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Causes of Wasteful Spending in the U.S. Healthcare System

The first article of this three-part Health Capital Topics series on the decreasing marginal utility in healthcare, discussed the exponential increase of U.S. healthcare expenditures in recent years, which has not necessarily resulted in better health outcomes for the U.S. population. Healthcare costs accounted for over 17% of the U.S. g*ross domestic product (GDP)* in 2011, and continues to grow at much higher rates than other comparable industrialized nations,[1] indicating that the U.S. may not be receiving sufficient "*value per dollar*" spent on the population's healthcare. One approach to increasing the "*value per dollar*" spent on healthcare is to reduce wasteful spending in the healthcare system. Reducing this wasteful spending necessitates the identification of the various types of waste in the U.S. healthcare system. The second installment of this three-part series will examine the different sources of waste that have allowed such inefficient and unsustainable healthcare spending to thrive in the U.S. despite the declining yield on investment.

In the context of healthcare spending, *waste* is defined as spending that could be eliminated without harming consumers or reducing the quality of care.[2] A 2013 study by the *Institute of Medicine* estimated that approximately 30% of healthcare spending, or roughly $750 billion, was squandered on unnecessary or poorly delivered services, excessive administrative costs, fraudulent claims, and other needless costs in 2009.[3] An April 2012 study published in the *Journal of the American Medical Association (JAMA)* estimated that six categories of wasteful spending (described below) annually consumed between $558 billion and $1.26 trillion, amounting to approximately 21% to 47% of total healthcare expenditures in the U.S.[4]

Failures of Care Delivery

The April 2012 JAMA study categorized the first type healthcare waste as *failures of care delivery.* This type of waste can be attributed to poor execution of effective preventive care and patient safety practices resulting in worse clinical outcomes and higher costs, such as *preventable adverse events*, which is defined as injuries to a patient caused by the medical intervention (rather than the underlying medical condition).[5] A *U.S. Department of Health and Human Services (HHS)* report estimated that these *preventable adverse events* led to roughly $4.4 billion in additional Medicare spending in 2009.[6] Overall, the April 2012 JAMA study estimated that waste resulting from *failures of care delivery* consumed between $102 and $154 billion in 2011.[7]

Failures of Care Coordination

Failures of care coordination account for the second category of waste,[8] which results from fragmented care due to a lack of communication and coordination between providers, and may lead to unnecessary hospital readmissions and preventable health complications.[9] A 2013 JAMA study on readmission rates of common hospital conditions found that from 2007 to 2009, the 30-day readmission rate was: (1) 24.8% after hospitalizations for heart failure; (2) 19.9% after hospitalizations for acute myocardial infarction; and, (3) 18.3% after hospitalizations for pneumonia.[10] Overall, the April 2012 JAMA study estimated that the waste resulting from *failures of care coordination* accounted for approximately $25 billion to $45 billion in 2011.[11]

Overtreatment

A third category of waste is attributed to *overtreatment*, which occurs when patients are subjected to medical services at a higher volume or cost than necessary.[12] One significant source of overtreatment is the practice of *defensive medicine*, when healthcare providers order unnecessary tests or services to protect themselves against malpractice liability.[13] In 2011, waste due to *overtreatment* was estimated by the April 2012 JAMA study to represent between $158 billion and $226 billion of wasteful healthcare spending.[14]

Administrative Complexity

Administrative complexity, a fourth category of waste, results from the inefficient and overly bureaucratic procedures of public and private health insurers, as well as accreditation agencies.[15] For example, physicians spend an average of approximately three hours per week interacting with health plans rather than on patient care.[16] When the amount of time devoted to such interactions by nursing and clerical staffs was included, the total time spent interacting with health insurers cost physician practices approximately $23 billion to $31 billion annually.[17] Overall, the April 2012 JAMA study estimated that waste due to *administrative complexity* accounted for approximately $107 billion to $389 billion in 2011.[18]

(Continued on next page)

Pricing Failures

A fifth category of wasteful healthcare spending may be attributed to *pricing failures*, which occurs when prices for healthcare services grossly deviate from those in well-functioning markets.[19] For example, the 30 most commonly prescribed drugs in the U.S. are 33% more expensive than those same drugs in Canada and Germany, and more than double the prices of those sold in Australia, France, and the United Kingdom.[20] Additionally, U.S. primary care physicians receive higher fees for office visits, and orthopedic physicians receive higher fees for hip replacements, than in Australia, Canada, France, Germany and the United Kingdom.[21] Overall, the 2012 JAMA study estimated the cost of pricing failures to total between $84 billion and $178 billion in 2011.[22]

Fraud and Abuse

The sixth type of waste is categorized as *fraud and abuse*.[23] *Fraud* is defined in the healthcare industry as an "*intentional deception or misrepresentation*" that can lead to unauthorized benefits or payments, and *abuse* is defined as "*actions that are improper, inappropriate, outside acceptable standards of professional conduct, or medically unnecessary*."[24] Examples of *fraud and abuse* include:

(1) Submitting claims for services not provided;
(2) Misrepresenting the frequency, description, or duration of services provided;
(3) Falsifying eligibility;
(4) Failing to maintain adequate financial or medical records; and,
(5) Improper billing practices.[25]

In 2011, the amount spent on fraudulent claims, as well as the additional enforcement activities to catch the wrongdoers, totaled between $82 billion and $272 billion.[26] Although *fraud and abuse* continues to be a major source of waste in healthcare spending, substantial progress has been made in recent years. Since the enactment of the *Affordable Care Act (ACA)*, the *Department of Justice (DOJ)* and *Office of Inspector General (OIG)* have increased both enforcement efforts and willingness to prosecute fraud and abuse violations. The DOJ recently announced a record-breaking recovery of $4.3 billion in fiscal year 2013 from individuals and entities who attempted to defraud federal healthcare programs.[27] This pattern of increased enforcement could significantly reduce waste in the U.S. healthcare system in the coming years.

Despite the recent flattening of U.S. healthcare expenditures per capita, policy makers are debating how to best combat wasteful spending. The key to reducing expenditures may well lie, in great part, in understanding these underlying causes of waste in the U.S. healthcare system. The third and final installment of this three-part series will examine various aspects of the latest iteration of healthcare reform which are designed to reduce wasteful spending and make healthcare more affordable.

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