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Default or Deliverance?
Healthcare Industry Could Lose as Congress Averts Debt Crisis

Healthcare industry clients should be prepared for possible cuts to the Medicaid program, Medicare provider and supplier reimbursement rates, Medicare Advantage, and Medicare Part D, and for increased fees for manufacturers.

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Negotiations and partisan posturing over a deficit reduction package continue this week in Washington, D.C. President Obama, Senate Majority Leader Harry Reid (D-NV), and House Speaker John Boehner (R-OH) are expected to set the tone for a new round of negotiations alongside Senate Minority Leader Mitch McConnell (R-KY) and House Minority Leader Nancy Pelosi (D-CA). Vice President Joe Biden's efforts to forge a bipartisan compromise ended abruptly Thursday when House Majority Leader Eric Cantor (R-VA) and Senate Minority Whip Jon Kyl (R-AZ) left the talks. Biden had been meeting for several weeks with six congressional leaders (Cantor, Kyl, House Minority Whip James Clyburn (D-SC), House Budget Committee Ranking Member Chris Van Hollen (D-MD), Senate Finance Committee Chairman Max Baucus (D-MT), and Senate Appropriations Committee Chairman Daniel Inouye (D-HI)) in closed-door talks to reduce the budget deficit by several trillion dollars. Deficit reduction is seen by both parties as a trade-off to enable congressional passage of an increase in the nation's $14.3 trillion debt ceiling. Treasury Secretary Timothy Geithner has stated that failure to raise the debt ceiling by August 2 could have catastrophic consequences for the nation's economy.

Republican Position

Driven by demands from conservatives to reduce government spending, the Republican House Budget Resolution for FY 2012 (H.Con. Res. 34, or the Resolution) includes $4.4 trillion in deficit reduction over 10 years. Healthcare cuts make up a large portion of the proposal, which passed the House on April 15. Although this Resolution has failed to pass in the Democratic-majority Senate, it clearly lays out the Republican vision for reducing deficits. The Resolution includes significant changes to healthcare entitlement programs. It would transform Medicaid into a state block-grant program, phased in over 10 years, an estimated savings to the federal government of $771 billion according to the Congressional Budget Office (CBO). The Resolution would also roll back the Affordable Care Act's Medicaid expansion, producing $650 billion in savings. The Resolution reduces Medicare spending by $30 billion and includes a controversial proposal by House Budget Committee Chairman Paul Ryan (R-WI) to replace Medicare's fee-for-service insurance with government-subsidized private insurance. The privatization would not apply to beneficiaries over the age of 55, and thus would not produce savings in the 10-year budget window. However, the CBO projects that under the Resolution, long-term federal healthcare spending would fall from approximately 12% to 5% of gross domestic product (GDP) by 2050, largely due to savings from privatizing Medicare. Critics argue that these savings would come at the expense of significantly increased cost-sharing for Medicare beneficiaries.

Republicans insist that any debt ceiling increase must be offset dollar for dollar by deficit reduction. This means that in order to extend the debt ceiling through the end of 2012, negotiators would need to find approximately $2.4 trillion in spending cuts or revenue increases. Republicans have strongly opposed any revenue increases, insisting that reductions should come exclusively from spending cuts, while Democrats are pushing to include some revenue-raising measures. The major focus of the revenue debate has been on closing corporate tax loopholes and capping tax deductions for the wealthy. Republicans leaders insist that the debt ceiling talks are not the proper forum to discuss tax reform, and conservatives are demanding that any tax loophole closures be used to lower taxes in other areas. This position is embodied in a pledge not to raise taxes, championed by Grover Norquist of the advocacy group Americans for Tax Reform and signed by most Republican candidates for political office.

Over the last few weeks, the Republican tax position appears to have softened slightly in the Senate as Senator Tom Coburn (R-OK) made news by securing 34 Republican votes for his amendment to end $6 billion in subsidies for ethanol. Although initially blocked by Democrats, a second vote adopted the amendment by a vote of 73 to 27. This vote signaled that a significant number of Senate Republicans were willing in principle to break with Norquist's interpretation of their no-tax pledge. Further, on Sunday, Senator Kyl stated that Republicans are discussing some fee increases and "some other things that would actually generate revenue." House Majority Leader Cantor's dramatic exit from talks with the Biden group—spurred by Democrats' continued insistence on unspecified revenue measures—may indicate an ideological divide amongst Republicans. The tone of negotiations may change as President Obama and congressional leaders take over the talks, but it remains to be seen whether the group can agree on terms that will satisfy various factions within the parties.

Democratic Position

In mid-April, President Obama released a deficit reduction plan, separate from his FY 2012 budget, which also calls for $4 trillion in reduced deficits. However, the President's plan includes $1 trillion in increased revenue, and many of the budget savings are achieved through the use of budget "triggers" that would automatically enact spending cuts and/or revenue increases if deficits exceed certain thresholds. Since the beginning of the Biden negotiations in early May, Democrats have not publicly ceded to Republican demands to offset any debt ceiling increase with dollar-for-dollar deficit reduction.

Democrats have vocally opposed the Republican plan to privatize Medicare. In the wake of polls showing negative public reaction to the plan, Democrats are positioning themselves as the defenders of the traditional Medicare program. Democratic leaders have pledged that they will not reduce Medicare benefits or significantly reform program structure. Instead, President Obama has proposed to expand the scope and authority of the Independent Payment Advisory Board (IPAB) although expanding the unpopular board is not likely to receive wide support from either Republicans or Democrats in Congress. Meanwhile, congressional Democrats have put forward a bill to apply Medicaid prescription drug rebates to dual-eligible beneficiaries, which according to the CBO would raise a projected $112 billion. Some in Congress have also called for negotiated drug prices under Medicare Part D.

These proposals have long been opposed by Senate Republicans and will not likely gain support as part of the deficit negotiations. Even if enacted, the changes would fall short of reducing spending by the trillions of dollars needed to produce a bipartisan deal. Without Medicare benefit reductions or major structural changes to entitlement programs, there is a strong possibility that negotiators could focus on cuts to Medicare provider and supplier reimbursements and reduced payment rates for Medicare Advantage and Medicare Part D. A major round of Medicare cuts were part of the Balanced Budget Act of 1997—the last big initiative to reduce the deficit.

A lack of public attention to the Medicaid program has some advocates worrying that large cuts will be made to the healthcare program for low-income Americans. Senator Jay Rockefeller (D-WV) is leading a group of Senate Democrats in attempting to raise public awareness of potential cuts and defend the program. There is some speculation that, at a minimum, an agreement could include a relaxing of Medicaid Maintenance of Effort (MOE) requirements, first put into place by the 2009 stimulus and expanded as part of the Affordable Care Act. Modifying MOE requirements would allow states to reduce their Medicaid expenditures by tightening eligibility requirements and would lower federal expenditures by $2.1 billion according to the CBO. Any reductions in Medicaid spending will likely face opposition from congressional liberals as well as consumer groups.

Where Will They Agree?

Whether or not Congress and the Administration can reach consensus on a long-term deficit reduction package, spending cuts are inevitable. Democrats have agreed to deficit reduction in principle, and Republicans will demand spending cuts to offset any debt ceiling increase. Therefore, it is likely that federal healthcare spending, the largest portion of our federal budget, will face significant reductions. In comments last week, Senator Baucus hinted that Medicare provider cuts would be included in a final deal, "I think we should keep working, difficult as it is, and try to balance between Medicare cuts—additional Medicare cuts—so long as there is commensurate additional revenue." Cuts to reimbursements have always been the simplest way to reduce Medicare spending, and, as the debt ceiling problem approaches a crisis situation, provider, supplier, and insurer payment cuts become more likely. Medical device and pharmaceutical manufacturers may also face significant cuts and/or increased fees, as some perceive that fees imposed by the Affordable Care Act were small compared to profits generated.

As part of the deficit talks, congressional leaders are also discussing the possibility of spending caps that trigger automatic spending cuts and/or revenue increases. There has been some acknowledgment of agreement on spending caps in principle. However, Democrats and Republicans differ on their preferred structure for such caps. Democrats would cap deficits and enforce the caps with automatic spending reductions and revenue increases. Republicans prefer restraining government spending to a set percentage of GDP and triggering spending cuts if the government grows beyond this limit. These caps could allow negotiators to postpone at least some tough decisions until a later date, although some members have expressed skepticism that Congress would eventually allow the automatic deficit reductions to take place.

Endgame

Senate Minority Leader McConnell and other Senate Republicans recently stated that if high-level talks could not reach consensus on a broader package, Congress would resort to a series of small debt limit increases with accompanying deficit reduction measures. House Majority Leader Cantor has not favored a short-term approach. Conservative House members continue to insist on major entitlement reforms as a prerequisite to increasing the debt ceiling, while Senate Democrats have vowed to protect these programs.

The final outcome of the deficit talks remains to be seen, but the potential consequences of inaction for the U.S. economy (namely an increased government borrowing rate and a potential bond market collapse) could be catastrophic. With so much at stake, Congress must eventually take action. However, as the 2011 Continuing Resolution debate demonstrated, today's hyperpartisan environment encourages and rewards brinkmanship, while early concessions are perceived as weakness. It remains an open question whether Congress can reach agreement before fears of default prompt a negative market reaction. If Congress must act quickly in the face of a crisis, large cuts to Medicare providers become more likely.

Our Commitment

Healthcare companies should remain vigilant to the real possibility of large spending cuts to federal healthcare programs. Provider and supplier reimbursement rates are particularly vulnerable to reductions due to both sides' inability to agree on major structural changes to entitlement programs. Morgan Lewis will continue to monitor the deficit and debt ceiling negotiations. We are dedicated to both helping clients cope with the shifting environment and advocating for our clients' needs with federal agencies and Congress.

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