Why Are Hospital Charges so High?

By

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Examining a U.S hospital bill often reveals a huge difference between what a hospital charges and what insurance companies actually pay the hospital. Hospital charges can be up to 10 times higher than what Medicare will pay,[1] or 10 times more than what the hospital will accept from cash paying patients for the same service. This is indicative of a total disconnect between hospital charges and the actual costs of the billed services. This article will examine some of the reasons why these discrepancies in charges versus payments occur.

Total Amount Billed	$28,768.21
Plan Discount	$25,433.21
Plan Paid	$3,035.00
Your Total Amount Owed	$300.00

Actual bill for hospital services that was reduced 88% due to insurance company agreement.

Reducing Tax Burdens

About half of all hospitals in the U.S. are nonprofit, tax-exempt corporations thereby saving billions of dollars in expenses. In 2011 nonprofit status was estimated to be approximately worth $24.6 billion in aggregate to these hospitals.[2] To obtain these tax exemptions, the IRS requires hospitals to provide programs or services, collectively called community benefits, that advance medical or health knowledge, reduce or relieve the burden of government or other community efforts, or improve community health and increase access to health care.[3]

However, there has been some criticism that many nonprofit hospitals do not pay enough back to the community to earn their tax-exempt status. One study using Medicare cost reports from nonprofit hospitals found that, on aggregate, they provided less charity care than for-profit hospitals, equaling about $2.3% of expenses versus 3.8% of expenses respectively.[4]

A review of 1,773 nonprofit hospitals' IRS filings found that 77% of them spent less for community benefits than they received in tax benefits as nonprofit institutions. The total "fair share" deficit (amount spent on community benefits minus the value of the tax deduction) for all these hospitals amounted to $14.2 billion in 2020 according to the report.[5] **However, the report did not include accounting for Medicaid payment shortfalls, spending on research, or training medical professionals as part of hospitals' fair share.**[6]

In 2020, The Government Accounting Office (GAO) reported that in 2016, 30 nonprofit hospitals reported to the IRS that they had offered no community benefits.[7]

Loss of nonprofit status can be very expensive for a hospital. For example, in 2015 a medical center in New Jersey lost a lawsuit that determined it was not meeting nonprofit criteria. The judge ruled that in a number of ways the medical center acted like a for-profit institution and subsequently lost its property tax exemption. The medical center agreed to pay the city it was located in $15.5 million in back taxes and penalties, as well as paying taxes on 24% of its property for the next 10 years.[8]

The 2010 Patient Protection and Affordable Care Act closed an accounting loophole by requiring that tax-exempt hospitals cannot charge individuals eligible for financial assistance more for medical services than they accept from patients with insurance.[7,10]

However, hospitals in many states consider the difference between billed services and Medicaid reimbursement, known as the Medicaid shortfall, to be part of their community benefits equation.[6,11,12] Higher hospital charges will increase the calculated community benefit from the Medicaid shortfall, with the most expensive hospitals tending to show the greatest paper losses from treating Medicaid patients.[12] It has been reported that close to 45% of community benefits claimed by nonprofit hospitals is from the Medicaid shortfall.[11,12]

For-profit hospitals can also claim tax deductions for losses from uncompensated care. Again, the higher the charges the larger the tax deduction.[2]

These reasons alone could explain why hospital charges are so much higher than their costs, but some hospitals have pursued a different strategy that can also lead to increased charges.

Out-of-Network Hospitals

In 2011, a New Jersey hospital was reported to be the most expensive hospital in the country.[13] The hospital went out-of-network with every private insurance company. It then billed those insurance companies at extremely high rates for any patients who were brought to their emergency department or admitted emergently. They were able to do this because New Jersey regulations mandated that insurance companies pay whatever an out-of-network hospital billed them for emergency patient visits. The result was that instead of operating at a loss, the hospital made a profit of $17 million within two years of instituting the policy.[14] Eventually the largest insurer in the state and the hospital

came to an agreement on pricing,[15] although some years later the entire situation recurred until another agreement was reached.[16] Another large for-profit healthcare chain also has been reported to use this type of model to increase revenues.[17]

Price Transparency

National regulations now require hospitals to make their prices public in an attempt to increase hospital pricing transparency and allow the public to compare costs between different hospitals. In a limited survey of three different hospital websites, price schedules were examined by this author. In one New York City hospital the billed price and the cash price were exactly the same. However, different insurance companies' payments to the hospital for the same procedure or service varied significantly. In contrast, a suburban New Jersey community hospital's billed prices for similar services were higher than the first hospital, but the cash payment prices were only 10% of the billed prices, thereby making it less expensive for a cash-paying patient. A large tertiary New York City medical center's pricing portal was not functioning correctly, but there was a large Microsoft Excel file that could be downloaded. In that file cash payor prices for services at this medical center were about 19% of billed prices. The medical center's payments from each insurance company for specific services again varied widely between insurance companies. This very limited survey revealed that for uninsured or cash paying patients, hospitals vary from charging full price to offering variable discounts off the billed price.

Despite these national requirements an August 2022 investigative report revealed that only 16% of hospitals were in compliance with the price transparency regulation. A repeat report in July of 2023 found a compliance rate of 36%.[18] A different survey found that 64% of Americans have never checked prices for a healthcare service.[19]

Summary

Hospital charges appear to have no relation to actual costs or insurance payments. The high charges appear to be at least partially due to how community benefits and/or tax deductions are calculated for nonprofits and for-profit hospitals respectively.

As compared to commercial insurance companies, Medicaid and Medicare reimbursements for services are fixed and not negotiable by the hospital. The negotiations between hospitals and insurance companies result in wide variations in payments for services to each hospital. It also results in differing insurance payment

amounts to different hospitals for the same services depending on each hospital's, or medical center's negotiating strength and geographic location.

Some hospitals and hospital chains have gone out-of-network with all private insurance companies and then raised their charges to extremely high levels to take advantage of state regulations requiring full reimbursement for emergency visits and admissions for insured out-of-network patients.

There appears to be a significant amount of gaming of the current system by hospitals and insurance companies. There may also be some cost-shifting by hospitals from insured and cash paying patients to cover shortfalls in Medicaid and Medicare reimbursement rates which may be lower than actual costs.[20] (Though not discussed, drug company and pharmacy benefit managers' policies and pricing also play a role in hospital charges.)

The result of the current health care environment is that each stakeholder is trying to maximize revenue and/or decrease expenditures. This results in artificially elevated hospital charges that have no relationship to actual costs, to improve a hospital's negotiating position with insurance companies, aid in tax reduction strategies, and possibly increase revenues from cash payors.

Price transparency seems like a good idea, but the pricing system used by different institutions found in my limited survey does not appear to be standardized in any way. Hospitals appear to independently calculate charges, cash payor prices and what is accepted as payment from commercial insurance companies. Not all hospital services were listed on some of the user-friendly hospital price transparency web sites I visited, and using a large Microsoft Excel file to try to find a specific procedure may be difficult for many patients. In addition, it appears that many hospitals are not in compliance with price transparency regulations.[18]

As long as the current system remains in place it seems that clarity of actual hospital pricing and a reasonable correlation of billed hospital charges to actual costs will likely not occur.

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