The Outlook

Can Managed Care Manage Costs?

Not long ago, some optimistic policy makers predicted that managed care would be the nation's antidote to runaway health-care costs. No more.

Health-insurance rate increases, which had moderated in recent years, are shooting up again. Some consultants handling negotiations for employers, traditional insurers and managed-care companies are forecasting a return to double-digit increases next year. The nation's second-largest health-care purchaser, the California Public Employees' Retirement System in Sacramento, has already agreed to pay average rate increases of 9.7% starting in January.

"If costs are going up that much at the most well-managed plans, then the likelihood is very strong that we will be seeing double-digits across the entire health-care marketplace," warns Chuck Hartwell, a consultant at William M. Mercer Inc., a leading benefits firm. "Our clients expect us to help solve this kind of issue, but the solutions will not be easy to come by. According to a Mercer survey, employers are expecting health-care costs to rise 9% this year, after increases of 6.1% in 1996, 0.2% in 1997, and 2.5% in 1996.

The pressures are coming from all sides, say health-maintenance organizations in California, the cradle of managed care, as they seek to justify the increases. Doctors and hospitals are demanding more money, patients are rebelling against restrictions on drugs and specialists, and lawmakers are considering "patients' rights" bills, including some that threaten to eviscerate managed care.

But if the system of managed care no longer manages costs, what sort of future does it have? That's becoming an issue for employers who are footing much of the bill, as well as policy makers and the managed-care industry itself.

For the moment, the booming economy lets HMOs postpone the hard decisions. Managed-care companies are enjoying the luxury of making themselves consumer-friendly and designing plans that offer more flexibility and choice. Consumers have rejected many techniques that once controlled costs, such as using a "gatekeeper" to restrict access to specialists, and these are being gradually abandoned. Instead of restricting access to expensive drugs, they are offering multilayered plans, including some that require co-payments of as much as 50% for certain drugs.

This approach hands the spending decision back to employers and individuals. But it's also a form of cost-shifting that asks consumers to pay more for what they want, rather than making the tough calls to manage care.

In the longer term, that path is a dangerous one for managed care. When the next economic downturn hits, many employees and individuals will dump their costly medical coverage, throwing more people into the ranks of the uninsured and renewing calls for government intervention. Unless the industry figures out how to re-engineer health care to improve both quality and efficiency, it could even be replaced by a government system.

"Managed care has failed so far in delivering on its promise of how to spend money more effectively," says Glenn Meineck, professor of public administration at the University of Southern California.

Waiting for the bigger answers, the old system continues to fray. In some markets, hospital utilization is edging up. New laws require longer stays for some patients. With the emergence of big hospital chains, HMOs can no longer dictate prices to hospitals as they once did. In a groundbreaking move, the American Medical Association is backing the formation of doctors' unions. And the shocking bankruptcies of some physician networks have convinced many HMOs that they must pay doctors more, not less, in order to restore stability and avoid a doctor revolt.

President Clinton's proposal to add prescription-drug benefits to the Medicare program is another government attack on HMOs. Because traditional Medicare hasn't offered those benefits, HMOs have been able to lure many seniors with their offers of drug coverage. This competitive edge will be lost if drug benefits are bestowed on all Medicare recipients.

One contrarian view is that ultimately, the rising costs aren't cause for alarm. According to this theory, many people today are prepared to spend a much bigger chunk of their discretionary income on health care if it helps them feel better, look better and live longer than their parents.

Health-care purchases today represent between 13% and 14% of the gross domestic product, up from only 4% or 5% after World War II. And there's no reason why that figure shouldn't keep climbing, says Joseph Newhouse, professor of health policy and management at Harvard University. "It's a question of what you want to spend your money on."

Certainly, Americans' definition of their health-care needs is expanding. Rather than put up with deteriorating vision, people are flocking to have corrective laser surgery and intraocular implants. Ligament-reconstruction surgery can put crippled weekend warriors back on the ski slopes and the tennis courts.

"There's a growing view, especially among baby boomers, that everyone should feel good all the time," says RandallAbbott, a senior consultant at Watson Wyatt Worldwide. At one of his clients, a financial services company, for example, he says the "No. 1 drug cost" is the antidepressant Prozac.

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