

# Medicare Auction Reform

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Before the Subcommittee on Healthcare and Technology  
United States House Committee on Small Business  
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Today I speak on a matter of great significance to our future: Medicare auction reform. Without the effective use of market methods to control costs, Medicare is unsustainable. This is why it is essential for Congress to step in and insist that CMS replace its fatally-flawed auction program with an efficient auction.

My testimony is that of an independent auction expert. I have spent in excess of 1,000 hours studying the CMS program. My work has involved five main steps:

- 1 Identify the problems in the CMS design.
- 2 Develop an efficient Medicare auction based on best-practice and science.
- 3 Educate the stakeholders about the problems with the CMS design.
- 4 Educate the stakeholders about how the problems with the CMS design can be addressed, and
- 5 Convince stakeholders that a reformed Medicare auction does indeed work.

Let me start with a point of consensus: Small businesses are the engines of innovation that allow the US economy to grow and prosper. We only need to think

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<sup>1</sup> My specialty is the design of complex auction markets. Since 1993, I have contributed extensively to the development of innovative auctions in many countries and industries. I have advised nineteen governments on major auctions, including the United States. I am currently advising the governments of the United Kingdom, Canada, and Australia on the design and implementation of major auctions in telecommunications, electricity, and timber. I frequently advise bidders in major auctions around the world. I have written over fifty practical papers on auctions and market design published in peer-reviewed journals. This research is available at [www.cramton.umd.edu](http://www.cramton.umd.edu) and citations of my work are available [here](#). I thank the Honorable Nancy Johnson, the twenty-four-year Congresswoman from the great state of Connecticut. She first introduced me to the Medicare auction problem and has been unfailing in her wisdom and encouragement throughout this difficult ordeal.

of Apple, Google, and Microsoft. These former-small businesses are the true job creators.

Indeed consensus will be a theme of my remarks. There is no disagreement among experts about what I will say and the issue is non-partisan.

The fatal flaws in the CMS auction design were first identified by auction experts in September 2010. 167 distinguished experts sent a letter to Congressional committees pointing out the flaws. Congress responded with numerous letters to CMS and HHS demanding action, but CMS failed to act. As a result of this inaction in June 2011, an expanded group of 244 experts including four Nobel laureates wrote to the White House again urging auction. I summarize from that letter:

The flaws in the auctions administered by CMS are numerous. The use of non-binding bids together with setting the price equal to the median of the winning bids provides a strong incentive for low-ball bids. This leads to complete market failure in theory and partial market failure in the lab. Another problem is the lack of transparency. Bidder quantities are chosen arbitrarily by CMS, enabling a wide range of prices to emerge that have no relation to competitive market prices.

The CMS competitive bidding program violates basic principles of regulation, especially the principles of transparency and of basing regulations on the best available science. Indeed, the current program is the antithesis of science and contradicts all that is known about proper market design.

Since the writing of our letter in September, several of us have done further detailed scientific study to explore the properties of the CMS design and contrast it to modern efficient auctions. The findings are dramatic and illustrate the power of science to inform auction design. Specifically, auction theory was used to demonstrate the poor incentive properties of the CMS design and how these lead to poor outcomes. Laboratory experiments were conducted at Caltech and the University of Maryland that demonstrate that these poor theoretical properties are observed in the lab....Finally, some of us have studied extensively the Medicare setting, speaking with hundreds of DME providers and beneficiaries, and have developed a modern auction design for the setting that is consistent with the best practice and market design methodologies.

This design step was far from a theoretical exercise. In April 2011, a Medicare auction conference was conducted at the University of Maryland to show how the modern auction methods work and to conduct a nearly full-scale demonstration of an efficient auction. Over 100 leaders in government and the DME industry attended the event. The mock auction achieved an auction efficiency of 97%. In sharp contrast, the CMS auction exhibited efficiencies well below 50% in the laboratory.

The complete lack of transparency is inappropriate for a government auction. We now know that CMS has almost complete discretion with respect to setting prices in a nontransparent way. It is now clear that the CMS design is not an auction at all but an arbitrary pricing process.

Sincerely, [244 auction experts]

In contrast, the proposed Market Pricing Program is a reformed Medicare auction based on best-practice and science. MPP addresses each of the flaws identified in the CMS design.

Non-binding bids and the median pricing rule are easily fixed. MPP make bids binding commitments. The median pricing rule is replaced with the clearing price—the price at which supply and demand balance.

MPP uses a simple and effective auction mechanism, the simultaneous descending clock auction. The auction format has been used for over ten years in many industries with great success.

Through theory, experiment, and practice, MPP has been shown to achieve least-cost sustainable prices.

One point on CMS assertion that the CMS auction saves money: I am reminded of the saying that my Dad taught me: “Figures don’t lie, but liars do figure.” The CMS cost savings of \$42.8 billion is a gross overestimate. The number has no basis in fact. It simply scales up an erroneous \$202 million number to the entire country for each of the next ten year.

CMS’ flawed program obliterates thousands of efficient small businesses. About 4,000 small businesses are wiped out under competitive bidding, over 90%.

The current CMS competitive bidding program is not only bad for small businesses; it is bad for big businesses—all efficient (low cost) providers are harmed by the status quo.

The great injustice is that these businesses are being wiped out not because they cannot compete, but because the CMS auction is so flawed.

It breaks my heart to learn of the demise of one business after another as a result of unsustainable prices. Just a few days ago, I received an email from Esta Willman saying that she is shutting down her small business. For twenty-five years her small business has provided life-supporting oxygen and other supplies to beneficiaries in rural California. The only thing she can cherish now is the love of the many beneficiaries who received quality services from her company for so many years.

Is it wise for Congress to include a specific design in the reform legislation?

Generally, I am opposed to including such specifics; however, CMS has demonstrated such specifics are needed.

Complex auctions can and have been implemented by government agencies. The agencies simply have to follow best-practice and science. Two leading examples are the FCC and FERC.

Only Congress can insist on Medicare auction reform. By passing the Market Pricing Program, Congress can ensure an efficient, transparent, and fair market for durable medical equipment. The market—rather than illustrate government failure—can become a brilliant example of the government using market methods for the benefit of society.