CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Peter R. Orszag, Director

December 19, 2007

Honorable Jon Kyl
United States Senate
Washington, DC 20510

Dear Senator:

As you requested, I am providing additional information regarding CBO's estimate of the budgetary impact of section 651 of H.R. 3162, the Children's Health and Medicare Protection Act of 2007. This letter is a follow-up to your letter of November 8, 2007, and a subsequent meeting with your staff on November 19, 2007. In this letter I will refer to hospitals that would not participate in Medicare as a result of section 651 as "the affected hospitals."

Under current law, physicians are prohibited from referring patients to a provider of health care services in which the physician has a financial interest. There are exceptions to that prohibition, however, for referrals to hospitals that serve predominantly rural populations or to a hospital in which the physician's financial interest is in the whole hospital (in contrast to an interest in some discrete component of the hospital).

Section 651 would require physician-owned hospitals to meet certain requirements to continue qualifying for an exception from that prohibition. Those requirements would include specific limits on the percentage of the hospital that physicians may own and on the allocation of financial returns on those investments, and would have the effect of limiting the number and size of physician-owned specialty hospitals. CBO estimates that enacting that provision would reduce Medicare spending by $0.7 billion over the 2008-2012 period and $2.9 billion over the 2008-2017 period.

CBO projects that, under current law, Medicare payments to physician-owned specialty hospitals will grow from about $1.3 billion in 2007 to more than $2 billion by 2011, and will continue to grow in future years. Most of the growth in costs is projected to result from payments to hospitals that are not

yet operating. CBO's estimate assumed that enacting section 651 would prevent those hospitals from participating in Medicare. The estimate also assumed that about three-quarters of existing physician-owned specialty hospitals would continue to participate in Medicare. Therefore, hospitals that do not currently participate in Medicare account for nearly all of the affected hospitals and for nearly all of the estimated budgetary impact of section 651.

CBO expects that a substantial volume of services would migrate to ambulatory surgical centers (ASCs)—particularly to new ASCs—if physician-owned specialty hospitals were not available. Because Medicare's payment rates for services furnished in an ASC are lower than those for services provided in a hospital, that shift would result in savings to the government, even though the volume of services provided might not change.

CBO's estimate took into account how much of specialty hospitals' services are performed on an inpatient or outpatient basis and whether, under the bill, services would instead be performed at community hospitals or at ambulatory surgical centers. In this regard, it is important to differentiate between types of hospitals. In the case of cardiac hospitals, for example, the Medicare Payment Advisory Commission (MedPAC) reported in 2006 that 79 percent of the charges of physician-owned specialty hospitals were for inpatient services. Therefore, CBO's estimate assumed that nearly all of the services that will be provided at affected cardiac hospitals under current law would, under section 651, be provided in community hospitals, not in ASCs (which provide outpatient surgical services).

In contrast, MedPAC also reported that most of the charges at physician-owned specialty orthopedic or surgical hospitals are for outpatient services; only 32 percent are for inpatient services. CBO's estimate assumes that about 60 percent of the services that will be provided by affected orthopedic or surgical specialty hospitals under current law would ultimately be provided on an outpatient basis in ASCs, many of them new, under section 651. Most of the estimated savings would result from that shift.

CBO's estimate relied on the results of several studies published in peer-reviewed journals that analyzed the relationship between physician ownership and the volume of services in other settings. On that basis, CBO estimated that for procedures that would be provided in community hospitals under the bill, fewer ancillary services would be provided than will, under current law, be

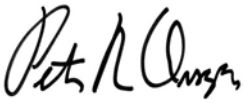
provided in physician-owned specialty hospitals. (That difference accounts for only a small portion of the estimated savings, however.) You asked if we can provide data from the Centers for Medicare & Medicaid Services that demonstrate that physician-owned specialty hospitals are billing Medicare for substantially more services than community hospitals. CBO is not aware of such data.

CBO anticipates that physicians will seek opportunities to invest in medical facilities, in part to offset the effect on their future earnings of real declines in Medicare's payment rates for physicians' services under the sustainable growth rate system. Under current law, CBO expects that physicians and other investors generally will choose to invest in a specialty hospital rather than an ASC. As we discussed with your staff, the higher payment rate for services furnished in a hospital is an important reason why it is currently more attractive to invest in a specialty hospital than in an ASC. Nevertheless, CBO expects that many physicians interested in investing in medical facilities would choose to invest in new ASCs if section 651 takes effect, because the alternative of investing in a new specialty hospital would no longer be as attractive.

CBO's baseline projection of growth in the use of specialty hospitals under current law and our estimate of the potential for services to migrate to ASCs under section 651 took into account the effect of state Certificate of Need (CON) laws. In 2007, according to the National Conference of State Legislatures, 24 states did not require a CON to open an ASC. Those states account for 56 percent of Medicare beneficiaries. Fewer Medicare beneficiaries—48 percent—live in a state that does not require a CON to open a hospital or add beds for acute care. Thus, CON laws pose less of a constraint on the growth of ASCs than they do on the growth of physician-owned specialty hospitals.

I hope this information is helpful to you. The CBO staff contact for further information is Shinobu Suzuki.

Sincerely,



Peter R. Orszag
Director

cc: Honorable Tom Coburn
Honorable John Cornyn
Honorable Kay Bailey Hutchinson

Identical letter sent to the Honorable Mike Crapo.