



BlueCross BlueShield
of Illinois

Economics of Health Care

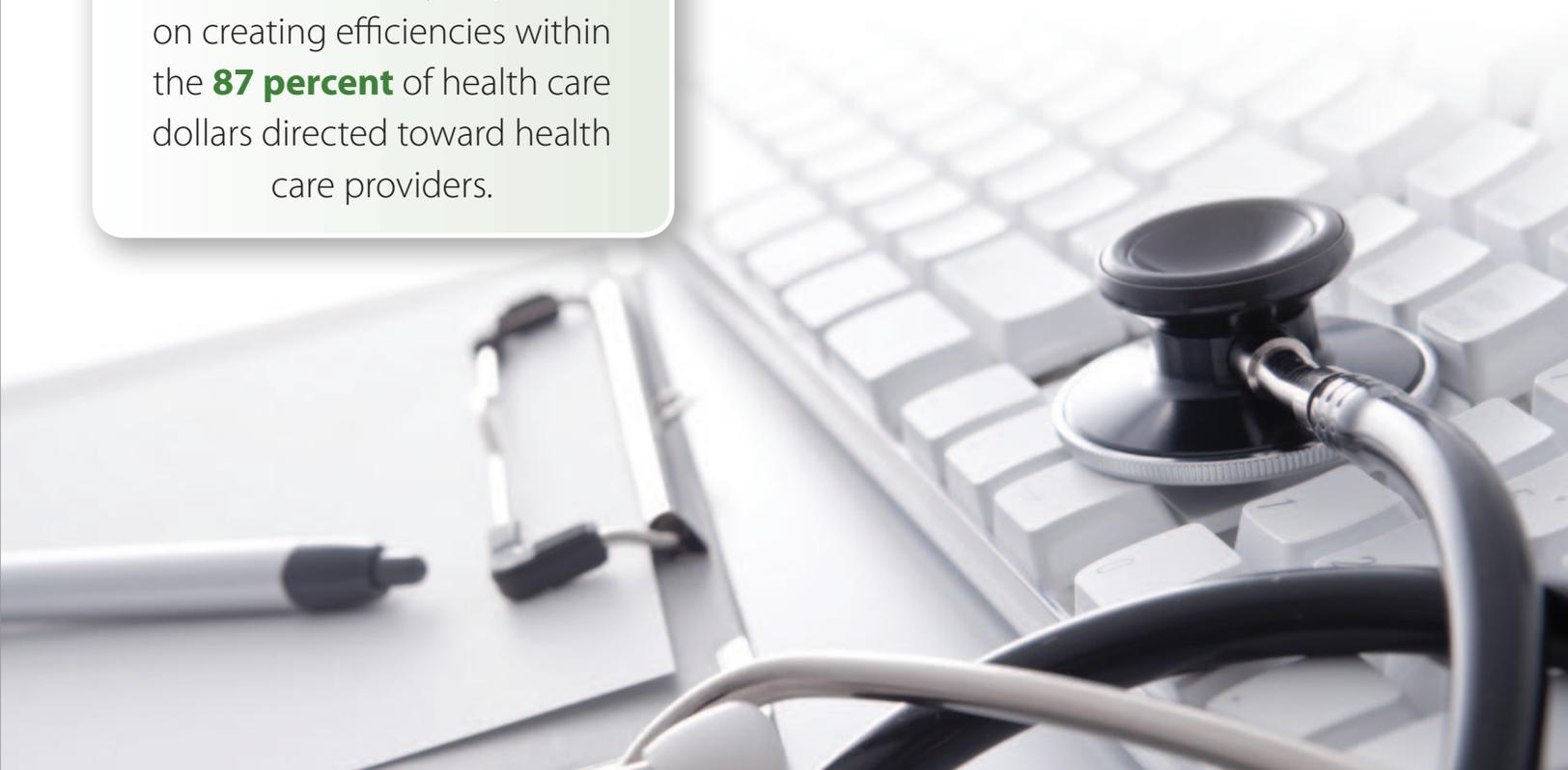
Part 1: Identifying health care costs

The rising costs of health care create an unsustainable burden on consumers, employers and government. It's important that members of Blue Cross and Blue Shield of Illinois (BCBSIL), as well as the general public, know how health insurance premium dollars are being spent. More important, there is a need for education and awareness about what truly drives costs and how to help keep down these expenses. While most Americans use health care, few really know where their money goes and what medical care and services actually cost.

Federal government data confirms that rising health care costs are driven by increased spending on hospital care, physician services, prescription drugs and other medical services. As the dollar image on the next page illustrates, 87 percent of every health insurance premium dollar is used to pay for such direct medical care. These medical treatment costs are rising at two to three times faster than the rate of inflation. But with the greatest challenge comes the greatest opportunity.

Health care affordability

and sustainability depends on creating efficiencies within the **87 percent** of health care dollars directed toward health care providers.



Where does the typical health insurance dollar go?



Based on a PricewaterhouseCoopers' analysis. *Factors Fueling Rising Healthcare Costs 2008*.

87¢ - Direct Medical Care Expenses

Hospital Costs (35%) – According to a study by Thomson Reuters, the average profit margin of America's hospitals reached more than 8 percent in the second quarter of 2009.¹ Hospitals, especially those with strong market power, have reaped higher revenues from private payers. This has led to weaker cost controls and higher costs per unit of service. Data gathered by the American Hospital Association revealed that, from 1999 to 2007, private insurers' payment-to-cost ratio increased **17 percent**, while Medicare's same payment-to-cost ratio decreased **9 percent**.² This process is shifting the costs from Medicare to private insurers, requiring them to pay increasingly more.

- **Inpatient Services** – Inpatient services include items and services ordinarily furnished by the hospital for the care and treatment of patients staying overnight. Patients may be admitted to the hospital for various reasons – giving birth, undergoing surgery, etc. BCBSIL claims data for the one-year period May 2011 through April 2012 shows the average expenses for childbirth are up to **\$5,500** for a natural delivery and over **\$9,000** for a C-section. (This includes all facility and professional costs for the inpatient stay.)
- **Outpatient Services** – Outpatient hospital services include less complicated procedures that do not require an overnight stay in the hospital. These generally occur when an individual visits the hospital to prevent sickness, get a diagnosis for a health condition or an illness, alleviate pain, or receive rehabilitation services. Emergency room visits also can be an outpatient service. BCBSIL claims data from the one-year period May 2011 through April 2012 shows that the average cost of a trip to the emergency room for our members, including facility and professional costs, is over **\$1,100**.

Where does the typical health insurance dollar go?

87¢ - Direct Medical Care Expenses *(continued)*

Physician Services (33%) – Physician services include the cost of patient care, such as salaries, facilities, technology and medical malpractice lawsuits.

Prescription Drug Costs (14%) – In February 2010, *Forbes* magazine released its list of the most expensive drugs, including one drug that cost **\$409,500** for a year's supply – meaning it costs more than \$1,000 per day, every day, all year.³ Some people argue that such prices are necessary due to drug research, development, manufacturing and marketing. However, the pharmaceutical industry benefits from a **19 percent** profit margin and is currently ranked the third most profitable industry in America.⁴

Other Medical Services (5%) – These costs include durable medical equipment, orthotics, therapy, hospice, skilled nursing services and other ancillary provider services.

Other Expenses

13¢

Administrative Government Costs (6%) – Payments to the government include taxes, mandates and compliance. These costs also include claims processing and other administrative costs. Illinois has more coverage mandates than most other states. It is important to understand that each mandate adds to the price of health insurance premiums. In total, mandates add from 25 to 50 percent to the price of premiums.⁵

Consumer Services (4%) – These costs include prevention services that help members stay healthy, as well as medical management programs, provider support and health information technology investments – all of which help to avoid millions of dollars a year in unnecessary medical costs.

Insurer Margin (3%) – Insurers typically operate with a profit margin of **3 percent** or less. This is one of the lowest profit margins in the health care industry. As a non-investor-owned company, we do not trade stock publicly.

Rather than returning earnings to shareholders, we retain earnings as capital reserve. This secures our ability to meet financial obligations, including claims payments.

The non-investor-owned model ensures that the monthly rates members pay are put to good use. Now, more than ever, health care customers need this structure and certainty.



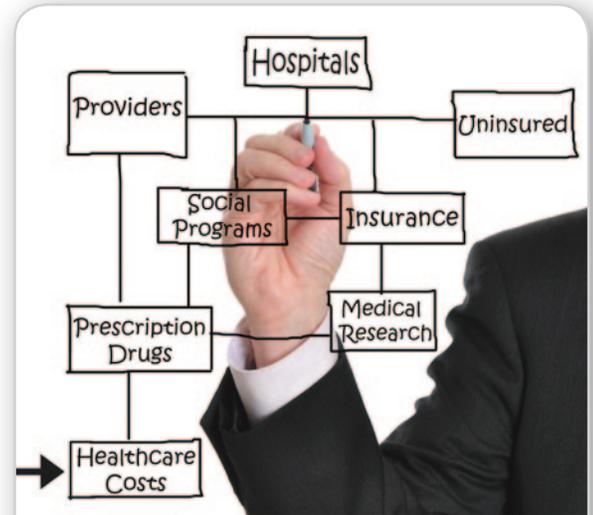


No simple task

Controlling health care costs is no simple task and will require the combined effort of the government, insurers, providers and the general public. As economic difficulties may pressure healthy individuals to go without insurance, the market includes a disproportionate number of unhealthy people who incur higher health costs. In addition, unemployment drives up the number of uninsured, which may increase the number of expensive visits to the emergency room.

With approximately 7 million members, BCBSIL is the largest health insurance company in Illinois and makes every effort to keep its coverage affordable and accessible to all Illinoisans. We're committed to working with hospitals, physicians and employers to provide access to quality medical care at competitive rates.

As a non-investor-owned company, our members are our shareholders, and we operate our business to their benefit. While investor-owned or publicly traded companies are forced to maximize shareholder value, we do not have this burden. This freedom allows us to better align our incentives and concentrate all our resources on our customers. The non-investor-owned model also enables us to focus on the long-term needs of policyholders instead of the short-term gains of shareholders.



We are committed

to working with hospitals, physicians and employers to provide access to quality medical care at competitive rates.

1. Thomson Reuters. Hospitals Continue Financial Recovery. Nov. 2009.
2. American Hospital Association and Avalere Health TrendWatch Chartbook 2010: Trends in Hospital Financing. 2010.
3. Forbes Magazine. "The World's Most Expensive Drugs." Feb. 22, 2010.
4. Fortune Magazine. Annual Ranking of the Largest Corporations – Top Industries: Most Profitable. 2009.
5. Council for Affordable Health Insurance. Health Insurance Mandates in the States. 2009.