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Price Transparency in U.S. Healthcare Market

Executive summary

The purpose of this policy analysis is to explore whether price transparency could enhance competition among healthcare providers to lower healthcare prices in U.S. Three potential solutions are examined: state-based legislation, federal-level legislation, and the reference pricing innovation. It is recommended that the FTC should encourage state-based legislation to promote price transparency in healthcare.

Background

In U.S., secrecy in health care pricing distorts the market, and keeps patients from making fully informed decisions. As a result, providers not only charge patients excessive prices, they also bill different payers different prices for the same services.

Federal government, states, and private sectors have all tried different approaches to address the price transparency issue, but none of them has produced substantial positive results.ⁱ At the federal level, three bills were introduced in Congress in 2010 to promote price transparency. The Affordable Care Act also requires hospitals to publish and update charge information annually.ⁱⁱ At state level, 34 states require reporting of hospital charges or reimbursement ratesⁱⁱⁱ and more than 30 states are pursuing legislation to enhance price transparency in health care.^{iv} In addition, several commercial health insurance plans

develop transparency tools to help their patient members access and understand price and quality data.^v

Evidence

This policy analysis is made based on literature review of articles from scientific literature and journals, information of federal and state legislations from government website, newspaper articles, and also some congressional research service reports. The main indicators mentioned in this analysis are plan-specific patient copayment, episode-based payments, and the variation of prices for identical healthcare procedures.

Problem

Information asymmetry leads to a market failure in U.S. healthcare. Patients are generally ignorant of the prices of health care services before they consume the products, and they also lack professional knowledge to assess the quality of different services. As a result, supply-demand forces cannot determine prices in healthcare market; instead, prices are set by collusion between hospitals and large health insurance companies with the aim of profit maximization.^{vi}

In the past, uninsured patients are the main group who are sensitive to healthcare prices. However, in recent years, as health care costs continue to rise, health insurance companies develop greater cost-sharing plans and high-deductible plans to shift the costs of healthcare onto their consumers, and also expect to incentivize consumers to make cost-conscious decisions.^{vii} If price information is unavailable, those insured patients would

be unable to choose high-value services, and their out-of-pocket expenditure on healthcare would increase dramatically. In this condition, insured patients would be more sensitive to healthcare prices. Up till now, most price transparency initiatives focus on the disclosure of average charges for certain services. However, what patients really care about is their copayment for episode, not the average cost for each procedure.^{viii} Actually, information about plan-specific patient copayment and episode-based payments would be more helpful. In addition, without easy-to-understand quality information, price transparency could perpetuate consumers' misconception that cost is the proxy for quality, which creates a perverse incentive for providers to raise prices. Therefore, a meaningful price transparency initiative should include a combination of price and quality information.

Policy options and criteria for selection

Option 1: Encourage state-based legislation to promote the release of healthcare prices

Based on several states' past experiences, a helpful state-based legislation could include: requiring health plans within the state provide consumers with quality information, provider-specific estimates of the cost-sharing for a procedure or episode, and instructions on how to use these data; requiring providers to offer an estimated charge for a procedure or service upon patients' request; creating a commission focusing on evaluating price variation within the state; setting up a health information center which collects information of healthcare costs and quality from all healthcare organizations, and publishes provider-specific relative costs on a public website.^{ix}

Past state-based trials show that the effectiveness of price transparency efforts

depends on local consumers' acceptability of the new information tools presented to them. Within the state, it's easy to know through public opinion surveys whether patients are satisfied with current price data, and which aspects need further improvement. In addition, in terms of political feasibility, state-level legislation on price transparency is much easier to get passed than federal-level legislation, especially when there is strong local industry support. This can be seen from several states' success in issuing price transparency legislations on healthcare. Furthermore, the administrative and coordinative cost at state level is much lower than that in federal level, which means that state-based efforts would be more feasible.

There are also some disadvantages of state-based efforts. Without mandates from federal government, it is difficult for some states to enact price transparency legislation. In 2012, Arizona attempted to pass legislation on price transparency, but opponents from health care industry fought forcefully against the proposed legislation, and finally it did not get passed.^x If there is no federal mandate, while consumers in some states can use transparent healthcare prices to make cost-conscious decisions, consumers in other states may still be blind in making healthcare choices. What's more, even if all state-based transparency legislations get passed, different types of prices are published in different states, and these data are shown to the public in an inconsistent way.^{xi}

Option 2: Create federal-level legislation mandating states to enforce healthcare price transparency

The federal-level legislation could call for states to establish laws requiring hospitals to

disclose price information for certain procedure or episode, require health insurers to offer their patient members the information on out-of-pocket expenditure for particular health procedures. It could also appoint a committee to study the cost-effectiveness of different healthcare services nationwide and provide such information for patients.^{xii}

The main advantage of federal-level legislation is its contribution to equity and social justice. Mandates from federal legislation ensure that all states must make efforts to enforce healthcare price transparency, no matter how strong local opposition forces are. In addition, federal-level mandates can guarantee that laws are consistent among different states. Patients would not be confused by different types of price information in healthcare markets. Technically speaking, federal government is better equipped with expertise to collect and analyze information on healthcare prices and quality, compared to state governments. Federal government can also evaluate price variation from a bigger perspective than state governments.

However, federal-level legislation also has significant drawbacks. In terms of political feasibility, if there is no strong evidence showing that price transparency can bring down healthcare costs, congressmen are not willing to take a risk to see if transparency can actually work.^{xiii} In this sense, political obstacles to price transparency legislation at federal level are bigger than that at state level. Moreover, federal-level efforts usually mean a large amount of administrative and coordinative costs. Up till now, almost all federal-level price transparency bills on healthcare have been killed in Congress. Therefore, there is little experience to learn from, which increases the risks of the failure of future federal efforts.

Option 3: Initiate reference pricing for health care, coupled with mandated use of diagnosis related group system for all patients^{xiv}

In reference pricing strategy, the insurers within a market area would only pay for a fixed amount for a particular medical procedure, pegged on the lower price range for the procedure.^{xv} The insured patients, with a good awareness of the prices for the procedure charged by different providers within the area, have to pay the full difference between the reference price and the higher price a health care services chosen by the insured may charge. ^{xvi} In addition, if reference pricing is coupled with mandated use of diagnosis related group system for all patients, every hospital would use the same relative value scale. In this condition, healthcare prices could be more powerful in differentiating competing providers.

The advantages of this strategy are obvious. Firstly, as insurers only pay a fixed amount for a particular procedure, insured patients would be more sensitive to healthcare prices. Actually, only when patients have the incentive to make a cost-conscious decision, prices can work as a signal to make the market efficient. Therefore, in the reference pricing model, raw market forces work better than that in the traditional coinsurance model. Secondly, in the new model, healthcare services are provided based on diagnosis related group system, which minimizes the difference of healthcare quality. As a result, patients with little professional medical knowledge would no longer be confused at how to compare providers with different quality and price information. Little room would be left for the misconception that higher-cost care must be better.

The biggest obstacle to this strategy comes from the tradition of anti-big-government in

U.S. In this strategy, health care providers are not only required to provide full information of healthcare prices, also mandated to use diagnosis related group system for all patients. This would be a big step of governmental interference in healthcare markets. Of course, physicians and health care organizations in U.S. could not tolerate the existence of such a government-mandated insurance system.

Recommendation

Given past experiences, political feasibility, and the relatively low administrative and coordinative cost, it is recommended that FTC should encourage state-based legislation to promote the price transparency in healthcare. Although recent studies evaluating the state-based transparency legislation in California and New Hampshire reveal that there is no substantial effect of hospital price transparency policies on lowering prices,^{xvii} it is too early to conclude that state-based transparency legislation is ineffective. As these studies are only based on two years of data at the beginning of their implementation, it is possible that after several years, the true impacts of state-based transparency legislation will be uncovered.

In order to promote state-based legislation on healthcare price transparency, the FTC should :

- Require health plans to provide easy-to-understand price and quality comparison tools to consumers;^{xviii}
- Educate consumers about the benefits of using transparency tools and help expand the availability of those tools;^{xix}

- Encourage consumer to ask for the estimated episode-based payments from providers;
- Allow purchasers to share their claims data with third-party vendors for developing transparency tools for consumers;^{xx}
- Take part in statewide data collection and analysis;
- Research on whether price transparency legislation could create a perverse incentive for healthcare providers to raise prices.

By providing consumers with full information about healthcare quality, plan-specific patient copayment, and episode-based payments, the state-based transparency legislation ensures that patients are able to make cost-conscious decisions before they consume health care services. It is predicted that such efforts could bring down the high healthcare costs and reduce the wide price variation for identical health care services in U.S.

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^{iv} Anna D. Sinaiko and Meredith B. Rosenthal, "Increased Price Transparency In Health Care – Challenges and Potential Effects", *New England Journal of Medicine*, (2011), 364:891-894.

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