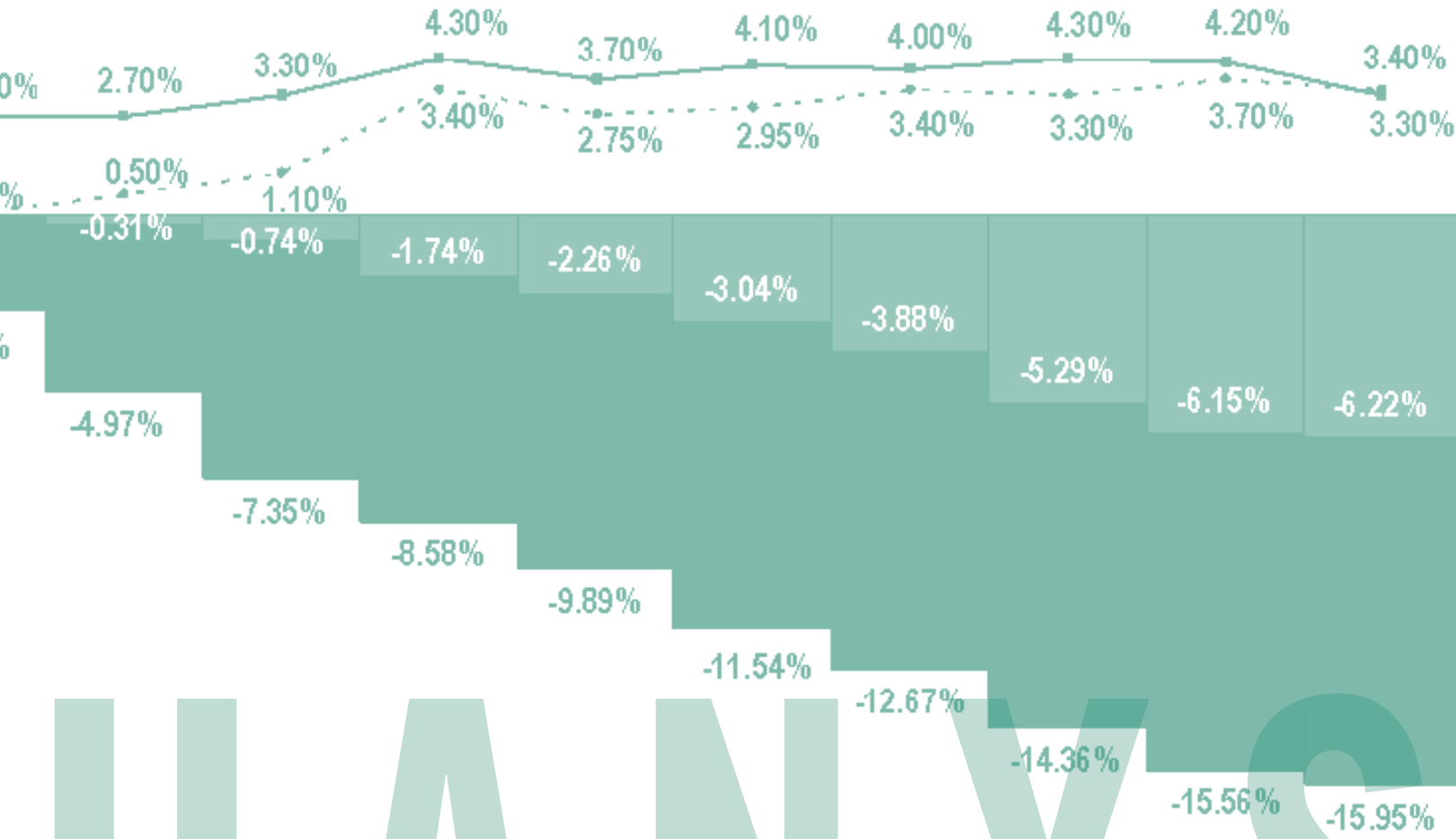


HANYS

FALLING BEHIND:

MEDICARE HOSPITAL PAYMENT POLICY
IN NEW YORK



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Healthcare Association
of New York State



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HANYS urges Congress to reject cuts to hospitals and health systems, whether by legislation or regulation.

Hospitals and health systems are under attack by federal policies that are systematically reducing Medicare reimbursement for the care these institutions provide to patients. These policies threaten the financial viability of health care providers and jeopardize patient access to care.

Hospitals and health systems are an integral part of New York's communities. They provide timely access to emergency care, stand ready to provide leadership during disasters, give care to the vulnerable and uninsured, invest in community health, and strive to invest in technology and infrastructure. Depriving hospitals and health systems of needed reimbursement stymies their ability to do all of these things, weakening the entire health care system.

Hospitals and health systems are not receiving responsible Medicare reimbursement that reflects the cost of providing care.

- Legislated cuts and hidden regulatory cuts have combined to hold New York's cumulative Medicare hospital rate increase to 15.4% over the last ten years. Costs have increased by almost three times as much—43.2%—over the same period.
- The failure of payments to keep up with costs has resulted in 56% of New York hospitals losing money, breaking even, or operating in a precarious condition with financial margins of 1% or less.

Beginning with the 1997 Balanced Budget Act, many Medicare policy changes were implemented to reduce Medicare hospital reimbursement.

- Congress has cut the annual inflation update to hospital payments five times in the last ten years, cutting hospital rates by almost 10%.
- Forecasting errors in determining the inflation update in eight of the last ten years have resulted in an additional “hidden” 6% cut.
- Other major cuts to Graduate Medical Education payments and Medicare wage indexes have made most hospitals fall further behind.

This year, in spite of the Medicare losses incurred by many hospitals, the Bush Administration proposed a budget with significant hospital payment reductions, and the Centers for Medicare and Medicaid Services (CMS) issued a proposed rule that would, in effect, freeze payment rates to hospitals in 2008.

- Congress rejected the cuts in the President's budget that would have cut New York's hospitals by \$2.5 billion over five years.
- When the President could not get Congress to cut hospitals and health systems, the Administration turned to the rulemaking process and proposed similar cuts through regulation that, if implemented, will cost New York hospitals more than \$2.1 billion over the same period.
- Other Administration proposals would decrease Medicaid and medical education payments to New York by another \$4.75 billion over five years.

Meanwhile, Medicare has been generous to Medicare Advantage managed care plans, which have received large annual payment increases.

- While hospital rate increases in New York have been reduced to a total of 15.4% over the last ten years, New York Medicare Advantage plans have seen their rates increase four times as much—62.6%—over the same time period.
- The Congressional Budget Office (CBO) recently estimated that payments to Medicare Advantage plans would exceed fee-for-service costs for providing the benefits by \$70 billion nationwide from 2008 to 2012.
- Over the same period, Medicare Advantage plans in New York would receive \$7 billion more than fee-for-service plans for providing the benefits.

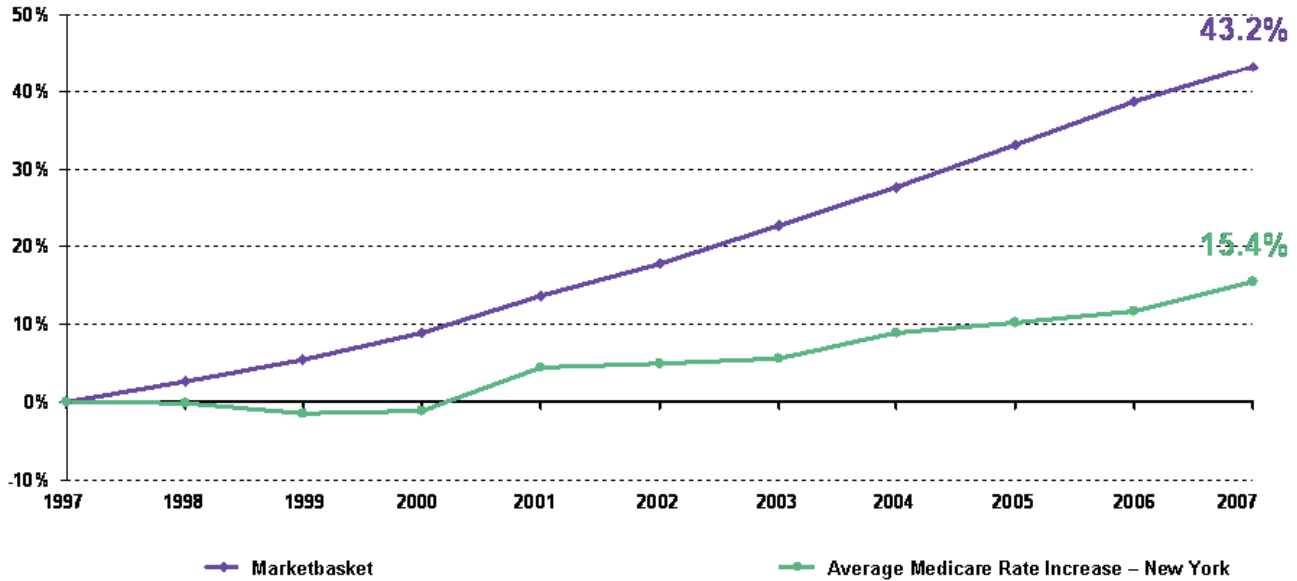
The charts on the following pages show the effects of past and proposed Medicare payment policy on U.S. hospitals. They illustrate the impact of Medicare payment policy on hospital reimbursement rates. Hospital rate increases are also contrasted to Medicare managed care plan rate increases.

MEDICARE HOSPITAL PAYMENTS FAIL TO KEEP UP WITH THE COST OF CARE

An analysis of New York hospital rate increases between 1997 and 2007, compared to inflationary cost increases, reveals that each year Medicare hospital payments fell behind inflation by an average of 2.3%, resulting in a cumulative shortfall of 27.8%

over the ten-year period. New York hospitals received payment increases of 15.4%, or 1.4% per year, while costs, as measured by the CMS hospital marketbasket, increased by 43.2%, or 3.7% per year.

CUMULATIVE NEW YORK MEDICARE HOSPITAL RATE INCREASES VS. MARKETBASKET COST INCREASES



The following table summarizes the key policy changes that affected the rate increases illustrated above:

Medicare Rate Component	FFY 1998	FFY 1999	FFY 2000	FFY 2001	FFY 2002	FFY 2003	FFY 2004	FFY 2005	FFY 2006	FFY 2007
Reductions Affecting All Hospitals										
Marketbasket Update	No Market Basket Update	Marketbasket Minus 1.9% Marketbasket Underprojection of 0.30%	Marketbasket Minus 1.8% Marketbasket Underprojection of 0.40%	Marketbasket Underprojection of 0.90%	Marketbasket Minus 0.55% Marketbasket Underprojection of 0.40%	Marketbasket Minus 0.55% Marketbasket Underprojection of 0.65%	Full Marketbasket Provided Marketbasket Underprojection of 0.60%	Marketbasket Underprojection of 1.0%	Marketbasket Underprojection of 0.50% (estimated)	Marketbasket Overprojection of 0.10% (estimated)
Post-Acute Transfer Policy		Post-Acute Transfer Policy Introduced Affecting 10					Post-Acute Transfer Policy Expanded to 28 DRGs		Post-Acute Transfer Policy Expanded to 182 DRGs	
Reductions to Select Hospitals										
Disproportionate Share Hospital (DSH) Adjustment	DSH Payments Reduced by 1.0%	DSH Payments Reduced by 2.0%	DSH Payments Reduced by 3.0%	DSH Payments Reduced by 3.0% (October - March) DSH Payments Reduced by 1.0% (April - September)	DSH Payments Reduced by 3.0%	Temporary DSH Payment Reductions Sunset				
Indirect Medical Education (IME) Adjustment	IME Adjustment Reduced from 7.7% Formula to 7.0%	IME Adjustment at 6.5%	IME Adjustment at 6.0%	IME Adjustment at 6.3% (October - March) IME Adjustment at 6.8% (April - September)	IME Adjustment at 6.5%	IME Adjustment at 5.5%	Temporary Increase in IME Adjustment to 6.0% (April - September)	IME Adjustment at 5.8%	IME Adjustment at 5.6%	IME Adjustment at 5.35%
Labor-Share									Hospitals With Wage Index >= 1.000: Reduced from 71.1% to 69.7%	
Improvements / Neutral										
Federal Standard Amount						Large Urban Amount Provided to All (April - September)	Large Urban Amount Provided to All Permanently			
Wage Index			Legislative Reclassifications Provided				Legislative Reclassifications Provided (April)	Labor-Market Areas Revised Based on 2000 Census		Legislative Reclassifications Extended
Labor-Share								Hospitals With Wage Index < 1.000: 62.0%		
Disproportionate Share Hospital (DSH) Adjustment					Threshold Reduced to 15% for Rural/Small Urban Hospitals (April)		Increased DSH Cap for Rural/Small Urban, All Hospitals Paid at Urban DSH Formula (April)			12% DSH Cap Removed for Medicare Dependent Hospitals (MDHs)
Special Rural Status				Option of 1996 Base Year Begins for Qualified Sole Community Hospitals (SCHs)						MDH Hospital-Specific Share of Rate Increased to 75% Option of 2002 Base Year Begins for Qualified MDHs

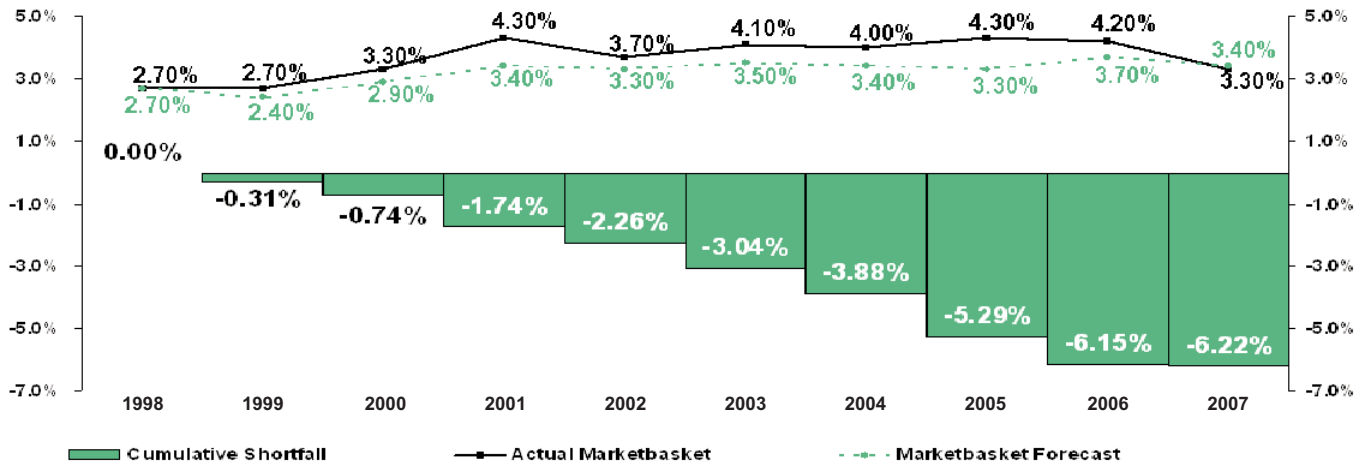
MEDICARE MARKETBASKET CONSISTENTLY UNDERESTIMATES COST INCREASES

Almost every year, the Administration hits hospitals with a hidden reimbursement cut, through faulty forecasts of the annual “marketbasket” inflation update. Since 1998, these forecast shortfalls have cut payments by an additional 6.2% beyond any legislated cuts to hospital payment rates. A comparison between the marketbasket increases forecasted by CMS each year and the

actual marketbasket increases as determined by CMS when costs are computed after each year is completed reveals that in eight of the ten years from 1998 to 2007 the forecasted marketbasket was less than the actual value. CMS does not reimburse hospitals in future years for its previous forecasting errors.

MARKETBASKET FORECAST VS. ACTUAL MARKETBASKET

1998 - 2007

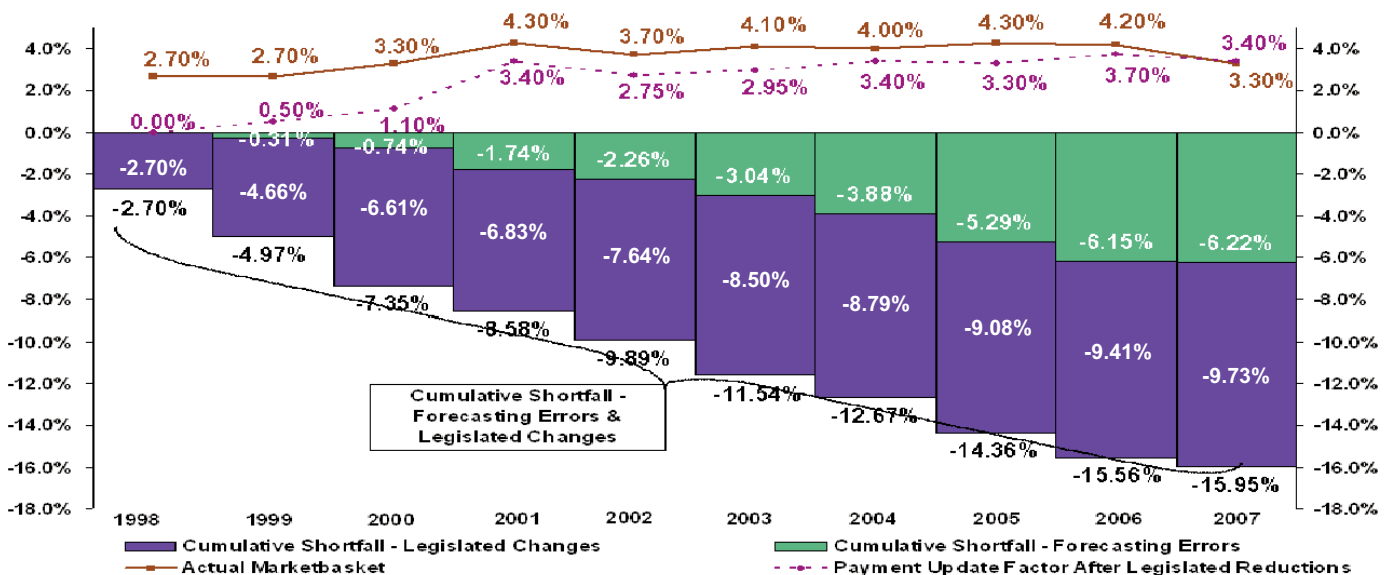


COMBINATION OF LEGISLATED CUTS AND HIDDEN MARKETBASKET CUTS CREATES A CUMULATIVE SHORTFALL

In addition to the hidden CMS marketbasket cuts, in five of the last ten years Congress has chosen to reduce the annual Medicare hospital payment update to below the marketbasket to

achieve savings. The impact of the hidden and legislated cuts from 1998 to 2007 has resulted in a cumulative shortfall of 16% over the last ten years.

ACTUAL MARKETBASKET VS. LEGISLATED PAYMENT UPDATE FACTOR, 1998-2007

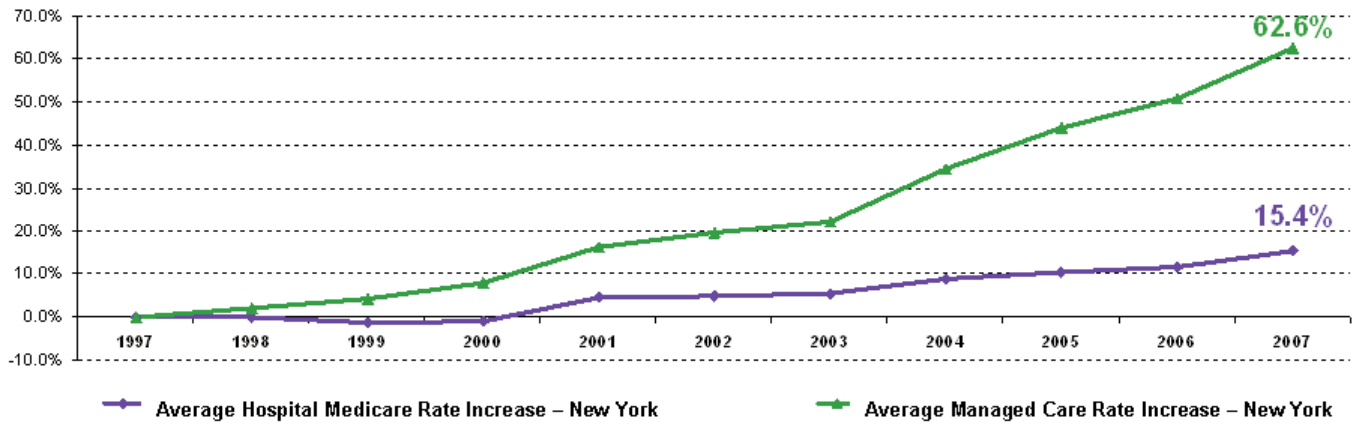


MEDICARE ADVANTAGE PAYMENT RATES SOAR WHILE HOSPITAL RATES ARE REDUCED

While hospitals are grappling with inadequate payment updates, very different Medicare payment policy decisions have been made for managed care plans. The greatest divergence in policy decisions has taken place since passage of the Medicare Prescription Drug, Improvement, and Modernization Act. In New York State, Medicare hospital payment rates increased 15.4% between 1997

and 2007, while the benchmark payment rates for Medicare Advantage plans in the state have increased more than 62% during the same period. The average annual payment increase to New York's hospitals was 1.4%; the average annual payment increase to Medicare Advantage plans was 5.0%.

HOSPITAL PAYMENT TRENDS VS. MEDICARE ADVANTAGE RATE TRENDS, 1997-2007

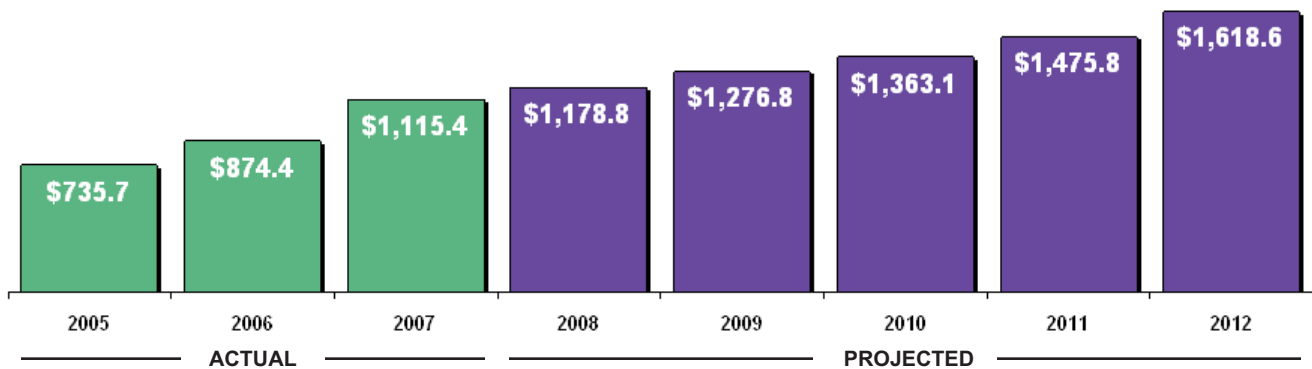


MEDICARE ADVANTAGE: IS IT WORTH IT?

Payment rates to Medicare Advantage plans exceed the actual costs of providing benefits under the traditional, fee-for-service program. The February 2007 CBO *Budget Options Paper* points out that if Medicare Advantage plans were paid rates that reflected actual fee-for-service costs, the program would save

\$70 billion over the five years from 2008 to 2012. HANYS' analysis of Medicare Advantage and Medicare fee-for-service data indicates that in New York State the savings would be almost \$7 billion over the same period.

OVERPAYMENTS TO MEDICARE ADVANTAGE PLANS IN NEW YORK STATE, 2005-2012



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HOSPITAL PAYMENT POLICY GOING FORWARD: IMPACT OF CURRENT PROPOSED REDUCTIONS ON NEW YORK

President Bush has proposed billions of dollars in Medicare cuts to hospitals by both legislation and regulation. The President's federal fiscal year (FFY) 2008 budget, which was rejected by Congress, would have cut New York's hospitals by \$2.5 billion over the next five years.

In addition to the President's budget proposal, CMS has proposed a Medicare inpatient hospital payment rule for FFY 2008 that would cut hospital reimbursement in a different way. Without need for congressional approval, the inpatient CMS proposal would effectively offset the full marketbasket update through regulation and make other redistributive changes. These changes would cost New York hospitals more than \$2.1 billion over the next five years.

Two other proposed CMS rules would make drastic reductions to New York's Medicaid funding. The first would cut New York's public hospital payments by \$1.75 billion over five years by restricting intergovernmental transfer payments. The second rule would move forward with a recommendation in the President's budget to eliminate Medicaid funding for Graduate Medical Education—worth \$3 billion to New York over five years. Both of these rules have been temporarily blocked by Congress.

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