AHIP
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Working Paper: An Illustration of the Impact on Hospitals in California of a Government-Run Health Plan that Pays Medicare Fee-for-Service Rates

CONTENTS

CONTENTS (continued)

Working Paper: An Illustration of the Impact on Hospitals in California of a Government-Run Health Plan that Pays Medicare Fee-for-Service Rates

Analysis of the finances of California hospitals from the state's Office of Statewide Health Planning and Development (OSHPD) suggests substantial net losses for hospitals from a large-scale switch to Medicare's fee-for-service (FFS) payment rates, even if their losses from the uninsured were eliminated.

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INTRODUCTION

One of the most controversial issues in the health care reform debate is the proposal to establish a government-run or government-sponsored health plan to compete with private health insurance plans. The implications of such a change have not been fully addressed, and much of the impact would depend on the design and parameters of the plan. Many are envisioning a government-run plan designed like Medicare's traditional fee-for-service (FFS) program; therefore, this paper focuses on the first-order effects of a government-run plan that would reimburse hospitals at Medicare FFS payment rates. In a preliminary attempt to illustrate the impact of such a change, we analyzed data from the State of California to show how a switch to Medicare FFS payment rates would affect the revenue and net income margins of California hospitals. Our analysis looked at how six different scenarios would impact hospital finances in California. The scenarios varied based on the percentage of the commercial revenue that was replaced by Medicare FFS reimbursement (50 percent or 100 percent), the Medicare FFS payment rate (current rates or 10 percent higher), and whether or not the hospitals' losses from the uninsured were covered (at cost). The State of California is unique in that it provides a rich set of data on the state's hospitals in an easy-to-use and publicly accessible format. We will update this working paper with new data as it becomes available from OSHPD.

IMPACT ON CALIFORNIA HOSPITALS OF MEDICARE FFS RATES AND COVERING THE UNINSURED

To illustrate the effects of a large-scale switch to Medicare FFS reimbursement rates on hospital net income, we examined comparable acute care hospitals statewide. The method was straightforward: we calculated the revenue for the hospital if half or all the costs associated with their commercially insured population (non-Medicare) were instead reimbursed at the Medicare FFS payment-to-cost ratio for each hospital. We assumed that the currently uninsured were covered at full cost. Thus, to model the impact of universal coverage, we simply eliminated hospitals' shortfalls from the uninsured patients and from county programs for the indigent.

Figure 1 (page 4) illustrates the effect of the various scenarios on the total net income – which includes net patient income, as well as non-patient revenues and expenses – for all comparable acute care hospitals in the State of California. It shows that California's hospitals would experience very large reductions in net revenues, even if all Californians currently uninsured were covered. For example, if half of the commercially insured population under 65 were moved to a government-run plan that paid at Medicare FFS rates, and all losses from the uninsured were covered, the combined net income for all 327 comparable acute care hospitals in California would be reduced from $3.5 billion to $45 million. Even at Medicare FFS rates plus 10 percent, these hospitals would still see a substantial decline in their combined income – a reduction of $2.8 billion – with all uninsured losses covered at cost.

On the other hand, if all commercially insured patients under age 65 were to migrate to a plan with Medicare FFS rates, California's comparable acute care hospitals would experience even greater losses. Their net income statewide would plummet from $3.5 billion to a deficit of $6.9 billion, statewide. Even by covering the uninsured losses and paying at Medicare FFS rates plus 10 percent, the annual deficit would still exceed $3.7 billion with both scenarios in place.

The choice of modeling both 50 percent and 100 percent of commercial business switching to Medicare FFS rates is only hypothetical, however, because if half of the commercial payments to hospitals in California were to switch to Medicare FFS rates, it is possible that, in fact, all of the commercial payments could soon disappear.[1]

This is because Medicare's below-market payment rates do not exist in a vacuum. As long as Medicare FFS pays below-market rates, without a corresponding reduction in actual health costs or improvements in health care itself, hospitals and commercial insurers are forced to adjust.[2] In California, as elsewhere, commercial health plans and HMOs may pay much higher rates to

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[1] For additional analysis on this point, see Dobson, A. DaVanzo, J., El-Gamil, A., and Berger, G. "Modeling the Impact of a Government-Run Plan Option on Hospital Finances and Commercial Premiums in California," unpublished manuscript, July 2009 (Available from Dobson DaVanzo & Associates, LLC). This new report, sponsored in part by AHIP, describes a larger model based on OSHPD data that takes into account the possible impacts of a government-run plan paying FFS rates on premiums for private coverage as well as hospital finances, under a variety of "cost-shifting" scenarios.

[2] Dobson, A., DaVanzo, J., and Sen, N. "The Cost-Shift Payment 'Hydraulic': Foundation, History, And Implications," *Health Affairs* 25, no. 1 (2006): 22–33. Found at: http://content.healthaffairs.org/cgi/reprint/25/1/22. Also, Ginsburg, P. "Can Hospitals and Physicians Shift the Effects of Cuts in Medicare Reimbursement to Private Payers?" *Health Affairs* Web Exclusive (October 8, 2003).

hospitals than Medicare FFS, but can make up part of the difference by reducing fraud, abuse and overutilization, and employing disease management and chronic care programs that help keep patients from becoming ill and requiring hospitalization or re-admission.[3] However, despite health plans' significant advances in chronic care management, care coordination, prevention and wellness, fraud prevention and health information technology, it is unlikely that the savings accrued by these initiatives could fully offset the differential enjoyed by a government-run plan paying providers at Medicare FFS rates.

CALIFORNIA'S OSHPD DATA

The OSHPD dataset contains financial and utilization profiles for individual hospitals operating in the state. The data include revenue, cost, and utilization measures by payer category, including traditional FFS Medicare, Medicare managed care, Medicaid (traditional and managed care), commercial third party, other state or local payers (generally local programs for the indigent), and direct patient payment (a category for patients without insurance, which generally showed large losses).[4]

Table 1 (see page 5) shows the combined net patient revenues and estimated costs for all comparable acute care California hospitals, by type of payer, including Medicare (FFS and managed care), MediCal, county indigent programs, private insurers, and self-pay patients (including the indigent uninsured). The data are for calendar year 2007, and were published on the OSHPD website as of April 2009.

Table 2 (see page 5) shows the resulting net surplus or loss from each payer category for the California acute care hospitals, and the payment-to-estimated cost ratio.

In 2007, California hospitals received 45 percent of their patient revenues from private (non-Medicare) insurers, and approximately 25 percent from Medicare's FFS program. However, the estimated costs incurred by Medicare FFS patients were nearly as high (30 percent) as those of commercial patients (32 percent). Thus, the payment-to-cost ratio for Medicare FFS was 83 percent, and the payment-to-cost ratio for private commercial insurers was just over 139 percent.

Table 3 (see page 6) shows the hypothetical impact on selected hospitals if 50 percent of their commercial business were instead paid at Medicare FFS rates, in terms of revenue loss and change in net income margin. To estimate these impacts, we simply calculated the payment-to-

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[3] AHIP Center for Policy and Research. "Working Paper: A Preliminary Comparison of Utilization Measures Among Diabetes and Heart Disease Patients in Eight Regional Medicare Advantage Plans and Medicare Fee-for-Service in the Same Service Areas," unpublished manuscript, as of July 2009. See also: http://www.heritage.org/Press/Events/ev042809a.cfm.

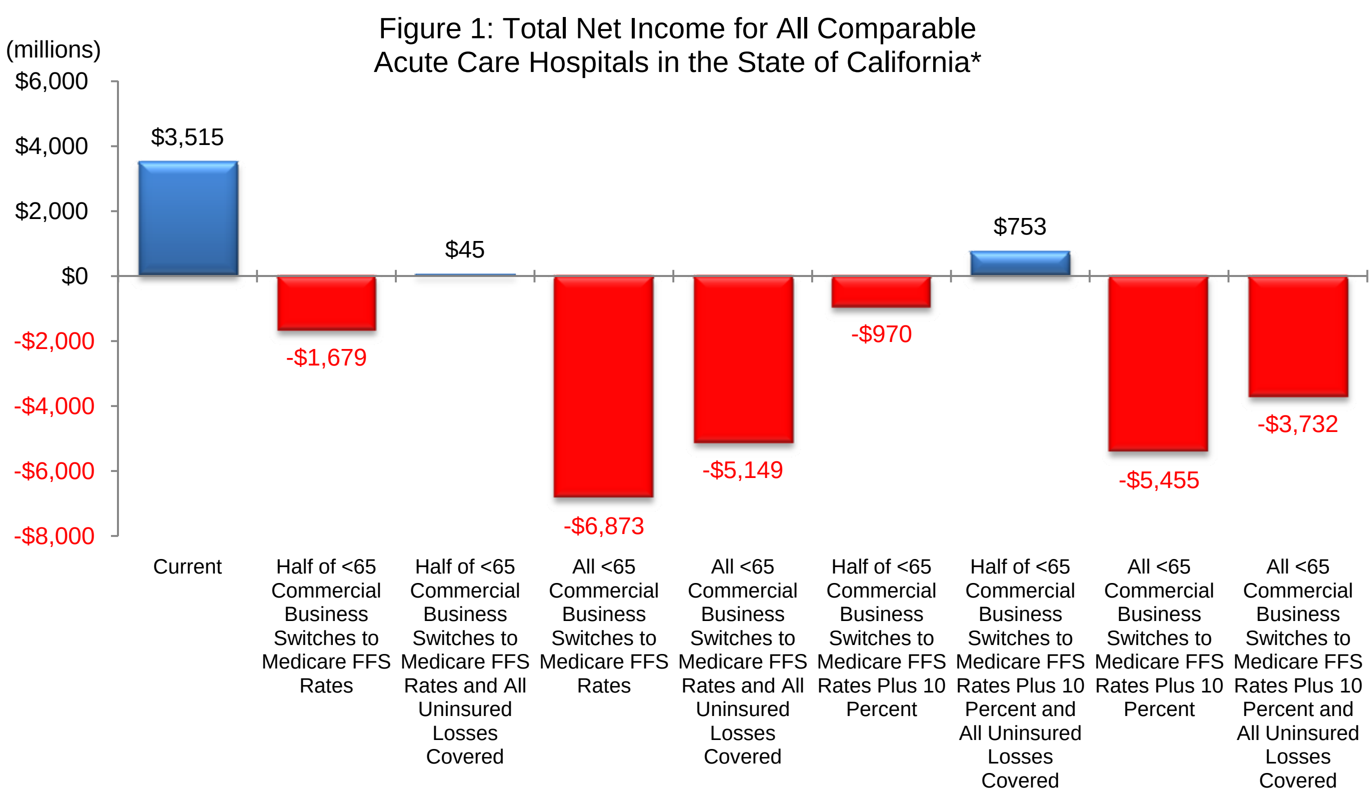
[4] State of California – Health and Human Services Agency, Office of Statewide Health Planning and Development. *Instructions for Downloading and Using OSHPD Hospital Annual Financial Pivot Table Profiles*. Available at: http://www.oshpd.ca.gov/HID/Products/Hospitals/AnnFinanData/PivotProfles/PivotTableInstructions.pdf. Accessed April 24, 2009. The OSHPD reporting system also includes data on beds and utilization by type of care, an income statement, a balance sheet, financial ratios, uncompensated care calculations, direct expenses by natural classification and cost center group, and labor productivity by employee classification. The data analysis here is based only on those hospitals designated as "comparable" by OSHPD for which sufficient data were available for analysis. "Non-comparable" hospitals have unique characteristics, and have been granted modifications to the annual reporting requirements. Examples of non-comparable hospitals in the OSHPD classification system for financial data include certain long-term care hospitals, psychiatric hospitals, and the Kaiser Hospitals.

estimated cost ratio for traditional Medicare, and applied that payment rate to half of the commercial business.

Table 4 (see page 7) shows the impact on the same hospitals with 50 percent of commercial business paid at Medicare FFS rates, but also with the assumption that hospitals would no longer incur losses for covering the uninsured. The impact of covering the uninsured was estimated by simply eliminating the reported shortfalls from local indigent programs and uninsured patients. Appendices B and C detail these calculations on a hospital-by-hospital basis, and include various rankings, by loss due to Medicare FFS rates, by margin (net gain or loss overall), and by Medicare FFS payment-to-cost ratio.

Tables 5 and 6 (see pages 8 and 9) show the impact on California hospitals under the scenario that 100 percent of commercial payments switched to Medicare FFS rates. Table 6 shows the impact assuming the uninsured are also covered, and Appendices B and C detail these estimated impacts on a hospital-by-hospital basis. Tables 7 and 8 (see pages 10 and 11), as well as Appendix D, illustrate the impact of 50 percent of commercial business migrating to a government-run plan that reimburses at Medicare FFS rates plus 10 percent. Similarly, Tables 9 and 10 (see pages 12 and 13) and Appendix E show the Medicare FFS plus 10 percent scenario, but with a 100 percent migration of commercial business to the government-run plan.

It is important to note that each of the appendices include data for all comparable hospitals – general acute care, psychiatric, and specialty – in California for which there were sufficient data for analysis (370 hospitals).



** Includes all comparable acute care facilities for which data were available for analysis.*
Source: AHIP analysis of 2007 California Office of Statewide Health Planning and Development (OSHPD) data. Available at: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.

Table 1. Summary of California OSHPD Data on Hospital Financial Status, by Payer Category				
	Net Patient Revenue ($ millions)	Percent	Estimated Costs ($ millions)	Percent
Medicare Traditional (FFS)	13,564	24.8%	16,304	30.1%
Medicare Managed Care	3,347	6.1%	3,273	6.0%
MediCal	10,429	19.1%	12,720	23.5%
County Indigent Programs	638	1.2%	1,816	3.4%
Other Third Parties (Commercial)	24,565	45.0%	17,521	32.3%
Other Indigent Care	184	0.3%	730	1.3%
All Other Payers	1,862	3.4%	1,831	3.4%
Total	54,588	100.0%	54,194	100.0%

Notes: Data for calendar year 2007, as of April 2009. Data are for all "comparable" acute care hospitals, a category which excludes non-comparable hospitals (e.g., Kaiser and state-run hospitals), as well as comparable psychiatric health and specialty facilities.
Source: California Office of Statewide Health Planning and Development (OSHPD) data. At: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.

Table 2. California Hospital Payer Surplus or Shortfall, by Payer Category		
	Payer Surplus (+) or Shortfall (-) ($ millions)	Payment-to-Cost Ratio
Medicare Traditional (FFS)	-2,741	82.6%
Medicare Managed Care	74	101.5%
MediCal	-2,291	81.4%
County Indigent Programs	-1,178	34.9%
Other Third Parties (Commercial)	7,044	139.2%
Other Indigent Care	-545	25.1%
All Other Payers	31	101.0%
Total	394	100.7%

Notes: Data for calendar year 2007, as of April 2009. Data are for all "comparable" acute care hospitals, a category which excludes non-comparable hospitals (e.g., Kaiser and state-run hospitals), as well as comparable psychiatric health and specialty facilities.
Source: California Office of Statewide Health Planning and Development (OSHPD) data. At: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.

Table 3: Effect on Net Income Margin and Revenue Loss, 50 Percent of Commercial Business Paid at Medicare FFS Rates, Selected Hospitals				
Facility Name	2007 Net Patient Revenue ($ millions)	2007 Medicare FFS Revenue-to-Expense Ratio	Revenue Loss, 50 Percent Commercial Paid at Medicare FFS Rates ($ millions)	Net Income Margin, 50 Percent Commercial Paid at Medicare FFS Rates
Cedars-Sinai Medical Center	1,467	72%	-268	-9%
Stanford University Hospital	1,412	82%	-160	4%
UCSF Medical Center	1,369	84%	-147	-3%
University of California Davis Medical	936	86%	-102	-6%
Sutter Medical Center – Sacramento	629	79%	-100	-7%
Mercy General Hospital	367	86%	-37	3%
Eisenhower Medical Center	286	73%	-27	1%
Kaweah Delta District Hospital	305	89%	-21	2%
Barton Memorial Hospital	91	70%	-19	-6%
Tri-City Medical Center	237	84%	-17	-10%
El Centro Regional Medical Center	75	73%	-7	-8%

Source: AHIP analysis of California Office of Statewide Health Planning and Development (OSHPD) data. Source data available at: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.

Table 4: Effect on Net Income Margin and Revenue Loss, 50 Percent of Commercial Business Paid at Medicare FFS Rates and All Uninsured Losses Covered, Selected Hospitals				
Facility Name	2007 Net Patient Revenue ($ millions)	2007 Medicare FFS Revenue-to-Expense Ratio	Revenue Loss, 50 Percent Commercial Paid at Medicare FFS Rates and All Uninsured Losses Covered ($ millions)	Net Income Margin, 50 Percent Commercial Paid at Medicare FFS Rates and All Uninsured Losses Covered
Cedars-Sinai Medical Center	1,467	72%	-260	-9%
Stanford University Hospital	1,412	82%	-147	5%
UCSF Medical Center	1,369	84%	-139	-2%
University of California Davis Medical	936	86%	-56	0%
Sutter Medical Center - Sacramento	629	79%	-83	-4%
Mercy General Hospital	367	86%	-32	5%
Eisenhower Medical Center	286	73%	-25	2%
Kaweah Delta District Hospital	305	89%	-15	3%
Barton Memorial Hospital	91	70%	-13	-1%
Tri-City Medical Center	237	84%	-10	-6%
El Centro Regional Medical Center	75	73%	-3	-2%

Source: AHIP analysis of California Office of Statewide Health Planning and Development (OSHPD) data. Source data available at: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.

Table 5: Effect on Net Income Margin and Revenue Loss, 100 Percent of Commercial Business Paid at Medicare FFS Rates, Selected Hospitals				
Facility Name	2007 Net Patient Revenue ($ millions)	2007 Medicare FFS Revenue-to-Expense Ratio	Revenue Loss, 100 Percent Commercial Paid at Medicare FFS Rates ($ millions)	Net Income Margin, 100 Percent Commercial Paid at Medicare FFS Rates
Cedars-Sinai Medical Center	1,467	72%	-536	-35%
Stanford University Hospital	1,412	82%	-319	-7%
UCSF Medical Center	1,369	84%	-294	-17%
University of California Davis Medical	936	86%	-204	-19%
Sutter Medical Center - Sacramento	629	79%	-200	-30%
Mercy General Hospital	367	86%	-74	-8%
Eisenhower Medical Center	286	73%	-53	-8%
Kaweah Delta District Hospital	305	89%	-43	-5%
Barton Memorial Hospital	91	70%	-38	-30%
Tri-City Medical Center	237	89%	-1	-3%
El Centro Regional Medical Center	75	73%	-13	-19%

Source: AHIP analysis of California Office of Statewide Health Planning and Development (OSHPD) data. Source data available at: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.

Table 6: Effect on Net Income Margin and Revenue Loss, 100 Percent of Commercial Business Paid at Medicare FFS Rates and All Uninsured Losses Covered, Selected Hospitals				
Facility Name	2007 Net Patient Revenue ($ millions)	2007 Medicare FFS Revenue-to-Expense Ratio	Revenue Loss, 100 Percent Commercial Paid at Medicare FFS Rates and All Uninsured Losses Covered ($ millions)	Net Income Margin, 100 Percent Commercial Paid at Medicare FFS Rates and All Uninsured Losses Covered
Cedars-Sinai Medical Center	1,467	72%	-527	-34%
Stanford University Hospital	1,412	82%	-307	-6%
UCSF Medical Center	1,369	84%	-286	-16%
University of California Davis Medical	936	86%	-158	-13%
Sutter Medical Center - Sacramento	629	79%	-184	-26%
Mercy General Hospital	367	86%	-69	-7%
Eisenhower Medical Center	286	73%	-52	-7%
Kaweah Delta District Hospital	305	89%	-37	-3%
Barton Memorial Hospital	91	70%	-32	-22%
Tri-City Medical Center	237	89%	-1	-3%
El Centro Regional Medical Center	75	73%	-10	-12%

Source: AHIP analysis of California Office of Statewide Health Planning and Development (OSHPD) data. Source data available at: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.

Table 7: Effect on Net Income Margin and Revenue Loss, 50 Percent of Commercial Business Paid at Medicare FFS Rates Plus 10 Percent, Selected Hospitals				
Facility Name	2007 Net Patient Revenue ($ millions)	2007 Medicare FFS Revenue-to-Expense Ratio	Revenue Loss, 50 Percent Commercial Paid at Medicare FFS Rates Plus 10 Percent ($ millions)	Net Income Margin, 50 Percent Commercial Paid at Medicare FFS Rates Plus 10 Percent
Cedars-Sinai Medical Center	1,467	72%	-247	-8%
Stanford University Hospital	1,412	82%	-131	6%
UCSF Medical Center	1,369	84%	-122	-1%
University of California Davis Medical	936	86%	-88	-4%
Sutter Medical Center - Sacramento	629	79%	-92	-6%
Mercy General Hospital	367	86%	-32	5%
Eisenhower Medical Center	286	73%	-24	2%
Kaweah Delta District Hospital	305	89%	-18	3%
Barton Memorial Hospital	91	70%	-18	-5%
Tri-City Medical Center	237	84%	-14	-8%
El Centro Regional Medical Center	75	73%	-6	-7%

Source: AHIP analysis of California Office of Statewide Health Planning and Development (OSHPD) data. Source data available at: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.

Table 8: Effect on Net Income Margin and Revenue Loss, 50 Percent of Commercial Business Paid at Medicare FFS Rates Plus 10 Percent and All Uninsured Losses Covered, Selected Hospitals				
Facility Name	2007 Net Patient Revenue ($ millions)	2007 Medicare FFS Revenue-to-Expense Ratio	Revenue Loss, 50 Percent Commercial Paid at Medicare FFS Rates Plus 10 Percent and All Uninsured Losses Covered ($ millions)	Net Income Margin, 50 Percent Commercial Paid at Medicare FFS Rates Plus 10 Percent and All Uninsured Losses Covered
Cedars-Sinai Medical Center	1,467	72%	-239	-7%
Stanford University Hospital	1,412	82%	-118	7%
UCSF Medical Center	1,369	84%	-114	0%
University of California Davis Medical	936	86%	-42	1%
Sutter Medical Center - Sacramento	629	79%	-75	-3%
Mercy General Hospital	367	86%	-27	6%
Eisenhower Medical Center	286	73%	-22	3%
Kaweah Delta District Hospital	305	89%	-12	5%
Barton Memorial Hospital	91	70%	-12	0%
Tri-City Medical Center	237	84%	-7	-5%
El Centro Regional Medical Center	75	73%	-2	-1%
Source: AHIP analysis of California Office of Statewide Health Planning and Development (OSHPD) data. Source data available at: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.				

Table 9: Effect on Net Income Margin and Revenue Loss, 100 Percent of Commercial Business Paid at Medicare FFS Rates Plus 10 Percent, Selected Hospitals				
Facility Name	2007 Net Patient Revenue ($ millions)	2007 Medicare FFS Revenue-to-Expense Ratio	Revenue Loss, 100 Percent Commercial Paid at Medicare FFS Rates Plus 10 Percent ($ millions)	Net Income Margin, 100 Percent Commercial Paid at Medicare FFS Rates Plus 10 Percent
Cedars-Sinai Medical Center	1,467	72%	-493	-30%
Stanford University Hospital	1,412	82%	-261	-3%
UCSF Medical Center	1,369	84%	-243	-12%
University of California Davis Medical	936	86%	-175	-15%
Sutter Medical Center - Sacramento	629	79%	-184	-26%
Mercy General Hospital	367	86%	-64	-5%
Eisenhower Medical Center	286	73%	-48	-6%
Kaweah Delta District Hospital	305	89%	-35	-3%
Barton Memorial Hospital	91	70%	-35	-27%
Tri-City Medical Center	237	89%	-1	-1%
El Centro Regional Medical Center	75	73%	-12	-17%

Source: AHIP analysis of California Office of Statewide Health Planning and Development (OSHPD) data. Source data available at: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.

Table 10: Effect on Net Income Margin and Revenue Loss, 100 Percent of Commercial Business Paid at Medicare FFS Rates Plus 10 Percent and All Uninsured Losses Covered, Selected Hospitals				
Facility Name	2007 Net Patient Revenue ($ millions)	2007 Medicare FFS Revenue-to-Expense Ratio	Revenue Loss, 100 Percent Commercial Paid at Medicare FFS Rates Plus 10 Percent and All Uninsured Losses Covered ($ millions)	Net Income Margin, 100 Percent Commercial Paid at Medicare FFS Rates Plus 10 Percent and All Uninsured Losses Covered
Cedars-Sinai Medical Center	1,467	72%	-485	-29%
Stanford University Hospital	1,412	82%	-249	-2%
UCSF Medical Center	1,369	84%	-236	-11%
University of California Davis Medical	936	86%	-130	-9%
Sutter Medical Center - Sacramento	629	79%	-167	-22%
Mercy General Hospital	367	86%	-59	-3%
Eisenhower Medical Center	286	73%	-46	-5%
Kaweah Delta District Hospital	305	89%	-29	-1%
Barton Memorial Hospital	91	70%	-30	-19%
Tri-City Medical Center	237	89%	0	-1%
El Centro Regional Medical Center	75	73%	-9	-11%
Source: AHIP analysis of California Office of Statewide Health Planning and Development (OSHPD) data. Source data available at: http://www.oshpd.state.ca.us/HID/Products/Hospitals/AnnFinanData/PivotProfles/default.asp. Accessed April 24, 2009.				

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