

# TRENDWATCH

The Impact of the BBA and the BBRA

March 2000, Vol. 2, No. 1

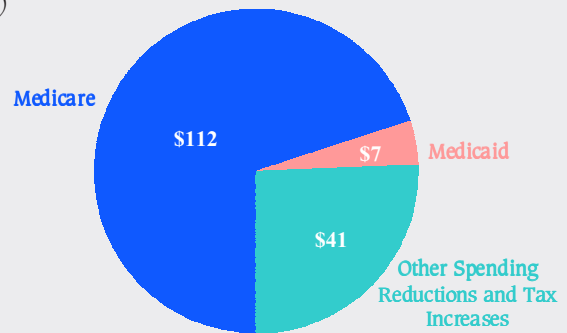
The Balanced Budget Act of 1997 (BBA) reduces spending across a broad range of government programs. The Congressional Budget Office (CBO) initially projected that the act would yield \$160 billion in spending reductions from 1998-2002. Additional spending on state Children's Health Insurance Programs and Welfare reform reduced net savings to \$127 billion. Nearly three quarters of the projected spending reductions came from Medicare and Medicaid. The Medicare cuts alone were projected to yield \$112 billion of savings over this period, \$44 billion of which would come from inpatient and outpatient hospital payments.

The BBA reduces Medicare spending by growing amounts each year with more than half of the total reduction occurring in 2001 and 2002. Even with the "backloaded" reductions, many providers were already feeling the pinch of the BBA by 1999. Later projections by CBO increased the total estimated Medicare savings to \$191 billion, an increase of over 70 percent relative to the original calculated impact. These projections coupled with reports by The Lewin Group and other independent analysts confirmed the testimony of hundreds of health care providers that the BBA payment reductions were having a greater than anticipated impact on the financial performance of the nation's hospitals.

In response to this groundswell of provider concern, Congress and the President enacted the Medicare Balanced Budget Refinement Act (BBRA) in 1999.

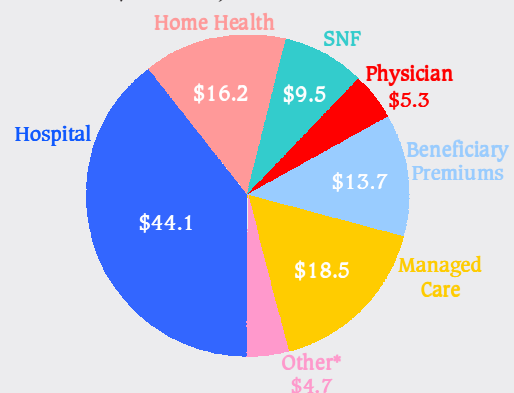
## BBA spending reductions total \$160 billion, with the majority of savings from Medicare...

Chart 1: Distribution of savings from the BBA (CBO estimate in billions)



## Total BBA spending reductions to hospitals of \$44.1 billion account for much of the Medicare cuts...

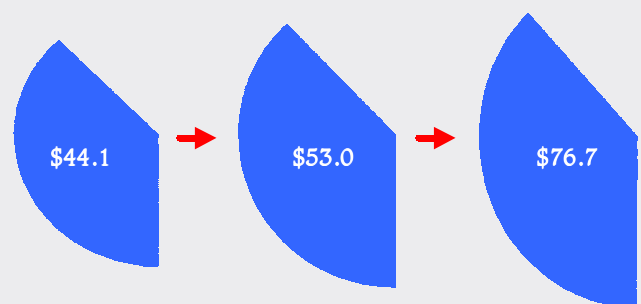
Chart 2: Distribution of Medicare payment reductions by type of service, 1998-2002 (in billions)



\*includes other reductions net of spending increases

## More recent projections indicate a much larger impact to hospitals.

Chart 3: Hospital reductions under the BBA, 1998-2002 (in billions)



CBO estimates of specific reductions to inpatient and outpatient hospital services.

Inpatient, outpatient plus AHA estimates of additional reductions for hospital-based home health and SNF services.

The Lewin Group estimates of total reductions for all services provided by hospitals.

"Many of the decisions that we made were probably a bit more arbitrary than we would have liked. I think the data is beginning to indicate that a thorough reexamination is appropriate."

- Rep. Bill Thomas (R-CA), in reference to the BBA. The Washington Post, May 1999

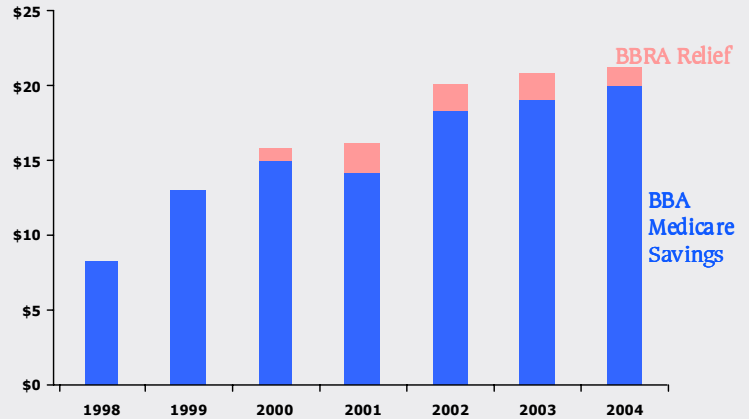
# Post-BBRA Payments Are Projected to Be Lower than 1997 Payments when Adjusted for Inflation

The Medicare Balanced Budget Refinement Act restored an estimated \$17 billion of the BBA's payment reductions and extended the BBA to 2004. About half, or \$8.4 billion, went to hospitals. This relief represents about 8.5 percent of the total BBA reductions to hospitals between 2000 and 2004 and is projected to increase hospital payments by 1 percent relative to BBA estimates over this time period. Even with the relief, when adjusted for inflation, Medicare payments to hospitals are projected to decrease in real terms from 1998 to 2004.

With remaining BBA payment reductions of \$110.5 billion after the BBRA, hospitals' total Medicare margins are projected to drop to negative 2.5% in 2002 and then increase to negative 1.6% by 2004 if costs increase at about 2 percent each year. Total Medicare margins increase after 2002 because the BBA provision reducing the inpatient payment update expires after 2002. Under today's law, payments for inpatient acute and PPS-exempt services would be fully increased for inflation in 2003 and 2004. If costs grow at the rate of inflation faced by hospitals (about 3 percent each year), total Medicare margins could drop to negative 6.6% by 2004.

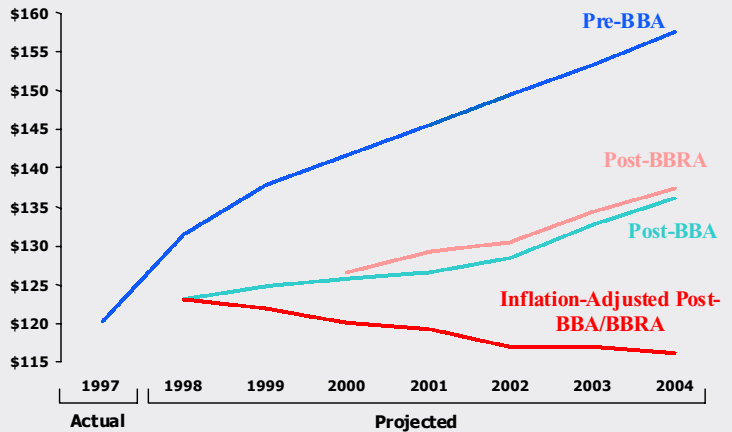
**BBA reductions to hospitals are projected to be \$118.9 billion from 1998-2004; the BBRA restored \$8.4 billion from 2000-2004...**

Chart 4: BBA reductions and BBRA relief payments by year (in billions)



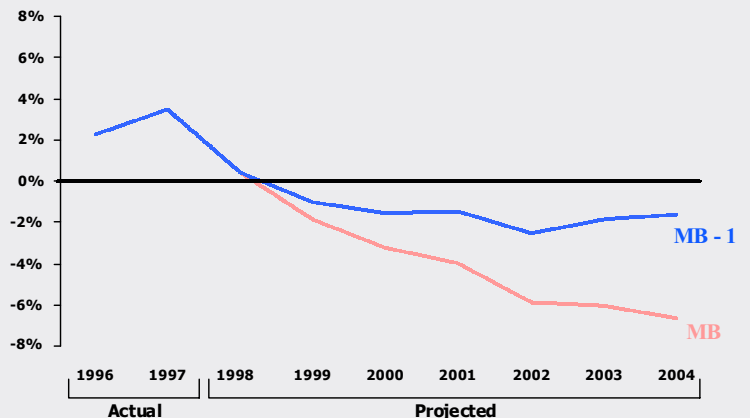
**And when adjusted for inflation, Post-BBRA payments are projected to drop below 1997 payments by 2002.**

Chart 5: Projected total Medicare payments to hospitals (in billions)



**Hospital Medicare margins could drop to negative 6.6% depending on cost growth.**

Chart 6: Actual and projected post-BBRA total Medicare margins



"Unfortunately [last year's BBA relief package] was only one step in the right direction, but we did not cross the finish line. This year we are going to cross the finish line."

- Sen. Kay Bailey Hutchison (R-TX), February 2000

Note:

MB = rate of increase in the prices of goods and services purchased by hospitals (about 3 percent each year).

MB-1 = rate of increase in the prices of goods and services purchased by hospitals less one percentage point (about 2 percent each year).

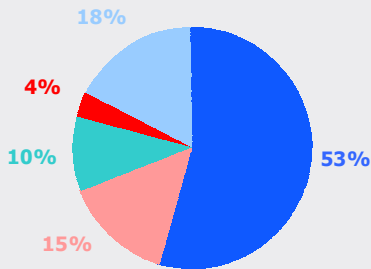
# Even with the BBRA, Inpatient Gains Will No Longer Be Sufficient to Compensate for Losses in Other Services

Most of the BBA payment reductions to hospitals were due to provisions related to inpatient services—including acute PPS, long-term, rehabilitation, psychiatric and other inpatient services—and outpatient services. However many hospitals have expanded the range of services they offer to provide a full continuum of preventive, acute, post-acute, and long-term care services. As a result, hospitals also faced payment reductions in skilled nursing, home health, medical supply, hospice, lab, ambulance and other services. Providing a wide range of services allows hospitals and health systems to deliver services in the most appropriate setting—but it also produces larger payment reductions to hospitals. For most hospitals, Medicare reimbursement for inpatient services subsidizes the services provided to Medicare patients in other care settings. However, with the BBA, the ability to continue to break even overall on Medicare is compromised.

**Inpatient PPS accounts for the majority of BBA cuts, while the majority of payment relief from the BBRA was to outpatient services.**

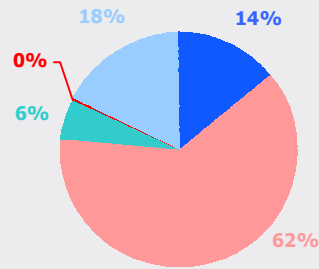
Chart 7: Percent of total hospital Medicare payment reductions and relief payments

**Distribution of BBA Payment Reductions by Type of Service, 1998-2004**



Total Reductions = \$118.9 Billion

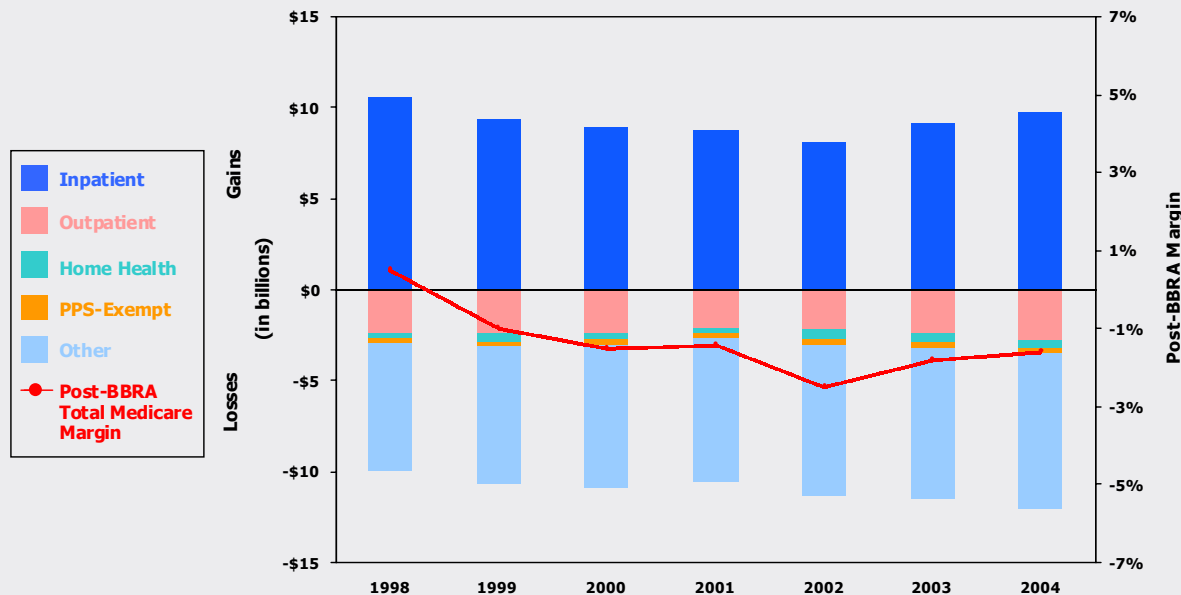
**Distribution of BBRA Relief Payments by Type of Service, 2000-2004**



Total Relief = \$8.4 Billion

**Total Medicare losses increase through 2002 as smaller inpatient gains are overwhelmed by larger losses in outpatient, home health, PPS-exempt, and other services.**

Chart 8: Post-BBRA margin and total Medicare gains/losses by service type, 1998-2004 (assuming costs grow at MB-1 or about 2 percent each year)



"In evaluating the potential impact of the BBA on access and quality, two issues seem especially important. One is how policies may interact to affect providers' ability and incentives to furnish care. Hospitals, for example, often furnish many types of services and must therefore face the combined effects of policy changes that have altered payments for virtually every service they provide...."

- Gail Wilensky, Chair of MedPAC, during testimony before the US House Committee on Ways and Means, Subcommittee on Health, October 1999

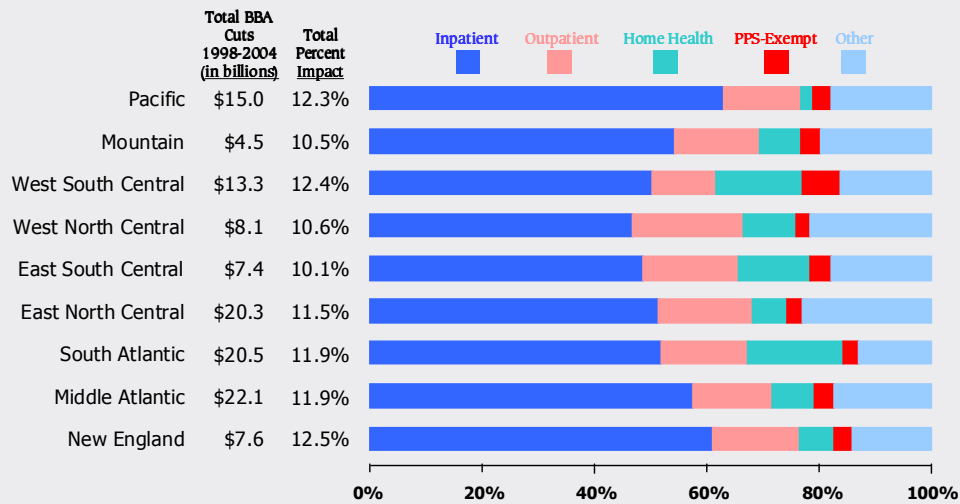
# Regions Were Affected Differently by the BBA and the BBRA

The percent reduction in Medicare payments was fairly consistent across different regions of the country, ranging from 10.1% to 12.5%. The dollar magnitude of the hits varied, however, because some regions receive a higher percentage of the nation's Medicare dollars due to the demographics of each region. There is also a wide variation in how the impact was distributed across service types. Approximately 47 percent of the total reductions are in inpatient services in the West North Central region compared to the Pacific region where inpatient reductions accounted for 63 percent of total reductions. Outpatient payment reductions had the second largest impact, except in the South Atlantic and West South Central regions. These variations are likely due to differences in practice patterns across regions (e.g. more home health services provided in southern regions).

The BBRA increased total Medicare payments to the nation's hospitals by 1.3 percent, with the regions' increases varying from 0.97 percent to 1.71 percent. Hospitals across all regions received outpatient relief. Only sole community, teaching, and disproportionate share hospitals received inpatient relief. Projected margins vary by region after the BBRA, but overall, between 60% and 68% of the nation's hospitals will lose money on Medicare by 2004, depending on cost growth.

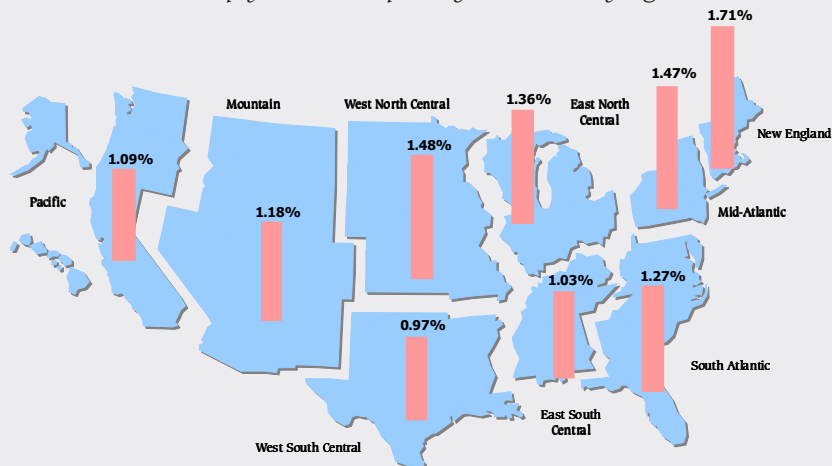
## Regions were affected differently by the BBA.

Chart 9: Total BBA reductions to hospitals by region and distribution by service type, 1998-2004



## And the BBRA increased Medicare hospital payments by a range of 1 percent in the West South Central region to 1.7 percent in New England.

Chart 10: Percent increase in total Medicare payments to hospitals after the BBRA by region, 2000-2004



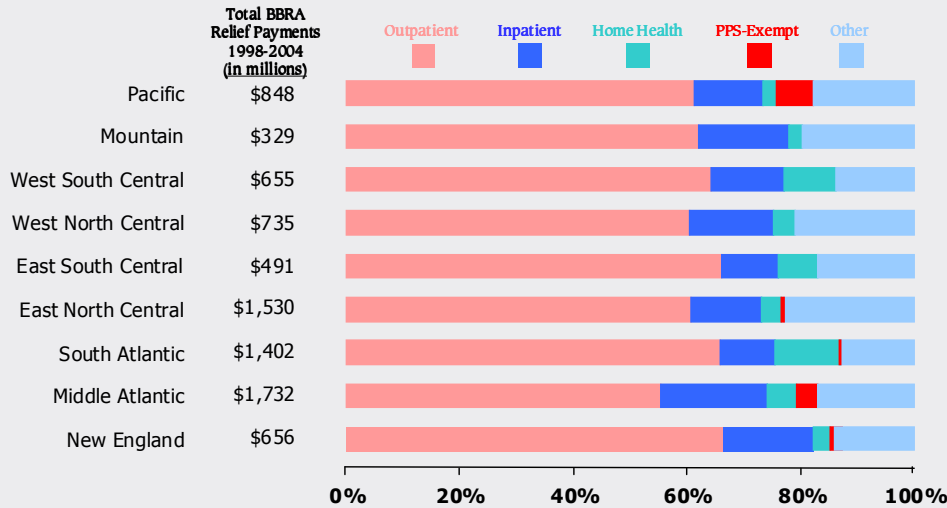
"The data shows that last year's effort was very modest, and it can only be viewed as a first step."

- Rick Pollack, AHA Executive Vice President, in reference to the impact of BBRA. February 2000

# The Regions of the Country Received Different Levels of Relief from Different Services

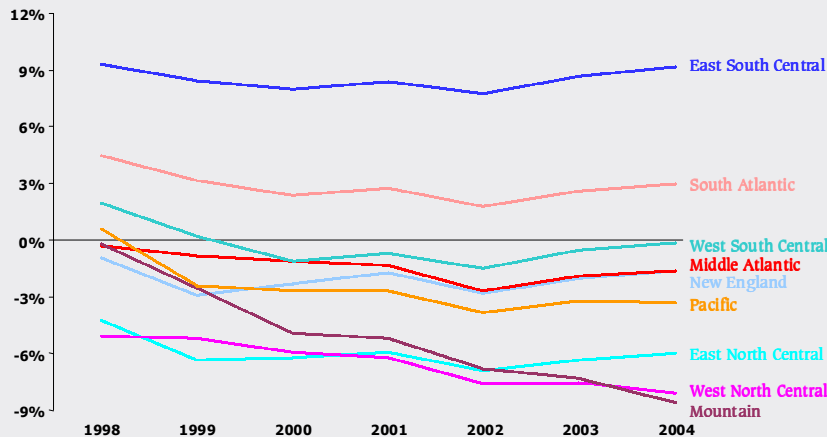
**Outpatient relief represents the majority of BBRA relief payments for all regions; relief from other Medicare services was varied.**

Chart 11: Total BBRA relief payments by region and distribution by type of service, 2000-2004



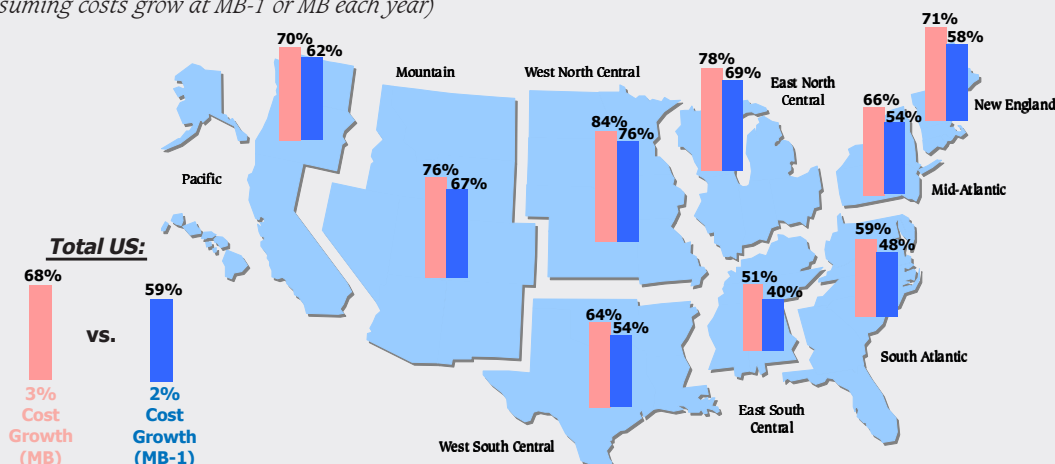
**Total Medicare margins for various regions vary widely after the BBRA...**

Chart 12: Total Medicare margins with costs increasing at MB-1 or about 2 percent each year, 1998-2004 by region



**... leading to a higher percentage of hospitals losing money on Medicare in the East North Central, West North Central and Mountain regions.**

Chart 13: Percent of hospitals with negative total Medicare margins, in 2004 (assuming costs grow at MB-1 or MB each year)



"We believe that even some of the strongest entities in our portfolio will experience weakening credit quality," Pamela Federbusch, Moody's senior vice president and the [annual] report's author, said of 1999's outlook [for not-for-profit hospitals]...

...Federbusch said uncertainty associated with mergers and acquisitions activity and revenue pressures brought on by the Balanced Budget Act are contributing to hospitals' troubles."

— AHA News, September 13, 1999

# Will Private Payers Continue to Cross-Subsidize Medicare Payment Reductions?

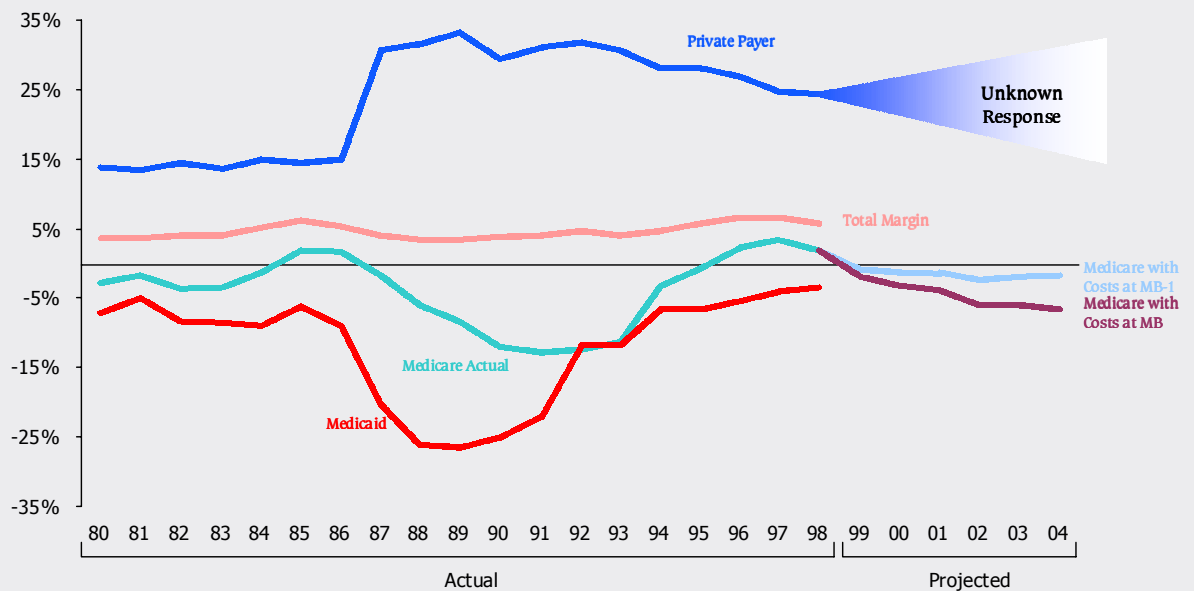
"We have the best hospital care system in the world. There is no sense in risking something that is working, something that is good, something that is indispensable to families across this country."

- Sen. Edward Kennedy (D-MA), February 2000

Private payers have historically covered the payment shortfalls of Medicare, Medicaid, and uncompensated care. Given increased competitive pressures in the private insurance marketplace, the ability and willingness of the private sector to increase reimbursements to hospitals to cover Medicare losses is in doubt. The combined impacts of BBA payment reductions, continued private payer pressures, and higher rates of growth in hospital costs, especially with increasing pharmaceutical prices and a tight labor market, threaten the financial stability of

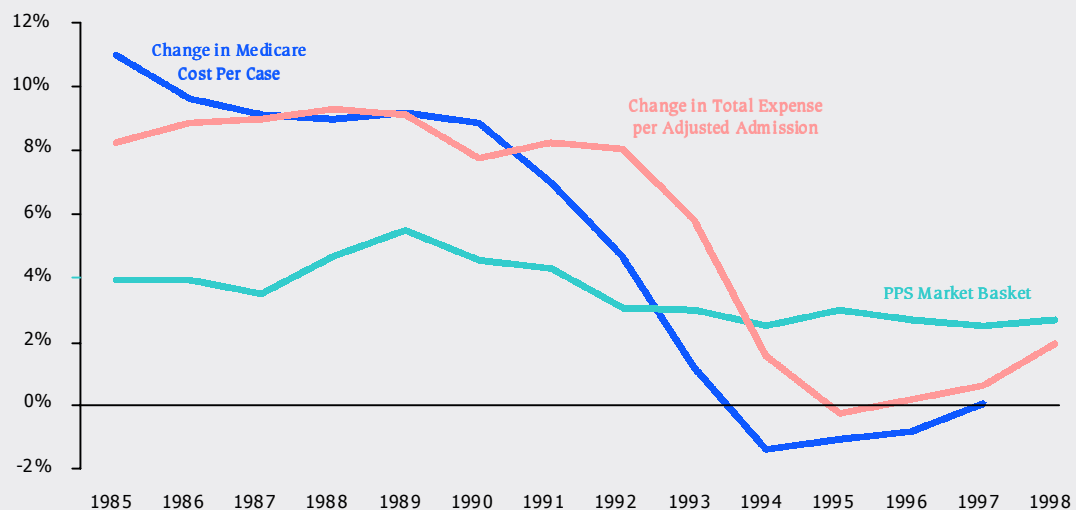
## In the past, private payers have cross-subsidized Medicare losses. Will this pattern continue?

Chart 14: Aggregate margins by payer, 1980-2004



## The rate of increase in hospital costs is on the rise, another unknown factor affecting hospital margins.

Chart 15: Annual change in Medicare cost per case and total expense per adjusted admission compared to the annual PPS market basket, 1985-1998



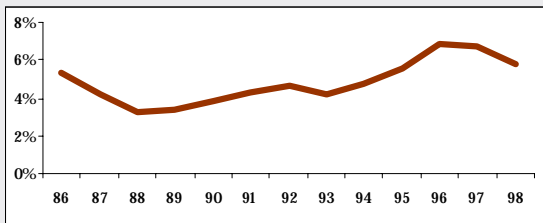
"All the easy cost shifts and management tricks you can make - they're all gone. We're to the point now where we don't have anywhere left to cut. So the next thing is, we start cutting services."

- Robert Hammer, Chief Executive Officer of Davis Memorial Hospital in Elkins, West Virginia, February 2000

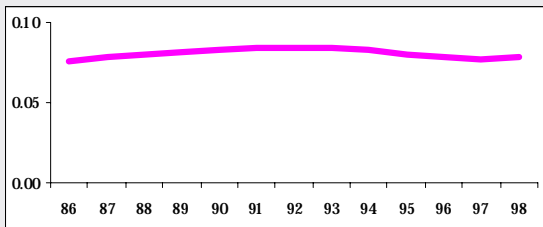
# Stats to know

## Hospital Sector

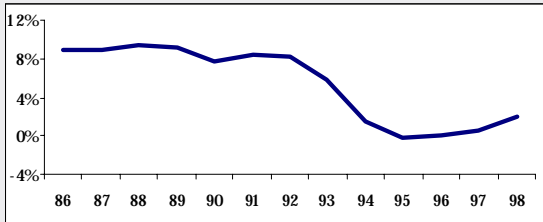
<b>Total Margin:</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
<b>86 to 98 Trend</b>	6.8%	6.7%	5.8%



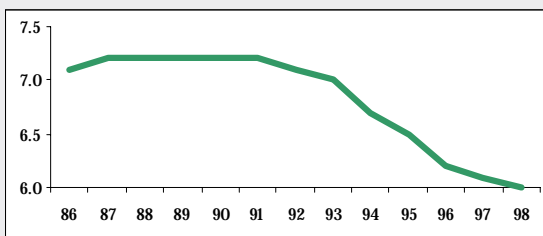
<b>FTE per Adjusted Admission:</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
<b>86 to 98 Trend</b>	0.08	0.08	0.08



<b>Percent Change in Expense per Adj. Admission: 86 to 98 Trend</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
	0.2%	0.6%	2.0%

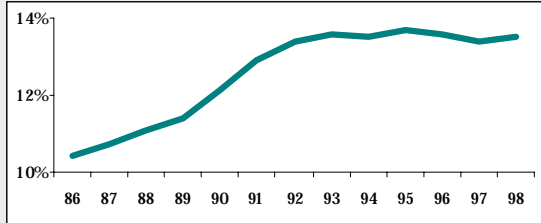


<b>Average Length of Stay (in Days): 86 to 98 Trend</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
	6.2	6.1	6.0

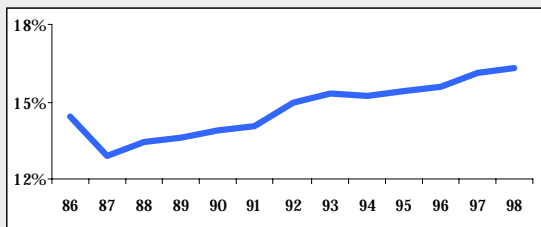


## Healthcare Industry

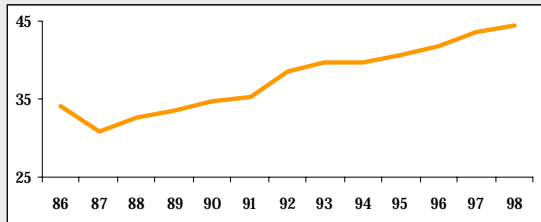
<b>National Health Expenditure as a % of GDP: 86 to 98 Trend</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
	13.6%	13.4%	13.5%



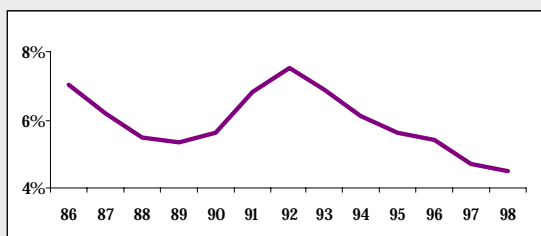
<b>Percent Uninsured: 86 to 98 Trend</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
	15.6%	16.1%	16.3%



<b>Number Uninsured (in Millions): 86 to 98 Trend</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
	41.7	43.4	44.3



<b>Percent Unemployed: 86 to 98 Trend</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
	5.4%	4.7%	4.5%



This issue of TrendWatch is based on The Lewin Group's most recent study on the impact of the BBA entitled, "The Impact of the Medicare Balanced Budget Refinement Act on Medicare Payments to Hospitals." A copy of the report is available on AHA's web site at [www.aha.org](http://www.aha.org).

### **Definitions:**

Pre-BBA Estimates: Projects Medicare payments and costs under the laws and regulations that were in place prior to the BBA legislation.

Post-BBA Estimates: Projects Medicare payments and costs through FY 2004 under the provisions included in the BBA.

Post-BBRA Estimates: Projects Medicare payments and costs under the BBA as modified by provisions in the BBRA.

Cost Assumptions: This analysis projects hospital costs based upon two different assumptions: Medicare costs per case increasing at the market basket (MB) rate of inflation (about 3 percent each year) and at market basket minus one percentage point (MB-1) (about 2 percent each year) beginning in 1999. The market basket inflation rate is the rate of increase in the prices of goods and services purchased by hospitals. Throughout this report the following acronyms will be used:

MB = rate of increase in the prices of goods and services purchased by hospitals.

MB-1 = rate of increase in the prices of goods and services purchased by hospitals less one percentage point.

### **Sources:**

Charts 1-2: Congressional Budget Office, CBO Memorandum: Budgetary Implications of the Balanced Budget Act of 1997, December 1997.

Chart 3: Congressional Budget Office, CBO Memorandum: Budgetary Implications of the Balanced Budget Act of 1997, December 1997, and The Lewin Group, The Impact of the Medicare Balanced Budget Refinement Act on Medicare Payments to Hospitals, February 1, 2000.

Charts 4-8: The Lewin Group, The Impact of the Medicare Balanced Budget Refinement Act on Medicare Payments to Hospitals, February 1, 2000.

Chart 9: The Lewin Group Analysis of 1998 American Hospital Association Annual Survey data for community hospitals.

Charts 10-15: The Lewin Group, The Impact of the Medicare Balanced Budget Refinement Act on Medicare Payments to Hospitals, February 1, 2000.

### **Sources for "Stats to Know":**

*Total Margin:* AHA Annual Hospital Survey, 1986-1998

*FTE/Adjusted Admission:* American Hospital Association Annual Survey, 1986-1998

*Percent Change in Total Expense per Adjusted Admission:* American Hospital Association Annual Survey, 1986-1998

*Average Length of Stay:* Hospital Statistics, 1999 Edition, Healthcare Infosource, Inc.

*National Health Expenditures as a Percent of GDP:* Compiled by HCFA on [www.hcfa.gov/stats/nhe-oact/tables/t1.htm](http://www.hcfa.gov/stats/nhe-oact/tables/t1.htm)

*Percent Uninsured:* Compiled by Bureau of the Census on [www.census.gov/hhes/www/hlthins.html](http://www.census.gov/hhes/www/hlthins.html)

*Number Uninsured:* Compiled by Bureau of the Census on [www.census.gov/hhes/hlthins/hlthins.html](http://www.census.gov/hhes/hlthins/hlthins.html)

*Percent Unemployed:* Compiled by Bureau of Labor Statistics on <http://stats.bls.gov/cpsaatab.htm#empstat>

---

*TrendWatch is a quarterly report produced by the American Hospital Association and The Lewin Group highlighting important and emerging trends in the hospital and health care field.*

---



American Hospital Association  
Liberty Place, Suite 700  
325 Seventh Street, N.W.  
Washington, DC 20004-2802  
(202) 638-1100



The Lewin Group  
3130 Fairview Park Drive, Suite 800  
Falls Church, VA 22042  
(703) 269-5500

TrendWatch March 2000, Vol. 2, No. 1  
Copyright 2000 by the American Hospital Association