

Cost Shifting In Healthcare

Posted on October 10, 2023

Cost shifting in healthcare is used as a healthcare policy and reform proposal as the basis for the Affordable Care Act (ACA) in the commercial health insurance industry. Insurers and employers criticize the government's policies for the rapid rise in employee health insurance premiums that have led private healthcare spaces to shift their costs to private patients and insurers. They are thought to pay the full charges of the hospitals because of the inadequate payments from the purchasers, such as Medicaid and Medicare. The healthcare services research estimates that different hospitals set varying prices for different patients for the same service, and this situation concludes that the raised prices of the hospitals are not fully adjusted for the payers. This essay examines the theoretical literature on cost-shifting in healthcare, factors associated with the profit-maximizing price, and the conditions under which cost-shifting occurs.

What is Cost-Shifting in Healthcare?

In broader academic literature, the term "cost-shifting" is precisely defined as private hospitals making up the losses they obtain from different payers, including government programs and insured patients, because they have received less cost from another payer. Economists call this phenomenon "price discrimination", as hospitals charge different amounts from different payers for the same services even at the same time at the same hospital. (Fuchs, 2009)

Private Purchasers vs. Government Payers-Price Discrimination

When a hospital from the private sector depends on its high market power, it has the ability to set unfair prices to profitably charge above the marginal costs from one payer than another. For instance, if one payer unfairly pays the amount less relative to the actual marginal costs, then the other payer, who may be a private insurer, has to pay much more because of the implied price discrimination. (Feldstein, 2015) In short, cost-shifting is a phenomenon where public payers charge less, such as Medicare, Medicaid, etc., and payment goes down, whereas, as a consequence, private insurers pay hospitals an amount that is double the actual amount and therefore, the payment goes up for them.

Setting the Profit-Maximizing Prices

Every corporation around the world prices its services and products in order to maximize profitable gains so that it can make as much money as possible to thrive more effectively among competitors in

the market. In the same way, hospitals, if they receive less generous payment from the public payers, continue the cost-shifting hypothesis that raises the amounts more than the hospital charges would otherwise. In consequence, healthcare costs for insurers' premiums will go up more quickly, which leads to insurance companies spending less on their insurance premiums, individuals from public space would not spend much, and in turn, hospitals would charge higher payments for the services they provide to private insurers. (Fuchs, 2009) Moreover, if healthcare costs at private hospitals could significantly be shifted with a public payment policy, hospitals would have equal payment-to-cost ratios for the private payers as well.

Here are some of the important points Feldstein (2015) discusses for setting prices of healthcare to maximize profits for hospitals:

Establishing a Profit-Maximizing Price

The first point is establishing a set price to maximize profit so that the additional received revenue can be equal to one more patient and the related cost. When there is a change in total revenue (TR), it is definite that choosing any other charge would be unprofitable, so there would be a change in total cost (TC).

Payments Should Not be Affected Due to Varying Costs

The second point is that if the hospital's fixed charges go up compared to the fixed price, it is not reasonable for the hospital to raise the price. If any hospital does so, it will earn less profit. If a hospital raises its prices with an increase in fixed costs, its profit will decline with every service and quantity sold. Therefore, changes in the fixed costs of hospitals should not affect the hospital's capacity to make profit-maximizing prices.

Changes in Variable Costs Would Raise Hospitals' Prices

The third significant point for setting a hospital's profit-maximizing price is that due to many reasons, such as the cost of supplies, nurses' wages, etc., if a hospital's variable costs change, then the hospital would find it profitable to raise the prices. For instance, if the variable cost increases, the price-quantity relationship would be unchanged, and if the price per quantity or unit remains the same, then the variable costs would likely increase. In this case, the hospital is expected to lose money; therefore, the hospital can realize profit-maximizing prices by lowering the charges if the variable cost decreases.

Varying Price-Quantity Relationship

Fourth, if the price-quantity relationship varies, the hospital is expected to raise the prices because the price and quantity are changed by a small fraction, payers or purchasers of the services are not price-sensitive, and so the hospital's demand above marginal costs is considered to be "price inelastic." However, when the change in the prices of quantity is more than the changed prices, purchasers become price sensitive, and therefore, the hospital's demand becomes "price elastic", where it is expected to lower the prices of the quantity sold even if prices are not changed. (Feldstein, 2015)

Conditions under Which Cost-Shifting Can Occur

Cost-shifting theory can occur in certain circumstances as many hospitals may have different pricing objectives and criteria if they purposely forgo some profits in order to make good community relationships so they do not set profit-maximizing prices. If a hospital wants the price to maximize its profits, it should have the market power to bargain, as the purchasers of the services or products the hospital offers have to be relatively price-sensitive to the spiking prices. (Fuchs, 2009) One condition under which cost-shifting can occur is when the government pays the hospitals a fixed price to exceed the benefits for the hospital; the cost-allocation process would help the hospital to optimize the payments from inpatients- patients who pay according to set price diagnosis-related group and the outpatients- patients who pay on the cost basis and are private (Feldstein, 2015). Another type of cost-shifting in healthcare occurs when the government imposes a shift of cost on employers, such as Medicaid or Medicare. It is to be more likely when the government requires all its employers to purchase healthcare insurance premiums by shifting the costs to their employers which otherwise government has to pay, the expenditures for the employers and their dependents are reduced to provide their healthcare benefits in return. Thus, the conditions and extents under which cost-shifting can occur to maximize profits are limited by the market and the government.

Conclusion

Cost shifting is not an easy hypothetical mechanism in this decade, as it may have been in the last centuries for many reasons. The healthcare insurance premiums and the nature of the hospitals have radically changed the competition according to the market as every hospital sets different prices for the different purchasers at the same time for the same services to make up for its unsponsored care in order to compensate hospital costs and to maximize the profits.

References

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Fuchs, V. R. (2009). Cost shifting does not reduce the cost of health care. *Jama*, 302(9), 999-1000.