Health Issues Brief

FLORIDA HOSPITAL
Government & Public Affairs

December 2011

The Economics of Not-for-Profit Hospitals

This Health Issues Brief describes the unique economics of not-for-profit hospitals.

The Not-for-Profit Difference

Not-for-profit (NFP) hospitals are community-based entities governed by boards that are accountable to the communities they serve. NFPs generate margins that are reinvested into new technologies, services and physical facilities. For-profit (FP) hospitals are governed by corporate boards, and they generate profits that return dividends to shareholders.

Not-for-profit hospitals receive certain tax exemptions for providing "Community Benefit" (as defined by the IRS). In Florida, not-for-profit hospitals:

- Provide far greater levels of charity care than for-profits: In Florida, not-for-profit hospitals operate 65% of the state's hospitals beds but provide 83% of the state's charity care.
- Are required to accept Medicare and Medicaid (which often do not cover the cost of care)
- Provide millions of dollars in Community Benefit through low-margin services (such as organ transplants, NICUs and trauma centers), medical education for physicians and other providers, research, health promotion activities, access to care, and community health improvement services.

Florida Hospital provided $383 million in Community Benefit in 2010, including $118 million in Charity Care (at cost, not charges). The hospital also invested $176 million in capital improvements.

Price-setting in a Free Market

In a free market economy, government plays a limited role. Consumers and businesses decide what they want to produce and purchase. Sellers are free to set prices, and consumers can choose to purchase those services.

In health care, hospitals purchase equipment, supplies and other goods at free market prices. However, the rest of hospitals' economic activity operates in a command market. This occurs because state and federal governments are the purchasers and the "price-setters" for Medicare and Medicaid payment rates, which do not cover the actual costs of care.

45% of Florida Hospital's patients are covered by Medicare and Medicaid. Nationally, NFP hospitals provide 56% of Medicare and Medicaid-covered care.

Cost Shifting

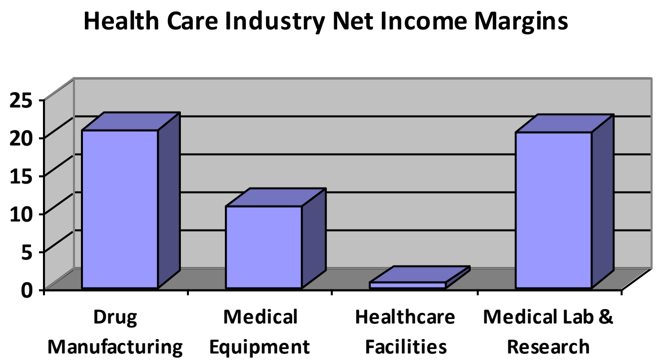
Hospital economics rely on the concept of cost shifting, or cross-subsidies. In this model, services that generate a profit subsidize those that lose money. Hospital cross-subsidies occur when businesses and insured people subsidize hospitals' Medicare and Medicaid losses as well as care for the uninsured.

At Florida Hospital, cost shifting adds approximately $2,000 to each insured person's inpatient bill.

Operating Margins

Any business enterprise must make more than it spends to keep pace with increased costs of salaries, equipment, supplies – and meet long-term capital needs. Health care economists recommend that hospitals aim for a 9.5% operating margin in order to meet the needs of a community.

Declining government reimbursement, rising costs and high levels of bad debt mean that hospitals in Florida consistently struggle with their operating margins. In 2008, hospitals in Florida had an average operating margin of 0.7%[i]. This compares to 11-20% for health care suppliers who operate in a true free market.



Uncompensated Care

Hospital uncompensated care falls into four categories:

1. Charity Care: Over 4 million Floridians – 25% of the population – lack health insurance. Hospitals count the costs of caring for these patients as "charity care." Florida Hospital's charity discounts are extended to people with incomes up to 400% of the federal poverty level (the state definition is 200%). Most of these individuals are employed but do not have health insurance.
2. Bad Debt: uncollected charges. Over 60% of Florida Hospital's bad debt is now incurred by insured patients whose insurance coverage was limited in coverage or who had high deductible plans.
3. Medicare write-offs– see below.
4. Medicaid write-offs – see below.

Florida Hospital provided $118 million in Charity Care in 2010, and absorbed $99 million in Medicaid write-offs (both numbers are at cost).

Medicare

Medicare, the federally administered health insurance program for persons 65 and older, reimburses at just 91.1% of the actual cost of care for Medicare patients.

Florida Hospital is the largest Medicare provider in the United States. Over 46% of Florida Hospital's patients are covered by Medicare. Medicare write-offs totaled over $115 million in 2010.

Medicaid

Medicaid is health insurance for low-income children and families. In Florida, it covers one of every four children and 49% of all pregnant women.

Medicaid is jointly funded by state and federal governments. In Florida, in 2010, every state dollar drew down an additional $67.64 (among the lower rates in the U.S.). The great majority of the state dollars actually come from revenue generated in local communities by county governments, hospital taxing districts, individual hospitals, and nursing homes. That money is turned over to the state and used to draw down matching dollars as well. A far smaller amount comes from state general revenues.

Florida Hospital absorbed $99 million in Medicaid losses in 2010.

Medical Education Provided by NFP Hospitals

Florida faces a serious physician shortage, especially among primary care physicians. It also has a shortage of physician training slots.

Florida ranks 44th in the nation in the ratio of Graduate Medical Education (GME) training slots per 100,000 population and 41st in the number of medical school students. The state needs 2,500 additional slots just to meet the national average.

By 2015, Florida will graduate 1,300 physicians a year but have only 850 residency slots for those graduates[ii]. It costs at minimum $145,000 per year to fund a GME slot. Almost all the residency programs in Florida are provided by not-for-profit hospitals.

Florida Hospital is a statutory teaching hospital with 13 residency programs and 141 students. The hospital spent over $9.6 million last year on graduate medical education services.

The Bottom Line

"Not-for-profit hospitals are especially pinched by the continuing state and federal budget pressures," said Richard Morrison, Senior Vice President.

"We fully support government efforts to improve quality and reduce health care costs," he continued, "but it is a major challenge when we lose money on well over half our patients. We cannot continue to shift the costs of entitlement programs to the private sector. It is not sustainable.

"We hope we do not see a time when, if the cuts keep coming, we are forced to re-evaluate some of our low-margin services," he said. "It is essential that policymakers understand this, and help us find solutions that do not negatively affect the health and welfare of our community."

---

[i] According to 2010 FHA Data Brief

[ii] 2011 Report by Council of Medical School Deans

For more information, please contact
rich.morrison@flhosp.org (407) 303-1607 or
julia.hartwell@flhosp.org (407) 303-7943