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# REAL SOLUTIONS: Policy Briefs

AMERIGROUP PUBLIC POLICY INSTITUTE

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## Savings in Medicaid Series

### Focus on Escalating, Rather than Administrative, Costs

#### Issue Defined

With the nation's total health care spending estimated at \$2.5 trillion this year, as well as the likelihood of such spending as a percentage of the national gross domestic product to exceed 30 percent in less than two decades, contemporary efforts to reduce costs are essential to the reform dialogue. One common policy solution has been to reduce Medicaid health insurer profits, but this strategy is not a dramatic cost saver as it is perceived. Administrative costs are just a small portion of a health insurer's overall Selling, General & Administrative (SG&A) budget. The major expenses are a result of business acquisition and marketing (25 percent), customer account and membership maintenance (41 percent) and medical and provider management (11 percent).

#### Background

Medicaid Administrative Costs are significantly less than the administrative costs of private health insurance plans – typically in the range of 4 to 6 percent of claims paid. By comparison, a health maintenance organization (HMO) with administrative costs of 8 to 12 percent would be regarded as efficient. An efficiently managed commercial health insurer would typically have administrative costs of 15 to 20 percent.

#### Recommendations

Factors that are substantially contributing to current and projected high levels of healthcare expenditures include:

- Rising prices above competitive market level
- Increased overuse of medical services, including hospital stays; inappropriate or ineffective use of care; and avoidable readmissions
- The expense of name-brand prescription drugs and biologics
- Regional healthcare cost variations
- The expense of researching and developing new medical technologies.

Strategies to eliminate cost increases in these categories are likely to result in a dramatic reduction in the health care spending growth outlook. Additional solutions to help defray administrative costs for adding new people include:

- Pooling Medicaid enrollment information with that of other publicly sponsored health programs, such as Temporary Assistance for Needy Families (TANF), to negotiate better rates – a practice commonly known as “cost allocation”
- Creating a Medicare drug rebate policy modeled on the current Medicaid rebate for purchases of brand-name prescriptions by Part D beneficiaries, which would require brand-name drug manufacturers to provide a rebate of 15 percent of the average manufacturer price to the federal government
- Raising revenue from other sources, such as a higher tax on alcohol or an excise tax on sugar-filled drinks and energy drinks.

The Congressional Budget Office (CBO) has estimated the addition of a 3-cents/12-ounce serving of soda would generate \$24 billion over the next four years.

### **Savings Outlook**

Any further reduction of administrative costs by the federal government would result in the possibility that a public health insurer would be unable to manage an effective Medicaid program for a state client. In fact, Medicaid administrative costs are low (5 percent of the program's total costs in 2007) and have increased modestly (4 percent annual growth since 2004). By comparison, Medicare's total administrative costs on a per-person basis were 24.8 percent higher on average than that of private insurers between 2001 and 2005. In view of this fact, the Medicaid program would be better served by previously mentioned strategies, such as creating a Medicare drug rebate policy modeled on the current Medicaid rebate for purchases of brand-name prescriptions by Part D beneficiaries, as well as the raising of revenue from such sources as a higher tax on alcohol. According to a CBO proposal, the federal government would save \$110 billion over a ten-year period by creating a new Medicare drug rebate policy. In addition, the CBO estimates that by increasing taxes on alcoholic beverages, the federal government would gain \$60 billion over a ten-year period.