



## The Cost of Hospital Care

A DISCUSSION FEATURING:

**Robert Murray**

*Executive Director*

Health Services Cost Review Commission  
State of Maryland

**Keith Kasper**

*Senior Vice President and Chief Financial Officer*  
University of Pennsylvania Health System

**Michael Stevenson**

*President and Chief Executive Officer*  
Murphy Medical Center

## FORUM SESSION ANNOUNCEMENT

FRIDAY, OCTOBER 8, 2010

11:45AM–12:15PM—Lunch

12:15PM–2:00PM—Discussion

### LOCATION

Reserve Officers Association  
One Constitution Avenue, NE  
Congressional Hall of Honor  
Fifth Floor  
*(Across from the Dirksen  
Senate Office Building)*

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How much does a hospital admission cost? Well, that depends. The American Hospital Association has reported that the average cost per admission was \$9,788 in 2008, but costs vary dramatically across patients and facilities.<sup>1</sup> Some types of patients are more costly to treat than others because they need surgery or specialized equipment or they have long stays. Some types of hospitals are more expensive because of their location or the intensity of the services they provide. A wide range of factors, including managerial decisions about staffing and service offerings, and circumstances, like catchment area and patient population, affect a hospital's ability to control costs as well as its ability to generate additional revenues to fund its operations.

In general, a hospital's costs depend on its size and volume, mix and cost of inputs, and patient and service mix or products. Cost per admission may be lower in high-volume facilities because of the ability to spread fixed costs over more admissions. Larger facilities, however, are likelier to have teaching programs, attract sicker patients, provide more intense treatments, and be located in urban areas, all of which are associated with higher costs. Medicare makes payment adjustments for factors that influence a hospital's costs but does not link payments directly to an individual hospital's costs. Whether private-payer rates recognize these hospital cost differences depends on the negotiation process between payer and provider: a private payer's relative market power and an individual hospital's market position may have more effect on what private payers actually pay than the hospital's underlying costs. Hospitals with similar costs may be paid very different amounts, depending on how much a private payer wants the hospital in its network.

Hospital costs play an important role in health reform. The Patient Protection and Affordable Care Act is projected to achieve some of its savings through lower updates to Medicare hospital payment rates. According to the law, Medicare's annual increases to hospital payments will incorporate productivity adjustments equivalent to economy-wide productivity gains through 2019, which will in effect reduce the updates to less than yearly inflation. Medicare's ability to hold the line with these productivity expectations has already been questioned.<sup>2</sup> Further, *Modern Healthcare* recently reported that aggregate hospital patient care revenues are below patient care costs.<sup>3</sup> Medicare rates cover only 90.9 percent of aggregate hospital costs, and Medicaid rates cover only 88.7 percent.<sup>4</sup> If cost growth is not slowed considerably, these percentages will continue to slip. For low-cost facilities, however, Medicare may be a good payer and

cover their average costs. Even for higher-cost facilities, Medicare rates may cover the incremental costs of patient care.

Hospitals' responses to fiscal pressure may well depend on their payer mix. In addition to using investment income and other sources of nonpatient revenue to finance revenue shortfalls, hospitals may raise prices to private payers to compensate for lower rates from public payers. Some refer to this practice as cost shifting. The Medicare Payment Advisory Commission has shown a different relationship, however, between hospital costs and revenues. Hospitals under more fiscal pressure, that is, those that have low non-Medicare profits, have lower costs than hospitals with higher private-payer profits.<sup>5</sup> Hospitals with additional revenues may not only make up "shortfalls" but also spend more in many areas, adding to current and future costs. Hospitals without the extra revenues have to find ways to limit costs to boost low margins.

## SESSION

This Forum session will provide an overview of hospital costs and cost drivers, focusing on the variation across different types of facilities. Speakers will discuss the relationship between hospital revenues and costs and the ability of hospitals to become more efficient. With health reform's expectation that hospitals achieve the same productivity gains as the rest of the economy, it is important to explore how some facilities will achieve these savings and what their potential impact will be on the quality of care.

## SPEAKERS

**Robert Murray**, the executive director of the Maryland Health Services Cost Review Commission, will present information on the costs of hospitals in Maryland, including the distribution of expenses across major categories and the variation in costs across hospitals. Because hospitals in Maryland are subject to a state rate-setting program, the state collects extensive data on their costs and the factors that affect their costs. Mr. Murray will be followed by two hospital executives, who will discuss the situation facing their respective facilities. **Keith Kasper** is the senior vice president and chief financial officer of the University of Pennsylvania Health System, one of the largest academic health systems in the country. **Michael Stevenson** is president and chief executive officer of Murphy Medical Center, a 57-bed hospital in rural, western North Carolina.

## KEY QUESTIONS

- Why do hospital costs vary? What distinguishes a high-cost hospital from a low-cost one? When a hospital is faced with declining margins, what factors affect whether it chooses to grow revenues or control costs?
- How do hospitals respond to constrained revenue? What are short-term responses? What are long-term responses? How have hospitals adapted to the recent fiscal crisis? How might longer-term constraints on Medicare payment increases affect patient care?
- How do hospital capital expenditures affect the overall costs of providing care? What are the effects of delayed capital spending on hospital costs? Beyond some level, do investments in medical technology and physical plant improve patient care? How often do these investments improve efficiency?
- Will the constraints on Medicare payment increases result in better control of all hospital costs and affect overall health care spending?

## ENDNOTES

1. American Hospital Association (AHA), "Trends in Hospital Financing," *Trendwatch Chartbook*, 2010, chap. 4, app. 4, p. A-34; available at [www.aha.org/aha/research-and-trends/chartbook/ch4.html](http://www.aha.org/aha/research-and-trends/chartbook/ch4.html). This value is for adjusted admissions, that is, "an aggregate measure of workload reflecting the number of inpatient admissions, plus an estimate of the volume of outpatient services, expressed in units equivalent to an inpatient admission in terms of level of effort."
2. John D. Shatto and M. Kent Clemens, Centers for Medicare & Medicaid Services, "Projected Medicare Expenditures under an Illustrative Scenario with Alternative Payment Updates to Medicare Providers," memorandum, August 5, 2010; available at [www.cms.gov/ReportsTrustFunds/downloads/2010TRAlternativeScenario.pdf](http://www.cms.gov/ReportsTrustFunds/downloads/2010TRAlternativeScenario.pdf).
3. Joe Carlson, "Booster Shot: Despite a shortfall in patient-care revenue for the past 25 years, hospitals turned a profit thanks to investments and other revenue," *Modern Healthcare*, August 2, 2010, p. 6–16.
4. AHA, "Trends in Hospital Financing," p. A-35.
5. Medicare Payment Advisory Commission, Report to the Congress: Medicare Payment Policy, March 2010, pp: 54–60; available at [www.medpac.gov/documents/Mar10\\_EntireReport.pdf](http://www.medpac.gov/documents/Mar10_EntireReport.pdf).