



Health, Education and Human Services Division

B-265657

August 11, 1995

The Honorable Joe Barton  
Chairman, Subcommittee on  
Oversight and Investigations  
Committee on Commerce  
House of Representatives

Dear Mr. Chairman:

Medicare costs are expected to continue to climb by about 10 percent annually over the next several years. To begin to address this issue, the Congress is discussing the potential for competitive bidding--as a means of setting prices of medical services and supplies--to achieve substantial Medicare savings. This correspondence responds to your request that we provide you with information on instances in which competitive bidding has achieved savings in various programs, the factors that would determine the magnitude of savings, and the amount that Medicare spends on the types of services that are likely candidates for competitive bidding.

COMPETITIVE BIDDING HAS BEEN  
SUCCESSFUL IN LOWERING COSTS

While competitive bidding may not be feasible in all cases and the savings it generates may vary, it can sometimes be an effective tool in controlling costs. The following three examples illustrate this point.

- The Department of Veterans Affairs (VA) establishes its price for oxygen supplies through competitive bidding. Recently, the Inspector General of the Department of Health and Human Services (HHS) reported that if Medicare were to adopt competitive bidding for oxygen (similar to the process used by VA), it could save \$4.2 billion over 5 years.<sup>1</sup>

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<sup>1</sup>Letter to Congressman Joe Barton from June Gibbs Brown, Inspector General, HHS (July 25, 1995), p. 4.

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- The state of Arizona has been successful in using competitive bidding to set capitation rates paid to health plans serving Medicaid beneficiaries. In the most recent bidding cycle, competition among managed care organizations resulted in capitation rates falling by 11 percent compared with the previous year.
- In 1990, we reported that state supplemental food programs that used a competitive bidding process to purchase infant formula paid, on average, about 23 percent less than states that did not use a competitive procedure.<sup>2</sup>

In addition, other information suggests that savings would be possible in some cases if Medicare were to pay market rates rather than its current reimbursement rates. For example, a substantial difference exists between Medicare's reimbursement rate and market prices for blood glucose monitors. The HHS Inspector General estimated that Medicare lost \$10 million during a 2-year period by overpaying for these monitors.

Although no comprehensive estimates are available of budget savings from competitive bidding throughout Medicare, more limited estimates have been done. For example, in a recent congressional hearing a Congressional Budget Office (CBO) official stated that CBO had prepared estimates of Medicare savings from "requiring competitive bidding for certain durable medical equipment and diagnostic tests."<sup>3</sup>

SAVINGS FROM COMPETITIVE BIDDING  
DETERMINED BY THREE FACTORS

The impact of competitive bidding on costs, in our view, depends upon three factors: the structure of the market, the process used to award bids, and the cost of administering the bidding process.

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<sup>2</sup>Savings varied by state and by year. For an evaluation of cost-containment initiatives in the Special Supplemental Food Program for Women, Infants, and Children (WIC), see Infant Formula: Cost Containment and Competition in the WIC Program (GAO/HRD-90-122, Sept., 1990).

<sup>3</sup>Fraud and Abuse in Medicare, statement of Paul N. Van de Water, Assistant Director, Budget Analysis Division, CBO, before the U.S. Senate, Committee on Finance, (July 31, 1995), p. 12.

### Structure of the Market

Market structure affects the potential savings from competitive bidding in two ways.

First, the markup on the service or supply--and hence the "room" for price reduction--is determined by the market structure. In markets that are already highly competitive, markups may be small and the gains from competitive bidding limited. Nonetheless, even in these markets competitive bidding may lower costs if the current Medicare reimbursement rate is above the market rate.

Second, the market structure determines the competitive pressures that firms would face under a competitive bidding process. Relevant factors include such things as the number of current suppliers; their ability to expand production; the existence of potential suppliers; and the barriers to entry facing new competitors (for example, capital required, regulations).

### Process Used to Award Bids

The structure of the competitive bidding process and the criteria for awarding contracts can greatly affect the savings from bidding. A competitive bidding process that awards the contract to a single supplier, for example, may produce the lowest bids but may leave Medicare vulnerable to interruptions in the delivery of service or supply that might not occur with multiple suppliers. Thus, factors other than price may be important in establishing an effective competitive bidding system. Some important issues that would affect potential savings (but that involve other trade-offs) include the following:

- For what geographical area would bidding be conducted-- the nation? regions? states?
- Would suppliers who bid have to make a commitment to supply the entire geographic area for which the bidding was conducted?
- Would the winner(s) take all? (That is, would Medicare only reimburse claims when the winners were the suppliers?) Or would the winning bid become Medicare's reimbursement rate but "losers" could still supply Medicare beneficiaries at that rate?

- Would bids be evaluated only on the basis of price (after suppliers met minimum quality and other standards)? Or would bids be scored on other criteria as well as price?
- What resources and rules would be used to prevent collusion among bidders?
- What reimbursement rate would prevail in areas in which there were no bidders?

#### Cost of Administering Bidding Process

Administrative costs of competitive bidding are influenced by bidding structure, bid collection and evaluation, bid protests, and contract monitoring and enforcement. All these involve administrative costs that reduce the net savings from competitive bidding.

#### POTENTIAL CANDIDATES FOR COMPETITIVE BIDDING

We have identified many examples of Medicare reimbursing claims at rates that substantially exceed market prices. These examples include clinical laboratory services and surgical dressings. While the feasibility or cost-saving potential of competitive bidding for specific services and supplies remains uncertain, some candidates that may have potential for competitive bidding include

- clinical laboratory services;
- durable medical equipment, for example, oxygen concentrators;
- magnetic resonance imaging (MRI) tests;
- computerized axial tomography (CT) scans; and
- cardiac procedures.<sup>4</sup>

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<sup>4</sup>The Health Care Financing Administration (HCFA) currently negotiates and contracts with select providers for coronary artery bypass grafts. We understand that HCFA is also exploring the extension of this approach to other cardiac procedures, such as angioplasty.

Table 1 lists Medicare outlays for the first four of these items in 1994. These numbers can be used to gauge the magnitude of aggregate savings. For example, table 1 indicates that for every 1 percent that competitive bidding lowers the cost of CT scans, Medicare would save up to \$5 million annually--assuming that the volume of CT scans remained constant.

Table 1: Medicare Outlays for Selected Items, 1994

Item	Outlays (billions)
Independent clinical laboratory services	\$2.0
Durable medical equipment	3.1 <sup>a</sup>
MRI tests	0.3
CT scans	0.5

Note: These figures pertain only to Medicare part B claims that are processed by carriers. It may be difficult to obtain comparable data for part B claims processed by fiscal intermediaries.

<sup>a</sup>Estimated 1994 Medicare outlay for durable medical equipment, based on allowed charges of \$3.9 billion--actual Medicare disbursements are approximately 80 percent of allowed charges.

Sources: HCFA Data Compendium and HCFA BESS database.

In general, services and supplies that can be compared on price alone--that is, do not differ in terms of quality or other characteristics--are the most promising candidates for competitive bidding. For example, the quality of clinical laboratory services may vary considerably among clinical labs, while the quality of surgical dressings may differ much less among suppliers.

SAVINGS POTENTIAL EXISTS,  
MAGNITUDE UNCERTAIN

Because Medicare pays above-market prices for some services and supplies, a purchasing system based on competitively set prices may be effective in reducing Medicare costs. Several other programs that have adopted competitive bidding have lowered their costs. However, their results

cannot be readily extrapolated to estimate savings from adopting competitive bidding on a wide array of Medicare services and supplies.<sup>5</sup> Precise estimates of these savings would depend upon the particulars of the situation--the services and supplies let out for bid, the scope of bidding in the Medicare program, the process of evaluating the bids and awarding contracts, and the cost of administering the program.

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Please call either James Cosgrove, Assistant Director, at (202) 512-7029 or me at (202) 512-7107 if you or your staff have any questions concerning this letter.

Sincerely yours,



Jonathan Ratner  
Associate Director,  
Health Financing Issues

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<sup>5</sup>In the mid-1980s, HCFA did design a competitive bidding demonstration for clinical lab services. In addition, HCFA has undertaken bidding for one cardiac procedure. Finally, as noted previously, CBO has estimated Medicare savings from bidding for certain durable medical equipment and diagnostic tests.