recipients of health care services are financially responsible for them. Because today's health care consumers are largely insulated from the cost of the services they receive, health care today is viewed as a pure public good: non-excludable, non-rivalrous, subject to free-riding and consumption well beyond what is medically necessary and economically efficient.

Holman Jenkins, writing in the June 18 *Wall Street Journal*, reminds his readers of Justice Alito's example in last year's Supreme Court debate on the Affordable Care Act: Healthy young adults are spending about \$850 out-of-pocket each year on health care. If the Act requires that they buy insurance costing \$5,800, these young adults are subsidizing – to the tune of nearly 7 times their current health spending – services that will be received by others.

Alito was obviously concerned about the implications of this wealth transfer. Yet the greater issue is cost containment: The transfers in the Affordable Care Act codify in law the separation of Americans' healthcare spending from the healthcare services they receive. It is difficult to imagine that the costs this generates will be outweighed by the savings provisions of the Act.

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