

POLICY CONSIDERATIONS FOR DEFINING ESSENTIAL HEALTH SYSTEMS

Within the U.S. health care system, a small share of hospitals provides a disproportionate share of care to low-income patients. Policymakers long have recognized the need to identify these hospitals because of their role in making health care affordable for patients. However, existing federal hospital designations fail to identify the hospitals most committed to providing essential care in their communities.

The bipartisan [Reinforcing Essential Health Systems for Communities Act \(H.R. 7145\)](#), introduced by Reps. Lori Trahan (D-Mass.) and David Valadao (R-Calif.), would fill this gap in federal law. The bill defines essential health systems using evidence-based and practical measures of a hospital's patient mix and the amount of uncompensated care it provides. The essential health systems identified by H.R. 7145 represent 17% of all U.S. hospitals but provide nearly 70% of the nation's charity care (Figure 1).¹

This policy brief outlines how an essential health system designation relates to existing designations and discusses policy considerations for developing measures to identify essential health systems. It concludes by reviewing how an essential health system designation could better target resources to hospitals that need them most.

BACKGROUND

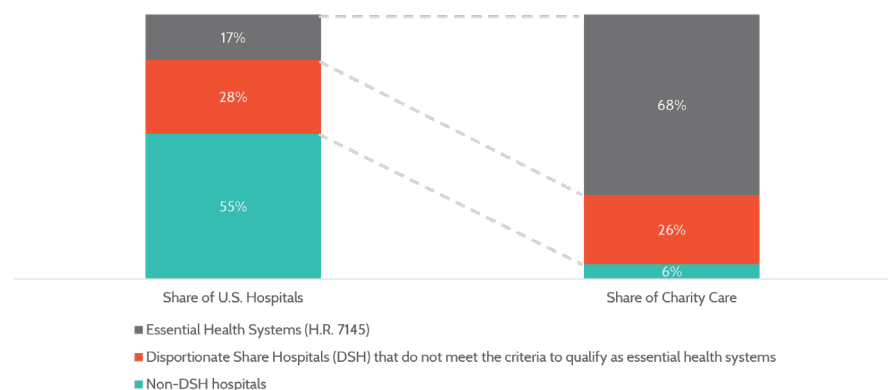
Congress has acted multiple times to identify hospitals with unique characteristics that merit special consideration in payment policy. About 26% of hospitals currently receive a designation based on their rural location, including critical access hospitals—geographically remote hospitals with less than 25 beds—and sole community hospitals—larger hospitals that also serve geographically isolated areas.

About 24% of hospitals receive special designations based on the populations they serve, including

children's, psychiatric, and long-term care hospitals.

Some existing methods identify hospitals that serve a high share of low-income patients. About 45% of hospitals currently receive Medicare disproportionate share hospital (DSH) payments. These payments are based on a federal formula that considers the share of Medicaid and low-income Medicare patients that a hospital serves (referred to as the DSH patient percentage). Additionally, about 41% of hospitals receive Medicaid DSH payments, which are determined by state-

FIGURE 1. ESSENTIAL HEALTH SYSTEMS BEAR A DISPROPORTIONATE SHARE OF CHARITY CARE IN THE UNITED STATES



Sources: Centers for Medicare & Medicaid Services. *Healthcare Cost Report Information System, Hospital 2552-10 Cost Report Data Files FY2023*. 2026.

Centers for Medicare & Medicaid Services. *FY 2023 Impact File (final rule) (CMS-1833-F)*. Aug. 4, 2025. <https://www.cms.gov/medicare/payment/prospective-payment-systems/acute-inpatient-pps/fy-2026-pps-final-rule-home-page>. Accessed May 27, 2026.

specific criteria. However, in 2000, the Institute of Medicine (IOM) recommended that policymakers develop a more targeted definition of “core safety net providers” that serve the highest share of Medicaid, Medicare, and uninsured patients.²

The need for a new designation became more apparent during the COVID 19 pandemic, when policymakers struggled to target provider relief funding to the hospitals that needed it most.³ In response, America’s Essential Hospitals convened experts to develop policy principles for a new essential health system designation.

POLICY CONSIDERATIONS

Building on prior recommendations from the IOM and feedback from essential hospital leaders, America’s Essential Hospitals recommends that an essential health system designation consider the following four factors:

- Payer mix that includes all low-income patients
- State variation in health coverage
- Availability and reliability of data metrics
- Mandate or mission to provide access to low-income patients⁴

PAYER MIX

The IOM recommended defining safety net providers based on the share of care they provide to all low-income patients, including Medicaid, Medicare, and uninsured patients. This metric is more reliable than using hospital margins and is a better measure of uncompensated care costs

than measures limited to a single payer, such as Medicare.

During the COVID-19 pandemic, provider relief funds for safety net providers were initially distributed based on hospital margins. However, this formula ended up excluding many essential hospitals that received local government support to offset uncompensated care costs. Although hospitals serving a high share of low-income patients often have lower operating margins because of the uncompensated care they provide, using margins to identify essential hospitals would ultimately limit policymakers’ ability to address these financial challenges. The essential health system designation introduced in H.R. 7145 would have been a valuable tool for Congress in that moment.

In 2022, the Medicare Payment Advisory Committee (MedPAC) developed a framework for identifying safety net providers that recognized the need to consider payer mix for all low-income patients. However, in 2023, MedPAC recommended a Medicare safety-net index (MSNI) measure that excluded Medicaid patients. Because MSNI relies on Medicare-only metrics, hospitals in the top quartile of the MSNI provide half as much uncompensated care as essential health systems that meet the criteria of H.R. 7145, which considers Medicaid, Medicare, and uninsured patients.⁴

STATE VARIATION

Using Medicaid payer mix in a safety net designation is challenging, in part, because state coverage decisions affect enrollment levels. States that

expanded Medicaid have higher Medicaid utilization and lower costs for uninsured patients, while states that did not expand have lower utilization and higher costs for uninsured patients.

The essential health system designation in H.R. 7145 accounts for this fluctuation by including measures of Medicaid and uninsured patients relative to other hospitals in the state. This approach mirrors the method used in the Medicaid statute to identify deemed DSH hospitals, which are hospitals that are required to receive Medicaid DSH payments.⁶

AVAILABILITY OF METRICS

Using existing measures to identify essential health systems is more feasible and less burdensome than collecting, reporting, and auditing new metrics. H.R. 7145 uses two measures already collected and reported through the annual update to the Medicare inpatient prospective payment system: (1) the disproportionate patient percentage, which captures a hospital’s share of Medicaid and low-income Medicare patients, and (2) the uncompensated care payment factor, a measure of uncompensated care provided for uninsured individuals.

MANDATE OR MISSION

In addition to payer mix, the IOM recommended that policymakers consider a hospital’s mandate or mission to care for a high share of low-income patients. Essential hospitals advance their mission by filling gaps in care in their communities. For example, they often are the only hospitals in their community that provide intensive inpatient care, such as trauma and

burn care, emergency psychiatric services, and neonatal intensive care units. They also have invested in expansive ambulatory care networks and other services designed to keep patients out of the hospital setting. However, because essential hospital services vary based on community needs, it is difficult to identify a one-size-fits-all definition of services they offer.

USING A DESIGNATION TO SUPPORT ESSENTIAL HEALTH SYSTEMS

Lawmakers can use an essential hospital designation to target public policy initiatives and resources in several ways, such as appropriating new funding streams to support the safety net and directing existing funding to hospitals that need it most. A designation would be particularly useful in emergencies to quickly allocate resources to hospitals serving the nation's most vulnerable populations.

H.R. 7145 also creates an essential health system index that could be used as an additional tool to calibrate payment levels and target a wider or narrower set of hospitals based on policy priorities and available funding. The index would rank hospitals based on the same evidence-based measures used to establish an essential health system designation. The legislation directs the Medicaid and CHIP Payment and Access Commission to report index data annually and to examine how states and federal policymakers can use data to design Medicaid payment policies that target support for essential community services.

Now, more than ever—given recent changes to Medicaid under the Working Families Tax Cut legislation, widening affordability gaps, and growing health care consolidation—Congress must recognize that not all hospitals are the same. Protecting essential hospitals should be a priority, and the designation established by H.R. 7145 would provide Congress a needed tool for creative and targeted policymaking. This could include direct funding, appropriate incentive payments, grants, enhanced reimbursement, graduate medical education slots, expanded services, and a wide array of protections for these unique hospitals. Congress must support policies that ensure essential hospitals can continue to serve as the backbone of their communities' health care infrastructure.

Endnotes

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- Siegel B. Letter to Chiquita Brooks-LaSure on Sept. 9, 2024. <https://essentialhospitals.org/wp-content/uploads/2024/09/AEHFY2025-OPPS-Comments-20240906.pdf>. Accessed May 4, 2026.
- One criterion used to identify deemed DSH hospitals is a Medicaid inpatient utilization rate that is one standard deviation above the mean in the state. Because data on which hospitals qualify for deemed DSH status is not publicly available, H.R. 7145 identifies hospitals in the top 16th percentile on measures of Medicaid and uninsured utilization, which is equivalent to one standard deviation above the mean in a normal distribution. This measure accounts for state variation in the number of Medicaid and uninsured individuals.