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Sequestration and Medicare: The Two Percent Solution?

By Ian Spatz and Wendy Krasner

Congress passed and President Obama signed into law on Aug. 2 the Budget Control Act of 2011 (BCA) to increase the federal debt limit and avoid a projected default on U.S. government obligations.

The BCA made reductions in future federal spending. It also created a process through which the Office of Management and Budget (OMB) will make automatic reductions in federal spending, known as a sequestration.

The BCA triggers these reductions if Congress does not pass and the President does not sign (or his veto is not overridden) legislation that reduces future estimates of the federal deficits by amounts specified in the legislation.

The reductions in federal spending that will occur if there is a sequestration will impact Medicare spending. This article describes that impact.

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BCA and Super Committee Process

The BCA creates a process for Congress to develop, consider, and act on budget reduction legislation on an expedited basis in 2011. The law creates a special, bicameral committee, known as the Super Committee, to develop the legislation. The 12-member committee is made up equally of Republicans and Democrats as well as representatives and senators.

Pursuant to the BCA, the Super Committee is charged with submitting its proposal to reduce the federal deficit by $1.5 trillion over a 10-year period by Nov. 23. The House and Senate must vote on this proposal by Dec. 23.

Because the Super Committee cannot make a recommendation without gaining seven votes, reaching an

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agreement will require the group to develop a combination of spending cuts and/or revenue increases that attracts at least one vote from a member of the other party.

Given the politics of deficit control, many believe that the Super Committee with either fail to get seven votes for any proposal or, if it does, that the plan would lack sufficient support to pass both the House and Senate. Even if it does get enacted, it might not survive a presidential veto or have sufficient votes to override a veto.

It is also possible that the Super Committee, even if it is successful and its recommendations are enacted into law, may come up with less than the required $1.2 trillion in deficit reduction over 10 years to avoid sequestration. Although BCA calls for Congress and the administration to find $1.5 trillion in spending reductions over 10 years, sequestration is required if they do not find at least $1.2 trillion. The sequestration would be set at $1.2 trillion minus the amount that becomes law through the action of Congress.

Therefore, there is good reason to look at the consequences of inaction—the mandatory sequestration of funds.

Sequestration

The BCA specifies the rules governing the calculation and imposition of a sequestration. The law provides a formula for allocating cuts across two main categories of spending—defense and non-defense—over the nine year sequestration period 2013-2021.

Within the non-defense category, the BCA exempts certain programs from cuts including Medicaid. It also provides that Medicare may be reduced by no more than two percent.

Although the trigger for sequestration is a failure of Congress to pass a bill by Dec. 23, 2011, and the President to sign (or have his veto overridden), the sequestration does not begin until Jan. 2, 2013.

The BCA provides instructions for the Medicare portion of the sequestration by referencing section 6 of the Statutory Pay-As-You-Go Act of 2010. That section in turn references the procedures of section 256(d) of the Balanced Budget and Emergency Deficit Control Act (BBEDCA) of 1985, as amended.

That section provides that the percentage reduction in Medicare is allocated as follows:

- ''in the case of parts A and B of such title, to individual payments for services furnished'';
- ''in the case of parts C and D, to monthly payments under contracts under such parts.''

The BBEDCA, as amended, provides further instructions on sequestration for Medicare. Specifically, the sequestration does not impact the computation of either the Part C or Part D growth percentages.

These are the percentages by which payments to Medicare Advantage Organizations (for Part C) or Prescription Drug Plan Sponsors (for Part D) (hereafter, together referred to as '' Plan Sponsors'') increase annually based on, in the case of Part C, the growth in per capita Parts A and B spending, and, in the case of Part D, the annual percentage increase in average per capita aggregate expenditures for covered Part D drugs for Part D eligible individuals. It also does not impact the calculation of risk corridors under Part D payment rates.

In addition, the BBEDCA, as amended, exempts three types of payments from any sequestration. (1) Part D low-income subsidies (LIS) including both premium and cost-sharing subsidies; (2) the catastrophic subsidies within Part D, and (3) payments to states for coverage of Medicare cost-sharing for certain low-income Medicare beneficiaries, known as QI premiums.

Impact of Medicare Sequestration

For Parts A and B, the impact of sequestration appears relatively straightforward. Section 256(d)(2) of the BBEDCA, as amended, provides that all sequestration reductions in payments for Medicare ''programs and activities'' will be ''at a uniform rate.'' This appears to preclude OMB or HHS from allocating Medicare cuts unequally among different providers or services.

While this section of the law uses the term ''programs and activities,'' the instructions for reductions in Parts A and B in section 256(d) use the term ''services furnished.''

This is also in contrast to the term ''items and services'' that is often found in Medicare law and raises the question of whether payments for items under Part B may not be included in a sequestration. While this interpretation is plausible, it is also possible that OMB, in computing a sequestration, would interpret ''services furnished'' in a broad way to encompass all payments provided for under Part B.

For Medicare Parts C and D, the impact of sequestration is more difficult to analyze given the exceptions and limits provided in law. These difficulties come primarily from the fact that both programs operate as a premium support so that reductions in payments to Plans Sponsors do not automatically translate into reduced payments to providers. Instead, reduced payments are most likely to lead to premium increases for certain beneficiaries.

For Part C Plan Sponsors, a sequestration would reduce payments by two percent (assuming that the maximum sequestration takes place). This two percent would come after the application of all other current formulas including the annual growth rate based on increases in Part A and B spending.

As with current law, Part C Plan Sponsors could choose to increase premiums to make up for this reduction. They could also reduce benefits (but not below required levels) and seek to reduce costs through reductions in payment amounts to providers of items and services.

For Part D Plan Sponsors, the sequestration reduction could lead them to shift the cost to beneficiaries in the form of higher premiums if they wish to maintain current levels of services (e.g., cost sharing, formularies, pharmacy access). They could also seek to reduce costs by seeking concessions from manufacturers and pharmacies.

Under Part D, the sequestration's impact is more muted because it does not impact catastrophic payments to plans and risk sharing payments. Each are integral to calculation of Part D premiums. In addition, the sequestration has no impact on the brand manufacturers' obligation to provide 50 percent discounts for drugs used in the Part D donut hole.

For LIS beneficiaries, the sequestration is more complex. Since the sequestration protects low-income subsidies, it is likely that LIS beneficiaries will see little or

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no change and indeed their enrollment may become more valued by Plan Sponsors.

However, it is possible that, if Part D Plan Sponsors overall increase their premiums, some may no longer be available to LIS beneficiaries because their premiums may rise above the thresholds that make them available to LIS beneficiaries.

Of note, the Congressional Budget Office (CBO) released a report on Sept. 12 estimating the impact of sequestration on the Medicare program. According to CBO, Medicare would be cut by a total of $170 billion from 2013 to 2021, including $123 billion from Medicare Parts A and B and Medicare Advantage and Part D, plus $47 billion in cuts to Medicare program activities that are not subject to the 2 percent cap.[1]

Likelihood of Sequestration

As discussed above, sequestration is a very real possibility given the procedures governing the operation of the Super Committee and, more importantly, the politics that make its success most questionable. However, it is important to note that, although the trigger for sequestration will occur in 2011, its implementation would not come until 2013.

Therefore, while sequestration may look inevitable if the Super Committee fails to act by Nov. 23, it is not. Congress and the President may agree on a new law at any time that prevents its implementation, reverses any implemented sequestration, or modifies the rules that govern any sequestration.

By January 2013, we will have completed a Congressional and Presidential election. Depending on the results of that election, in the fall of 2012, we may have a lame duck session of Congress. In that session, Congress and President Obama could amend or eliminate the sequestration.

Further, even though a new Congress will not be sworn in until Jan. 3, 2013, and a new President, if President Obama is not reelected, would not be sworn in until Jan. 20, it would still be possible for the new Congress to send to the President legislation that would eliminate the sequestration and, if desired, reverse its impact during the period between Jan. 2 and whenever new legislation become law.

Therefore, the ultimate impact of sequestration on Medicare may not be clear until, or if, it is eventually implemented.

Regardless of whether sequestration is eventually implemented in 2013, Part C and D Plan Sponsors will need to incorporate the expected impact of sequestration into their bids filed in 2012 for 2013. Therefore, even if the sequestration is ultimately not implemented, its impact on Parts C and D will be very difficult to forestall or unravel.

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[1] Congressional Budget Office. ''Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act.'' September 12, 2011. http://cbo.gov/doc.cfm?index=12414.