

STATE OF NORTH CAROLINA
DEPARTMENT OF HEALTH AND HUMAN SERVICES

JOSH STEIN
GOVERNOR

DEV DUTTA SANGVAI
SECRETARY

April 2, 2026

SENT VIA ELECTRONIC MAIL

Mr. Brian Matteson, Director
Fiscal Research Division
Suite 619, Legislative Office Building
Raleigh, NC 27603-5925

Dear Director Matteson:

Session Law 2021-61, Section 5 requires the Department of Health and Human Services, in response to changes in the Medicaid reimbursement environment that may occur as a result of the transition to managed care, to report to the Joint Legislative Oversight Committee on Medicaid and the Fiscal Research Division with a proposal to replace or adjust the market basket percentage as the inflation factor that is used in the modernized hospital assessments in Part 2 of Article 7B of Chapter 108A of the General Statutes, as well as in the hospital base rates for Medicaid fee-for-service reimbursements, beginning July 1, 2026. Pursuant to the provisions of law, the Department is pleased to submit the attached report.

Should you have any questions regarding this report, please contact Karen Wade, Director of Policy, at Karen.Wade@dhhs.nc.gov.

Sincerely,

DocuSigned by:
Melanie Bush on behalf of Devdutta Sangvai
B8DC650BFB454DA...
Devdutta Sangvai
Secretary



STATE OF NORTH CAROLINA
DEPARTMENT OF HEALTH AND HUMAN SERVICES

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SENT VIA ELECTRONIC MAIL

The Honorable Benton Sawrey, Chair
Joint Legislative Oversight
Committee on Medicaid
North Carolina General Assembly
Room 521, Legislative Office Building
Raleigh, NC 27603

The Honorable Donny Lambeth, Chair
Joint Legislative Oversight
Committee on Medicaid
North Carolina General Assembly
Room 303, Legislative Office Building
Raleigh, NC 27603

The Honorable Larry Potts, Chair
Joint Legislative Oversight
Committee on Medicaid
North Carolina General Assembly
Room 307B1, Legislative Office Building
Raleigh, NC 27603

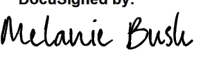
The Honorable Donna White, Chair
Joint Legislative Oversight
Committee on Medicaid
North Carolina General Assembly
Room 307B, Legislative Office Building
Raleigh, NC 27603

Dear Chairmen:

Session Law 2021-61, Section 5 requires the Department of Health and Human Services, in response to changes in the Medicaid reimbursement environment that may occur as a result of the transition to managed care, to report to the Joint Legislative Oversight Committee on Medicaid and the Fiscal Research Division with a proposal to replace or adjust the market basket percentage as the inflation factor that is used in the modernized hospital assessments in Part 2 of Article 7B of Chapter 108A of the General Statutes, as well as in the hospital base rates for Medicaid fee-for-service reimbursements, beginning July 1, 2026. Pursuant to the provisions of law, the Department is pleased to submit the attached report.

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B8DC650BFB454DA... on behalf of Devdutta Sangvai
Devdutta Sangvai
Secretary

Inflation Factor for Modernized Hospital Assessment and Medicaid Fee for Service Base Rates

Session Law 2021-61, Section 5



Report to

**Joint Legislative Oversight Committee on Medicaid
and**

**Fiscal Research Division
by**

North Carolina Department of Health and Human Services

April 2, 2026

Background

Session Law 2021-61, Section 5 requires the Department of Health and Human Services to submit a report to the Joint Legislative Oversight Committee on Medicaid and the Fiscal Research Division with a proposal to replace or adjust the market basket percentage as the inflation factor that is used in the modernized hospital assessments in Part 2 of Article 7B of Chapter 108A of the General Statutes, as well as in the hospital base rates for Medicaid fee-for-service reimbursements, beginning July 1, 2026. The Division of Health Benefits (DHB) specifically uses the hospital inpatient prospective payment system (IPPS) market basket minus the multifactor productivity adjustment established in rule by the Centers for Medicare and Medicaid Services (CMS) as the inflation factor for these purposes today (G.S. 108A-145.3(11)).

What the IPPS Market Basket Reflects

The IPPS market basket is designed to measure how the cost of operating a hospital changes over time ([CMS, 2023](#)). Rather than tracking overall inflation in the economy, the market basket focuses specifically on the prices hospitals pay for the goods and services required to deliver inpatient care, such as labor, medical supplies, utilities, and contracted services.

In practice, the market basket serves as an estimate of hospital input price inflation and represents how much more expensive it becomes each year for hospitals to purchase the resources needed to treat patients. CMS uses this measure to update Medicare inpatient payment rates so that payments reflect changes in hospitals' underlying cost structure.

At a high level, the market basket reflects three core concepts:

- **How hospitals spend their money.** The market basket reflects hospital spending patterns to determine the relative importance of major cost categories, such as wages and benefits, supplies, and overhead.
- **How prices for those inputs change over time.** For each major spending category, the market basket tracks an external price or wage index that reflects changes in the cost of that input.
- **How those cost changes combine into overall hospital inflation.** The individual cost changes are weighted and combined to produce a single index showing how hospital input prices have grown from one period to the next.

Together, these elements allow the market basket to capture hospital-specific inflation, which can differ meaningfully from broader measures such as the Consumer Price Index or general medical inflation.

Assessment of Inflation Factors:

Pursuant to Session Law 2021-61, Section 5, the Department assessed whether the inflation factor currently used in modernized hospital assessments and Medicaid fee-for-service hospital base rates should be replaced or adjusted beginning July 1, 2026. To inform this assessment, the Department compared the IPPS market basket (less the productivity adjustment) to several alternative inflation measures that are commonly referenced in health care payment policy, including the Medicare Economic Index (MEI), the Consumer Price Index for All Urban Consumers (CPI-U) for the South Region, and CPI-U Medical Care. The analysis examined annual inflation rates from 2020 through 2025 and calculated multi-year averages for each inflation factor.

Summary of Findings

Overall, the IPPS market basket (less productivity) has tracked closely with other medically focused inflation measures over time and generally falls in the middle of the range when compared to alternatives:

- Since 2020, the IPPS market basket has been slightly lower than the Medicare Economic Index on average, reflecting differences in the underlying cost structures captured by each index.
- Over the same period, the market basket has been higher on average than CPI-U Medical Care. CPI-U has also exhibited greater year-to-year volatility.
- In years heavily affected by the COVID-19 pandemic, the IPPS market basket was significantly lower than CPI-U for All Urban Consumers (South Region), which experienced sharp inflationary spikes driven by broader economic conditions.
- Outside of the COVID-19 period, the market basket has generally been higher than CPI-U (South Region), suggesting that hospital input costs have grown faster than general consumer prices in more typical economic conditions.

As shown in the table 1, average inflation rates across the 2020–2025 period ranged from approximately 2.5 percent to 4.0 percent across the indices reviewed. The IPPS market basket less productivity averaged 2.8 percent, placing it between broader consumer inflation measures and other health-specific indices.

Table 1: Comparison of Select Inflation Factors, 2020-2025

Inflation Factor	Time Period	2020	2021	2022	2023	2024	2025	Average
Current State								
<u>Medicare IPPS Market Basket Index, Less Productivity Adjustment</u>	FFY	2.6%	2.4%	2.0%	3.8%	3.1%	2.9%	2.8%
Potential Alternatives								
<u>Medicare Economic Index</u>	CY	1.9%	1.4%	2.1%	3.8%	4.6%	3.5%	2.9%
<u>CPI-U for All Urban Consumers, South Region</u>	FFY	1.3%	5.6%	8.4%	4.1%	2.1%	2.7%	4.0%
<u>CPI-U Medical Care (Seasonally Adjusted)</u>	FFY	4.1%	0.4%	5.9%	-1.7%	3.2%	3.3%	2.5%

Recommendation

Based on this comparative analysis, the IPPS market basket (less the productivity adjustment) appears to be a reasonable inflation factor for both the Modernized Hospital Assessment and Medicaid fee-for-service hospital base rates. It reflects hospital-specific input cost growth and avoids the greater volatility observed in broader consumer price indices.

Accordingly, the market basket percentage currently used by DHB most effectively provides stability to hospitals and remains aligned with other medically focused inflation measures considered in this review. Given these findings, the Department recommends that the General Assembly not make changes to statute requiring the use of a different inflation factor for the Modernized Hospital Assessment and Medicaid fee-for-service hospital base rates. The Department consulted with the North Carolina Healthcare Association (NCHA), and they agree with this recommendation.

Appendix A:

Session Law 2021-61, Section 5

SECTION 5. In response to changes in the Medicaid reimbursement environment that may occur as a result of the transition to managed care, the Department of Health and Human Services shall report to the Joint Legislative Oversight Committee on Medicaid and NC Health Choice and the Fiscal Research Division by January 1, 2026, with a proposal to replace or adjust the market basket percentage as the inflation factor that is used in the modernized hospital assessments in Part 2 of Article 7B of Chapter 108A of the General Statutes, as well as in the hospital base rates for Medicaid fee-for-service reimbursements, beginning July 1, 2026.