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How Congress Is Killing Competition: The Future of Specialty Hospitals

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Specialty hospitals provide the only real competition to traditional hospitals, and they offer a real opportunity to improve quality and cost control in the highly protective health care sector. However, Congress is once again considering measures to block or hinder specialty hospitals from effectively competing with traditional hospitals. During the current session of Congress, the House of Representatives has already included and enacted such restrictions in the Children's Health and Medicare Protection Act of 2007 (H.R. 3162). There is discussion of reviving these kinds of restrictions in draft Medicare legislation.

Under Section 651 of H.R. 3162, Congress would impose a permanent ban on physician referrals of Medicare patients to new specialty hospitals in which they have an ownership interest; require existing hospitals to limit physician ownership to 40 percent; and limit individual physician ownership to 2 percent. It would also prohibit the addition of new inpatient beds and operating rooms in existing specialty hospitals that get Medicare reimbursement. This policy would essentially kill any new specialty hospitals, including those under construction. Moreover, it would fundamentally change the way that existing specialty hospitals are managed.

This legislation, which is strongly supported by traditional hospitals, is the most recent in a series of attempts to terminate the growth of specialty hospitals. As Professor Regina Herzlinger, Nancy McPherson Professor of Business Administration at the Harvard Business School, has observed, this congressional attempt to suppress competition was not advanced in the interest of patient care: "… no one alleged that the specialty hospitals were *bad for the consumers' health.* No, instead, the general hospitals alleged that the specialty hospitals were *bad for their health.*"[1]

Hospital Specialization. A specialty hospital is defined by the U.S. Government Accountability Office (GAO) as "a hospital in which two-thirds or more of its inpatient claims were in one or two major diagnosis categories, or two-thirds or more of its inpatient claims were for surgical diagnosis-related groups."[2] There are currently more than 125 specialty hospitals in the U.S., focused on providing specialized services in cardiac, orthopedic, or general surgery. Specialty hospitals, which are predominately physician-owned, provide patients with a more consistent hospital experience due to their focus on a limited range of patient services.

Government Research Findings. Due to the rapid increase in the number of specialty hospitals, and accusations of unfair competition from traditional hospitals, Congress in 2003 commissioned a study on the impact of specialty hospitals on traditional hospitals. Congress assigned the Medicare

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Payment Advisory Commission (MedPAC)—a special federal panel that makes recommendations on Medicare payment to medical professionals and institutions—the task of examining the financial impact of specialty hospitals. Meanwhile, the Center for Medicare and Medicaid Services (CMS) was assigned to study the impact of specialty hospitals on the quality of patient care. During the18-month duration of these studies, Congress restricted any Medicare reimbursements to specialty hospitals established after November 18, 2003.[12]

In the spring of 2005, both MedPAC and HHS reported their findings. The key revelations were as follows:

- **Specialty hospitals had no significant negative impact on the financial condition of traditional hospitals.** The studies revealed no conclusive data showing any financial harm to traditional hospitals as a result of the operation of specialty hospitals; in particular, there was little impact on community hospital profitability during the time period studied.[3] Moreover, there was no difference in the ratio of more profitable, low-severity surgeries to less profitable, high-severity surgeries between the two hospital groups.
- **Specialty hospitals could promote innovation in patient care.** MedPAC analysts cited specialty hospitals as a possible and important competitive force to promote innovations in the health care field.[4]
- **Specialty hospitals provide predictable scheduling and patient care.** CMS analysts determined that the specialty hospitals provide a more uniform set of services and have fewer competing pressures than community hospitals, leading to more predictable scheduling and patient care. Moreover, cardiac specialty hospitals had fewer complications and lower mortality rates than those at full service hospitals, although the duration of patient stays at these cardiac hospitals was not significantly different. Also, patient satisfaction was high at the specialty institutions.[5]
- **The Medicare reimbursement system needs to change.** Medicare payments should be reevaluated to eliminate disparities and equalize payments to all inpatient hospitals. This would require an overhaul of the current system of diagnosis related groups (DRG), in which hospitals receive a predetermined amount per patient based on diagnosis. Under current arrangements, according to the researchers, the DRGs would encourage the cherry-picking of patients.

Since MedPAC recommended reimbursement reforms, CMS has initiated changes to the DRG system to reflect the severity of the patients' cases and the true cost of the hospital services.

Even though the results of a second set of government reports were consistent with the first, Congress is considering a permanent ban on new specialty hospitals, citing figures from the Congressional Budget Office (CBO) that indicate the ban will save the government $700 million over five years and $2.9 billion over 10 years.[6] However, these savings are based on the assumption of increased utilization of ambulatory surgery centers if specialty hospitals are restricted. Most of the traffic from specialty hospitals would likely go to traditional hospitals, rendering the estimates by the CBO significant overestimations.

Improving Patient Care. Specialty hospitals offer patients a viable option to obtain high-quality,

1. Herzlinger, Regina. *Who Killed Health Care?* (New York: McGraw Hill, 2007), p. 81.
2. Specialty Hospitals: Information on National Market Share, Physician Ownership, and Patients Served. Washington, D.C.: U.S. General Accounting Office (2003).
3. Medicare Payment Advisory Commission, "Report to the Congress: Physician-Owned Specialty Hospitals," March 2005, p. 23, at *www.medpac.gov/documents/Mar05_SpecHospitals.pdf*.
4. *Ibid.*, p. 43.
5. Centers for Medicare and Medicaid Services, "Study of Physician-owned Specialty Hospitals Required in Section 507(c)(2) of the MMA," 2005, p. 36, at *www.cms.hhs.gov/MLNProducts/Downloads/RTC-StudyofPhysOwnedSpecHosp.pdf*.
6. Congressional Budget Office, "Preliminary CBO Estimate of the Effects on Direct Spending and Revenues of H.R. 3162," Washington, D.C., July 24, 2007.

reliable health care. They have consistent operations and results while incorporating desirable features that increase quality, such as a low patient-to-nurse ratio, high procedure volume, electronic physician ordering, and the latest medical equipment and technology. Compared to traditional hospitals, it is not surprising that specialty hospitals have higher patient satisfaction, lower mortality rates, and lower costs.[7] Some key findings on studies about specialty hospitals are listed below:

- **Specialty hospitals have higher rates of patient satisfaction.** Numerous focus groups have compared patients' experiences in specialty versus traditional hospitals. Most panels conclude that patient satisfaction is very high in specialty hospitals. In an effort to continue to improve their performance, 92 percent of specialty hospitals tend to collect patient satisfaction data to improve the patient care experience.[8] Customer-based services, with routine patient feedback, will continue to drive innovation in these institutions.
- **Specialty hospitals have lower mortality rates.** Risk-adjusted, 30-day mortality rates were significantly lower for specialty hospitals than for community hospitals.[9] This finding has been documented in both cardiac and orthopedic hospitals, including the report from the HHS commissioned by Congress.[10] The main force behind this notable achievement is that the streamlined procedures of specialty hospitals allow for shorter hospital stays, which decreases the chance of patients acquiring preventable, hospital-based infections.
- **Specialty hospitals have comparable costs to traditional hospitals.** MedPAC reported that, currently, costs are not lower at specialty hospitals, despite fewer complications and shorter hospital stays. This discrepancy, however, is most likely due to the initially high, fixed costs of the specialty hospitals; with time, it is expected that "overhead costs may decrease from having operations performed in the specialty hospitals [rather] than in community hospitals."[11]
- **Specialty hospitals focus on a select number of services.** Specialty hospitals focus on a smaller number of procedures, which tend to be the higher reimbursement procedures. Of course, this is also the best strategy for getting superior results in those types of procedures. Moreover, despite the assumption that specialty hospitals are solely focused on profits, recent research shows that "…specialty hospitals incurred a greater net community benefit burden than their not-for-profit competitors did."[12]
- **Physician referrals to specialty hospitals are not self-serving.** The fear that physicians are mainly self-referring to specialty hospitals in which they have a part ownership is exaggerated. According to an analysis published in *Health Affairs*, a prominent health policy journal, there is "…little difference in referral patterns between owners and non-owners, which suggests that specialization of the hospital is potentially a pri-

7. L. Greenwald, et al., "Specialty Versus Community Hospitals: Referrals, Quality, and Community Benefits," *Health Affairs,* 25, no. 1 (2006), pp. 106–118.
8. J. Schneider, R. Ohsfeldt, and J. Benton, "The Effects of Physician-Owned Specialty Hospitals: A Critical Review of the Evidence," Health Economics Consulting Group, October 9, 2007.
9. L. Greenwald, et al., "Specialty Versus Community Hospitals: Referrals, Quality, and Community Benefits," *Health Affairs,* 25, no. 1 (2006), pp. 106–118.
10. P. Cram, et al., "Cardiac Revascularization in Specialty and General Hospitals," *New England Journal of Medicine* 352 (14), (2005), pp. 1454–1463; P. Cram, et al., "A Comparison of Total Hip and Knee Replacement in Specialty and General Hospitals," *Journal of Bone and Joint Surgery* 89 (8) (2007), pp. 1675–1684; Centers for Medicare and Medicaid Services, "Study of Physician-owned Specialty Hospitals Required in Section 507(c)(2) of the MMA," 2005, p. 39, at *www.cms.hhs.gov/MLNProducts/Downloads/RTC-StudyofPhysOwnedSpecHosp.pdf.*
11. Jason Shafrin, "Do We Need Specialty Hospitals?" *Healthcare Economist*, June 28, 2006.
12. L. Greenwald, et al., "Specialty Versus Community Hospitals: Referrals, Quality, and Community Benefits," *Health Affairs,* 25, no. 1 (2006), pp. 106–118.

mary issue, not ownership alone."[13] Moreover, those physicians who have less than a 1 percent share in a specialty hospital refer, at most, 10 percent of their patients to that specialty hospital; the referral rate, however, does increase as the percentage of ownership increases.[14]

- **Specialty hospitals have higher procedural volume.** Specialty hospitals do have higher procedural volume than traditional hospitals for those procedures performed at specialty hospitals.[15] However, most of the studies draw inferences from utilization rates, which do not take into account the specific factors driving demand. According to one recent analysis, "…markets with specialty POHs [physician owned hospitals] tend to be associated with lower expenditures, and general hospitals in markets with specialty POHs tend to be more efficient."[16]

The Right Policy. Congress should encourage competition and consumer choice in the health care system. Specialty hospitals have demonstrated that they can offer a higher quality, lower cost alternative to traditional hospitals. By imposing artificial statutory or regulatory restrictions on specialty hospitals, Congress is killing a catalyst for improvement and for bringing innovations to the health care sector.

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13. *Ibid.*
14. *Ibid.*
15. P. Cram, et al., "A Comparison of Total Hip and Knee Replacement in Specialty and General Hospitals," *Journal of Bone and Joint Surgery* 89 (8), pp. 1675–1684.
16. J. Schneider, et al., "The Effects of Physician-Owned Specialty Hospitals: A Critical Review of the Evidence." Health Economics Consulting Group, October 9, 2007.