In September 2000, a team of researchers visited Phoenix, Ariz., to study that community’s health system, how it is changing and the effects of those changes on consumers. The Center for Studying Health System Change (HSC), as part of the Community Tracking Study, interviewed more than 85 leaders in the health care market. Phoenix is one of 12 communities tracked by HSC every two years through site visits and surveys. Individual community reports are published for each round of site visits. The first two site visits to Phoenix, in 1996 and 1998, provided baseline and initial trend information against which changes are tracked. The Phoenix market encompasses Maricopa and Pinal counties.

With the addition of 100,000 people a year, Phoenix continues to grow rapidly, making its health care market attractive to national firms. A series of hospital acquisitions since 1998 has left these firms in control of the majority of the area’s hospital capacity. National firms are also dominant in the health plan market, although a new focus on profitability is leading some to eliminate unprofitable lines of business, including Medicare+Choice. A national hospital management company is credited with helping to stabilize the community’s major safety-net provider, but concerns remain about the area’s capacity to care for the uninsured.

Against this backdrop, key developments in Phoenix since 1998 include:

- Hospitals began to increase their leverage with health plans, but financial pressures mounted as some physicians shifted focus from hospitals to independent specialty facilities.
- Changes to plans’ Medicare+Choice products have left seniors with fewer choices and higher costs.
- Arizona citizens used ballot initiatives to secure funding to care for the uninsured.
Specific areas of the geographically broad market to ensure their indispensability to health plan networks. As one hospital executive put it, “Geography is destiny” in the Phoenix market. Most hospital systems have focused their strategic efforts on securing strongholds in key geographic submarkets. Catholic Healthcare West, for example, strengthened its market position with the acquisition of Chandler Regional Hospital, which gave it a foothold in the rapidly growing East Valley. Newly consolidated BannerHealth Arizona has a strong market position because it offers the broadest geographic coverage in the market.

Health plans report that hospitals’ virtual monopolies in certain geographic areas give hospitals a significant advantage in negotiations, resulting in more favorable contract terms and higher payment rates for hospitals. In addition, plans contend that BannerHealth Arizona has begun to leverage its strong market position and name-brand recognition to secure higher payment rates and better contract terms, limiting health plans’ ability to hold down costs.

Physicians Shift Focus to Specialty Facilities

Physicians’ discontent with the local health care system has reached new heights over the past two years, and physicians are aggressively pursuing strategies to improve their financial situations. Perhaps most significant, some specialists have cut back on their affiliations with traditional hospitals, choosing instead to devote more time to their own ambulatory treatment and surgery centers or specialty hospitals in which they have equity interests. These facilities offer the potential for physicians to generate higher incomes by sharing in facility profits. The drawback is that the growth of specialty facilities threatens traditional hospitals with the loss of profitable services and, as a result, limits their...
ability to sustain cross-subsidies essential for financing less profitable lines of business.

Moreover, to avoid seeing uninsured patients for whom they will not be reimbursed, some specialists have stopped providing emergency room coverage in Phoenix. Hospitals report that it is increasingly difficult to provide on-call coverage for certain specialties, and they say that some specialists are banding together in “cartel-like” arrangements to demand above-market reimbursement from hospitals for their services. Specialists’ decisions not to provide emergency room coverage may have gained impetus from regulations under the federal Emergency Medical Treatment and Labor Act, which imposes hefty fines if a physician or hospital inappropriately transfers a medically unstable patient to another facility for any reason, including inability to pay.

Relationships between physicians and health plans in Phoenix have also become very contentious in the past two years. On the heels of financial difficulties that many attribute largely to managed care, physicians increasingly are refusing to enter into risk contracts with health plans, and health plans are reverting to fee-for-service payment. Meanwhile, nearly every attempt at building organizations to allow physicians to accept risk has failed, leaving dim prospects for risk contracting in the future.

Health Plans Seek to Regain Profitability

Health plans’ profitability has eroded considerably in Phoenix since 1998, a situation that has led to rising premiums and instability in the health plan market. Of the 10 commercial health maintenance organizations (HMOs) currently operating in Phoenix, only two—Cigna and PacifiCare—are reportedly profitable. Health plans in Phoenix once relied on a strategy of increasing their market share by keeping premiums low. Like other health plans nationally, however, many of them have concluded that this strategy is unsustainable and are increasing premiums and eliminating unprofitable or marginal lines of business to improve their financial condition.

Individuals with coverage from large employers appear to have been largely sheltered from health plans’ premium increases. In the tight labor market (currently under 3 percent unemployment), most large firms have sought to absorb the added costs or make only minor changes to benefit structures, viewing increased out-of-pocket costs for their employees as a last resort. Observers note, however, that small employers—which account for the vast majority of Phoenix area workplaces—have been more likely to change health plans to get a better price or to drop coverage for employees altogether if they are unable to find affordable rates. This trend has significant implications in a market where more than 25 percent of the population already goes without health insurance.

Health plans’ recent financial problems have prompted the Arizona Department of Insurance (DOI) to place two plans, UnitedHealthcare and Intergroup, on a “watch” status to monitor their performance more closely. DOI’s actions are attributed to criticism the agency received for not adequately monitoring the financial condition of Premier Healthcare, a small provider-sponsored HMO that became insolvent and went into receivership in November 1999. Problems with plans failing to pay providers on time have also prompted increased scrutiny by DOI, resulting in fines for some plans.

DOI’s recent interventions reflect an increasingly regulated health plan environment that has emerged in Arizona and nationally. In 1999, the Arizona legislature enacted an HMO reform law giving patients various rights to appeal their health plan’s decisions, including the right to sue their health plan. The list of legislatively mandated health plan regulations under the federal Emergency Medical Treatment and Labor Act, which imposes hefty fines if a physician or hospital inappropriately transfers a medically unstable patient to another facility for any reason, including inability to pay.

Health Insurance Status

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<thead>
<tr>
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<th>Phoenix Metropolitan areas above 200,000 population</th>
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<tbody>
<tr>
<td>Persons under Age 65 with No Health Insurance</td>
<td>17% 15%</td>
</tr>
<tr>
<td>Children under Age 18 with No Health Insurance</td>
<td>16% 11%</td>
</tr>
<tr>
<td>Employees Working for Private Firms that Offer Coverage</td>
<td>86% 84%</td>
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<tr>
<td>Average Monthly Premium for Self-Only Coverage</td>
<td>$151 $181</td>
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Sources:

Health System Characteristics

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<thead>
<tr>
<th></th>
<th>Phoenix Metropolitan areas above 200,000 population</th>
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<tbody>
<tr>
<td>Staffed Hospital Beds per 1,000 Population</td>
<td>2.2 2.8</td>
</tr>
<tr>
<td>Physicians per 1,000 Population</td>
<td>1.7 2.3</td>
</tr>
<tr>
<td>HMO Penetration, 1997</td>
<td>34% 32%</td>
</tr>
<tr>
<td>HMO Penetration, 1999</td>
<td>34% 36%</td>
</tr>
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Sources:
1. American Hospital Association, 1998
2. Area Resource File, 1998 (includes nonfederal, patient care physicians, except radiologists, pathologists and anesthesiologists)
3. InterStudy Competitive Edge 8.1
4. InterStudy Competitive Edge 10.1
benefits, which continues to grow, now includes cancer clinical trials and chiropractic services. Under a new state law that takes effect this year, Arizona's bifurcated system of managed care oversight will be eliminated, and the health delivery and quality monitoring responsibilities of the Department of Health Services will be transferred to DOI.

Health plan respondents claim that Arizona's new managed care regulations are increasing costs, resulting in higher premiums for consumers. Other respondents assert, however, that the regulations are needed to ensure that patient care and provider payment are protected adequately in a managed care environment.

Seniors Face Fewer Choices and Higher Costs

Phoenix is one of the strongest Medicare managed care markets in the country. Zero dollar premiums and generous benefit packages, including pharmaceutical coverage, have attracted 168,000 local Medicare beneficiaries (42 percent) to Medicare+Choice HMOs. Recently, however, the struggle by Phoenix health plans to restore profitability has led some health plans to withdraw from Medicare+Choice. Other plans have instituted premiums and/or reduced benefits in their Medicare HMOs, leaving seniors with fewer choices and higher out-of-pocket costs.

Since 1998, two health plans have dropped out of the Phoenix Medicare+Choice market. The withdrawal of UnitedHealthcare and Blue Cross Blue Shield of Arizona affected 20,000 Medicare beneficiaries, most of whom are thought to have enrolled in other HMOs. Though seven other plans are expected to participate in the Medicare+Choice market in 2001, these plans say that low payment rates, coupled with Balanced Budget Act imposed rate ceilings that are significantly below medical cost trends, limit their ability to make long-term participation commitments.

Furthermore, health plans that remain in the Phoenix Medicare+Choice market are requiring seniors to contribute more to the cost of care. Seniors who previously paid no premiums in most Medicare+Choice plans now face monthly premiums of $25 or more, higher copayments and more restrictive caps on prescription drug coverage. Despite these changes, demand for Medicare+Choice plans in Phoenix remains strong, especially among the area's many young and healthy retirees and individuals who want the prescription drug benefit. Health plans contend that they have no recourse other than to increase beneficiary contributions and reduce benefits if they are to continue to participate in the Medicare+Choice program and remain financially sound.

Some health plans are considering alternative Medicare products such as preferred provider organizations (PPOs), but so far no new managed care products have been introduced into the market. Recently, Sterling Life Insurance Company began marketing a Medicare private fee-for-service product in Phoenix. It is too soon to determine what, if any, impact such fee-for-service products will have on the market.

Arizona Citizens Press for Aid for Large Uninsured Population

The Phoenix area has one of the highest rates of uninsurance in the country, with more than one-quarter of the population lacking coverage. Only 60 percent of working adults and their dependents receive health insurance through their employers, and the preponderance of low-wage jobs in the local employment sector makes it likely that many people cannot afford to purchase insurance on their own. Federal welfare reform legislation enacted in 1996 has contributed to the insurance coverage problem, because reportedly large numbers of former welfare recipients who remain eligible...
for Medicaid have not reenrolled. Arizona's State Child Health Insurance Program (SCHIP), KidsCare, was implemented in November 1998, and roughly 80,000 children have gained coverage as a result of KidsCare outreach efforts—half through Medicaid and half through SCHIP. State officials had originally hoped to enroll 60,000 children in KidsCare alone and are now stepping up efforts to reach this population.

Historically, Arizona's political climate has not been supportive of state-sponsored initiatives to provide funding for the uninsured, but in recent years, Arizona citizens have used state ballot initiatives to force the hand of the legislature to address the insurance coverage problem. An Arizona state ballot initiative passed in 1994 created a tobacco tax, with 70 percent of the revenues dedicated to subsidizing health care for the uninsured. Currently, these tobacco tax revenues are the only source of funding that can be used to provide care for undocumented immigrants in Phoenix and elsewhere in the state. With health care costs continuing to escalate, however, there are concerns that tobacco tax revenues will not keep pace with the health care needs of the large number of uninsured persons.

In November 2000, Arizona citizens passed two competing state ballot initiatives—Proposition 200 and Proposition 204—that earmark the state’s $3.1 billion tobacco settlement monies to expand coverage to the population without health insurance. Proposition 204 had the most votes and was recently approved by federal officials. The new funding will expand Medicaid eligibility by raising the income ceiling for eligibility to 100 percent of the federal poverty level, extending coverage to 130,000-180,000 Arizona residents who lack health insurance—a 30 percent increase over current Medicaid enrollment.

Despite the pressures of a large uninsured population, the Phoenix safety net has been relatively stable, but that stability may now be in jeopardy. Four downtown hospitals—the county-owned Maricopa Integrated Health System (MIHS), Good Samaritan, St. Joseph's and Phoenix Memorial—provide care for the uninsured, as does an extensive network of community health clinics (CHCs) in Phoenix. Market observers report that uninsured individuals have reasonably good access to primary care through the CHCs, either by appointment or on a walk-in basis. Securing specialty and inpatient care through the CHCs, however, is reportedly more difficult. To link uninsured individuals with specialty or inpatient care, CHCs rely largely on relationships they have established with providers in the community.

Some respondents express concern that access to care for the uninsured is deteriorating at MIHS. In 1994, following substantial losses that threatened its continued existence, MIHS entered into a management agreement with the for-profit hospital management company, Quorum Health Resources. Quorum has been successful in helping to restore profitability to the county-owned system, which reportedly now has a surplus in excess of $18 million. Although MIHS’s improved financial condition may help to stabilize the system as a key provider of care for the uninsured, some respondents speculate that its financial turnaround has been the result of a decline in the amount of uncompensated care the system provides.

Consistent with these reports, other hospitals have noted significant increases in emergency room use by uninsured persons. Some observers fear that this situation will worsen under MIHS’s plan to shed its county hospital image by obtaining state authorization to form a hospital district. This change will enable MIHS to compete for a broader base of business, but some observers worry that it may also undermine MIHS’s commitment to serve the uninsured.
Issues to Track

Rapid population growth continues to shape the Phoenix health care market, attracting national firms and helping them to attain a dominant position among both hospitals and health plans. Consolidation and new partnerships have helped to strengthen hospitals’ bargaining power relative to health plans during the past two years, but shifts by some physicians from providing services through traditional hospitals in favor of their own specialty facilities are adding to hospitals’ financial pressures and disrupting coverage arrangements. Meanwhile, health plans have been struggling to regain financial stability. The result has been higher premiums, reduced benefits and fewer plans participating in Medicare+Choice. Large numbers of Phoenix residents remain uninsured, and respondents worry that further changes in the county-owned hospital system threaten to weaken the safety net in the future.

As the Phoenix health care market continues to evolve, the following issues are important to track:

• What effects will contrary pressures—hospitals’ increasing negotiating leverage with health plans and physicians shifting to specialty facilities—have on hospital prices and overall health care costs?

• As health plans attempt to restore profitability by increasing premiums, how will the low-wage market respond? Will employers shift the increased costs to their employees? Will they drop coverage? Or will purchasers push for more tightly managed products?

• What impact will changes by health plans in their Medicare products have on the Phoenix market? Will Phoenix seniors see improved choice of plans, lower costs and/or expanded benefits? Will seniors return to traditional fee-for-service coverage?

• How will increased funding allocated under recent ballot initiatives affect insurance coverage? Will the local safety net continue to have sufficient capacity to serve the remaining uninsured?
Phoenix’s Experience with the Local Health System, 1997 and 1999

The information in these graphs comes from the Household and Physician Surveys conducted in 1996-1997 and 1998-1999 as part of HSC’s Community Tracking Study.

* Site value is significantly different from the mean for metropolitan areas over 200,000 population.
# Statistically significant difference between 1997 and 1999 at p< .05.
The Community Tracking Study, the major effort of the Center for Studying Health System Change (HSC), tracks changes in the health system in 60 sites that are representative of the nation. Every two years, HSC conducts surveys in all 60 communities and site visits in 12 communities. The Community Report series documents the findings from the third round of site visits. Analyses based on site visit and survey data from the Community Tracking Study are published by HSC in Issue Briefs, Data Bulletins and peer-reviewed journals. These publications are available at www.hschange.org.

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