



Advising the Congress on Medicare issues

Reforming Medicare's wage index systems

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Construction of the current Medicare wage indexes

- Medicare's wage indexes adjust base payment rates for geographic differences in labor costs
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	Current wage indexes
Data	IPPS hospitals' aggregate labor costs (per cost reports)
Labor market areas	Metropolitan statistical areas and statewide rural areas
Exceptions	Numerous and often non-empirical exceptions for IPPS hospitals (and none for most other types of providers)

Concerns with current Medicare wage indexes

- Current wage indexes fail to accurately reflect differences in labor costs across geographic areas and create inequities across providers
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	Concern
Data	IPPS hospital data is circular and can deviate from market-wide labor costs
Labor market areas	Broad areas mask differences in labor costs within areas and create large differences across some adjacent areas
Exceptions	Can exacerbate inaccuracies and inequities, be manipulated, and add administrative burden

Approach for improving Medicare's wage indexes and illustrative alternative method

	Approach	Illustrative alternative
Data	Use all-employer, occupation-level wage data with different occupation weights for the wage index of each type of provider	Data from BLS and US Census Bureau
Labor market areas	Reflect local area differences in wages between <i>and within</i> MSAs / statewide rural areas	Blend of MSA / statewide rural and counties (up to +/- 5%);
	Smooth wage index differences across adjacent local areas	Cap wage index cliffs between adjacent counties (at 10%)

Benefits of alternative wage indexes

	Approach	Benefit
Data	All-employer	Decreases circularity and more accurately reflects relative labor market costs
	Provider type occupation weights	More accurately reflects relative labor market costs for each provider type (e.g. IPPS, SNF, etc.)
Labor market areas	Local areas	More accurately reflects variation in relative labor costs within broader labor market areas
	Smoothing	Decreases inequities between providers in adjacent areas
Exceptions	None	Increases accuracy and equity, removes opportunities for manipulation, and decreases administrative burden

Redistributional effects of alternative wage indexes would be material and require transition

- Because of substantial inaccuracies in current wage indexes, effects would be material for many providers
- Therefore, there would need to be a transitional period
- To the extent policymakers are concerned about certain providers, any needed additional support should be targeted specifically to those providers and not made inefficiently through the wage index