AHA
Advancing Health in America

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Medicare Payment Advisory Commission
601 New Jersey Avenue, Suite 9000
Washington, DC 20001

Dear MedPAC Commissioner:

At your upcoming meeting, the Medicare Payment Advisory Commission (MedPAC) will be making important decisions about Medicare payment to hospitals in fiscal year (FY) 2005 and beyond. The decisions you reach on hospital and other provider payment updates will greatly affect the ability of our nearly 5,000 member hospitals, health systems, networks, and other health care providers to deliver health care services to their patients and communities.

As you prepare for next week's meeting, we would like to share our concerns over a number of unanswered questions from your December meeting.

Are Medicare payments to hospitals adequate?

For the majority of America's hospitals, Medicare is not paying adequately. **In 2002, 55 percent of hospitals had negative Medicare margins, that is, nearly 2,700 hospitals lost money treating Medicare patients.** Hospitals' Medicare margin has continuously dropped since 1997. AHA Annual Survey data indicate that this trend is continuing, with an aggregate Medicare margin of *negative* 2.1 percent in 2002, down from *negative* 1.6 percent in 2001. Regardless of cost allocation, the bottom line is clear – the majority of hospitals lose money treating Medicare patients.

Nearly one-third of hospitals have *negative* total margins and are losing money on every patient they treat. Yet all hospitals are facing escalating cost pressures. The inpatient Medicare cost per case grew 6.6 percent in 2001 and MedPAC staff estimated growth of approximately 8 percent in 2002. Our own AHA Annual Survey data showed growth in total expense per adjusted admission of 5.4 percent in 2002.

Will hospital cost growth continue at current rates?

Cost growth in recent years reflects the extreme pressures on hospitals due to several factors.

- Hospital workforce shortages continue to push labor and benefit costs upward and, according to the Bureau of Labor Statistics for the 12 months ending August 2003, total compensation for hospitals went up by 4.5 percent compared to 3.2 percent for other service industries.
- Growing demand (inpatient admissions up 2.0 percent, outpatient visits up 3.2 percent and emergency department visits up 3.8 percent) at the same time as capacity is constrained in many hospitals.
- Rising pharmaceutical and technology costs (largely paid in a budget neutral manner by Medicare).
- Soaring medical liability premiums. One-quarter of all hospitals faced premiums that were doubled or more than doubled in 2003.
- Replacing outdated clinical information systems.
- Increasing expenses for "public goods" including care for the uninsured, emergency services, and disaster preparedness (including SARS).

These pressures – largely beyond the control of hospitals – were important factors driving cost growth in 2001 and 2002. Hospitals believe that these are still major pressures that hospitals will face for the foreseeable future. MedPAC staff, however, have assumed that cost growth will abate or decline in 2004 and 2005.

Do hospitals have adequate access to capital?

The majority of our nation's hospitals do not have affordable access to capital. Hospitals are struggling to finance needed physical improvements and clinical information systems for enhanced care, quality improvement, and patient safety. A recent report by the Healthcare Financial Management Association (HFMA) reported that only 36 percent of hospitals had broad access to capital in 2001. For other hospitals, capital investment is difficult and more costly to access, and decisions to move forward with capital projects – out of necessity – often further deteriorates the financial footing of many hospitals due to higher debt burden, less cash on hand, and lower profitability. In a second report by HFMA, they found that 41 percent of hospitals are not investing enough capital to keep ahead of asset depreciation. The disparities between the "haves" and "have nots" are growing and the quality of nearly half the nation's hospital facilities and their ability to meet future demand for services are in jeopardy.

We encourage you to ask more of the MedPAC staff in supporting their claims that access to capital is sufficient for the hospital field. We believe the statistics clearly point to a different conclusion. Medicare payment that keeps up with inflation is important to improving the overall financial performance of hospitals and we encourage the Commission to investigate additional alternatives for addressing the capital financing needs of hospitals.

What is an appropriate adjustment for productivity change?

While it is difficult to measure and estimate productivity growth, MedPAC staff have provided no information on the appropriateness or accuracy of the proposed productivity adjustment – the single largest reduction proposed. Without any analysis, MedPAC staff have recommended that the hospital update be adjusted downward by 0.9 percentage points to reflect a "productivity improvement target" for hospitals that equals the ten-year average of multifactor productivity change for the general economy.

A recent analysis by Columbia University economist Frank Lichtenberg suggests a different conclusion. He finds hospital productivity growth is less than half the average rate of growth in productivity of the general economy as would be expected because of specific characteristics of the hospital field that correlate to less productivity growth including: high labor intensity, smaller firm size, lower capital investment in information technology, and lower investment in research and development.

While hospitals strive to improve their operations and are continually pressured by public and private payers to reduce costs and perform more efficiently, Lichtenberg's findings indicate that there should be limits to payer expectations, short of major changes or innovations that alter care delivery or the market. We urge you to review Lichtenberg's report (attached). **In the absence of <u>any</u> MedPAC analysis of hospital productivity or appropriate improvement targets, we strongly urge Commissioners to delete the Staff recommendation to reduce the hospital update by 0.9 percentage points for productivity change.**

For hospitals, your update decisions are among the most important as your work influences the Congress to either pay or withhold billions of dollars each year. You may not realize it, but a single percentage point increase or decrease in MedPAC's update recommendation for inpatient and outpatient care translates in to about $1 billion a year either paid to or withheld from America's hospitals.

Given the rising cost pressures hospitals face and the growing inadequacy of Medicare payment, it is essential that Medicare payment updates at least account for inflation. A full market basket update for <u>all</u> hospitals is critical for ensuring that hospitals have the resources needed to continue to provide access to quality health care in their communities.

We appreciate your consideration of these important issues. If you have any questions, please contact me at (202) 626–2266 or Don May at (202) 626–2356.

Sincerely,

Carmela Coyle

Carmela Coyle
Senior Vice President, Policy