

Understanding Costing in Healthcare

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Over the past 50 years there has been a tremendous improvement in healthcare as a result of new screening methods, diagnostic tests, devices and drugs. Prior to being approved for clinical use these items must pass rigorous tests to demonstrate safety and efficacy. Many countries are raising the bar further because of rising healthcare costs and limited budgets by demanding the new products to be cost-effective as well. Unfortunately cost-effectiveness analysis is often misunderstood to mean cheaper. In this short article we begin by first trying to understand the basics of costing in a healthcare system from the perspective of the patient.

Why are costs important in healthcare? There are at least 3 reasons to do costing studies in health care. (1) We want to know what resources are used for; (2) to understand the functioning of services or programs; and (3) to act to improve results and get better value.

We begin our understanding of costs from the perspective of the economist who is concerned about the total costs of health care and its impact on society. This is where a fundamental rift occurs that separates the way economists and accountants look at the world.

For the accountant they will only consider what is called an explicit cost. Economists consider both explicit and implicit costs. The best way to explain the difference between these types of costs is through an example of a typical hospitalization.

Example: A patient enters a hospital for a procedure and stays in the hospital for 1 week. At the end of his/her stay they are released from the hospital and presented a hospital bill. The hospital bill is an example of an explicit cost also referred to as a direct cost. It is concrete you have the bill in your hand and for the accountant this is the entire costs of a hospitalization.

However, if you ask the patient how much the hospitalization cost him/her they will undoubtedly give you a much higher figure. This is where we see the introduction of implicit costs. There are at least 3 more costs that the economist considers. The first is Direct Non-Medical Costs: this is the cost of transportation to the facility, parking, food for their families while they are away from home, and hotel rooms for family members. The second types of cost are Indirect costs.

An example of indirect costs is seen when a patient is not paid while they are away from work so they lose 1 week of pay while in the hospital or drugs the patient needs to take after they leave the facility that may not be covered by the third party payer. The third type of costs is an Intangible cost. An



intangible cost 2 is a type of costs that is difficult to quantify but negatively impacts the patient.

For example, if the patient walks with a slight limp after the surgery or they cannot do everything they use to do prior to surgery (i.e., exercise).

Therefore, if you ask the patient

how much did the week in the hospital cost?

They will tell you well it cost me the hospitalization bill + transportation costs + hotel fees + food + 1 week of loss pay + drugs + any intangible costs.

The cost of being hospitalized for 1 week is much higher than the hospital bill specifies.

However, and more importantly, because third party payers do not reimburse outpatient medications, physicians tend to extend their patient's hospital stay which leads to higher healthcare costs in Lebanon. The first step in understanding and controlling costs in a healthcare system is to begin by quantifying all the costs that the patient must bear and determining how third party payer policies affect costs for the healthcare system as a whole.

Hospitals in Lebanon are in a similar situation as the patient who is not being reimbursed for all costs. Just as patients are not being reimbursed for all their costs, third party payers do not reimburse hospitals in Lebanon for medical supplies under an arbitrary \$20 of value. This policy does not make economic sense for 2 reasons. First it does not allow hospitals to charge third party payers for all the supplies utilized which means they will need to find indiscrete methods to charge the third party payer. Second, it will create health care inflation since hospitals are then driven to use more expensive supplies over \$20 in value that will be reimbursed. Moreover, indirect costs such as quality accreditation costs are not being reimbursed properly which provides no motivation for hospitals to improve.

In order to have a health care system that functions properly and is constantly improving market distortions that create waste, inefficiency and escalating costs must be eliminated.

The first step is to understand the costs in the health system. In the next article I will discuss cost-effectiveness analysis in hospitals.

Please send your comments to vtanzi@globalhcm.com

Suggested Reading

Drummond MF, Richardson WS, O'Brien BJ, Levine M, Heyland D. Users' guides to the medical literature. XIII. How to use an article on economic analysis of clinical practice. A. Are the results of the study valid? Evidence-Based Medicine Working Group. *JAMA*. 1997;277:1552-7.

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