GoodRx Health

What Drives Health Care Costs in the U.S.?

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Published on April 20, 2022

Key takeaways:

- The U.S. spends an estimated $12,530 per person on healthcare every year, which is far higher than any other country in the world, including high-income countries.

- Hospital care and physician and clinical services make up the largest shares of these expenses. Taken together, they make up slightly over half of all healthcare spending.

- Reducing administrative costs and tackling other forms of waste are two ways to reduce healthcare costs without compromising quality.

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The U.S. has by far the highest per capita healthcare spending in the world, with no signs of slowing down. In 2020, healthcare spending in the U.S. reached $4.1 trillion, or $12,530 for every person in the country.

Medicare and Medicaid expenditures collectively made up 36% of that cost, or $4,510 per capita. That's nearly the same as the 2019 per capita spending of the U.K. ($4,582) and Finland ($4,450) both of which insure every resident of the country. Yet Medicare and Medicaid combined only insure about 40% Americans.

The Centers for Medicare and Medicaid Services (CMS) estimates national health spending will increase to $6.2 trillion by 2028.

Unfortunately, this spending has not led to the best outcomes in the world. While no single healthcare system is the best in the world in all aspects, the U.S. lags behind many other developed nations in access to care, equity, and healthcare outcomes.

In this post, we'll look at the biggest drivers of healthcare spending in the U.S. and explore ways the U.S. might be able to reduce costs without compromising quality.

The largest healthcare expenditures

According to the CMS, the three largest categories — and only categories that account for more than 5% of overall spending — are hospital care, physician and clinical services, and retail drug prescriptions. Let's explore each one.

Hospital care

Hospital care accounted for $1.3 trillion, or 31%, of the total health expenditures pie in 2020. That represents $3,884 for every person in the U.S. Hospital care was defined as all services provided to patients by hospitals.

This includes, but is not limited to:

- Hospital services

- Inpatient physician services

- Inpatient pharmacy services

- Hospital-based nursing home and home health services

It was by far the largest category of spending, and the only category over $1 trillion.

Physician and clinical services

In 2020, physician and clinical services totaled $809.5 billion, or 20% of total health expenditures. Physician and clinical services were defined as services provided in establishments operated by physicians, outpatient care centers, and the portion of medical laboratories services that are billed independently by the laboratories.

Clinical services provided in outpatient clinics by the U.S. Department of Veterans Affairs (VA), Coast Guard Academy, Department of Defense, and Indian Health Service (IHS) were also included.

Retail prescription drugs

As defined by the CMS, retail prescription drugs include all retail sales of prescription drugs sold in pharmacies — including chain, independent, and mail order — and all other retail establishments.

In 2020, total spending on retail prescription drugs was $348.4 billion, or 8% of total expenditures. Spending in this category increased 3% between 2019 and 2020, which was slower than the 4.3% growth seen the year before. CMS attributes this to lower out-of-pocket expenses due to less utilization and the use of coupons.

Healthcare expenditures by payer

In 2020, Medicare accounted for 20% of total healthcare expenditures, or $829.5 billion. However, by 2028, 75 million people are expected to be covered under Medicare. This increases projected spending to approximately $1.6 trillion, or 25% of total projected spending.

In 2020, Medicaid accounted for 16% of total healthcare expenditures, or $671.2 billion, while private health insurance accounted for 28%, or approximately $1.2 trillion. Out-of-pocket spending accounted for 9% of expenditures, or $388.6 billion. This included payment for services not covered by insurance, copays, deductibles, and health savings accounts (HSA).

The remainder is accounted for by various other programs, like the VA, Children's Health Insurance Program (CHIP), IHS, and worker's compensation. It also comes from public health activities and other investments in healthcare.

What will healthcare spending look like in the future?

According to the CMS, healthcare spending is projected to grow at an average annual rate of 5.4%, reaching $6.2 trillion in 2028. It is also projected to outpace annual growth in gross domestic product (GDP). As of 2020, healthcare spending accounted for close to 20% of GDP.

An aging population will contribute to faster spending growth with Medicare, leading to an average annual growth of 7.6% from 2019 to 2028. That's even faster than the growth rate of healthcare spending on the whole.

Despite this continued increase in spending, the number of uninsured Americans is not projected to improve. In fact, the CMS projects that the insured share of the population will decline slightly, from 90.6%, in 2018, to 89.4%, in 2028. While that might seem like a small change, using the current population count of approximately 330 million, a 1.2% decrease in the share of insured Americans means close to another 4 million people without health insurance.

Reducing cost

Reducing cost is the subject of intense research. While there are numerous opinions on how to reduce cost, even among health economists, here we'll focus on waste, because the majority of Americans can agree on reducing waste in healthcare.

Administrative costs

According to one study, administrative costs totaled an estimated $950 billion in 2019, or about 25% of overall healthcare spending. The study estimated that up to $265 billion could be saved through administrative simplification, or about 6.5% of all healthcare spending, without significantly changing the structure of the healthcare system.

The authors divided these changes into two categories:

1. **Within and between interventions at the organizational level:** These are interventions that can be implemented within organizations, or through an agreement between organizations, but do not require industry-wide change. This includes reducing manual and inefficient processes and workflow, especially in "industry-agnostic" functions like human resources and finance. Examples are automating financial statements, using tools to better predict and coordinate staffing, and improving interoperability between payers and hospitals.

2. **Seismic interventions at the industry level:** These interventions would require the entire industry to intervene and come to an agreement on the solution. Examples provided include changes in payment design, a centralized, automated claims clearinghouse, standardized policies across

payers for things like more expensive medications, diagnostics, and treatments.

In addition to complexity, high administrative costs have also been [attributed](#) to health insurer profits. The Affordable Care Act requires 80% or 85% of [insurance premiums](#) to be spent on medical care. (If that doesn't happen, the insurer is required to issue a rebate for the difference to its customers.) But that still leaves up to 20% of premiums that can be kept by insurers.

Reducing waste

In addition to reducing administrative costs, proposals have been made to reduce waste in other ways. A [2019 study](#) published in the Journal of the American Medical Association estimated that waste costs the U.S. healthcare system up to $935 billion annually.

The authors divided waste into the following categories and provided 2019 costs for each:

- **Failure of care delivery:** $102.4 billion to $165.7 billion

- **Failure of care coordination:** $27.2 billion to $78.2 billion

- **Overtreatment or low-value care:** $75.7 billion to $101.2 billion

- **Pricing failure:** $230.7 billion to $240.5 billion

- **Fraud and abuse:** $58.5 billion to $83.9 billion

- **Administrative complexity:** $265.6 billion

Again, in this study, administrative complexity accounted for the largest category of waste. Interestingly, both studies found administrative waste to cost about $265 billion annually.

Interventions proposed across all categories were estimated to save up to a total of $286 billion annually.

Pending legislation

In his first [State of the Union address](#), President Joe Biden outlined his plan for healthcare reform, including addressing spending. In November 2021, Biden's key piece of legislation, the "[Build Back Better](#)" plan, which includes many of the reforms mentioned in the address, was passed by the House of Representatives. But it still must pass the Senate to become law, and the Senate has [proposed](#) their own versions of the bill.

A recent [analysis](#) from the Kaiser Family Foundation estimates this bill would reduce the number of uninsured Americans by 3.4 million. It would also reduce federal healthcare spending with some provisions, like the government being able to negotiate drug prices, and increase federal spending with other provisions, like expanding Medicaid coverage.

Key proposals that Biden outlined in his State of the Union address included:

- Capping the out of pocket cost of insulin for patients to $35 per month

- Making permanent the American Rescue Plan's tax credits, which reduce premium costs by an average of $50 per person per month, to people who purchased insurance through the [marketplace](#)

- Tackling the opioid crisis with reforms — including increasing funding for prevention, treatment, harm reduction, and recovery — and expanding providers' ability to [prescribe treatment](#)

- Enacting a series of [reforms](#) to the regulation and oversight of nursing homes

- Outlining a [plan](#) to improve mental health care

- Enacting a "[Test to Treat](#)" COVID-19 policy, in which patients can be tested at pharmacy-based clinics and other sites of care and prescribed antivirals at the time of the visit, if positive

The bottom line

Healthcare costs in the U.S. are by far the highest in the world, with no signs of slowing down. Hospital care is by far the largest share of those costs, at close to a third of overall spending. Reforms will be necessary to reduce costs. And while not everyone agrees on what that will look like, taking steps to reduce high administrative costs and tackling other forms of healthcare waste could save a significant amount of money without compromising healthcare quality.

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