

# Economic Analysis

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## **Extending Medicare Payment Rates to the Private Sector Would Save \$77.4 Billion Per Year**

*Large Employers Would Save \$41.4 Billion, or 901,000 Jobs*

By D. Mark Wilson

According to the Congressional Budget Office, Medicare's and Medicaid's fee-for-service payment rates are, on average, lower than private sector payment rates.<sup>1</sup> Specifically, Medicare's payment rates for physicians in 2006 were nearly 20 percent lower than private rates and its payment rates for hospitals were as much as 30 percent lower.<sup>2</sup> As for Medicaid, its payment rates for physicians and hospitals were about 40 percent and 35 percent lower, respectively, than private rates.<sup>3</sup>

Regardless of the debate over cost-shifting, permitting private sector payers to pay health care providers the same rates that Medicare and/or Medicaid pay would substantially lower health care costs for both employers and employees and significantly reduce the possibility of cost shifting.<sup>4</sup>

- An analysis by MedPAC found Medicare's payment rates for physicians were, on average, 18.7 percent lower than private insurers' rates in 2006.<sup>5</sup>
- The difference between Medicare's payment rates and those in the private sector varies geographically. According to one study, the rates paid to physicians by private insurers are an average of 30 percent higher than Medicare's rates in small metropolitan areas and rural areas, 10 percent higher in medium-sized metropolitan areas, and 1 percent higher in large metropolitan areas.<sup>6</sup>
- Private sector payment rates are also noticeably higher than Medicare's rates in areas with less competition among providers.<sup>7</sup>
- If Medicare's rates were extended to the privately insured, health care expenditures would fall, and the decrease in national health spending would deliver a substantially lower health care costs for both employers and employees.<sup>8</sup>
- Permitting large employers to pay health care providers at Medicare's rates would save \$41.4 billion per year, which is equivalent of 901,000 jobs.<sup>9</sup>
- Permitting *all* private sector payers to pay health care providers at Medicare's rates would save employees and employers \$77.4 billion per year, which is equivalent to almost 2.0 million full-time jobs.<sup>10</sup>

The Patient Protection and Affordable Care Act, if fully implemented, will increase cost-shifting from Medicare and Medicaid to the private sector by \$20.7 billion per year.<sup>11</sup> If employers do not have either the ability to fix the market or the power to force it to reengineer itself, perhaps employers should be permitted to pay health care providers the same rates that public programs pay. Although this would not address issues surrounding the volume of health care services, it would level the playing field by eliminating any real or potential cost shifting from Medicare and Medicaid that is driving up the cost of employment-based coverage.

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<sup>1</sup> Congressional Budget Office, *Key Issues in Analyzing Major Health Insurance Proposals*, December 2008, p. XIX, available at: <http://www.cbo.gov/ftpdocs/99xx/doc9924/12-18-KeyIssues.pdf>.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> Cost shifting occurs when health care providers charge private payers a higher fee to make up for low reimbursement rates paid by federal and state governments for Medicare and Medicaid and for uncompensated care from uninsured individuals who seek treatment but cannot pay. Unlike the federal and state governments, employers must negotiate with doctors and hospitals for their care, and they cannot force them to accept unilaterally imposed payment rates as the federal government is able to do. As a result, efforts to cut reimbursement rates for public programs in order to control government costs will very likely result in higher costs for private payers.

<sup>5</sup> Medicare Payment Advisory Commission, *Report to the Congress: Medicare Payment Policy*, March 2008, pg. 89.

<sup>6</sup> Dyckman & Associates, *Survey of Health Plans Concerning Physician Fees and Payment Methodology*, report prepared for the Medicare Payment Advisory Commission, August 2003.

<sup>7</sup> Congressional Budget Office, *Key Issues in Analyzing Major Health Insurance Proposals*, December 2008.

<sup>8</sup> Congressional Budget Office, *Options for Extending Medicare's Payment Rates and Covering the Uninsured*, July 1991, available at: [http://www.cbo.gov/ftpdocs/99xx/doc9930/1991\\_07\\_optionsforextending.pdf](http://www.cbo.gov/ftpdocs/99xx/doc9930/1991_07_optionsforextending.pdf)

<sup>9</sup> Applied Economic Strategies estimate based on data from the Congressional Budget Office, the Census Bureau, and the Bureau of Labor Statistics.

<sup>10</sup> *Id.*

<sup>11</sup> D. Mark Wilson, *Employer Costs for Health Care Reform*, Applied Economic Strategies, Economic Analysis No. 2010-1, March 25, 2010. Although PPACA will reduce cost shifting to private payers from uncompensated care as the number of uninsured individuals is reduced, it is likely to increase cost shifting from Medicare and Medicaid. For example, PPACA calls for significant reductions in hospital payments under Medicare. In addition, the law expands Medicaid eligibility that will add 16 million Americans to the program. Given the gap between Medicare and Medicaid reimbursement rates and private insurance rates, it is likely that providers will charge employers higher fees to make up for some part of the Medicare cuts and Medicaid expansion. The Congressional Budget Office estimates that "changes in cost shifting seems likely to be quite small" and "the total amount of cost shifting in the current health care system appears to be modest relative to the overall cost of health insurance" (Letter to Senator Evan Bayh, November 30, 2009, p. 12). The \$20.7 billion cost-shifting estimate represents 1.7 percent of the projected total private insurance expenditures in 2016. Although CBO's assessment of "the evidence is that a small amount of cost shifting occurs but that it is not as widespread or extensive as is commonly assumed", other research has found that a substantial amount of cost shifting occurs. One recent study found that average hospital prices paid by private insurers increase by 21 cents for every dollar reduction in public revenue (Vivian Wu, *Hospital Cost Shifting Revisited: Evidence from the Balanced Budget Act of 1997*," *International Journal of Health Care Finance and Economics*, August 12, 2009).