

**FOR IMMEDIATE RELEASE:**  
**Wednesday, June 6, 2007**

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**Private Payers Subsidize Public Programs; Only Slight Effect from Uninsured**  
*Study Finds Cost Shifting from Medicare and Medi-Cal is Substantial;*  
*Minimal Cost Shift from the Uninsured*

Government underpayments to hospitals in the Medicare and Medi-Cal programs are a substantial factor in driving up private health care costs, according to a study released today by the California Foundation for Commerce and Education (CFCE). But the study also found that the impact on private payers of uncompensated care for the uninsured was minimal.

The extent to which health care providers shift costs – increase the markup charged to private patients in response to other (public or uninsured) patient’s underpayments – is a key issue in health reform debates. Evidence of cost shifting from Medicare or Medi-Cal is used to support increases in the programs’ reimbursement rates. Evidence of cost shifting from the uninsured is used to support policies such as an employer or individual mandate.

In the first study to focus on the extent to which California uncompensated care costs are actually shifted to private payers, Professor Daniel P. Kessler of the Stanford University Graduate School of Business, and Senior Fellow at the Hoover Institution, found that cost shifting from Medicare and Medi-Cal is substantial: increasing reimbursements to cover these patients’ costs would lead to a decline in hospitals’ private payer markup of 10.8 percentage points.

On the other hand, according to Prof. Kessler, cost shifting from the uninsured is minimal: increasing reimbursements to cover indigent patients’ costs would lead to a decline in California hospitals’ private payer markup of 1.4 percentage points. These findings have several implications for current policy debates. According to Prof. Kessler, “state health policy reforms that seek to cover the currently uninsured are unlikely to lead to significant reductions in private insurance premiums, at least due to decreases in cost shifting. In contrast, increases in public-program reimbursement rates could have an economically important impact on premiums.”

CFCE President Loren Kaye added, “The message to state and federal policy makers is clear: the most efficient way to reduce private health care premiums is to increase public insurance program reimbursements. There are many benefits from increased health care coverage for the uninsured, but a significant reduction in private payer premiums is not one of them.”

The study also reviewed the current literature on the magnitude and effect of the cost shift, and found that it has significant limitations. Only two studies investigate the extent of cost shifting from the uninsured, and these have fundamental weaknesses. Until now,

no study has yet analyzed the most recent data from California hospitals, to investigate whether cost shifting in the State has intensified or moderated in the 2000s.

### Methodology

This paper uses publicly-available data on California hospitals from the Office of Statewide Health Planning and Development from 2000 to 2005. The author calculates how hospitals' markups on Medicare, Medi-Cal and indigent patients affect their markup on private-payer patients, holding other characteristics of hospitals and their market environment constant. Then the author calculates how hospitals' markups on private-payer patients would fall if the revenues for Medicare, Medi-Cal and indigent patients were increased to cover costs.

### Daniel P. Kessler

Daniel Kessler is a professor at Stanford Graduate School of Business, a senior fellow at Stanford's Hoover Institution, a professor (by courtesy) at Stanford Law School, and a Research Associate at the National Bureau of Economic Research. His research interests include empirical studies in antitrust law, law and economics, and the economics of health care.

His recent work focuses on the consequences of hospital mergers and ownership for the cost and quality of medical care. His new book, *Healthy, Wealthy, and Wise: Five Steps to a Better Health Care System* (with John Cogan and R. Glenn Hubbard), outlines how market-based health care reform in the U.S. can help fix our system's current problems.

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