Medicare hospital wage index

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- Used to adjust payment rates for differences in wages across geographic areas
- In 2007, MedPAC recommended an alternative method to compute the wage index to address issues of concern
- Since then, Congress and CMS have added additional adjustments to the already byzantine hospital wage index
  - 67% of IPPS hospitals received at least one special adjustment in 2022
- Today, we provide background on the mechanics of the hospital wage index and the Commission's concerns

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Source: MedPAC analysis of inpatient prospective payment system (IPPS) final rule data files for fiscal year 2022.
Results preliminary; subject to change.

Calculating the hospital wage index

To calculate each IPPS hospital's wage index, CMS:

1. Collects cost report data on hospitals' wages and hours
2. Aggregates this data across all hospitals in a geographic labor market area, and nationally
3. Calculates an unadjusted wage index for each labor market area as the area's average hourly wage relative to the national average hourly wage
4. Applies numerous wage index adjustments

1. Collecting wage data

CMS collects wage data from IPPS-eligible hospitals' cost reports

- In FY 2022, CMS calculated the wage index based on wages and hours from about 3,180 hospitals' costs reports that began in FY 2018

Included Wage Data	Excluded Wage Data
Salaries	Services provided in other components of the hospital
Wage-related costs	Services provided by physicians

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2. Aggregating hospital wage data in a labor market area

CMS defines geographic labor market areas for the wage index using:

- Metropolitan statistical areas (MSAs)
- A residual called the statewide rural area (or balance-of-state)

In FY 2022, CMS calculated a hospital wage index for 412 urban areas (defined by MSAs) and 47 rural areas (defined by balance-of-state)

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3. Calculating an unadjusted wage index for each labor market area

CMS aggregates wage data by labor market areas to calculate an unadjusted average hourly wage (AHW) for each labor market area.

$$\textbf{Unadjusted Average Hourly Wage (AHW) in area} = \frac{\textbf{Total wages in area}}{\textbf{Total hours in area}}$$

$$\textbf{Unadjusted wage index for area} = \frac{\textbf{Area's AHW}}{\textbf{National AHW}}$$

4. Applying adjustments in IPPS wage index

Based on requirements in statute and through regulations, CMS applies numerous adjustments to the unadjusted wage index

Area-level adjustments	Provider-level adjustments
Occupational-mix	Out-migration
Geographic reclassifications	Low-wage index
Wage index floors	Transition

Adjustment: Geographic reclassifications and related policies

- Congress created geographic reclassification pathways that allow a hospital to "reclassify" into different area
  - Since 2016, hospitals can have multiple active reclassifications

- In FY 2022, 33 percent of IPPS hospitals had at least one active reclassification (vs. 23 percent in 2007)
  - Also affected 11 percent of hospitals that did not reclassify

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Source: MedPAC analysis of inpatient prospective payment system (IPPS) final rule data files for fiscal year 2022; MedPAC 2007.
Results preliminary; subject to change.

Effect of geographic reclassifications and related policies

	Share of IPPS hospitals	Median marginal effect on wage index (max)	Budget neutrality adjustment
Reclassified	33%	5.8% (40.7%)	-1.3%
Did not reclassify but benefitted from reclassifications	11%	0.4% (14.4%)	

➔ A subset of hospitals received substantial wage index increases from geographic reclassifications, funded by decreases to all hospitals' payments

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Adjustment: Rural and imputed rural floors

Congress created wage index floors that set a minimum wage index for specific hospitals

Rural floor	Imputed rural floor
An urban hospital's wage index cannot be less than rural hospitals in its state	Alternative policy for urban hospitals in all-urban states, reestablished in 2022

- In FY 2022, 11 percent of IPPS hospitals received either the rural or imputed rural floor, sometimes based on a single hospital
- The Commission has stated the rural floor is based on an erroneous assumption that urban wages are always higher than rural

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Results preliminary; subject to change.

Effect of rural and imputed rural floors

	Share of IPPS hospitals	Median marginal effect on wage index (max)	Budget neutrality adjustment
Rural floor	9%	3.9% (55.8%)	-0.7%
Imputed rural floor	2%	8.3% (18.2%)	N/A (+ $195 million)

➔ A subset of hospitals received substantial wage index increases from the rural or imputed rural floor, funded by a combination of decreases to all hospitals' payments and increased IPPS payments

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Wage index adjustments are a growing problem

- Both the number of wage index adjustments and share of IPPS hospitals receiving one adjustment have been increasing
  - Share of IPPS hospitals received at least one special adjustment has grown from ~40% in 2007 to 67% in 2022
- A subset of hospitals received > 20% increase in their wage index, and corresponding substantial increases in payments
- Because most adjustments are budget neutral, IPPS hospitals with adjustments benefit at the expense of other hospitals

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Source: MedPAC analysis of inpatient prospective payment system (IPPS) final rule data files for fiscal year 2022; MedPAC 2007. Results preliminary; subject to change.

Concerns about Medicare's wage index policies

Source of wage data

- Circular for IPPS hospitals
- Not necessarily representative for other types of providers
- Limited occupation-level data

Labor market areas

- Mask wage variation within a single MSA or balance of state
- Large variation across adjacent areas creates wage index cliffs

Numerous adjustments

- Complicated and administratively burdensome
- Opportunities for wage index manipulation
- Volatility over time

MedPAC's 2007 recommendations and next steps

- In 2007, the Commission recommended replacing the wage index and its numerous exceptions, starting with the following principles:
  - Use wage data from all employers
  - Use boundaries for geographic areas that are commonly understood, such as counties
  - Smooth differences across areas (as a replacement for wage index exceptions)
  - Phase in any large changes in wage indexes

➔ In Spring 2022, will discuss whether these design principles for wage index redesign still hold and if modifications are warranted

Discussion

- Questions on current Medicare hospital wage index policies?
- Other concerns on wage index policies?
- Suggestions on next steps?