REPORT

Assessing the Adequacy of Proposed Updates to the Hospital Inpatient Prospective Payment System

Overview

On April 18, 2022, the Centers for Medicare & Medicaid Services (CMS) released its annual proposed rule for the fiscal year (FY) 2023 Inpatient Prospective Payment System (IPPS), projecting a market basket update of 3.1 percent, to be reduced by a 0.4 percent productivity adjustment.[1] This year marks the third consecutive rate setting period mired in pandemic-related uncertainty. While federal relief funding sustained hospitals and health systems through the initial waves of COVID-19, providers continue to grapple with myriad financial pressures, from supply chain disruptions to labor shortages to rising inflation. FTI Consulting's analysis finds that reliance on lagging indicators of hospital costs to determine prospective market basket and productivity adjustments in this highly dynamic and uncertain health care environment would likely result in significant underpayments to acute care hospitals in FY 2023.

[1] FY 2023 Hospital Inpatient Prospective Payment System (IPPS) and Long Term Care Hospitals (LTCH PPS) Proposed Rule - CMS-1771-P." CMS, April 18, 2022. https://www.cms.gov/newsroom/fact-sheets/fy-2023-hospital-inpatient-prospective-payment-system-ipps-and-long-term-care-hospitals-ltch-pps.

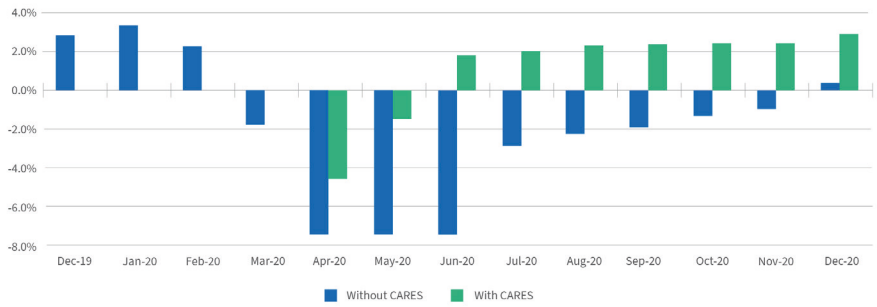
Background: Financial Condition of U.S. Hospitals

Impacts of COVID-19 Continue to Reverberate

The U.S. health care system has undergone a period of severe disruption in recent years driven by the COVID-19 pandemic and record-high inflation. In the early stages of the pandemic, hospitals curtailed elective procedures to free up capacity to care for COVID-19 patients while demand for emergency services dropped as a result of lockdowns.[2,3] Coupled with a rise in the number of uninsured patients, this dramatic decline in patient volume cut off many hospitals' most essential revenue streams,[4] just as the cost of providing care began to rise. Although Congress and the Biden Administration implemented numerous policies to lessen the adverse impact of the pandemic, including the creation of the Provider Relief Fund (PRF), which allocated over $170 billion to heath care providers,[5] financial challenges persist for many hospitals.

Though many hospitals have long struggled to stay afloat on narrow margins, the COVID-19 pandemic put additional, unforeseen strains on hospitals and health systems, particularly in rural and underserved areas. Skyrocketing expenses – driven by the rising cost of supplies, supply chain issues, and labor shortages – led to a 14.4 percent increase in labor expenses per adjusted discharge in 2020 compared to pre-pandemic levels.[6] As a result of this and other pandemic-related challenges, hospitals' median operating margins fell 55.6 percent in 2020 and have yet to fully recover (Figure 1).[7] More recently, during the peak of the Omicron surge in early 2022, government assistance to hospitals was insufficient to fully offset inflationary pressures, alongside continuing supply chain challenges, and widespread labor shortages that caused wage escalation, leaving many hospitals in the red.[8] In April 2022, total expenses and total labor expenses were 25.2 and 26.2 percent higher than 2020 levels, respectively.[9] As federal COVID-19 funds are depleted and inflationary pressures continue to escalate, hospitals are likely to remain embroiled in a precarious financial position throughout the remainder of 2022 and into FY 2023.

Figure 1: Kaufman Hall Operating Margin Index YTD by Month



Source: "National Hospital Flash Report: January 2021." Kaufman Hall, January 25, 2021.

[2] Mattingly, Aviva S., Liam Rose, Hyrum S. Eddington, Amber W. Trickey, Mark R. Cullen, Arden M. Morris, and Shery M. Wren. "Trends in US Surgical Procedures and Health Care System Response to Policies Curtailing Elective Surgical Operations During the COVID-19 Pandemic." JAMA Network Open. JAMA Network, December 8, 2021. https://jamanetwork.com/journals/jamanetworkopen/fullarticle/2786935.

[3] Hartnett, Kathleen P., Aaron Kite-Powell, Jourdan DeVies, Michael A. Coletta, Tegan K. Boehmer, Jennifer Adjemian, and Adi V. Gundlapalli. "Impact of the COVID-19 Pandemic on Emergency Department Visits - United States, January 1, 2019–May 30, 2020." Centers for Disease Control and Prevention. Centers for Disease Control and Prevention, June 11, 2020. https://www.cdc.gov/mmwr/volumes/69/wr/mm6923e1.htm.

[4] Boserup, Brad, Mark McKenney, and Adel Elkbuli. "The Financial Strain Placed on America's Hospitals in the Wake of the COVID-19 Pandemic." The American Journal of Emergency Medicine. Elsevier Inc., July 2021. https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7347328/#:~:text=The%20financial%20strain%20created%20by,the%20current%20surge%20in%20unemployment.

[5] Biniek, Jeannie Fuglesten, Nancy Ochieng, MaryBeth Musumeci, and Tricia Neuman. "Funding for Health Care Providers during the Pandemic: An Update." KFF, January 27, 2022. https://www.kff.org/coronavirus-covid-19/issue-brief/funding-for-health-care-providers-during-the-pandemic-an-update/.

[6] "National Hospital Flash Report: January 2021." Kaufman Hall, January 25, 2021. https://www.kaufmanhall.com/insights/research-report/national-hospital-flash-report-january-2021.

[7] "High Hospitalization Rates, Consumer Fears Hit Hospitals, Physician Groups Hard." Kaufman Hall, January 25, 2021. https://www.kaufmanhall.com/news/high-hospitalization-rates-consumer-fears-hit-hospitals-physician-groups-hard.

[8] Swanson, Erik. "National Hospital Flash Report: May 2022." Kaufman Hall, May 31, 2022. https://www.kaufmanhall.com/insights/research-report/national-hospital-flash-report-may-2022.

[9] Ibid.

Even setting aside pandemic-related pressures, Medicare has historically under-reimbursed hospitals for their services, putting them in a deficit position. Hospitals' aggregate Medicare margins have ranged from -5.4 percent to as low as -9.9 percent over the last decade according to the Medicare Payment Advisory Commission (MedPAC).[10,11] In its most recent report to Congress, MedPAC predicted that IPPS hospitals' Medicare margins will be around -9 percent in 2022 even after COVID-19 relief funds are factored in, and nearly -10 percent without COVID-19 relief.[12] These persistent negative margins in uncertain economic times demonstrate the importance of ensuring that adjustments to IPPS payment rates reflect the current financial reality faced by hospitals and health systems.

Macroeconomic-Level Factors

IPPS, which determines payments for acute care hospital inpatient stays under Medicare Part A, relies on lagging indicators of hospital costs to set reimbursements prospectively.[13] For example, the FY 2023 proposed payment adjustments incorporate FY 2021 Medicare Provider Analysis and Review (MedPAR) data, as well as FY 2020 Medicare Cost Reports, while relying upon a 2018-based market basket to determine cost and expenditure weights and the third quarter 2021 Employment Cost Index (ECI) to predict changes in the price proxies.[14] This results in a projected market basket update of 3.1 percent, which is then reduced by 0.4 percentage points to account for a productivity adjustment.[15] To the extent that historical data are good predictors of future changes in market basket components, it is reasonable from an economic perspective to use such historical data to calculate prospective Medicare rate changes. However, it is highly unlikely that the COVID-19 pandemic and the ensuing recovery period would in any sense be considered indicative of a steady-state economic environment. To that end, these lagging indicators and outdated data do not adequately capture and thereby cannot predict the significant disruptions created by the COVID-19 pandemic for hospitals, health systems, and other providers.

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The demand and supply shocks experienced during the early years of the pandemic and continuing well into this year strongly indicate that great caution and consideration must be factored into calculating the market basket and productivity adjustments in setting prospective payment rates. In the FY 2023 IPPS proposed rule, price proxies in the market basket reflect IHS Global Inc.'s (IGI's) fourth quarter 2021 forecast, which is based on a four-quarter percentage change in the moving average. Although these adjustments are based on forecasts using the most recent data available at the time of the proposed rate setting, the results are released on a lagged basis, usually three to four months after preparation of the forecast. As such, they do not adequately account for recent economic trends that have significantly increased costs to hospitals, including labor and inflation.

Hospital Labor Costs and Workforce Shortages

Hospitals and health systems have been especially hard hit by the workforce shortages associated with the pandemic. The pandemic exacerbated existing shortages of physicians, nurses, and other hospital personnel by increasing competition for workers, as well as driving up the burnout rate among clinicians.[16] With hospital workers stretched to the limit due to the demand for hospital services and the burden of caring for severely ill patients in record numbers, widespread burnout placed enormous pressure on health

[10] "March 2021 Report to the Congress: Medicare Payment Policy." MedPAC, March 15, 2021. https://www.medpac.gov/document/march-2021-report-to-the-congress-medicare-payment-policy/.

[11] "March 2022 Report to the Congress: Medicare Payment Policy." MedPAC, March 15, 2022. https://www.medpac.gov/document/march-2022-report-to-the-congress-medicare-payment-policy/.

[12] Ibid.

[13] "FY 2023 Hospital Inpatient Prospective Payment System (IPPS) and Long Term Care Hospitals (LTCH PPS) Proposed Rule - CMS-1771-P." CMS, April 18, 2022. https://www.cms.gov/newsroom/fact-sheets/fy-2023-hospital-inpatient-prospective-payment-system-ipps-and-long-term-care-hospitals-ltch-pps.

[14] Ibid.

[15] Ibid.

[16] "Impact of the COVID-19 Pandemic on the Hospital and Outpatient Clinician Workforce." The Office of the Assistant Secretary for Planning and Evaluation (ASPE). Department of Health and Human Services, May 3, 2022. https://aspe.hhs.gov/sites/default/files/documents/9cc72124abd9ea25d58a22c7692dccb6/aspe-covid-workforce-report.pdf.

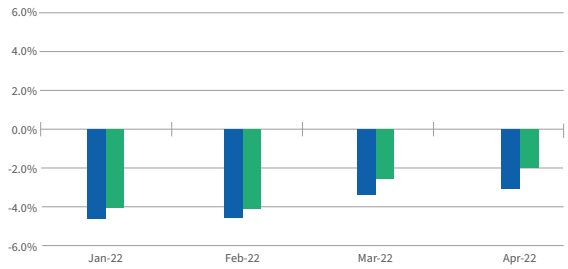
systems to pay more to attract and retain workers. That trend has yet to abate: a March 2022 report from Elsevier Health found that 47 percent of U.S. clinicians plan to leave their jobs in the next two to three years.[17]

Moreover, hospitals face more competition than ever from travel and temporary nurse staffing firms that are attracting a greater share of the workforce with higher pay and more generous benefits, a trend driving up hospital labor costs.[18] The cost of contract labor relative to total labor expenses increased five-fold in 2022 compared to 2019, primarily due to the need to replace departing staff nurses with travel or agency nurses.[19] Median wages for contract nurses reached triple the median wages of employed nurses in March 2022.[20] Due to rising labor expenses coupled with only small increases in volume and revenue, hospitals saw large declines in operating margins in January through March 2022.[21]

Although the inflated wages and benefits offered by traveling and temporary staffing nursing agencies have somewhat moderated in recent months,[22] it is unlikely that the upward pressures on labor costs for hospitals will be mitigated anytime soon. An October 2021 survey by Kaufman Hall indicated that 92 percent of hospitals have experienced challenges in attracting and retaining support staff.[23]

Significant increases in hospitals' labor costs, coupled with workforce shortages, continue to place immense strain on the health care system. All told, as of March 2022, hospital labor expenses had increased by more than one-third relative to pre-pandemic levels.[24] Hospital financials for the first quarter of 2022 returned to worrisome levels due to the Omicron surge in early 2022 (Figure 2).[25] Inflationary pressures within the economy and fierce competition for health care workers will continue to put upward pressure on wages and benefits through 2022 and likely into 2023. Using data that typically lags two to four years to project labor costs in this uncertain economic environment will fail to account for the ongoing staffing challenges faced by acute care hospitals. CMS should recognize in its market basket adjustments how the understated market basket forecasts for 2021 and 2022 due to COVID-19 and inflation are embedded in payments, as well as how upward pressure on wages and benefits, and costs of supplies and pharmaceuticals, will likely be a mid- to long-term factor adversely affecting hospital operating costs and margins.

Figure 2: Kaufman Hall Operating Margin Index YTD by Month



Source: "National Hospital Flash Report: May 2022." Kaufman Hall, May 31, 2022.

[17] "Clinician of the Future Report 2022." Elsevier, March 15, 2022. https://www.elsevier.com/__data/assets/pdf_file/0004/1242490/Clinician-of-the-future-report-online.pdf.

[18] Yang, Y. Tony, and Diana J. Mason. "Covid-19's Impact on Nursing Shortages, The Rise of Travel Nurses, And Price Gouging." Health Affairs, January 28, 2022. https://www.healthaffairs.org/do/10.1377/forefront.20220125.695159/.

[19] "The Financial Effects of Hospital Workforce Dislocation: A Special Workforce Edition of the National Hospital Flash Report." Kaufman Hall, May 11, 2022. https://www.kaufmanhall.com/insights/research-report/special-workforce-edition-national-hospital-flash-report.

[20] Ibid.

[21] Ibid.

[22] Norman, Hannah. "Travel Nurses Raced to Help during Covid. Now They're Facing Abrupt Cuts." NBCNews.com. NBCUniversal News Group, May 8, 2022. https://www.nbcnews.com/health/health-news/travel-nurses-raced-help-covid-now-facing-abrupt-cuts-rcna27716.

[23] "2021 State of Healthcare Performance Improvement Report: COVID Creates a Challenging Environment." Kaufman Hall, October 18, 2021. https://www.kaufmanhall.com/insights/research-report/2021-state-healthcare-performance-improvement-report-covid creates#:~:text=2021%20State%20of%20Healthcare%20Performance%20Improvement%20Report%3A%20COVID%20Creates%20a%20Challenging%20Environment,-October%2018%2C%202021&text=The%20COVID%2D19%20pandemic%20continues,health%20systems%20across%20the%20country.

[24] "The Financial Effects of Hospital Workforce Dislocation: A Special Workforce Edition of the National Hospital Flash Report." Kaufman Hall, May 11, 2022. https://www.kaufmanhall.com/insights/research-report/special-workforce-edition-national-hospital-flash-report.

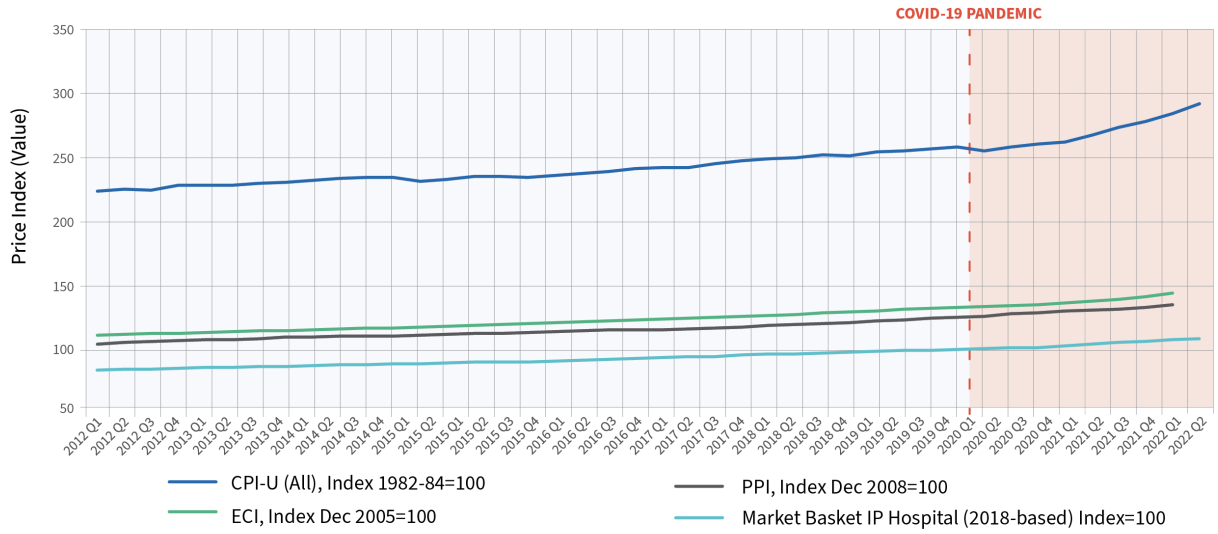
[25] Swanson, Erik. "National Hospital Flash Report: May 2022." Kaufman Hall, May 31, 2022. https://www.kaufmanhall.com/insights/research-report/national-hospital-flash-report-may-2022.

Current and Projected Inflation

In an era of historic inflation across the broader economy, the Altarum Institute notes that health care inflation hovers close to its historic average of two percent as a result of prospective rate-setting.[26] This contrasts sharply with the Consumer Price Index (CPI), a measure of general inflation, which hit 8.6 percent over the 12-month period ending in May 2022.[27] The differential exists because health care costs paid by consumers typically reflect rates negotiated in the year prior, rather than the actual cost of inputs borne by hospitals and health systems at the time of care delivery.[28]

In a steady state economy with small and stable changes in inflation and costs, it is possible to predict with some accuracy the anticipated rate of increase in the cost of goods and services to determine provider reimbursements. That is the rationale for using historical data and adjusting IPPS price proxies using the ECI, a measure of compensation costs, despite its reliance on lagging indicators. However, significant changes in the CPI, which measures changes in prices paid by consumers, and the Producer Price Index (PPI), which tracks changes in price experienced by producers, can have a major impact on wage and salary expectations that can feed into future changes to the ECI. Higher inflation can create upward pressure on wage expectations as workers seek an increase in wages to better meet the increasing cost of living. This can be exacerbated when labor is in short supply, as is currently the case in the hospital sector. Figure 3, below shows the major price indices relevant to understanding these inflationary pressures for hospital workers. These data reveal that – despite shocks in price indices over time – the market basket captures these in a muted way that is in stark contrast to what hospitals and health systems actually experience.

Figure 3: Price Index, Cost Index, and CMS Market Basket IP Hospital, Quarterly, Seasonally Adjusted (2012-2022)

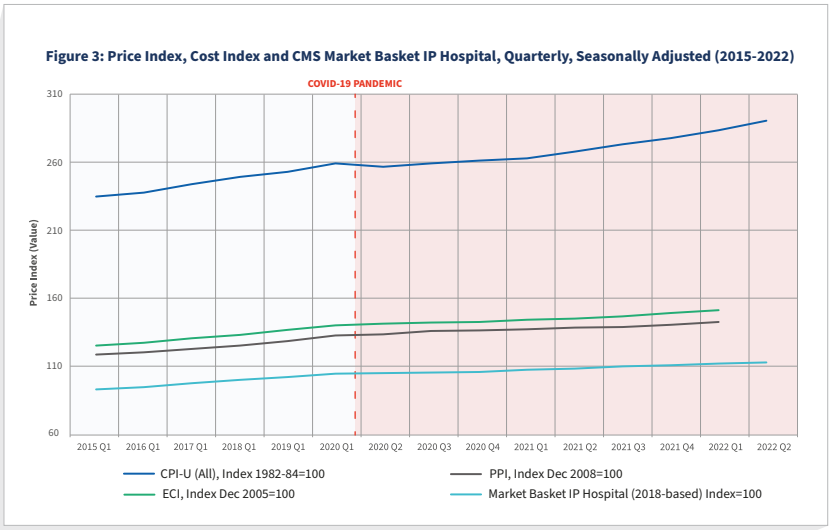


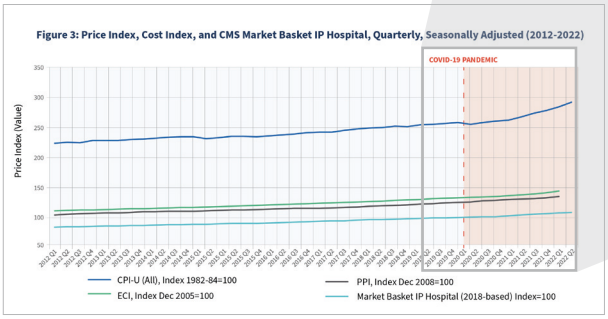
Source: Consumer Price Index (CPI) Databases, U.S. Bureau of Labor Statistics; Employment Cost Index (ECI), FRED, Federal Reserve Bank of St. Louis; Producer Price Index (PPI), FRED, Federal Reserve Bank of St. Louis; CMS Market Basket Index Levels, IHS Global Inc. (IGI) 2021q4 Forecast by CMS, OACT, National Health Statistics Group

[26] "Inflation Is Booming. Why Hasn't It Hit Health Care?" Advisory Board. Advisory Board, April 15, 2022. https://www.advisory.com/daily-briefing/2022/04/15/inflation-us.

[27] "Consumer Price Index Summary - 2022 M05 Results." U.S. Bureau of Labor Statistics. U.S. Bureau of Labor Statistics, June 10, 2022. https://www.bls.gov/news.release/cpi.nr0.htm.

[28] "Inflation Is Booming. Why Hasn't It Hit Health Care?" Advisory Board. Advisory Board, April 15, 2022. https://www.advisory.com/daily-briefing/2022/04/15/inflation-us.





Source: Consumer Price Index (CPI) Databases, U.S. Bureau of Labor Statistics; Employment Cost Index (ECI), FRED, Federal Reserve Bank of St. Louis; Producer Price Index (PPI), FRED, Federal Reserve Bank of St. Louis; CMS Market Basket Index Levels, IHS Global Inc. (IGI) 2021q4 Forecast by CMS, OACT, National Health Statistics Group

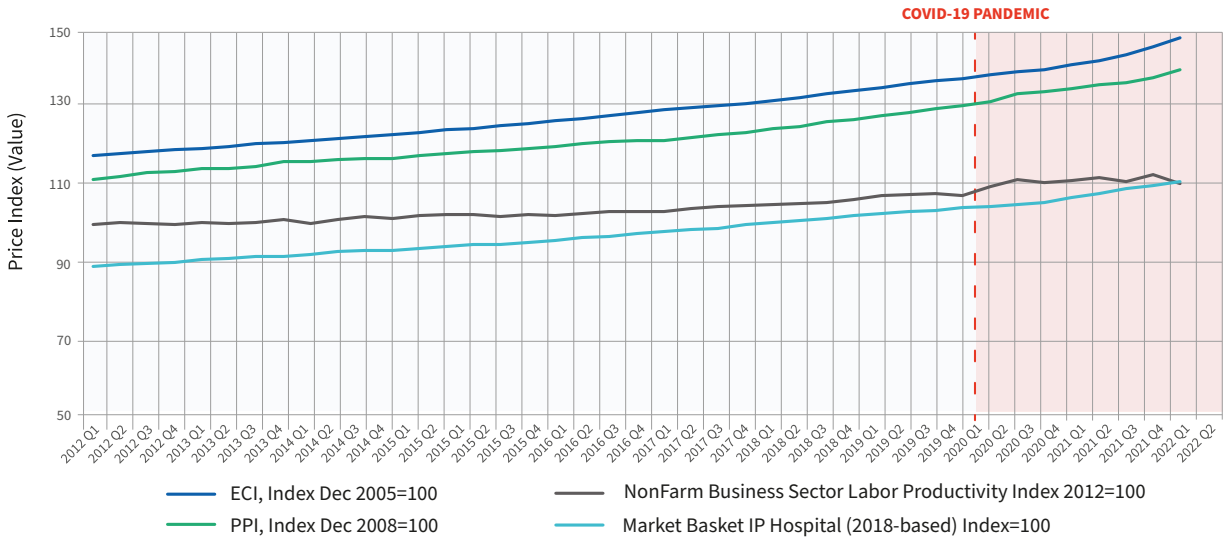
The CPI for All Urban Consumers (CPI-U) for all services shows a significantly steeper upward trend than is reflected in the market basket for inpatient hospital services. Since the start of the pandemic, this growth has exceeded growth in the Market Basket for Inpatient Hospital Services (Figure 3).[29] These more recent inflationary pressures are likely to work their way into wage expectations, particularly in industry sectors where labor is in short supply, thus driving up labor costs even further.

Using the third quarter 2021 data for market basket forecasting, as the FY 2023 IPPS Proposed Rule would do, risks capturing only the very beginning of this upward pressure on prices and wages in the economy (Figure 4).[30] Although the ECI has historically been fairly stable with annual growth rates ranging from a low of about 1.6 percent to a high of 2.8 percent just prior to the beginning of the pandemic, compensation costs have increased rapidly over the past year. From 2.6 percent in April 2021 to the most current estimate of 5.0 percent in January 2022, workers are commanding significantly higher wages. Historical data from the fourth quarter of 2021 misses this continuing upward trend in early 2022.

[29] Consumer Price Index (CPI) Databases, U.S. Bureau of Labor Statistics; Employment Cost Index (ECI), FRED, Federal Reserve Bank of St. Louis; Producer Price Index (PPI), FRED, Federal Reserve Bank of St. Louis; CMS Market Basket Index Levels, IHS Global Inc. (IGI) 2021q4 Forecast by CMS, OACT, National Health Statistics Group

[30] Employment Cost Index (ECI), FRED, Federal Reserve Bank of St. Louis; Producer Price Index (PPI), FRED, Federal Reserve Bank of St. Louis; NonFarm Business Sector Labor Productivity, FRED, Federal Reserve Bank of St. Louis; CMS Market Basket Index Levels, IHS Global Inc. (IGI) 2021q4 Forecast by CMS, OACT, National Health Statistics Group

Figure 4: Cost Index and CMS Market Basket IP Hospital, Quarterly, Seasonally Adjusted (2012-2022)



Source: Employment Cost Index (ECI), FRED, Federal Reserve Bank of St. Louis; Producer Price Index (PPI), FRED, Federal Reserve Bank of St. Louis; NonFarm Business Sector Labor Productivity, FRED, Federal Reserve Bank of St. Louis; CMS Market Basket Index Levels, IHS Global Inc. (IGI) 2021q4 Forecast by CMS, OACT, National Health Statistics Group

Although it may reach its peak in 2022, the high rate of inflation the U.S. economy is experiencing is not projected to abate in the near term, furthering the critical need to consider the likelihood that these inflationary pressures will factor into costs and wage expectations. Fannie Mae projects that inflation, as measured by the CPI, peaked in March 2022 at an annual rate of 8.5 percent, although month-to-month changes may continue.[31] Nonetheless, Fannie Mae forecasts inflation to remain elevated, averaging 5.5 percent in the fourth quarter of 2022.[32] With respect to ECI, the Congressional Budget Office (CBO) projects a 5.4 percent increase for 2022 and a 4.1 percent increase for 2023.[33] The CBO estimates the ECI increased 5.0 percent in 2021. The CBO's projections typically fall in the middle range of the likely outcomes under current law, suggesting the possibility that the actual increase in compensation costs could be even higher.[34]

Accounting for recent and future trends in inflationary pressures and cost increases in the Hospital Market Basket will be essential to ensuring that Medicare payments for acute care services in FY 2023 more accurately reflect the cost of providing hospital care.

[31] "Inflation Rate Signals Tighter Monetary Policy and Threatens 'Soft Landing'." Fannie Mae, April 19, 2022. https://www.fanniemae.com/research-and-insights/forecast/inflation-rate-signals-tighter-monetary-policy-and-threatens-soft-landing#:~:text=Inflation%2C%20as%20measured%20by%20the,and%20declines%20in%20auto%20and.

[32] Ibid.

[33] "The Budget and Economic Outlook: 2022 to 2032." Congressional Budget Office, May 25, 2022. https://www.cbo.gov/publication/58147.

[34] Ibid.

Productivity

Under the Affordable Care Act (ACA), CMS is required to annually adjust hospital payments under the IPPS to reflect anticipated gains in productivity over time.[35] The productivity adjustment is equal to the 10-year moving average of changes in the annual economy-wide, private nonfarm business total factor productivity (TFP).[36] The measure is intended to contain health care spending by ensuring payments more accurately reflect the true cost of providing hospital care. In the FY 2023 IPPS Proposed Rule, CMS proposes using IHS Global, Inc.'s (IGI's) fourth-quarter 2021 forecast of the IPPS market basket rate of increase, which uses data through third-quarter 2021.[37] This produces a projected productivity adjustment of 0.4 percentage points to the proposed FY 2023 market basket adjustment of 3.1 percent, reducing the update to 2.7 percent.[38,39]

The use of nonfarm business TFP by CMS in its productivity adjustment formula is meant to capture gains from new technologies, economies of scale, business acumen, managerial skills, and changes in production.[40] Using private nonfarm business TFP effectively assumes the hospital sector should be able to mirror productivity gains across the broad private nonfarm business sector. However, in an economy marked by great uncertainty in performance due to the demand and supply shocks of dealing with a public health crisis such as COVID-19, this assumption may generate significant departures from economic reality.

Basing the adjustment on a 10-year moving average of the change in TFP also mitigates large year-to-year fluctuations that might occur. Over the last decade, there have been only four periods of productivity decreases. Notably, two of the periods of decreased productivity occurred during the COVID-19 pandemic – a 0.4 percent decline in July 2021 and a 0.6 percent decline in January 2022.[41] Two productivity declines in the last 12-month period is a material disruptor of the relatively steady-state increases in private, nonfarm productivity gains. Although the productivity adjustment uses a 10-year moving average for private nonfarm business productivity gains, two declines in this productivity metric should be noteworthy when considering the appropriate payment updates in the FY 2023 IPPS.

CMS has acknowledged the disconnect between Medicare productivity and the 10-year moving average private nonfarm business TFP. A 2016 analysis by the CMS Office of the Actuary (OACT) found that the average growth rate of hospital multi-factor productivity (now referred to as TFP) ranged from 0.1 percent to 0.6 percent compared with the average growth of private nonfarm business multifactor productivity (MFP) of 1.0 percent.[42] More recent research cited in the CMS OACT analysis indicates that hospitals could achieve productivity gains of 0.4 percent per year over the long run compared with an assumed growth in private nonfarm business MFP of 1.1 percent, representing just over one-third (36.3 percent) of the gains in the private nonfarm business sector.[43] Particularly in a period of record inflation and unprecedented public health challenges, using the 10-year moving average nonfarm business sector TFP to adjust the market basket percentage increase could exacerbate Medicare underpayments to hospitals.

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[35] "Methodology for Projecting Total Factor Productivity for the Private Nonfarm Business Sector." CMS, March 2022. https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/MedicareProgramRatesStats/Downloads/TFP_Methodology.pdf.

[36] "Compilation Of The Social Security Laws." Social Security Administration. Accessed June 1, 2022. https://www.ssa.gov/OP_Home/ssact/title18/1886.htm.

[37] "Methodology for Projecting Total Factor Productivity for the Private Nonfarm Business Sector." CMS, March 2022. https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/MedicareProgramRatesStats/Downloads/TFP_Methodology.pdf.

[38] Total factor productivity is calculated as follows: *TFP growth = Output growth - [(labor input growth * labor share) + (capital input growth * capital share)].* This is a measure of changes in efficiency that cannot be accounted for by the change in total combined inputs (i.e., hours worked, capital and intermediate purchases).

[39] "FY 2023 Hospital Inpatient Prospective Payment System (IPPS) and Long Term Care Hospitals (LTCH PPS) Proposed Rule - CMS-1771-P." CMS, April 18, 2022. https://www.cms.gov/newsroom/fact-sheets/fy-2023-hospital-inpatient-prospective-payment-system-ipps-and-long-term-care-hospitals-ltch-pps.

[40] Methodology for Projecting Total Factor Productivity for the Private Nonfarm Business Sector." CMS, March 2022. https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/MedicareProgramRatesStats/Downloads/TFP_Methodology.pdf.

[41] "Methodology for Projecting Total Factor Productivity for the Private Nonfarm Business Sector." CMS, March 2022. https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/MedicareProgramRatesStats/Downloads/TFP_Methodology.pdf.

[42] Spitalnic, Paul, Stephen Heffler, Bridget Dickensheets, and Mollie Knight. "Hospital Multifactor Productivity: An Updated Presentation of Two Methodologies." CMS, February 22, 2016. https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/ProductivityMemo2016.pdf.

[43] Ibid.

The COVID-19 pandemic continues to negatively affect hospital services, unlike other areas of private nonfarm business economy. Whereas the private nonfarm business economy experienced a rapid increase in output and productivity gains when communities began emerging from COVID-19 lockdowns in late 2021, the same has not been true for hospital services.[44] Generally, hospital services have been slower to return to pre-pandemic levels,[45] and it is highly unlikely that hospitals have achieved the significant productivity gains incorporated into the FY 2023 IPPS prospective rate adjustments. An October 2021 survey conducted by Kaufman Hall found that many hospitals and health system leaders feel the COVID-19 pandemic made it significantly more difficult for them to improve their performance.[46]

CMS currently relies on the most recent TFP forecast available even when economic trends, such as employment and labor productivity, are uncertain or highly variable. Recently, the COVID-19 pandemic, along with the trillions of dollars in relief funds appropriated in response, injected significant volatility into the U.S. economy. This in turn exacerbated the disconnect between projections used in the proposed rules and the most recent data available prior to finalizing the IPPS productivity adjustment. For example, in FY 2021, CMS initially proposed a negative productivity adjustment of .4 percent to the IPPS market basket,[47] which was ultimately set to zero in the final rule.[48]

According to the Bureau of Labor and Statics' (BLS) most recent release on TFP, nonfarm business sector labor productivity decreased 7.3 percent in the first quarter of 2022 as output decreased 2.3 percent and hours worked increased 5.4 percent.[49] This represents the largest decline in quarterly productivity since the third quarter of 1947.[50] This decrease in TFP is more akin to FY 2021 productivity adjustments where a decrease in productivity of 0.1 percent points resulted in a zero productivity adjustment.[51] Here, if the decrease in productivity continues into the second quarter, we should expect to see a significant reduction in the productivity adjustment, possibly even a zero productivity adjustment. It is important to note that the FY 2021 zero adjustment is based on a forecast of a 0.1 percentage point decline in TFP that pales in comparison to the most recent productivity declines.

Significant uncertainty will persist into the first half of 2023, and likely beyond, regarding the direction and magnitude of U.S. economic performance as inflationary pressures caused by multiple factors (such as fiscal and monetary policy, supply chain disruptions, and the war in Ukraine) have affected productivity. This uncertainty, as well as the likely greater divergence of hospital services productivity from overall private nonfarm business sector productivity, should be considered in settling on a productivity adjustment for FY 2023.

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[51] FY 2022 IPPS productivity adjustment was proposed at 0.2 percentage points based on IGI's fourth quarter 2021 forecast of TFP but IGI's second quarter 2021 forecast reflected a significant change in the estimate to 0.4 percentage points for FY 2022. The FY 2021 productivity adjustment proposed was 0.4 percentage points using IGI's fourth quarter 2019 forecast. More recent data based on IGI's June 2020 forecast indicated a -0.1 percentage point growth for FY 2021. As section 1886(b)(3)(B)(xi)(I) of the Act requires a reduction not an increase for the productivity adjustment, the adjustment was set to zero.

Conclusion: Current Economic Realities Are Not Reflected in Proposed IPPS Update, Put Hospitals' Financial Viability at Risk

As CMS prepares to finalize the FY 2023 IPPS and LTCH PPS Rule – as well as Fiscal Year 2023 Inpatient Rehabilitation Facility (IRF), Inpatient Psychiatric Facility (IPF), and Medicare Hospital Outpatient Prospective Payment System (PPS) Final Rules – considering the ongoing impacts of COVID-19 and recent inflationary pressures will be essential to ensuring the stability and resiliency of the health care system as it emerges from a global pandemic. Hospital operating margins in 2022 reveal the adverse impact of higher costs and a change in the mix of resources needed to respond to new surges and new COVID-19 variants. The proposed FY 2023 IPPS rate adjustment effectively attempts to return to the steady-state lagged adjustment methodology used prior to the pandemic without fully accounting for dynamics like the continuing effects of wage and inflationary pressures. Given the long history of Medicare underpayments, the failure to account for these pressures in the latest IPPS rule will likely exacerbate the deficit in Medicare funding that hospitals already experience and create further challenges for our hospitals and health system, at a time when they remain vulnerable to financial distress.

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SUSAN H. MANNING, PH.D.
Senior Managing Director
susan.manning@fticonsulting.com

CHARLENE MACDONALD
Senior Managing Director
charlene.macdonald@fticonsulting.com

SABIHA QUDDUS
Senior Director
sabiha.quddus@fticonsulting.com

SOPHIA SETTERBERG
Senior Director
sophia.setterberg@fticonsulting.com