

# Economic Factors that Drive Healthcare Costs

*by Sophia Tutorial*



## WHAT'S COVERED

In this lesson, you will learn how to identify factors that contribute to rising healthcare costs. Specifically, this lesson will cover:

1. Factors that Contribute to Rising Costs
2. Public Funding, the Aging Population, and Utilization
3. Rising Employment Costs
4. Reflect

## 1. Factors that Contribute to Rising Costs

It's important for nurse leaders to understand the economic factors that control healthcare costs and decision making. Some of these factors may be difficult to control because they are external. That doesn't mean they should be ignored. Healthcare leaders still have a responsibility to ensure cost controls. In fact, the Department of Health and Human Services through CMS recently ramped up their fight against wasteful spending in healthcare.

As part of the Affordable Care Act, in 2011 CMS rolled out an incentive program to improve healthcare finance and efficiency called "meaningful use guidelines." Meaningful use guidelines focused on electronic health records and patient data/information gathering. CMS provided incentives for hospitals and physicians to upgrade their health information technology systems to improve sharing and reduce errors such as duplicate services, over-billing, and data entry errors.

In 2016, meaningful use guidelines further expanded into the Merit-based Incentive Payment System known as MIPS. Under MIPS, hospitals and physician offices received financial incentives for efficient and effective use of electronic health records and for following clinical practice guidelines known to reduce healthcare costs. These programs are of financial interest to healthcare organizations as they reward them for being efficient. Today's nurse leader needs to understand what factors push costs up and how to create an efficient yet effective working environment.

## 2. Public Funding, the Aging Population, and

# Utilization

The United States is one of the only industrialized nations in the world not to have publicly funded universal healthcare coverage for its citizens. While there have been many attempts at universal coverage, the United States still has a high number of uninsured and under-insured individuals. In fact, the United States spends more on healthcare and less on social programs than most other high-income nations (Bush, 2018).

It's important for healthcare managers to understand the overall healthcare system and healthcare economics. Healthcare economics has an impact on how services are provided and the overall financial health of an organization. It's important that nurse leaders understand some of the root causes related to high healthcare costs.

Understanding the rising cost of healthcare is not always easy. The United States healthcare system is very complex. However, it is important to understand that the U.S. population is aging. While many attribute the aging population to the rising cost of healthcare, it isn't the whole story. Yes, the aging population has contributed to increased costs, especially in certain sectors. In fact, from 1996 to 2013, the aging population led to a 12% increase in healthcare spending while service intensity and price increases led to a 50% increase in spending (Dieleman, et al. 2017). In a 2017 study on why healthcare costs are rising, it was found that the aging and growth of the population has less to do with the rising costs than other factors such as the utilization of services and price increases (Dieleman, et al. 2017). This is not to say that the aging population doesn't contribute. However, healthcare leaders cannot ignore other factors.

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## 3. Rising Employment Costs

Employment costs are one of the biggest contributors to healthcare spending. On average, employment accounts for roughly 70% of hospital expenses and 50% of expenses for physician offices, outpatient centers, and other common health services (Gried, Ma, and Solis-Roam, 2016). According to Skinner and Chandra, 2018, there is a direct correlation between increases in healthcare employment and healthcare spending across the United States. Unlike other sectors of the economy, technology growth in healthcare does not typically replace personnel. It's quite the opposite: As innovation increases in healthcare, so does the demand for highly-skilled employees with training to manage and operate the new technology. This can also be said for nursing. The demand for nursing continues to grow in healthcare and healthcare itself is a very labor-intensive sector of the economy. As demand grows, so do salaries.

Adding to the expense of employment, there's an ongoing nursing shortage. While the nursing shortage in the United States impacts different regions and areas differently, overall, it's a contributor to rising healthcare costs. The aging population also plays a role in nurse shortages. Because of the baby boom, many nurses are retiring at a faster rate than in previous years (Haryanto, 2019). Also, the aging population is contributing to a rise in healthcare utilization. Baby boomers tend to use more services and chronic disease management and have an increased life expectancy. Combined, these factors create a growing need for more nurses. One other concerning area is a shortage of nursing schools. According to Haryanto 2019, in 2016, nursing schools in the United States turned away roughly 80,000 qualified bachelor or graduate-level nursing school applicants due to faculty shortages, budgetary constraints, and lack of space.

Rising employment costs and the nursing shortage are real contributors to the rising costs of healthcare overall. Furthermore, they add to growing expenses at healthcare organizations. Nursing leaders need to realize the impact employment issues have on healthcare finance. It will take innovation, modern retention strategies, and strong leadership to manage this growing expense.

## 4. Reflect

Review the financial statement from Sneed Hospital below.

Sneed Hospital Statement of Operations For the Year Ended September 30, 20X1	
<b>Unrestricted revenues</b>	
Net patient revenue (net of contractual allowances)	\$720,000
Provision for bad debts	(7,000)
Net patient service revenue less provision for bad debts	713,000
Net assets released from restriction	220,000
<b>Total revenues</b>	<b>933,000</b>
<b>Operating expenses:</b>	
Labor expense	444,000
Supply expense	144,000
Depreciation expense	65,000
Interest expense	18,000
<b>Total operating expenses</b>	<b>671,000</b>
<b>Excess of revenues over expenses</b>	<b>262,000</b>
<b>Increase in unrestricted net assets</b>	<b>\$262,000</b>

### ? REFLECT

- Examine the difference between total patient revenue and net patient revenue minus the bad debt.

*It is important to understand that not all claims that are billed out will always be paid.*

- Looking at the operating expense, what expense jumps out as the highest contributor to overall operating expenses?

*It's important to understand that labor costs are typically the highest percentage of costs in most hospitals and healthcare organizations.*

### ☆ BIG IDEA

Considering those two points, think about if you were a nurse manager for this hospital. It would be extremely important to ensure you kept a close eye on labor costs. It is a delicate balance between ensuring the right amount of staff and keeping a close eye on rising expenses. Working closely with the human resources department on employee retention to prevent turnover is an important part of being a nurse leader. Not only

is keeping a close eye on staffing important, ensuring the supplies and other operating expenses stay in step with revenue streams will help the organization with financial viability. Operating expenses such as supplies sometimes can often rise faster than expected when caseloads get busy. As staff focuses on the increase in-patient care, more supplies are likely to be used. Making sure to limit wasteful use of supplies should be a best practice, otherwise, this may off-set gains made from increased patient revenues. Also, note the amount of supply expenses. This should not increase faster than staffing expenses, even if revenues increase.

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## Support

If you are struggling with a concept or terminology in the course, you may contact **NurseLeaderSupport@capella.edu** for assistance.

If you are having technical issues, please contact **learningcoach@sophia.org**.