THE AMERICAN JOURNAL of MEDICINE®

Negative Secular Trends in Medicine: High Hospital Profits

It is estimated that in 2013 the 10 most profitable hospitals in the United States earned from $163.5 million to as much as $302.5 million from patient care services.[1] The top 4, and 7 of the top 10, are (supposedly) "not-for-profit." Included on the list are 2 world-class teaching and research institutions: Stanford at #3 ($224.7 million) and the University of Pennsylvania at #7 ($184.5 million). For perspective, the almost quarter of a billion dollars of profit earned by Stanford in just 1 year could fund the tuition of all of Stanford's medical students—for the next decade.

Why are "nonprofit" institutions so profitable? The Internal Revenue Service (IRS) and Congress have been asking that question for more than 2 decades. A review of the history of how nonprofit institutions are defined will explain how the present situation evolved and provide recommendations for how it can be rectified.

Since 1956 the IRS has recognized how hospitals can qualify as tax-exempt, with the provision of charity care as the sine qua non of tax-exempt status.[2] The passage of Medicare and Medicaid in 1965 as part of President Johnson's Great Society markedly decreased the write-offs for charity care. In 1969 the IRS revised the standard, eliminating charity care as a basic requirement and substituting "community benefit." This nebulous term provided hospitals and their administrators with wide latitude. The less well defined requirements allowed hospitals to substitute programs in community health improvement and the social determinants of health for direct charity care. As it relates to this discussion, the "nonprofits" used this as a go-ahead to maximize profits. By 2002 the Congressional Joint Commission on Taxation estimated the value of the nonprofit tax exemption at $12.6 billion.[3]

However, the trend continued, prompting the IRS in 2006 to initiate the IRS Exempt Organizations Hospital Study. The result was that in 2009 the IRS required all hospitals claiming tax exempt status to comply with the new policies on what constituted community benefit as described in Schedule H of their annual Form 1099 filing. These revisions were accompanied by more amendments enacted as part of the Affordable Care Act.

A goal was that "nonprofit" hospitals would spend at least 5% of revenues on charity care. The effort was unsuccessful. The trend of the "nonprofit" hospitals to maximize profits not only continued, it accelerated. By 2011 it was estimated that the value of the tax exemption had ballooned to a whopping $24.6 billion.[3] A 2013 study showed that charity care represented only 1.9% of "nonprofit" hospitals' operating expenses.[4]

The executives of "nonprofit" health chains have seized some of the tax-exempt advantage for their own personal enrichment. In a previous article[5] I noted that in 2011 or 2012, 30 executives at "nonprofit" health care organizations in the United States made more than $4,000,000 in a year, with a mean total compensation of $6,500,000. Two executives made more than $10,000,000, and 1 made more than $20,000,000. I do not believe the average chief executive officer on that list is more valuable to society than 100 registered nurses. It is further noted that chief executive officer compensation was up a whopping 24.2% from 2011 to 2012. Possible adjectives to describe these salaries at "nonprofit" institutions include "generous," "rock-star," "outrageous," or even "obscene."

Because the efforts remained unsuccessful, the IRS recently finalized changes in Section 501(r), which require hospitals to establish a written financial-assistance policy that applies to all emergency and medically necessary care and to access the health needs of their community every 3 years.[6] That these latest cosmetic changes will result in the desired effect is wishful thinking bordering on naiveté.

FOR-PROFIT HOSPITALS

I do not believe it is a coincidence that the first for-profit hospital in the United States opened in 1967, barely 2 years after the passage of Medicare and Medicaid decreased the need for charity care.

There are only a limited number of ways a hospital can generate the excess revenue to pay investors a profit. The first is to provide better, more efficient care. There is no reason to expect this, and it has never been shown. In fact,

Funding: None.

Conflict of Interest: None.

Authorship: The author had access to the data and participated in writing this manuscript.

Requests for reprints should be addressed to Robert M. Doroghazi, MD, The Physician Investor Newsletter, 115 Bingham Road, Columbia, MO 65203-3577.

E-mail address: rdoroghazi@yahoo.com

0002-9343/$ -see front matter
http://dx.doi.org/10.1016/j.amjmed.2016.07.005

some studies suggest the opposite.[7,8] The next is to charge more. Forty-nine of the 50 highest-charging hospitals in the United States are for profit.[9] The last way is to "cherry pick": minimize patients who cannot pay, while maximizing the profitable ones, especially those requiring high-end procedures.

RECOMMENDATIONS

1. Congress must intervene and define a nonprofit institution as one that makes no profit, aside from that required to maintain quality operations, prudent reserves, and fund future capital needs.
2. The salaries of the administrators of "nonprofit" institutions should match those of real, acknowledged nonprofits, such as the Boy Scouts of America and the Salvation Army. This will also require congressional intervention, because the boards of directors of the various institutions have so far been unable to rein in the 7 and even 8-figure salaries of their administrators.
3. I believe the quest for profits between all hospitals, nonprofit and for-profit, has been one of the main drivers causing our healthcare costs to be the highest in the world, far outstripping inflation. There are 2 kinds of competition. Henry Ford was relentless in building cars that were of higher quality and less expensive. This is America at its best: all society benefitted. I believe current hospital competition has done nothing but drive up costs: new hospitals are often described by locals as a Taj Mahal, with spacious, well-appointed rooms, art work on the walls, and lobbies larger than in-door football fields. Hospitals add high-end, expensive technology that benefits few, and then unleash their Madison Avenue-size advertising budget to tell everyone they are the fourth in the area to have a helicopter.
4. Is it logical to operate a hospital for profit?

Robert M. Doroghazi, MD
The Physician Investor Newsletter
Columbia, Mo

References

1. Bai G, Anderson GF. A more detailed understanding of factors associated with hospital profitability. *Health Aff (Millwood)*. 2016;35(5):889-897.
2. Rosenbaum S. Hospital community benefit spending: leaning in on the social determinants of health. *Milbank Q*. 2016;94(2):251-254.
3. Rosenbaum S, Kindig DA, Bao J, Byrnes MK, O'Laughlin C. The value of the nonprofit hospital tax exemption was $24.6 billion in 2011. *Health Aff (Millwood)*. 2015;34(7):1225-1233.
4. Young GJ, Chou CH, Alexander J, Lee SY. Provisions of community benefit by tax-exempt U.S. hospitals. *N Engl J Med*. 2013;368:1519-1527.
5. Doroghazi RM. Negative secular trends in medicine: high CEO salaries. *Am J Med*. 2016;129(2):e1-e2.
6. Nikpay SS, Ayanian JZ. Hospital charity care—effects of new community-benefit requirements. *N Engl J Med*. 2015;373:1687-1690.
7. Herrera CA, Rada G, Kuhn-Barrientos L, Barrios X. Does ownership matter? An overview of systematic reviews of the performance of private for-profit, private not-for-profit and public healthcare providers. *PLoS One*. 2014;9(12):e93456.
8. Gani F, Ejaz A, Makary MA, Pawlik TM. Hospital markup and operation outcomes in the United States. *Surgery*. 2016;160(1):169-177.
9. Bai G, Anderson GF. Extreme markup: the fifty US hospitals with the highest charge-to-cost ratios. *Health Aff (Millwood)*. 2015;34(6):922-928.