

# Safety-Net Association of Pennsylvania

112 Walnut Street • Harrisburg, PA 17101 • 717-234-6970 • 717-234-6971 fax • www.pasafetynet.org

June 21, 2005

Pennsylvania Department of Public Welfare  
Office of Medical Assistance Programs  
Deputy Secretary's Office  
Attention: Regulations Coordinator  
Room 515, Health and Welfare Building  
Harrisburg, PA 17120

To Whom it May Concern:

I am writing on behalf of the Safety-Net Association of Pennsylvania (SNAP) to convey our strong opposition to the proposed change in the *Pennsylvania Bulletin*, Volume 35, Number 23 (35 Pa.B. 3266) that would revise the commonwealth's method of paying for selected supplemental payments. Under the proposed change, to take effect July 1, 2005, the state would limit certain supplemental payments – outpatient disproportionate share, medical education, Community Access Fund, and Hospital Uncompensated Care or Hospital Extraordinary Expense payments – to hospitals with operating margins less than one percent so that such payments do not contribute to hospitals' operating margins exceeding the one percent level.

SNAP believes that operating margins are an inadequate, inappropriate, and misleading measure of hospital financial performance that, if used for this purpose, will contribute to the deterioration of the very institutions that do the most to care for Pennsylvania's Medical Assistance and low-income populations. The association believes that all hospitals eligible for these payments should continue receiving them. We oppose this proposal on six specific grounds:

1. Operating margin is an inadequate measure of hospital financial performance.
2. Limiting hospital supplemental payments based on a one percent operating margin is arbitrary and baseless.
3. The proposed policy singles out hospitals for special treatment – and punishment – and sets a dangerous precedent in the relationship between government and the private sector.
4. The proposed policy is inconsistent with the principles of a prospective payment system.
5. The proposed policy relies on hospitals to continue to provide care to Medical Assistance beneficiaries even when it makes no business sense for them to do so.
6. The proposed policy would do the most harm to the very hospitals – safety-net hospitals – that are most important to the Medical Assistance program.

## **Operating Margin is an Inadequate Measure of Hospital Financial Performance**

A hospital's operating margin expresses the difference between its total operating revenue and total operating expenses as a proportion of total operating revenue. Different hospitals account for different revenue in different ways, and the same is true, to a degree, for hospital expenses. This makes it impossible to use operating margin as the single barometer of hospital financial health or to use it to compare a hospital's operating margin to an arbitrary standard. For these reasons, this proposed policy makes no sense at all.

### **Limiting Hospital Supplemental Payments Based on a One Percent Operating Margin is Arbitrary and Baseless**

SNAP can find no documentation from any source anywhere that asserts that a one percent operating margin is adequate for any kind of business. Consequently, we believe the Department of Public Welfare (DPW) must document why it believes that limiting hospitals to a one percent operating margin constitutes sound public policy. Without such an explanation, accompanied by adequate documentation, we believe that the proposed one percent standard is arbitrary and capricious and driven solely by the desire to achieve budget savings and has no reasonable financial, economic, or policy basis. Despite this, DPW is now preparing to impose it anyway on one of the state's largest industries. In so doing, it threatens to cripple key parts of that industry.

### **The Proposed Policy Singles Out Hospitals for Special Treatment – and Punishment – and Sets a Dangerous Precedent in the Relationship Between Government and the Private Sector**

Limiting recipients of state funds to a stipulated operating margin is without precedent in Pennsylvania – and it is only being done to this one group in this year's budget. The state is making no similar demands of others in the health care system, imposing no similarly draconian financial penalties. It does not propose reducing payments to pharmacies for dispensing drugs, does not require insurers to accept less than actuarially sound rates, and does not demand that physicians treat patients with no expectation of payment for their services if any of these entities have operating margins greater than one percent. The state does not have such expectations, nor does it propose such limits, because it knows they all would cease doing business with Pennsylvania's Medical Assistance program. Only hospitals are being singled out – and punished – in this manner.

This proposal would establish a very dangerous precedent in the relationship between government and private industry. Imagine how much revenue the state could raise if, as a matter of tax policy, Pennsylvania limited all businesses in the state to one percent operating margins, with anything greater than one percent going to the state treasury. This would certainly solve the state's revenue shortfall in the short run – but the exodus of businesses from the state would be virtually immediate and breathtaking.

### **The Proposed Policy is Inconsistent With the Principles of a Prospective Payment System**

DPW employs a prospective payment system for the Medical Assistance program. The essence of a prospective payment system is that it is supposed to compel hospitals to operate like businesses, offering them set fees to treat patients with specific conditions. Like any other business, if a hospital can provide the service at a cost less than the fee, it gets to keep the difference. If, on the other hand, the cost of the service is greater than the payment, the hospital loses money on that particular service.

With this proposed policy, however, the state is telling hospitals that if they manage to deliver services for less than the payments they receive, they will be penalized and the money will be taken back from them by the state. This defeats the entire purpose of a prospective payment system. If hospitals are expected to behave like businesses when it benefits the state, the state must be consistent in its approach when the result of this approach benefits hospitals.

### **The Proposed Policy Relies on Hospitals to Continue to Provide Care to Medical Assistance Beneficiaries Even When it Makes No Business Sense for Them to Do So**

Except for hospitals, there are no vendors that do business with the commonwealth that are routinely expected to accept payments less than their costs for every single service they deliver. Now, any hospital that manages to overcome this enormous handicap and find a way to achieve profitability faces the prospect of the state imposing new, additional financial penalties designed to erase the hospital's hard-won business success. All businesses have their tough customers, but Pennsylvania's Medical Assistance program now proposes raising the concept of a tough customer to an entirely new level.

### **The Proposed Policy Would do the Most Harm to the Very Hospitals That are Most Important to the Medical Assistance Program**

While all Pennsylvania hospitals participate in the state's Medical Assistance program, they do not do so as equals. Pennsylvania's safety-net hospitals – the 25 percent of the state's hospitals that care for the highest proportion of low-income and uninsured patients – provide 56 percent of all Medical Assistance services. The proposed policy will hurt many hospitals, but none more than the very hospitals that care for the most Medical Assistance patients and the most uninsured patients.

These hospitals already pay a fearful price for the front-line roles they fulfill in the state's health care safety net. Today, Medical Assistance pays them less than 75 cents on the dollar for the care they provide to Medical Assistance patients; this means that the more Medical Assistance patients they serve, the more money they lose. In addition, because of where these hospitals are located, they care for significant numbers of uninsured patients as well.

State officials have long recognized their underpayment for Medical Assistance services and the damage it could cause and have attempted to compensate for those underpayments. Instead of raising Medical Assistance reimbursement for all hospitals, they chose instead to direct additional resources to the hospitals that care for the most Medical Assistance patients. Those supplemental payments came in the form of outpatient disproportionate share, medical education, Community Access Fund, and Hospital Uncompensated Care or Hospital Extraordinary Expense payments – the very payments that DPW now proposes stealing from these hospitals. For years, the commonwealth at least attempted to protect its partners in caring for the poor. With this proposal, however, DPW is announcing its intention to abandon them.

### **Conclusion**

The proposed change to limit supplemental payments to Pennsylvania hospitals with an operating margin of no more than one percent is a bad idea. It has no basis in hospital operations, business finance, or public policy. It relies on operating margin, a poor measure of hospital financial performance, and arbitrarily chooses to limit hospitals to operating margins of no greater than one percent with no rationale for choosing that particular level – and, in fact, it is widely understood that the chosen level of one percent is wholly inadequate for the effective management and operation of a hospital. The proposed policy singles out hospitals and only hospitals for such treatment, imposing no comparable limits on the rest of the health care industry, any other recipients of Medical Assistance funds, or any other recipients of state funds. It also is inconsistent with business principles in general and the principles of prospective payment in particular. Finally – and most important, in our view – this policy will, if implemented, cause

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significant harm to the very hospitals that play the most prominent role in caring for the 1.7 million Pennsylvanians who rely on Medical Assistance for their health care safety net.

For these reasons, we encourage you not to move forward with this proposed change.

Sincerely,

Charles DeBrunner  
President