

# REPORT OF THE COUNCIL ON MEDICAL SERVICE

CMS Report 7-I-13

Subject: Strengthening Medicare Through Competitive Bidding

Presented by: Charles F. Willson, MD, Chair

Referred to: Reference Committee J  
(Dolleen M. Licciardi, MD, Chair)

---

1 Policymakers continue to struggle with how to address Medicare’s increasing demands on the  
2 federal budget. Solutions are needed that will enhance the quality of care delivered to Medicare  
3 beneficiaries, while simultaneously lowering the trajectory of health care spending growth. In  
4 addition to delivery and payment reforms, the concept of competitive bidding is becoming  
5 increasingly popular as a way to reduce costs by right-sizing the amount of money the federal  
6 government spends on Medicare benefits, particularly through the Medicare Advantage (MA)  
7 program. A thoughtfully designed competitive bidding program has the potential to lower costs and  
8 stimulate better quality and innovation by leveraging market forces and providing incentives for  
9 health plans to provide Medicare services efficiently.

10  
11 As part of its ongoing commitment to developing policies to help strengthen the Medicare program,  
12 the Council presents the following report, which describes current uses of competitive bidding in  
13 the Medicare program, and explores ways in which its use might be expanded to other parts of the  
14 program. The report also proposes a set of principles to help guide the structure of a competitive  
15 bidding program.

## 16 ADMINISTRATIVE PRICING VERSUS COMPETITIVE BIDDING

17  
18  
19 Competitive bidding offers an alternative to traditional administrative pricing as a way to determine  
20 how much the government will spend on providing Medicare benefits. Under an administrative  
21 pricing system, the government relies on a combination of historical data and budget considerations  
22 to set the price it will pay to vendors to provide certain Medicare benefits. Prices that are  
23 administratively set may not reflect conditions in the actual marketplace that influence the cost that  
24 vendors would incur to provide the required services. Because administrative pricing often fails to  
25 capture market signals, there is a risk of over- or under-valuing services provided through the  
26 Medicare program. This could result in wasteful spending or, in the case of under-valued services,  
27 a shortage of vendors willing to provide services at the price Medicare is willing to pay.

28  
29 Under a competitive bidding framework, vendors tell the government how much it will cost to  
30 provide a defined set of Medicare benefits, and the government uses this information to calculate  
31 the price it will pay. There are several potential advantages to a competitive bidding process. One  
32 advantage is that vendors have the opportunity to assess and determine the costs associated with  
33 providing the service. Rather than the government specifying what it is willing to pay, a  
34 competitive bidding process places the responsibility on vendors to determine how much they need  
35 to provide the defined set of Medicare benefits. A second advantage of a competitive bidding  
36 process is that competition among suppliers helps ensure that each supplier’s cost estimates reflect  
37 their true cost of doing business, rather than inflated costs that would drive up the cost to the

1 federal government. Finally, competition is likely to stimulate innovations and improvements that  
2 can ultimately result in lower costs and greater efficiencies as health plans seek to gain a larger  
3 share of the Medicare market.

#### 4 5 EXAMPLES OF COMPETITIVE BIDDING IN MEDICARE 6

7 The Medicare Modernization Act of 2003 (MMA) established the Part D prescription drug benefit,  
8 which was designed to stimulate competition among private plans by using a competitive bidding  
9 process to determine the government's contribution to plan premiums. Private insurance plans  
10 submit bids annually that reflect what it will cost them to provide a basic minimum set of  
11 pharmaceutical benefits to an average Medicare beneficiary. CMS calculates the amount the  
12 government will contribute to premiums within a given region based on the weighted average of  
13 the bids submitted. Part D plans are allowed to offer benefits beyond the minimum required  
14 package, and may also charge higher premiums than the amount paid by CMS, but beneficiaries are  
15 required to pay the difference. Part D costs have been significantly lower than original program  
16 projections. Although there are many factors that seem to have contributed to the lower than  
17 projected costs, some analysts attribute significant costs savings to the influence of competition  
18 within the program.

19  
20 The MMA also created a competitive bidding process for the purchase of selected durable medical  
21 equipment, prosthetics, orthotics and supplies (DMEPOS). Implementation of the program was  
22 delayed, but CMS began phasing in the DMEPOS Competitive Bidding Program in 2011. Under  
23 the program, suppliers within select geographic areas submit bids for supplies and equipment  
24 covered by the program. In order to preserve choice, CMS awards multiple contracts to suppliers  
25 who meet all program requirements and offer the best prices. The price CMS will pay for covered  
26 items is determined by the average of all winning bids for each item. In areas where the DMEPOS  
27 Competitive Bidding Program operates, beneficiaries can only receive covered supplies from  
28 contracted suppliers, who agree to accept the fee determined by the bid process on all claims for  
29 bid items.

30  
31 According to CMS, the first phase of the DMEPOS Competitive Bidding Program yielded a 42  
32 percent reduction in expenditures during the first year of implementation. CMS also reported that  
33 the new process has had no negative impact on beneficiary access to services or on beneficiary  
34 health. The second phase of the program was launched in July 2013, and CMS estimates that the  
35 program will save Medicare \$25.7 billion between 2013 and 2022. Beneficiaries are expected to  
36 save more than \$17 billion during the same 10-year period due to the reduction in coinsurance and  
37 reduced premiums.<sup>1</sup>

38  
39 Since 2006, MA plan payments have also been calculated using a bidding process. However, plan  
40 sponsors compete against external benchmarks, rather than each other, when they set the price for  
41 delivering a set of services to Medicare beneficiaries. The benchmarks are tied directly to local fee-  
42 for-service Medicare spending, which results in plans being guaranteed a certain payment  
43 regardless of how much it costs the plan to provide the core set of Medicare services. Plans that bid  
44 below the established benchmarks are required to return 75 percent of the difference to  
45 beneficiaries in the form of enhanced benefits or reduced cost-sharing (the remaining 25 percent is  
46 retained by Medicare). Unlike Part D, where the government contribution is determined relative to  
47 the bids submitted by plans each year, the MA pricing methodology is constrained by existing  
48 Medicare spending levels, limiting the ability of the bidding process to independently identify a  
49 price for providing Medicare services.

1 COMPETITIVE BIDDING IN THE CONTEXT OF MEDICARE REFORM

2  
3 Competitive bidding is helping preserve patient choice and more effectively manage costs in the  
4 Part D program, and early results from the DMEPOS Competitive Bidding Program are promising.  
5 Expanding the use of competitive bidding to other components of the Medicare program has the  
6 potential to generate cost savings and address program inefficiencies while preserving access to the  
7 benefits and services to which beneficiaries are entitled.

8  
9 The Bipartisan Policy Center (BPC) released a report in April 2013 recommending a set of policies  
10 intended to help strengthen the health care system by improving quality and eliminating waste.<sup>2</sup>  
11 One of the key recommendations is to use competitive bidding to pay MA plans. As noted, MA  
12 payments are currently benchmarked to traditional Medicare prices in each given region, and the  
13 majority of potential cost savings are converted into richer benefits for enrollees. The fact that so  
14 many private insurers are willing to provide extra benefits for no additional cost indicates that  
15 Medicare is likely overpaying for the core set of services that it is required to provide for  
16 beneficiaries.

17  
18 To address this apparent inefficiency of overpayment in the MA program, BPC recommends  
19 establishing a standardized minimum benefit that all MA plans would have to cover, and soliciting  
20 bids from competing private plans to cover these services. The government would pay plans based  
21 on a weighted average of all plan bids, or the 35<sup>th</sup> percentile of bids for regions where Medicare  
22 Advantage enrollment exceeds 40 percent. BPC proposes that the minimum benefit reflected in the  
23 bid include all services covered by traditional Medicare, plus a cap on out-of-pocket spending and  
24 slightly lower cost sharing, both of which are consistent with the benefits currently provided by  
25 most MA plans. Plans would be required to offer enrollees a plan that includes only the minimum  
26 benefit package. If the premium for the plan is lower than the federal payment, beneficiaries would  
27 get a rebate; if the premium is higher, beneficiaries would be required to pay the difference. Plans  
28 could also offer richer benefit packages, for which beneficiaries would also pay a higher premium.

29  
30 The American Enterprise Institute (AEI) supports expanding competitive bidding to include  
31 traditional Medicare as well as MA. In a paper released in April 2013, AEI advocates using a  
32 competitive bidding process to determine the benchmark price that the federal government will pay  
33 for any Medicare health plan, whether it be, traditional Medicare, an MA plan, or another plan  
34 available to beneficiaries under a premium support system.<sup>3</sup> The AEI outlines a model of  
35 competitive bidding in which the federal government and private plans submit bids to provide  
36 Medicare benefits in a target market area, and the federal contribution is set at the amount of the  
37 second-lowest bid. Using the second-lowest bid to determine the government contribution ensures  
38 that beneficiaries will have a choice of at least two plans for which they would not have to pay  
39 anything additional out-of-pocket beyond the typical Part B premium.

40  
41 A key component of establishing an effective competitive bidding process is carefully identifying  
42 the basket of services that must be included in the bid. If a competitive bidding system were to  
43 include traditional Medicare, it is likely that in order to compete effectively and fairly with other  
44 plans, traditional Medicare's benefit structure would have to be modernized and redesigned into a  
45 uniform system of premiums, deductibles and copayments, with an out-of-pocket spending limit. In  
46 addition, consideration would need to be given to ways to level the playing field between the  
47 federal government and private plans, especially with regard to administrative costs and regulatory  
48 restrictions that may apply differently to public and private entities.

1 It is important to note that a competitive bidding process, per se, does not define the amount of the  
2 government contribution. The bidding process reveals information about the prices plans are  
3 willing to accept to provide a defined set of services. Given widespread concern that the federal  
4 government is paying too much for the benefits provided through the Medicare program, a  
5 competitive bidding process will provide valuable information about the true cost of services,  
6 which can then be the basis of further discussions about Medicare financing and the federal budget.  
7 Federal spending on Medicare would be based on the results of the bidding process, rather than on  
8 an administratively set amount determined by historical spending, budget constraints, or other  
9 factors unrelated to the actual cost of delivering the specified benefits.

#### 10 11 AMA POLICY

12  
13 AMA policy on competitive bidding is limited to support for using the process for the purchase of  
14 home medical equipment by CMS (Policy D-330.922). Policy D-390.967 supports eliminating  
15 subsidies to MA plans. The Council notes that transitioning to a payment methodology based on  
16 competitive bidding could help achieve this policy goal.

17  
18 Policy H-330.889 outlines principles that should be included as part of a Medicare defined  
19 contribution program. Specifically, the policy supports setting the amount of a Medicare defined  
20 contribution at the value of the government's contribution under traditional Medicare. The intent of  
21 this principle was to ensure that beneficiaries had at least one option (i.e., traditional Medicare)  
22 under a defined contribution framework that would not require additional out-of-pocket spending.

23  
24 As noted, if traditional Medicare were to compete in a competitive bidding process, Medicare's  
25 benefit structure would need to be redesigned to more closely resemble benefit packages available  
26 in the private sector. Policy H-330.896 supports short-term reforms that must be made in order to  
27 strengthen and modernize the Medicare program, including restructuring beneficiary cost-sharing  
28 and adding a catastrophic cap for out-of-pocket costs.

#### 29 30 DISCUSSION

31  
32 The concept of competitive bidding complements other components of AMA Medicare reform  
33 policy, and is consistent with the AMA's broad support for market based approaches to organizing  
34 health care delivery. Expanding the use of competitive bidding in the Medicare program could  
35 create a bridge between short-term Medicare reform initiatives (e.g., combining cost-sharing  
36 requirements and capping catastrophic expenses) and long-term structural changes, such as a  
37 transition to a premium support program. The Council is particularly persuaded by the potential of  
38 a well-designed competitive bidding process to reveal information about the true cost of providing  
39 services to Medicare beneficiaries.

40  
41 A competitive bidding process should include several elements to help ensure that it works  
42 efficiently and fairly. Requiring plans to meet specific quality and financial requirements at the  
43 start of the bidding process helps ensure that all bidders are capable of providing the services that  
44 are the subject of the bid. Plans must also be able to demonstrate their ability to maintain an  
45 adequate network of physicians and providers in order to protect patient access to care. In addition,  
46 a critical component of a competitive bidding process is clearly defining the services that should be  
47 included in the bid. It may ultimately be necessary or desirable to define a new benefit package for  
48 the Medicare program, but the Council believes that traditional Medicare's benefit package is an  
49 acceptable starting point for soliciting bids, as long as a catastrophic cap is included.

1 The bidding process should also include clear parameters about the population being served. Bids  
2 should be solicited based on providing the standard benefit package to an average Medicare patient  
3 within a geographic area, which is consistent with the bidding process used for Part D and MA  
4 plans. Geographic areas should be defined in order to ensure patient access to care and to maximize  
5 plan competition. Risk adjustment procedures should also be in place to ensure that plans are  
6 compensated adequately for enrolling patients with higher than average medical costs.  
7

8 The Council recognizes that including the traditional Medicare program in a competitive bidding  
9 arrangement would require significant adjustments to the current program and the way program  
10 costs are calculated. However, minimal changes would be required to transition payments for MA  
11 plans to a competitive bidding process. Although efforts are being made to reduce overpayments to  
12 MA plans, there continues to be concern that the MA program is not maximizing the potential  
13 savings associated with competition among private plans. Using competitive bidding to set  
14 payments for MA plans could result in increased program efficiencies, and provide valuable  
15 information for how to design a defined contribution system that would preserve choice and access  
16 to affordable, appropriate coverage.  
17

18 Finally, the Council is aware that the specific method used to determine the amount of the  
19 government contribution under a competitive bidding program (e.g., average bid, second-lowest  
20 bid) will have important implications for the potential for achieving federal cost savings while  
21 simultaneously preserving patient choice and access. The intent of this report is to establish  
22 principles for a competitive bidding program that will generate meaningful information about the  
23 cost of providing benefits through the Medicare program. As noted, current AMA policy supports  
24 setting the amount of a Medicare defined contribution at the value of the government's contribution  
25 under traditional Medicare, which is conceptually consistent with a competitive bidding process  
26 that is designed to ensure that federal payments are set at levels that preserve beneficiary access to  
27 affordable coverage options.  
28

## 29 RECOMMENDATIONS

30

31 The Council on Medical Service recommends that the following be adopted and the remainder of  
32 the report be filed:  
33

- 34 1. That our American Medical Association support the following principles to guide the use of  
35 competitive bidding among health insurers in the Medicare program:  
36
  - 37 a. Eligible bidders should be subject to specific quality and financial requirements to  
38 ensure sufficient skill and capacity to provide services to beneficiaries.
  - 39 b. Bidding entities must be able to demonstrate the adequacy of their physician and  
40 provider networks.
  - 41 c. Bids must be based on a clearly defined set of standardized benefits that should  
42 include, at a minimum, all services provided under the traditional Medicare program  
43 and a cap on out-of-pocket expenses.
  - 44 d. Bids should be developed based on the cost of providing the minimum set of benefits  
45 to a standardized Medicare beneficiary within a given geographic region.  
46  
47  
48

- 1 e. Geographic regions should be defined to ensure adequate coverage and maximize  
2 competition for beneficiaries in a service area.  
3
- 4 f. All contracting entities should be required to offer beneficiaries a plan that includes  
5 only the standardized benefit package. Expanded benefit options could also be offered  
6 for beneficiaries willing to pay higher premiums.  
7
- 8 g. Processes and resources must be in place to provide beneficiary education and support  
9 for choosing among alternative plans. (New HOD Policy)  
10
- 11 2. That our AMA support using a competitive bidding process to determine federal payments to  
12 Medicare Advantage plans. (New HOD Policy)

Fiscal Note: Less than \$500 to implement.

## REFERENCES

---

<sup>1</sup> Centers for Medicare and Medicaid Services. Competitive Bidding Update – One Year Implementation. April 17, 2012. Available at <http://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/DMEPOSCompetitiveBid/Downloads/Competitive-Bidding-Update-One-Year-Implementation.pdf>

<sup>2</sup> Bipartisan Policy Center. A Bipartisan Rx for Patient-Centered Care and System-Wide Cost Containment. April 2013. Available at <http://bipartisanpolicy.org/sites/default/files/BPC%20Cost%20Containment%20Report.pdf>

<sup>3</sup> Feldman, R, Dowd, B, Coulan, R. A Competitive Bidding Approach to Medicare Reform. American Enterprise Institute. April 2013. Available at: [http://www.aei.org/files/2013/04/15/-a-competitive-bidding-approach-to-medicare-reform\\_141610273790.pdf](http://www.aei.org/files/2013/04/15/-a-competitive-bidding-approach-to-medicare-reform_141610273790.pdf)