EBRI NOTES

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MEDICARE MOVES TO PROSPECTIVE PRICING FOR HOSPITAL CARE

P.L. 98-21, the Social Security reform legislation signed into law on April 21, 1983, not only affects the Social Security retirement and disability programs--it also affects the way Medicare pays hospitals. Under the new legislation, Medicare payments to hospitals are based on the patient's diagnosis, rather than on the actual hospital services provided to the patient, or the length of the patient's hospital stay. Hospital reimbursement based on diagnostic-related groups (DRGs) is intended to reward efficient hospitals, or those whose patients have shorter hospital stays. These hospitals will profit by retaining the dollar difference between the actual cost of caring for Medicare patients and the DRG-based reimbursement for those patients. Conversely, hospitals whose patients experience above-average lengths of stay, or hospitals with unusually intense service delivery for particular DRGs, will bear the loss of Medicare reimbursements below the hospital's incurred costs. This "prospective" system of paying hospitals replaces Medicare's former method of reimbursing retrospective hospital costs.

New Jersey is the only state that has used DRGs to determine hospital reimbursement levels. New Jersey's system has been evaluated as a limited success. Under this system, hospital charges are set for all payers, including Medicare, Medicaid and private insurers. When New Jersey hospitals are reimbursed below cost by one payer (e.g., Medicare), they cannot shift their losses by increasing prices to other payers (e.g., private insurers). As a result, the incentives for New Jersey hospitals to hold down the cost of care for all patients have been effective.

Medicare's new method of paying hospitals, however, is unlike New Jersey's method. In states, that do not regulate hospital charges to all payers, Medicare will be the only payer of hospital costs which prospectively prices hospital care.

Before passage of prospective Medicare pricing, some groups raised questions about this system's effect on private payers for hospital care. Since most states do not regulate hospital charges to all payers, hospitals are free to shift unreimbursed Medicare costs to private payers in the form of higher prices. In the absence of federal or state regulations, individual private insurers are unlikely to adopt prospective pricing to protect themselves from Medicare cost shifting. Individual insurers who initiate prospective pricing risk their ability to survive in an increasingly competitive environment.

As first proposed in Congress, prospective Medicare pricing would have provided broad opportunity for cost shifting by relying exclusively on DRGs for reimbursement calculation. Adjustments to DRG-based reimbursement levels would have been made only for area labor costs. No adjustments would have been made for hospital size or for the more complex or severe illnesses that characterize teaching-hospital patients. Experts argued that under this arrangement, hospitals would receive and respond to "windfall" gains and losses in Medicare reimbursement. Since Medicare is a major purchaser of hospital care, critics of the proposal were concerned that inefficient dislocations (i.e., adjustments in hospital charges and practice patterns) would occur.

The Congressional Budget Office (CBO) estimated the size of windfall gains and losses that would occur for selected hospital categories under this proposal. Their figures do not necessarily reflect real differences in hospitals' costs of serving Medicare patients.1/ CBO's analysis, summarized in table 1, indicated that hospitals with less than 100 beds would have received 23 percent more in Medicare reimbursement under this proposal than they would have received under the Medicare reimbursement limits established in 1982.2/ Conversely, hospitals with 300 or more beds would have lost 6 percent. Urban hospitals--those located in a Standard Metropolitan Statistical Area (SMSA)--would have lost 4 percent. Rural (non-SMSA) hospitals would have gained 19 percent. CBO's estimates assume that total Medicare reimbursements to all hospitals would be held at the level allowed by the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA). TEFRA constraints on total reimbursements were not repealed by P.L. 98-21.

The implication of windfall gains and losses, along with the ability of hospitals to shift Medicare losses, alarmed critics of the proposal. They argued that in order to constrain Medicare costs, the proposal encouraged overall hospital cost inflation. If some hospitals received windfall bonuses and others shifted losses to the private sector, no hospital could lose. This system, they contended, provided no incentives for hospitals to contain costs and encouraged some hospitals to raise costs.

One estimate of the potential 1984 cost-shift to private payers under the original proposal totalled $3.1 billion. This is a 5.3 percent increase in the total 1984 estimated payments of private insurers and individual payers. This $3.1 billion is in addition to a $2.7 billion cost-shift (an increase in

1/ Statement by Nancy M. Gordon of the Congressional Budget Office before the Subcommittee on Health, U.S. Congress, House Committee on Ways and Means (Washington, D.C., February 14, 1983), p. 5.

2/ The 1982 Tax Equity and Fiscal Responsibility Act limited annual increases in Medicare cost-based reimbursement for fiscal years 1983 through 1985. By 1985, TEFRA limitations are expected to hold Medicare reimbursements by as much as 9 percent below the level they would otherwise reach. Medicare reimbursement limits under TEFRA expire in 1986.

TABLE 1

Estimated Average Gains and Losses under the Administration's Proposed DRG-Based Payment System, by Type of Hospital [1]

	Aggregate Effect as Percent of Reimbursement		
	All Hospitals [2]	Hospitals that Would Gain [3]	Hospitals that Would Lose [4]
All Hospitals	0 [5]	23	-12
Bed Size			
less than 100	23	35	-10
100-299	2	21	-11
300 or more	- 6	17	-13
Standard Metropolitan Statistical Area [6]			
SMSA	- 4	20	-13
non-SMSA	19	29	- 6
Region			
northeast	- 4	19	-12
north central	- 4	21	-13
south	8	26	- 9
west	- 2	23	-13
Teaching Status			
teaching	- 7	18	-13
nonteaching	7	24	-10
Ownership			
nonprofit	- 2	20	-12
government	9	29	-12
proprietary	- 1	22	-13

Source: Congress of the United States, Congressional Budget Office. Preliminary estimates based on Medicare Cost Reports for 1980.

1/ Assumes an average payment level needed to keep outlays at the same level as under TEFRA in fiscal year 1984. Average gains and losses are incremental to those under TEFRA, which are assumed to be the average for each group. An adjustment for teaching hospitals is included.
2/ Average calculated for all hospitals.
3/ Average calculated for hospitals that would gain.
4/ Average calculated for hospitals that would lose.
5/ Because aggregate reimbursements were assumed to be the same as under TEFRA, increased payments to some hospitals would be exactly offset by decreased payments to others.
6/ As defined by the Bureau of the Census.

private-sector costs of 4.6 percent) that was already anticipated under TEFRA.3/ These estimates, adjusted for the share of all hospital revenues from private payers, suggest that the original proposal would have raised the hospital cost inflation rate by about 2 percentage points in 1984.

In an effort to eliminate some of the potential problems, Congress made changes to the proposal. The version of the proposal that was passed in P.L. 98-21 refines the area labor cost adjustments of DRG-based payments to hospitals. Also, it provides that prospective pricing be phased in over three years. During this time, Medicare will factor individual hospital costs into the reimbursement amount, using the cost categories traditionally recognized by Medicare.4/ Nevertheless, the opportunity remains for cost-shifting and for a net inflationary impact from Medicare prospective pricing. As the administration and Congress move into a new round of cuts in the federal budget for Medicare, this is a source of concern to consumers and private insurers.

SURVEYS SHOW THAT INDIVIDUAL RETIREMENT ACCOUNTS (IRAs) ARE POPULAR

According to the results of four nationwide surveys, 9 to 17 percent of United States households have opened IRAs. Respondent tabulations indicate that an additional 11 to 38 percent will open IRAs in the near future.

The surveys were conducted between February 1982 and February 1983 by: (1) Washington Post/ABC survey departments; (2) Life Insurance Marketing and Research Association, Inc. (LIMRA); (3) American Bankers Association (ABA); and (4) Cadwell-Davis (a New York City advertising firm). The surveys were based on "representative" national samples ranging from 1,500 to 3,600 households. The ABA and LIMRA surveys detail IRA investments, while the Post/ABC poll provides limited investment information.

The combined survey results show that between 20 and 55 percent of all households intend to open IRAs. According to the Post/ABC and LIMRA polls, 50 to 57 percent of respondents with IRAs contributed at least $2,000 for the 1982 tax year. The ABA and LIMRA surveys indicate: 57 to 60 percent of all respondents with IRAs have opened their accounts at commercial savings banks; 8 to 10 percent at credit unions; 5 to 9 percent in mutual funds; 10 percent with life insurance companies; and 6 to 11 percent with brokerage firms.

The wide variation in utilization rate responses can be attributed to survey dates (earlier surveys yielded a lower rate), and to the respondents' income distribution. All surveys show that IRA utilization increases with household

3/ Estimates produced by the Prudential Insurance Company of America, Mimeographed (New Jersey, February 23, 1983), p. 5.

4/ P.L. 98-21 makes some adjustments to the level of reimbursement allowed within conventional Medicare cost categories. In particular, payments to proprietary (i.e., for-profit) hospitals for return on equity (profit) were cut by one-third. This cut has been a major source of concern to proprietary hospitals that compete in capital markets against the authority of nonprofit hospitals to issue tax-exempt bonds.

income. The surveys with a slightly larger proportion of lower income households show lower overall utilization rates. For more information, see EBRI's March 1983 Issue Brief #16 which reviews rate of return experience of IRA investments between 1974 and 1982.

WOMEN'S EQUITY PROPOSALS GAINING ATTENTION

A number of legislative proposals intended to increase women's pension benefits were introduced in the 97th Congress, but they received little attention. The 98th Congress, however, is likely to be more attentive to such proposals. On January 26, the Retirement Equity Act of 1983 (S. 19) was introduced; on March 19, the Economic Equity Act of 1983 (S. 888 and H.R. 2090) was introduced; and on April 2, the Private Pension Reform Act of 1983 (S. 918 and H.R. 2100) was introduced. These bills have broad bipartisan sponsorship and are expected to be given serious consideration. There is speculation that some of these bills' provisions could be included in the budget reconciliation process.

The Senate Finance Committee will probably hold hearings on these bills in May. EBRI is preparing to submit materials which will provide Congress with additional information on these proposals. We will use information from previous EBRI studies on pension vesting, participation and coverage. The bills hold broad implications for employers, employees and spouses. For example, consider the following summary of employee-benefit-related provisions in the proposed Economic Equity Act:

- Private pensions - Lower the minimum participation age to twenty-one. Additionally, modify break-in-service rules as they apply to maternity and paternity rules, and modify survivor benefits.

- Individual retirement accounts (IRAs) - In determining allowable deductions for IRA contributions, treat support payments as "compensation." Increase lower-paid spouses' accessibility to IRA benefits.

- Public pensions - Establish women's rights to a prorata share of spousal benefits accrued during marriage to a Civil Service employee for at least ten years. Before retiree can waive survivors benefits, require written consent from the spouse.

- Dependent care - Increase the percentage of dependent care expenditures eligible for tax credits. Refund the dependent care credit for low-income earners. Establish a "seed money" grant program to develop child care information and referral services. Amend definitions in section 501(c)(3) of the tax code; these definitions presently disqualify day care centers from section 501 (c)(3) status.

- Sex discrimination - Prohibit sex discrimination in insurance.

- Regulatory reform - Amend federal regulations that reflect unequal treatment of women based on sex.

EBRI ACTIVITIES

Executive Director Presents Congressional Testimony

Senate Committee on Labor and Human Resources--Dallas L. Salisbury, Executive Director of EBRI, presented testimony before the Senate Committee on Labor and Human Resources on March 21, 1983. Salisbury's statement, "The Current Health and Future Prospects for Defined Benefit Pension Plans," provided: (1) an overview of the retirement income system; (2) a discussion of impediments to pension plan growth; and (3) comments on the future of private pensions. Reference #T-10, 44 pages, $4.50.*

Research Director Presents Congressional Testimony

Senate Budget Committee--Sylvester J. Schieber, EBRI's Research Director, testified before the Senate Budget Committee on February 4, 1983, during deliberations on the First Concurrent Budget Resolution for fiscal year 1984. The hearing considered the financing problems of employer-provided health care and retirement programs. Schieber's testimony focused on the funding status and budgetary implications of the Civil Service Retirement System and military retirement programs. Reference #T-12, 14 pages, $1.50.*

As a follow-up to Schieber's testimony, Senator Domenici requested additional analysis of the Civil Service Retirement System's funding status. The analysis is presented in a paper entitled "An Explanation of the Current Funding Status of the Civil Service Retirement System." The paper explains the historical funding pattern of the federal retirement program and the relative employer-employee contribution levels. It also details the growth in and source of the program's unfunded liabilities. Reference #P-10, 36 pages, $3.50.*

House Ways and Means Social Security Subcommittee--Schieber testified at the Social Security Subcommittee hearings held February 8, 1983. His testimony analyzed: (1) the implications of covering federal workers under Social Security; and (2) the distributional effects of various options for resolving the long-term Social Security financing deficit. Extensive questions relating to confusion over the implications of covering new federal workers were addressed. Reference #T-11, 23 pages, $2.50.*

Senate Finance Committee--The Senate Finance Committee asked Schieber to testify on: (1) the implications of covering new federal workers under Social Security; (2) the funding and cost of the current federal retirement plan; and (3) the issues involved in designing a new retirement plan. His testimony, delivered on February 23, 1983, also discussed the trade-off in raising Social Security normal retirement age versus adjusting the benefit formula. Reference #T-13, 32 pages, $3.00.*

Schieber again testified before the Senate Finance Committee on April 11, 1983. He noted that TEFRA's impact on employee benefits cannot yet be quantitatively assessed. Schieber's submission focused on three major points: (1) the prevalence of tax incentives for pension plans, and other factors, have contributed to the historical growth of pension protection; (2) the pension

*Copies of testimonies are available through EBRI.

system's growth pattern has been sensitive to changes in public policy; and (3) the measurement and cost of tax incentives to pension participants, as represented by government "tax expenditure" estimates, are unsubstantiated, undocumented and arbitrary. Reference #T-14, 50 pages, $5.00.*

EBRI Articles

The Compensation Planning Journal published Dallas L. Salisbury's article on "Future Changes in Employee Benefits: Impact on the Corporate Bottom Line" in their March 1983 edition. The article notes that "...we are increasingly in an era in which employee benefits and corporate survival are intertwined." Salisbury contends that demographic, economic and government trends are the three factors behind the present employee benefit program transformation and this "...will influence the corporate environment for decades to come." He concludes by noting, "Our challenge is to help turn this period of crisis and transformation into a time of renewal and reward."

EBRI Speeches

Mr. Salisbury participated in several conferences during January and February. These included a Social Security conference held at the University of Maryland, meetings of the National Association of Manufacturers in Washington, DC and Chicago, and the annual Risk and Insurance Management Society, Inc. (RIMS) conference in Los Angeles.

Sylvester Schieber delivered a number of presentations during March and April to the following: (1) Business Roundtable Social Security and Pension Task Force, Newark, NJ; (2) Presidential Management Intern Program, Washington, DC; (3) American Paper Institute (API), Washington, DC; (4) Society of Government Economists, Alexandria, VA; and (5) Western Gerontological Society, Albuquerque, NM.

Integration Study Released

Pension Integration: Concepts, Issues and Proposals is now available through EBRI for $10.00. This book provides comprehensive explanation, description and analysis of pension integration. It also discusses the implications of current proposals to change integration regulations. See EBRI's February 1983 Issue Brief #15 for an overview of the study.

OUTSIDE ACTIVITIES AND PUBLICATIONS

Employers Council on Flexible Compensation (ECFC)

ECFC has announced they will hold a major conference on flexible compensation on May 9-10, 1983 in Washington, DC. The conference will focus on the status of cafeteria plans and cash or deferred arrangements. For more information, contact: ECFC, 1700 Pennsylvania Avenue, NW, Suite 600, Washington, DC 20006, (202) 393-1728.

* Copies of testimonies are available through EBRI.

Association of Private Pension and Welfare Plans (APPWP)

APPWP is sponsoring a conference on "Employee Benefits in Crisis," on May 24-26, 1983. The conference's subject matter is recent legislative change and prospects for the future. For more information, contact: APPWP, 1201 Pennsylvania Avenue, NW, Suite 340, Washington, DC 20004, (202) 737-6666.

Cost Containment of Health Care Benefits, Carlton Harker, F.S.A.

This book provides a comprehensive review of health care cost containment ideas and techniques. It includes up-to-date facts about successful cost containment approaches. In addition to discussing direct costs, indirect costs--such as absenteeism, turnover, productivity and morale--are covered. This publication is designed to aid hospital administrators, employee benefit practitioners, corporate officers, health care providers and all others interested in containing health care costs. For more information, contact: Actuarial Consulting Company, P.O. Box 11674, Winston-Salem, NC 27116-1674, (919) 765-7781. Price-$30.00.

Getting the Most Out of Washington: Using Congress to Move the Federal Bureaucracy, Senator William Cohen

In this publication, Senator Cohen (R-ME) offers suggestions on how to ask a senator or congressman for assistance with problems. The Senator's recommendations include: (1) Submit written requests with signature including name, address and phone number. (2) Be concise, candid and clear in describing the nature of the problem and note any steps already taken. (3) Keep copies of all correspondence. (4) Request assistance for problems which can still be resolved, e.g., avoid waiting until the last minute. Price-$8.95.

Monthly Benefit Statistics, United States Department of Health and Human Services, Social Security Administration

Subscription price-$13.00 annually; foreign price-$16.25. Single copies $2.00; foreign price $2.50. For more information, contact: Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Updated Government and Washington Information Directories

Federal Executive Telephone Directory--A comprehensive, up-to-date telephone directory of all executive managers in cabinet departments and agencies--updated every two months. Price-$96.00.

Washington Information Directory--This directory lists more than 5,000 information sources in Congress, the executive branch and private organizations. Price-$29.50.

Congressional Yellow Book--This loose-leaf publication lists members of Congress, committees, aides and subcommittee staffs and is updated four times each year. Price-$95.00.

Federal Yellow Book--A loose-leaf directory listing federal departments, agencies and employees. The volume is updated as changes occur--at least two complete versions in every twelve-month period. Price-$130.00.

Directory of Washington Representatives--A listing of Washington representatives from companies, associations, unions, special interest groups, foreign agents, lobbying organizations and law firms. Price-$30.00.

Washington Lobbyists/Lawyers Directory--This directory lists 9,500 lobbyists by name and is cross-indexed by affiliation. The publication has greatly expanded since its first edition in 1975 and contains a previously unobtainable list of "highly influential" people. Price-$34.50.

To order these publications, write to: H & M Publishers, 44 West Market Street, P.O. Box 311, Rhimebeck, NY 12572, (914) 876-2081.

The Employee Benefit Research Institute (EBRI) was established in 1978 to contribute to the development of public policy in the employee benefit field. EBRI, a nonprofit organization, has a broad membership that includes private sector companies and individuals with interests in employee benefit education, research and public policy.

EBRI also has a separate Education and Research Fund (ERF) which is operated exclusively to conduct charitable educational and research activities. The Fund is tax exempt under section 501(c) (3) of the Internal Revenue Code and is not a private foundation. EBRI Associates make contributions or grants to the Fund which are deductible as charitable contributions.

EBRI's policy forums, research studies, issue briefs, pamphlets and other publications aid public and private sector decision makers, managers, the press and the general public in formulating and articulating positions on employee benefit issues. As health and retirement issues receive increasing attention, the Institute strives to make effective and responsible contributions to public policy.

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EBRI NOTES, a bimonthly newsletter, includes information about: 1) newly released employee benefit statistics; 2) brief summaries of EBRI's ongoing research studies and forum discussions; and 3) reviews of outside research and publications.

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