# Leveraging Reference-Based Pricing to Contain Hospital Prices

Rising health care costs limit people's health care choices and put a strain on family and government budgets. A main driver of those rising costs are the prices charged by hospitals, which only continue to increase as a consequence of consolidation. In some states, hospitals charge commercial carriers an average of three times what they charge Medicare. These higher prices paid by health insurers result in health plans increasing premiums and out-of-pocket costs as they attempt to recoup revenue. This impacts patients, employers, and state and federal governments in significant ways – costs go up, health care value stagnates, quality does not improve, and health inequities are made worse.

**A Solution: Reference-Based Pricing**

Recognizing the impact of these trends on state budgets and consumers, alike, policymakers are increasingly pursuing solutions to lower hospital prices. One emerging solution is to directly limit the prices hospitals charge by implementing reference-based pricing within programs states run or regulate, such as state employee health plans (SEHPs). Reference-based pricing directly targets what hospitals can charge by benchmarking prices to a "reference price" – most often a percent of Medicare reimbursement rates. This solution brings the prices charged for hospital services more in line with the actual cost to provide services, rather than relying on negotiated rates set by hospitals, because Medicare rates are regularly reviewed and updated to reflect local market conditions. Reference-based pricing programs can also be designed to improve access to high-value care by creating *payment floors* for specific services or types of providers, such as behavioral health services or for primary care providers.

**Benefits of Reference-Based Pricing**

Reference-based pricing provides the opportunity to constrain cost growth, lowering costs for the state and other purchasers, such as consumers and employers. For example, specifically targeting the rates paid through SEHPs has the potential to generate significant savings for states, which can be reinvested into other areas of the state budget, including Medicaid or other affordability programs. A recent report found that capping hospital payments at 200% of Medicare rates would have saved SEHPs an average of $150.2 million per state in 2022, totalling $7.1 billion nationwide, all while minimally impacting hospital operating margin.

When used in the commercial market, reference-based pricing benefits other purchasers by helping to lower premiums and out-of-pocket costs. This policy can also provide more predictability for consumers by establishing more uniformity and fairness with prices that don't rely on how well their plan is able to negotiate with an individual hospital or health system.

**State Reference-Based Pricing Approaches and Success**

Each state's approach to designing a reference-based pricing program to lower health care costs should be unique to their own state landscape and health system goals. While states have taken many approaches to meeting their goals and maximizing impact, we recommend states consider the following when designing a successful reference-based pricing program:

1. **Identify the market:** States can tailor reference-based pricing approaches to apply within specific markets or programs they oversee, such as the individual market, small group market, or within their SEHP, or to apply more broadly to all providers in a state. Additionally, policymakers can establish caps, floors, set rates, or a combination of those.

2. **Achieve meaningful savings**: States should decide what level and how broadly to apply reference-based pricing to achieve desired savings. For example, reference-based pricing can be used for certain services, such as for outpatient hospital care, or to certain categories of providers, such as large health systems with a lot of negotiating power. States may also consider including a limitation on out-of-network rates in order to equalize negotiating power between payers and providers.. Ultimately, the reference rate established under this policy drives the savings–the lower the rate, the larger the savings.

   However, policymakers should note that while incorporating reference-based pricing more broadly leads to larger savings, efforts should be made to balance people's access to affordable care and the fiscal health of providers. To do this, policymakers can utilize existing data, such as the state's all payer claims database, to inform and target their efforts based on their state's specific health care landscape. This data provides needed information on current prices, the size of employer market shares, and the level of consolidation within the state's providers, which can help policymakers find the highest cost drivers and savings opportunities.

3. **Leverage savings**: Policymakers must also consider the mechanism by which the savings generated through a reference-based pricing program are funneled back to consumers. Both direct mechanisms through consumer premium offsets or improved benefit coverage, or indirect mechanisms through reinvesting the savings into other health care priorities, such as Medicaid or the health care safety net, are options for policymakers to consider.

4. **Align affordability efforts**: States should consider combining this policy with other state-based cost containment strategies, like cost-growth targets, to maximize impact. Reference-based pricing policies can also be designed to align with existing patient-first care models, such as hospital global budgets, or other efforts that move away from a fee-for-service payment system.

Several states have implemented hospital reference-based pricing in their SEHPs, with momentum growing as 13 states consider pursuing reference rates during the 2025 legislative session:

1. **Oregon** legislated a hospital-based reference-based pricing program for its SEHP, which caps hospital prices at 200% of Medicare rates for in-network facility services, and 185% of Medicare rates for out-of-network services, and includes price growth cap. The state saw an estimated $107.5 million in savings in the first 27 months of the program.
2. **Montana** led the way in leveraging the power of their SEHP to negotiate caps for each individual large hospital in the state, implementing caps at between 220% -225% of Medicare rates for hospital inpatient services, and between 230% -250% for hospital outpatient services. Montana's SEHP reference-based pricing program saved the state an estimated $47.8 million from 2017 to 2019.

**Moving Forward**

With cuts to state budgets and Medicaid programs looming, coupled with rising health care spending outpacing wages and inflation, people are looking to state policymakers for relief from unaffordable premiums and out-of-pocket costs. Reference-based pricing provides a unique solution for states to meaningfully address the soaring hospital prices placing a larger-than-ever financial burden on people, employers, and state budgets.