Economic Impact Analysis
Virginia Department of Planning and Budget

12 VAC 30-70 – Methods and Standards for Establishing Payment Rates – Inpatient Hospital Services
Department of Medical Assistance Services
November 24, 2003

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

Summary of the Proposed Regulation

Pursuant to the 2003 Appropriations Act, Item 325 OOO, the proposed change reduces the inpatient hospital capital reimbursement to 80% of the allowable costs from 100% for non-teaching hospitals. The proposed change has been in effect since July 2003 under the emergency regulations.

Estimated Economic Impact

The proposed regulation will permanently reduce the Medicaid capital reimbursement to non-teaching hospitals from 100% of the allowable actual costs to 80% of the allowable costs. This change will reduce Medicaid reimbursements to 106 non-teaching hospitals for inpatient capital costs by about $5.2 million per year. Of that amount, approximately one half is the state share and the remaining is the federal share. Thus, this change represents approximately $2.6 million savings in Medicaid expenditures annually for the Commonwealth, which can be used beneficially through other government expenditure or through lower taxes than would be required to maintain the higher reimbursement rates.

Probably the largest cost of this proposed change is the loss of approximately $2.6 million in federal funding. In other words, in order to save $2.6 million, the Commonwealth will give up another $2.6 million in federal funding.

In response to the reduction in reimbursement rates for Medicaid Inpatient capital costs, non-teaching hospitals could potentially: 1) choose to no longer serve any Medicaid recipients (beyond emergency cases), 2) choose to raise rates to private payers to offset the loss of Medicaid revenue, or 3) scale back services.

The economic impact of the proposed rate reduction depends on the effect on each non-teaching hospital's profit margin. If a hospital cannot offset its revenue losses from other sources such as private payers, it could end the participation in the Medicaid program. However, the department is not aware of any hospitals that have left the program since July 2003 when the payments were reduced.

Also, the available research lacks evidence that hospitals are able to shift costs to private providers in response to reduction on Medicaid rates.[1] Since no hospitals stopped participating in the Medicaid program and they seem to be limited in their ability to shift costs to private payers, the most likely response would be reducing services to Medicaid recipients. This could be a reduction in the quantity of services if hospitals start prioritizing patients with willingness and ability to pay higher rates, or a reduction in the quality of services if hospitals choose to operate with fewer support staff and eliminate services that are considered beneficial, but non-essential. This reduction in inpatient services could also increase the inpatient services provided by teaching hospitals whose rates are higher. Thus, we may also see a substitution away from non-teaching hospitals toward teaching hospitals in the delivery in inpatient Medicaid services.

[1] Zwanziger, Jack, Melnick, Glenn A., and Anil Bamzai, "Can Cost Shifting Continue in a Price Competitive Environment?" *Health Economics*, v9, n3 (April 2000): 211-25.
Showalter, Mark H., "Physicians' Cost Shifting Behavior: Medicaid versus Other Patients," *Contemporary Economic Policy*, v15, n2 (April 1997): 74-84.

Businesses and Entities Affected

The proposed regulations affect the 106 non-teaching hospitals that provide inpatient services to Medicaid recipients, as well as their staff and patients.

Localities Particularly Affected

The proposed regulations apply throughout the Commonwealth.

Projected Impact on Employment

The proposal to limit non-teaching hospitals to 80% of their allowable costs for inpatient capital costs will likely reduce services and some employment at these hospitals. Conversely, if there is a significant shift of services from non-teaching hospitals to teaching hospitals we may see an increase in employment at teaching hospitals, which would balance some of the possible employment loss at non-teaching hospitals.

Effects on the Use and Value of Private Property

The lower reimbursement rates will consequently lower the value of private non-teaching hospitals. Private hospitals may react by offering fewer services.