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HEALTH MAINTENANCE ORGANIZATIONS: AN ANALYSIS OF THEIR EVOLUTION, DEVELOPMENTAL OBSTACLES, AND FUTURE ROLE IN THE HEALTH CARE DELIVERY SYSTEM

Pace University

D.P.S. 1985

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Health Maintenance Organizations: An Analysis of Their Evolution, Developmental Obstacles, and Future Role in the Health Care Delivery System

A Dissertation
Presented to
The Faculty of the Lubin Graduate School of Business
Pace University

In Partial Fulfillment
of the Requirements for the Degree
Doctor of Professional Studies

Geoffrey J. Suszkowski
1985

SUMMARY ABSTRACT

Health Maintenance Organizations:
An Analysis of their Evolution,
Developmental Obstacles, and Future Role in the
Health Care Delivery System

Health care is what economists call a "superior good," one that claims an increasing part of the consumer's dollar as his or her income rises. Economic growth, therefore, will tend to boost the share of national income devoted to health care. According to actuarial projections, the cost of hospital insurance under Medicare, 2.97 percent of the social security wage base in 1982, will more than double by 2005 to 6.29 percent, and nearly quadruple by 2035, to over 11 percent. It is obvious that hospitals will come under increasing cost pressures as our population base ages and the remaining work force begins paying more for the medical care of this aging population.

If United States citizens could be confident that the expected incremental benefit of all medical care they buy exceeds the incremental cost of those services, the growth in medical expenditures, like similar past increases in spending on automobiles, televisions and computers, would be a measure of the superior capacity of new commodities to satisfy consumer wants. But, the system of third party reimbursement precludes such rosey interpretations. Because care is essentially free when demanded, incentives encourage the provision of all care that produces positive benefits whatever the costs.

Because of this continuing unacceptable growth in health care expenditures, the government, business, unions and, to some extent, the general public, have voiced an opinion that HMO's may be an alternative form of health care delivery that provides an acceptable level of medical care at a much reduced cost.

The problem in the United States, as well as in all developed nations, is how to alter the behavior of providers of health care and patients so that expenditures are curtailed on care that, in some sense, is worth less than it costs and yet, not destroy the moral fabric of society. To many, HMO's appear to offer a vehicle whereby expenditures can be curtailed while a reasonable level of care can be maintained.

The impact HMO's have made on the health care delivery system cannot be measured in absolute numbers of HMO's in operation today. The real impact HMO's have made is to change the way health care providers, insurers and the public, view the health care delivery system and evaluate alternate forms of care delivery.

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CHAPTER I

THE PROBLEM

Introduction

Health maintenance organizations are receiving renewed attention by business, organized labor and the Federal government as a means to control rising health care costs. The prepaid group health care concept has been around for a long time, nearly fifty years, but expansion of the concept is being hampered by financial and legislative problems as well as by a limited level of acceptance by the public. As a result of the rising cost of health care, widespread attention is being devoted to health maintenance organizations in an attempt to overcome these obstacles and to focus a major segment of the health care delivery system around this concept.

Statement of the Problem

The purpose of this study is to identify the developmental obstacles encountered by health maintenance organizations and analyze the effects they will have on the future role and development of HMO's as part of the health care delivery system.

Specific Problems

The first problem is to research and document the developments and trends which have led to the growth of the HMO concept.

The second problem is to identify and document those critical

problems the HMO concept faces by threatening the traditional health care delivery concept.

The third problem is to compare and analyze the potential of these two problems on an expanding HMO role in the health care delivery system.

Definition of Terms

The following definitions will be used for the purpose of this study:

"Health Maintenance Organization (HMO)" is a group health care program offering comprehensive physician services and inpatient hospitalization purchased annually at a prepayment rate through capitation contracts.

Capitation is the per member amount of money paid for a full range of medical services, whether such reviews are utilized or not, and do not vary with membership except at certain predetermined critical levels of membership.

Delimitations of Study

This study will be limited to health maintenance organizations in the United States. The survey data was collected and compiled during the period May to September 1981. This study did not attempt to document physician or public viewpoints of HMO's since other researchers have conducted such studies. Additionally, HMO's were not surveyed since they too have been surveyed by other researchers.

Need For The Study

In 1970, national expenditures for health care represented 7.1 percent of the Gross National Product (GNP).[1] In 1982 this percentage increased to 10.5 percent, double the percentage expended in 1950.

The rate of increase of health care service prices has continued at a double digit rate, exceeding rates for all other services and goods except fuel oil. Between 1965 and 1976 physicians' fees rose 92 percent and the hospital semi-private room charge rose 211 per-cent. This compares to an increase in the entire Consumer Price Index (CPI) of 71 percent.[2] More recently, medical care prices have increased more rapidly.

In 1969, Time magazine ran a feature article entitled "The Plight of the U.S. Patient."[3] This article was the first in a series of articles in many major news publications which began questioning the cost of health care. In January 1970, the feature article in Fortune magazine was entitled "Our Ailing Medical System: It's Time to

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[1] United States Department of Health, Education and Welfare, Office of Health Research, Statistics and Technology, Health, United States - 1979, p. 184.

[2] Testimony by Joseph D. Hawkins, Insurance Commissioner of the State of Texas before the Council on Wage and Price Stability, Houston, Texas, October 31, 1976.

[3] "The Plight of the U.S. Patient," Time Magazine, February 21, 1969, pp. 53-58.

Operate."[4] Business Week magazine followed with an article entitled "The $60 Billion Crisis Over Medical Care",[5] and Harvard Business Review published an article entitled "New Blood for Tired Hospitals."[6]

Primarily as a result of the public outcry, President Richard M. Nixon, in his 1971 health message to the 92nd Congress, made the reorganization of health delivery services the focal point of his proposed health program.[7] He proposed a health maintenance organization (HMO) system which would offer comprehensive services purchased annually at a prepayment rate from a medical group through capitation contracts. Rather than massive federal regulations, investment and planning, Nixon envisioned economic and professional incentives with an emphasis on self-regulation based on a competitive market and on the preventive maintenance of health.

On December 29, 1973, President Nixon signed into law P.L. 93-222, the Health Maintenance Organization Act of 1973. Passage of this bill represented a historic breakthrough in the health policy of the Federal government. Joseph L. Dorsey, M.D., notes that prior to

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[4] "Our Ailing Medical System: It's Time to Operate," Fortune, January 1970, pp. 46-52.

[5] "The $60 Billion Crisis Over Medical Care," Business Week, Special Report, January 17, 1970, pp. 36-48.

[6] Ray G. Wasybeka, "New Blood for Tired Hospitals," Harvard Business Review, September-October 1970, pp. 65-74.

[7] Richard M. Nixon, "Health Message from the President of the United States Relative to Building a National Health Strategy," House Document No. 92-49, 92nd Congress, 1st Session, February, 1971.

passage of this bill, Federal health care legislation was directed at the purchase of health care services (Medicare and Medicaid), at planning for the allocation and distribution of health care services (Comprehensive Health Planning Act and Regional Medical Programs), or at improving the availability of facilities and manpower resources (Hill Burton and Health Manpower Acts).[8] None was directed at changing the structure of the delivery system.

Although the success of three Kaiser Permanente HMO's in California and the availability of federal funds spurred the start of a number of HMO's, the response has not been as outstanding as the proponents of the legislation had envisioned. Regina Herzlinger has cited three reasons for the lack of enthusiastic development of HMO's: (1) Consumers must give up their freedom of choice and limit themselves to the HMO's providers; (2) Most of the HMO's established are much too small to avail themselves of any economics of scale; (3) Many providers of care view HMO's as a form of socialized medicine and do not support its concept.[9] Peter F. Drucker has additionally pointed out several problems associated with the HMO concept and contends that "it is an idea whose time has passed."[10]

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[8] Joseph L. Dorsey, M.D., "The Health Maintenance Organization Act of 1973 (P.L. 93-222) and Prepaid Group Practice Plans," Medical Care, January 1975, Vol. XIII, No. 1, pp. 1-9.

[9] Regina Herzlinger, "Can We Control Health Care Costs?," Harvard Business Review, March-April 1978, pp. 102-110.

[10] Editorial, "Examining HMO's," Review, June 1978, Vol. II, No. 4, p. 16.

However, health care costs continue to rise, and business and organized labor are struggling to contain the increase through innovation and alternate health care delivery programs such as HMO's. Victor M. Zinc, Director of Employee Benefits and Services at the General Motors Corporation, testified at hearings held by the Council on Wage and Price Stability that health insurance costs for an employee and his family in Michigan were $130 per month. For General Motors as a whole, insurance costs amounted to $825 million in 1976.[11] At similar hearings, Joseph R. Ferrara, Area Director of Region 9 of the United Automobile Workers, testified in support of Zinc's testimony that the cost of health insurance was a larger component of an automobile's cost than the cost of steel.[12] The United Automobile Workers and the Amalgamated Clothing Workers of America, among other organized labor groups, have established HMO's for their memberships. Among employers, R.J. Reynolds has organized the Winston-Salem Health Care Plan, Inc., for its 15,000 North Carolina employees. R. J. Reynolds is building its own health care center at a cost of over $2 million.[13]

In response to this new interest in HMO's, Secretary of Health, Education and Welfare, Joseph Califano centralized all of the

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[11] Council on Wage and Price Stability, "The Complex Puzzle of Rising Health Care Costs: Can the Private Sector Fit it Together?," A Summary of Hearings, December 1976, (Washington: Executive Office of the President) p. 2.

[12] Council on Wage and Price Stability, Ibid., p. 2.

[13] Council on Wage and Price Stability, Ibid., p. 151.

activities associated with HMO's on the Federal level and established the new Office of Health Maintenance Organizations on March 1, 1978. The objective of the new office is to make the HMO concept better known throughout the country to business and labor groups as well as the general public, and most especially, to the providers of care, namely hospitals, boards of trustees, physicians, nurses and other associated groups and individuals.

In May, 1978, the Senate Human Resources Committee completed its recommendations on the HMO Amendments Act of 1978. The bill, S. 2534, was spurred on by the release of a Senate Government Affairs panel report warning of potential fraud and abuse among prepaid health plans. It calls for strict monitoring of HMO reimbursements and funding, because of unethical activity in the early 1970's by certain California prepaid plans that has since been prohibited by state law.[14]

It thus becomes clear that health maintenance organizations are in a transitional state, in which their need on one hand is being questioned and on the other hand, they are being viewed by other groups as the answer to restraining the rising costs of health care.

Summary

Despite a slowdown in inflation during the past year, health care

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[14] Sheila L. Simlar, "Bill to Scrutinize Health Maintenance Organization, Funding and Reimbursement," Modern Healthcare, Vol. 8, No. 6, June 1978, p. 17.

costs have continued to soar creating an economic crisis that threatens to undermine the availability of medical care for many Americans. These increases in health care costs have been yearly experiences for the past two decades.

In 1982, the inflation rate fell from the double digit range to 6.1 percent. Yet hospital room costs rose 14.8 percent in 1981 and 15.7 percent in 1982.

Spending on overall health care has more than tripled in the last decade, so that the $362 billion in private and public funds spent on health care in 1982 exceeded federal outlays for defense by almost $150 million.

Hospitals receive about 42 percent of all money spent on health care. Moreover, physicians, who get about 20 percent of the health care expenditures, make a significant portion of their earnings from services performed in hospitals.

These conditions make the hospital industry a prime target for reform. States are imposing hospital cost cutting regulations. The Federal government is planning major shifts in the 57 billion dollar Medicare program for the elderly. Business and insurance carriers are challenging hospital charges and bargaining for discount rates. Consumers and unions are demanding better protection against potentially bankrupting medical bills.

Health Maintenance Organizations (HMO's) have been identified as possibly being a provider of health care services that can be utilized to stem the cost spiral. HMO's on a local and regional basis have demonstrated that they can provide health care services at a

reasonable cost. The federal government, state governments and other groups have been taking steps to foster the development of HMO's. If this development effort does grow, HMO's may prove to be a major force in the health care delivery system and could cause a significant alteration of the system.

CHAPTER II

REVIEW OF THE LITERATURE

Interest in and concern over rising health care costs has become an overriding public issue of the Federal Administration. The Administration cites as a basis for their concern, the doubling of total health care expenditures between 1970 and 1975.[15] Total health care expenditures have increased from 7.1 percent of GNP in 1970 to 10.5 percent of GNP in 1982. Administration officials appear to be most alarmed over the 813 per-cent increase in federal health care spending over the last ten years.[16] HEW Secretary Joseph Califano has declared that, "We have no more urgent, immediate priority than to deal with runaway health costs."[17] John Knowles, President of the Rockefeller Foundation, in support of the Administration's position, has stated:

> There exists a profound national concern that despite a massive increase in health expenditures over the past decade, the nation's health has improved less than was promised or expected. The benefits have not appeared to justify the costs.[18]

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[15] Dr. Alice Rivlin, Director, Congressional Budget Office, Testimony to Subcommittee on Health, Senate Committee on Labor and Public Welfare, May 17, 1976, p. 10.

[16] Executive Office of the President, Council on Wage and Price Stability, Staff Report, "The Problem of Rising Health Care Costs," Washington, D.C., April, 1976, p. 2.

[17] Joseph A. Califano, Jr., Secretary, Department of Health, Education and Welfare, News Release, February 22, 1977.

[18] John H. Knowles, M.D., "The Responsibility of the Individual," Daedalus, Journal of the Academy of Arts and Sciences, Winter, 1977.

The interest in, and concern over, rising health care costs is not a new phenomenon nor is it limited to the Federal Government. In January 1970, Business Week magazine devoted one issue to an analysis of health care costs and entitled their report, "The $60 Billion Crisis Over Medical Care." The report explored the failure of the Amercan health care system as well as the promise of National Health Insurance and physician group practices. In defining the failure of the health care system, the report stated:

> The total health bill for Americans now stands at some $60.3 billion a year. This comes to 6.7 percent of the gross national product, a greater proportion of national resources than any other country puts into health care. The national bill per person for medical goods and services is up to $293, more than double what it was a decade ago, and is still rising. Since 1966 the cost of health care has been climbing at an average annual rate of 7 percent, well above the rates of increase in other consumer prices.
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> For all this, the U.S. has been slipping behind other nations in the key indexes of national health. In infant mortality we now rank 14th behind many Western European countries. Men live longer in 17 other countries; women live longer in 10.
>
> Few dispute that the U.S. medical research in most fields is the world's most advanced and that many U.S. hospitals are among the world's best equipped. But the fruits of this research are not getting out to the great bulk of the population.[19]

Ten years later, the rate of increase and the total national expenditures for health care continued to surpass prior estimates. In 1980, total national expenditures for health care were $247.6 billion, representing 9.4 percent of GNP. Projections to 1990, only a ten year

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[19] "The $60 Billion Crisis Over Medical Care," Ibid., p. 39.

period, estimate more than a threefold increase in expenditures to $757.9 billion, representing 11.5 percent of GNP.[20]

The Business Week report discussed the four National Health Insurance proposals being considered as the means for closing the gap between the insured and uninsured segments of the population. The uninsured were estimated to be 187 million people distributed as follows: 24 million under 65 years of age with no health insurance at all; 61 million with no inpatient hospitalization coverage; and 102 million with no insurance to help pay for doctor's office visits.

New York's Health Insurance Plan (HIP) and California's Kaiser Permanente Group Health Plan were cited as examples of medical group practice cost containment programs exhibiting the added advantage of preventive medicine. The report stated:

> Their record also shows that they can reduce the need for hospitalization by at least 30 percent, because doctors have no economic reason to hospitalize patients, and subscribers get preventive care.

Edmund K. Faltermayer, commenting on prepaid group practice plans in general and specifically on the Kaiser plan, has stated:

> Their expansion would exert a badly needed competitive discipline upon the rest of the medical system...By almost any measure, then, the Kaiser program represents a quantum leap ahead of the prevailing pattern of health care in the U.S.[21]

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[20] U.S. Department of Health, Education and Welfare, Health Care Financing Administration, Health Care Financing Review, Winter 1980, Vol. 1, No. 3, pp. 7-8.

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