

### Lessons on Public/Private Partnership from the Boston City Hospital/University Hospital Merger

*On May 30, 1996, Pioneer Institute board member and former Secretary for Administration and Finance **Peter Nessen**, now a special advisor to Boston Mayor Thomas Menino on health care issues, addressed a Pioneer Forum about the then-proposed merger between Boston City Hospital and University Hospital. Nessen discussed how the merger fit into the ongoing revolution in health care and explained the process that led to the merger, which was approved by the Boston City Council on June 30. He went on to compare his experiences in the public and private sectors, and discuss some of the barriers that restrict creative, efficient public/private partnerships.*

When Mayor Menino asked me to serve as special advisor to him on health care issues, he never sought out my true credentials: I have no science background, I am terribly frightened of blood, and you never want to be with me when I visit anyone in the hospital. However, in many ways my credentials are exactly what are needed to wrestle today's health care issues. Sadly, the issues revolve around financial and economic concerns more than medical ones.

Before I talk about the Boston City Hospital/University Hospital merger, I would like to discuss the recent history of health care finance. Just five years ago, the federal government was actually providing incentives for the health care industry to build new facilities. Medicare and Medicaid reimbursements provided the cash flow to facilitate this growth in fixed assets. Status in the hospital industry came to be measured by who had the most beds.

Another aggravating factor is that health care's very success is also its failure. Believing that cures are available if we are willing to spend the dollars, we drove the profession to give us those cures. Suddenly another voice came along and said, "STOP!" It was the voice of the employer who had basically been bearing the cost of these cures.

The health care industry responded with alphabet soup: HMOs and PPOs, followed by managed care and then capitated programs. The aim of all these programs is to cut utilization of the very beds that had come to be the mark of achievement in health care delivery. Yesterday's asset has become today's liability.

What then do we make of the merger between Massachusetts General and Brigham & Women's Hospitals, the two hospitals that own the most beds? Why would they entertain a proposal to take over New England Medical Center? Some say the strategy is to expand in order to own all the available beds in the city. In Boston's health care marketplace, we currently have twice as many beds as we need. The continuing rise of managed care will only result in more vacancies.

Health care is experiencing an ongoing revolution and we are at the center of it, because Massachusetts is on the cutting edge of high technology medical care. Since 1989, 13 Massachusetts hospitals have closed. Twelve hospitals have transformed themselves from providers of acute care to providers of another type of care. Eight more have merged, 13 have been acquired and 28 have entered into some contractual affiliation. Some estimate that we currently have two-thirds more specialists than we need and that one-third of medical schools as we currently know them will close. According to a Federal Reserve study, New England will lose 45,000 medical jobs over the next five years.

What is our response to this revolution? We all cherish a system that has brought us wonderful health care, but we know it has gotten too expensive. Interestingly, the leadership that brought us hospital growth is the same group we are now challenging to restructure medical delivery. The result in many cases has been tinkering around the edges rather than taking a bite of the whole. Bold leadership will be required to guide health care's transformation from a hospital-based system to one in which the hospital is only a part of a good health care delivery system.

As in any other industry, health care executives are first trying to secure market share. Public hospitals were established 130 years ago because the underserved were being overlooked by the private sector. Now teaching hospitals are aggressively marketing themselves to traditionally underserved patients. Why not just declare victory, celebrate our universal commitment to the underserved, and call it a day? But we have a mayor and a city council who fear that these hospitals are courting the underserved not out of genuine concern, but out of economic necessity, because the underserved come with a marginal dollar

that is better than no dollar at all. That is fine unless a new reimbursement scheme changes the incentives.

There is another issue to which I would like to draw your attention. If you were in Lexington or Concord about fifteen years ago and decided to sell surplus school buildings to a condominium developer without looking at the demographics, you would currently be looking at a significant growth in the number of school children and not enough dollars to rebuild the very buildings you sold. The health care industry has changed dramatically in a brief period and change is the only thing we can continue to count on.

## **The Merger**

With this in mind, the mayor and city council are dealing with the question of whether this is the time to merge City Hospital (BCH). Significantly, the mayor opted to stay in the business of serving the underserved. Once that commitment was made, it became clear that it could not be done alone.

We believe University Hospital is the right partner for several reasons. The most obvious is that it is across the street, but more importantly, it has a mission that is compatible if not parallel to City Hospital's. In addition, few people realize the professional staffs of the two institutions have already been merged. It also has a mutuality of arrogance, which helps in hospital dealings, and a mutuality of humility, since both hospitals are in similar financial condition. The new combined entity would also have a realistic payor mix. Individually, neither hospital had the right mix to survive change.

Let me tell you why I think the proposed merger is a fair deal. If you speak to BU or to the city, each thinks it bailed the other one out. If you dig into the numbers, you will find it really is a fair deal.

University Hospital gave a bit more here and BCH a bit more there, but when you put it all together, it is a fair deal. University Hospital is pooling all its assets with all of City Hospital's to create a merged entity that will be called the Boston Medical Center.

From the outset, the mayor made it very clear that he was concerned about three things. First and foremost, we had to preserve the mission. Second, we had to preserve jobs. The hospitals are a major employer in an economically depressed area of the city. Third, it had to be the right financial choice for the city. We needed to find the option that cost the least, but preserved mission and jobs.

It came down to three options. The first was to do nothing. The best projections we could get indicated that we would hemorrhage at about \$150 million over five years. The second choice was to change BCH from a public hospital to an independent authority hospital, which meant some savings, but still left a \$130 million loss over the next five years. The merger will cost the city around \$12 million each year for the next five years. Even if we closed BCH, the city would be left with 17 years of remaining debt at a minimum of \$17 million per year. From a financial point of view, the merger is clearly the best option.

Let me go back to jobs for a moment, because they are so intertwined with both the financial concern and preservation of mission. We will see a reduction in force over the next six years of about 1300 people, of which 400 will be layoffs. The remaining 900 will be the result of early retirement, reducing overtime, and work rule reform. Compared to the Federal Reserve prediction of 45,000 lost health care jobs in New England over the next five years, I think we are doing pretty well.

From the business point of view, this merger is a done deal. There is little more I can do for this transaction. Its fate will now be determined by the political process, as it should be. The merger preserves City Hospital's mission and is economically right.

This merger is not about saving hospital buildings, beds, or even a medical school. It is about saving an urban health system. Around the country, one public hospital after another is closing. We are getting calls from other cities and states because we represent a viable alternative to selling or closing a public hospital and merely hoping that someone will care for the underserved. The new Boston Medical Center will truly be a cornerstone of urban health; a system that understands and works with families in the community, a system that deals with the entire spectrum, from pre-natal care to serving the elderly. In short, it will truly be committed to public health, not just cures.

## **Public vs. Private**

As a private sector person who has now had a few experiences in the public sector, I have learned many lessons. One is that, despite their admirable missions, public institutions are sometimes unable to survive in the competitive marketplace. Another lesson has to do with personnel. In the public sector, there is civil service and a phenomenon known as "bumping." Let's say I want A to come in so I can get rid of B and C,

but B and C both have more seniority than A. C could bump B (assuming C had more seniority), and B could then bump A, throwing out the very person I wanted to bring in.

The public sector also has inflexible work rules that restrict its competitiveness. If I want to move an employee from the top floor of a public hospital because of an immediate need in the emergency ward, I have to give that employee two weeks notice before he is required to respond to my need. That just does not work. Between holidays, vacation, sick days, and personal time, many public employees start with 43 days off-the equivalent of two months of workdays-per year. We must respect the honor and dignity of the worker, but we need greater latitude if we hope to compete.

## **Resisting Change**

One thing the public and private sectors have in common is that both hate change. It is always seen as a threat, never an opportunity. Surprisingly, the state has been most creative in using change to its advantage. Reacting to change 20 years ago, the state spun out social service employees and designated them as not-for-profit providers from whom the state would buy services. This provided a buffer between the state and the clients it served, shifting liability from the state to the provider.

But as with the recent revolution in health care, the state's very success has led to problems. As the state bought services instead of making them, the number of state employees decreased. Remaining state employees became concerned and applied pressure that resulted in the 1993 passage of what is known as the "Pacheco Law," which seeks to prohibit the state from contracting with private vendors. Pacheco requires that any private bid be compared not to what it costs for state employees to provide the service, but to the hypothetical cost of state employees if they were to work "in the most cost-efficient manner." There is no mechanism to measure the public employees' actual level of efficiency. The private vendor must also pay wages and provide benefits that are at least equal to those provided state employees, which are often extremely generous. Finally, if the private bid somehow prevails, the state auditor is required to review the bidding process and may veto the proposed contract on grounds as vague as its not being "in the public interest."

We live in an uncertain and sometimes fearful time. Our institutions are experiencing radical change at an unprecedented pace. We must not be threatened by this change, but must instead view these new challenges as an opportunity. All our creative energies will be required to treat people with dignity and serve our community by having the courage to confront change and provide quality services at a fair price.

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