STRATEGIC HEALTH CARE

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KEY PROVIDER ISSUES IN HEALTH CARE REFORM

April 2010 **PRODUCTIVITY AND OTHER ADJUSTMENTS TO ANNUAL UPDATES**

Section 3401 of the healthcare reform law decreases the annual update factors for Medicare's payment systems by a "productivity adjustment" as well as a series of additional reductions. The productivity adjustments, the additional reductions, and any penalties individual providers face due to failure to report quality information or meet quality standards are additive: The law states that the cumulative impact of the decreases could pull the update below zero and result in payment rates being less than rates in the previous year.

Productivity

This adjustment is projected to reduce Medicare spending by billions of dollars for each of Medicare's payment systems.

- Beginning in 2011: Ambulatory surgery centers, some DME, lab services, ambulance
- Beginning in 2012: Inpatient and outpatient hospital; IRF, LTACH, and psychiatric hospitals, skilled nursing facilities, dialysis
- Beginning in 2013: Hospice
- Beginning in 2015: Home health agencies

The theory behind measuring productivity

Over time, businesses are able to produce more output with the same amount of labor and capital. The factors that increase output are: research and development, technologic advances, increasing scale, management improvements, and better organization. The Bureau of Labor Statistics compares the change in the level of inputs (hours worked, workforce characteristics, investments, and assets used) and the change in level of output (the gross domestic product). Any increase in output above the increase in input is estimated as the national productivity improvement.

The potential impact of the productivity adjustment

Current uncertainty about our economy's future makes it difficult to predict the exact value of future productivity adjustments. However, the adjustment is likely to remain close to its recent level, a little below 1.5%, for the near future because it will be based on a ten-year moving average: each year the oldest year is dropped, the latest year is added, eight of ten years remain the same. Also adding to the

stability is the breadth of the measure: The health care sector is included in the calculation, along with such sectors as transportation, chemicals, textiles and beverages. The last column in the table below provides the historical values of productivity and a likely range for future "productivity adjustment" reductions to Medicare payments.

Year	Annual productivity	Ten-year moving average
2008	1.1	1.3
2007	0.2	1.3
2006	0.5	1.4
2005	1.3	1.5
2004	2.6	1.4
2003	2.6	1.2
2002	2.1	0.9
2001	0.4	1
2000	1.1	0.9
1999	1.3	0.8
1998	1.3	0.7

Additional reductions

These additional reductions to Medicare's annual updates, conceptually, are intended to offset the additional revenues which providers could realize as more people become insured under the new law. At one point in the reform debate, some of these reductions were tied explicitly to triggers based on the number of uninsured adults. However, the triggers were removed as part of the final push for reconciliation and passage of the bill. The table below describes the size and timing of each reduction by provider type (the type of year follows the annual update for each provider type: fiscal-, calendar- or rate-year).

Additional market basket reductions

	2010	2011	2012	2013	2014	2015-16	2017-19
Inpatient and Outpatient Hospital, Psych, IRF	-0.25	-0.25	-0.1	-0.1	-0.3	-0.2	-0.75
LTACH	-0.25	-0.50	-0.1	-0.1	-0.3	-0.2	-0.75
Home health		-1.0	-1.0	-1.0	Rebase		
Hospice				-0.3	-0.3	-0.3	-0.3