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# Political Preoccupation With Prescription Drug Costs May Distract From Larger Problem Of Hospital Costs



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Healthcare

*I write about prescription drug value, market access, healthcare systems, and ethics of distribution of healthcare resources*

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Stethoscope with dollar shaped cord. GETTY

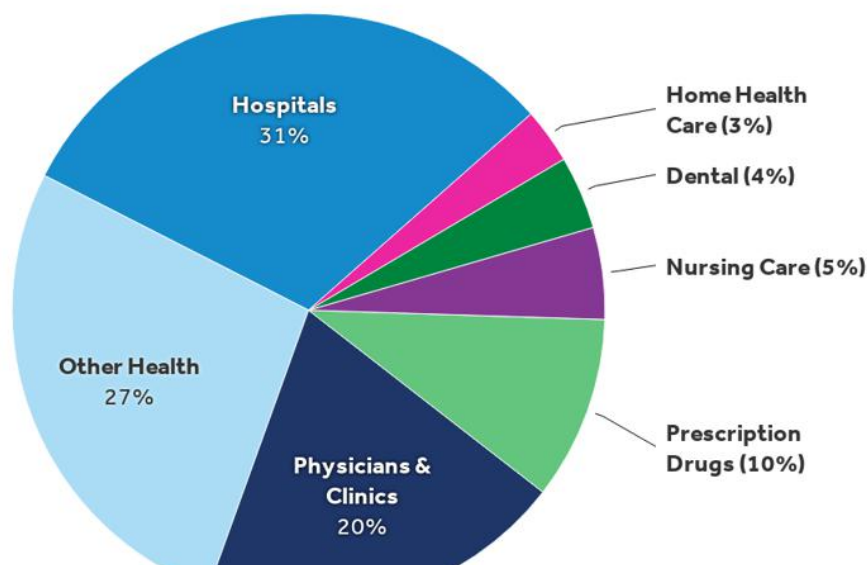
It's no secret that per capita healthcare costs are very high in the U.S. This wouldn't be as much of a problem if the system produced correspondingly excellent health outcomes. But, overall, it doesn't. The U.S. ranks at or [near the bottom](#) among peer nations.


To address healthcare costs, politicians on both sides of the aisle have been crafting legislation that mostly targets prescription drugs, while generally ignoring other healthcare sectors. Whether it's the Elijah E. Cummings Lower Drug Costs Now Act, H.R. 3, the Biden Administration's July [executive order](#), or the prescription drug expenditure component contained in the budget reconciliation [blueprint](#), the almost exclusive focus is on reducing drug spending.

The rising costs of prescription drugs regularly feature as news items in the media. At the same time, increasing hospital and medical professional service costs rarely do. Political preoccupation with drug costs may distract from the larger problem of other healthcare sector expenditures.

Prescription drug cost growth is not the main driver of rising healthcare costs. Hospital, physician, other medical professional services take up [much larger slices](#) of the healthcare pie - see figure below - and are growing annually at roughly the same clip as prescription drugs.

Relative contributions to total national health expenditures, 2019





Notes: 'Other Health' includes spending on other non-durable products, residential and personal care, administration, and other state and federal expenditures.

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Source: KFF analysis of National Health Expenditure (NHE) data  
• PNG

Peterson-KFF  
**Health System Tracker**

Slices of the healthcare pie. Hospital slice is the biggest, KFF

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In 2019, spending on hospital and medical professional services (physicians, nurses, dentists, and others) was nearly six times higher than spending on outpatient prescription drugs. Together, hospital and medical professional services accounted for approximately 58% of total healthcare expenditures. These categories' shares of the healthcare pie have been fairly consistent for years.

In 2019, outpatient prescription drugs accounted for less than 10% of U.S. healthcare spending. Hospital inpatient and most physician-administered drugs are reported on the hospital and healthcare professional services' ledger. These have been estimated to comprise additional drug expenditures of approximately 4% of U.S. healthcare [spending](#). And so, as a whole, prescription drugs - outpatient, physician-administered, and hospital-based - constitute around 14% of healthcare costs, with net annual increases in pharmaceutical spending [similar](#) to increases in hospital, physician services, and outpatient care expenditures.

To illustrate, the U.S. spent 6.2% more on hospital care and 4.7% more on physician and other healthcare professional services in 2019 than in 2018.

Meanwhile, spending on outpatient prescription drugs increased by 5.7%. A key difference between the increase in these categories is that more than 100% of outpatient drug spending growth resulted from more utilization, or a greater number of prescriptions being dispensed. [Net outpatient drug price growth](#) is below 0%.

The system in which preferential formulary placement of prescription drugs is granted in exchange for rebates has created a large and growing gap between list and net drug prices - coined the “gross-to-net bubble” by [Adam Fein](#) - particularly in therapeutic classes with many competitors, such as insulin.

Of course, patients care about their rising out-of-pocket costs - cash-pay prescriptions, deductibles, co-payments and co-insurance - and this may explain politicians’ fixation on drug prices. Their constituents are directly impacted by a rising out-of-pocket burden for prescription drugs.

Patient cost-sharing has increasingly been denoted by co-insurance. In this context, co-insurance is calculated on the basis of rising list prices of drugs and not declining net prices. Therefore, drug costs are visible in ways that other healthcare costs aren’t. As a way of illuminating this issue, in 2019, while spending on hospital care was more than \$822 billion higher than outpatient drug spending, patients spent \$18 billion more out-of-pocket on outpatient drugs than hospital services.

This could help to explain why hospital costs remain largely out of public scrutiny. Patients aren’t directly affected, or so it appears on the surface. Yet, there are indirect effects, stemming from the fact that hospital care costs have soared over the past two decades by [200%](#). These increases in costs contribute substantially to ever [higher insurance premiums](#) for patients. In just the past 10 years, the average family health insurance premium has climbed by [55%](#).

A recent New York Times article by Sarah Kliff and Josh Katz [highlighted](#) wildly divergent hospital prices for the same procedure, depending on the health insurer. The examples cited point to a rather obvious market failure in the hospital care marketplace. Markets work optimally when there's full transparency with respect to products' prices, complete information regarding products' efficacy and safety profiles, and lack of excessive market concentration. Well, hospital care in the U.S. checks none of the boxes. And, this is problematic, given that the hospital service sector is the largest contributor to healthcare cost growth. Conspicuously, anti-competitive practices in the hospital service sector appear to fly under the radar of most legislators.

The point here is not to ignore prescription drug costs, or the issues surrounding sub-optimal markets for pharmaceuticals and lack of transparency. As mentioned, the increase in list prices of, say, insulin, may not matter as much to payers and pharmacy benefit managers as they extract greater rebates. But it certainly matters to patients, as those rebates aren't passed through to them, and their co-insurance payments rise inexorably over time. This lack of pass-through reflects another market failure.

However, the problem is that instead of paying attention to the bigger picture of the healthcare system's costs as a whole, politicians, and even many policymakers, rarely discuss the more important causes of higher spending. Hospital and medical professional services are somehow a third rail of sorts. To successfully tackle healthcare cost growth, this will need to change.

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