MEDPAC Medicare Payment Advisory Commission

MEETING BRIEF

December 13-14, 2001

# Assessing payment adequacy and updating payments for hospital inpatient and outpatient services

**ISSUE:** Effective fiscal year 2002, do we believe that payments for all services hospitals provide to Medicare beneficiaries (primarily acute inpatient and outpatient, plus hospital-based rehabilitation, psychiatric, home health, and skilled nursing facility services) are adequate? What is the appropriate adjustment to account for efficient hospitals' cost increases next year? In the course of updating payments, should we close the gap in base payment rate between hospitals in large urban areas and those in other urban and rural areas?

**KEY POINTS:** Although data for 2001 have yet to come in from our National Hospital Indicators Survey (NHIS), all available information point toward the conclusion that the cost base for hospital inpatient and outpatient services is appropriate. Looking at payments relative to those costs, the 1999 overall Medicare margin is 4.7 percent. For the meeting, we will extend this number out to 2002, reflecting three years of payment updates, estimated per unit cost increases, and several other policy changes implemented between 1999 and 2003. Other information that bear on the adequacy of payments (particularly trends in volume and provider entry and exit) are generally consistent with a conclusion of adequate payments.

The appropriate allowance for the increase in efficient providers' costs next year appears to be the forecasted increase in the hospital market basket, which is 3.2 percent for fiscal year 2003 (used for updating inpatient payments) and 3.3 percent for calendar year 2002 (used for updating outpatient payments). The Commission will have to decide whether to apply an across-the-board adjustment for cost increases in the coming year, or whether in the course of updating payments to:

- Adjust the relationship of inpatient and outpatient base payment rates. The measured outpatient margin is much lower than the inpatient margin but has been artificially reduced by excessive allocation of costs to outpatient services.
- Adjust the relationship of the inpatient base rates for hospitals located in large urban areas relative to those in other urban or rural areas. Margins are higher in large urban areas, whether calculated with or without disproportionate share (DSH) payments and the portion of indirect medical education (IME) payments above the cost impact of teaching.

**ACTION:** At the meeting, we will present options for a conclusion on the adequacy of payments, for the inpatient and outpatient adjustments for cost increases in the coming year, and for potential redistributional adjustments. The Commission needs to make policy decisions in all three of these areas, hopefully at this meeting but extending to the January meeting as necessary.

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