July 27, 2017

Opening Pandora's Box

Kenneth Kaufman, Chair
Kaufman, Hall & Associates, LLC

With debate underway in the Senate over repealing and replacing the Affordable Care Act (ACA), U.S. lawmakers are perilously close to opening Pandora's Box. However, that risk goes far beyond changing the ACA.

Having a Republican President and Republican majorities in both houses of Congress created an opportunity for the party to make good on seven years of promises to repeal the ACA. However, when draft legislation emerged, the most potent changes were to the size and nature of Medicaid—a formerly sacrosanct healthcare safety net that has been in place since 1965.

The bills proposed by the House and Senate are starting points for debate. It is unclear whether any bill will have enough votes to pass the Senate and make its way to the president's desk. However, the President and Republican Congressional leaders are eager for a near-term victory and ready for a longer-term process.

The changes proposed in the Senate and House healthcare bills would affect a large and highly vulnerable population: poor children, people with disabilities, elderly people whose resources have been depleted, and adults suffering from short-term or long-term poverty. Yet, the House and Senate bills contain no direction on how to implement the proposed changes in a way that would not hurt the millions of people the program serves or the many others touched by Medicaid. These high-stakes effects would be left to states and providers to remedy and for these populations to absorb.

Our nation's healthcare system is a large and complex web system of interdependencies among individuals, providers, governments, employers, payers, and many other stakeholders. Any change to one part of that system could cause multiple, hard-to-predict effects on any and every other part. The consequences of a fundamental change to Medicaid are extremely hard to calculate.

Medicaid's Scope

Medicaid covers 77 million people, more than any other government health program. Beneficiaries include 34 million children, 27 million adults, 9 million people with disabilities, and 6 million people age 65 and over. To put these numbers in perspective, Medicaid covers approximately:

One-fifth of the nation's population
One-third of the nation's children
One-half of the nation's births
Two-thirds of the nation's nursing home residents

Medicaid touches almost two-thirds of Americans, either through direct coverage or through coverage of a family member or close friend. Within 10 years, the number of Medicaid enrollees could rise to 87 million according to the CBO, or about one-quarter of the projected population.

This huge scope comes with a huge price. In 2016, the federal government paid states $349 billion for Medicaid, which is 9 percent of total federal spending and 16 percent of all personal healthcare spending. For most states, Medicaid is the largest single federal revenue source.

What Might Emerge from Pandora's Box

The House and Senate healthcare bills propose reshaping Medicaid in two basic ways. First, the bills would end the Medicaid expansion that 32 states adopted as a result of the ACA. Second, the bills would alter the basic nature of how the federal government funds Medicaid. Rather than paying based on the cost of services provided, federal Medicaid spending would be capped based on the number of people covered.

Following is a sketch of how those changes could affect citizens, states, and healthcare providers.

Millions of people would lose access to care

Based on a CBO analysis of the July 20 Senate bill, Medicaid would cover 15 million fewer people by 2018, and 22 million fewer people would have health insurance by 2026. The total number of people without health insurance would be 50 million.

Lack of access to health insurance would mean lack of access to timely care by these millions of adults, children, the elderly, and the disabled. The effects could be felt disproportionately

by people with disabilities, as that group accounts for 42 percent of Medicaid spending. This population includes those with physical disabilities such as cerebral palsy and traumatic brain or spinal cord injuries, intellectual or developmental disabilities such as Down syndrome and autism, and mental illness.

States would be forced to make painful cuts

The bills would cause drastic cuts in Medicaid funding. The CBO analysis of the July 20 Senate bill found that by 2026, Medicaid spending would be reduced by $756 billion, or 26 percent. By 2036, federal funding for Medicaid would decline 35 percent, according to a Kaiser Family Foundation analysis.

States would have little chance of significantly reducing Medicaid costs through improvements in operations—certainly not enough to make up for proposed cuts in federal spending. Therefore, states would be left with a number of unpalatable options:

- Raise taxes
- Cut back on other government services
- Reduce non-mandatory Medicaid benefits,
- Limit coverage of high-cost enrollee groups, particularly people with disabilities
- Reduce payments to providers
- Shift financial responsibility to beneficiaries, who already have limited means

Providers would face reduced payment rates, reduced revenue, and increased uncompensated care

Hospitals already operate in the red under Medicaid, getting on average 90 cents for every dollar spent on Medicaid patients. (Hospitals get 88 cents on the dollar for Medicare services.) A potential reduction in Medicaid rates by cash-strapped states would only exacerbate that situation, and would come at a time when both Medicare and commercial payment levels also are under pressure.

A reduction in overall Medicaid services also would reduce hospital Medicaid revenue, with hospitals in Medicaid expansion states seeing an average decline of 14 percent by 2026, according to a Commonwealth Fund analysis of the House healthcare bill. The Senate bill contained an additional hit to the provider bottom line by eliminating so-called "retroactive eligibility" for Medicaid. Current law allows a person who needed hospital care and who was eligible for Medicaid, but could not enroll before services were provide, could enroll and receive benefits retroactively. Eliminating this feature would mean hospitals would receive no payment for these services. For some health systems, this would mean a multi-million dollar annual revenue reduction.

The Commonwealth Fund also found that hospitals in all states would experience a rise in uncompensated care under the House healthcare bill. Medicaid expansion states would be hit particularly hard, with a projected increase of 78 percent in uncompensated care costs over 10 years.

Under the House bill, hospitals in every state would see a decline in operating margin. On average, operating margin in Medicaid expansion states would fall to –5.3 percent by 2026 under the House bill. Rural hospitals in states that did not opt for Medicaid expansion would have margins of –3.3 percent in 2026 under the bill.

The Path Forward

In this political environment, the Boards and C-Suites of America's healthcare organizations face some hard truths and steep challenges.

Pandora's Box may yet be opened

These changes have been advanced unapologetically. Vice President Pence said, "Let me be clear: President Trump and I believe the Senate healthcare bill strengthens and secures Medicaid for the neediest in our society." Many Republicans in Congress have called for an end to the ACA for more than seven years and are unlikely to stop now. Senator John Thune of South Dakota, a supporter of the Senate bill, said, "People are going to hold us accountable…on this issue….It's going to have to be dealt with."

No matter what happens in the Senate, we have reached a point where significant changes to Medicaid and the social safety net are central to the political discussion.

America's healthcare providers will be largely on their own

People without health insurance often will avoid or delay getting care, but at a certain point, they will absolutely need care. Then they will show up at our nation's hospitals, where they will not be turned away.

Without specific policies that would redesign our system to reduce the total cost of care, providers will be largely on their own. They will still need to provide care for this population, but will have to do so on a significantly reduced revenue base, and under different and evolving rules in each state.

Hospitals will never make more Medicaid revenue than they do today, and Medicare may not be far behind

Events of recent weeks show the current and future vulnerability of Medicaid payment rates. Given the role of healthcare spending in the nation's rising debt, Medicare payment is equally at risk.

Although President Trump has said he does not favor Medicare reductions, the most recent House budget proposal calls for $487 billion in Medicare cuts over 10 years.

Providers will need a new level of cost and a new approach to care
Given the likely trajectory of revenue, America's providers will need to achieve a fundamentally lower cost position. Incremental reductions in labor and supply costs will not get providers to where they need to be.

Health systems will need to do a thorough review of their facility and service portfolios, eliminating unnecessary duplication. More important, and more daunting, providers will need to systematically reexamine the very processes of care—processes that have developed over long periods of time and that surely offer opportunities for significant streamlining.

New approaches to care should also incorporate new technology. Eric Topol, a renowned cardiologist and one of the nation's leading thinkers about the future of medical technology, says that new digital tools hold great promise in solving America's healthcare cost problem. "The key tools," Topol writes, "are cheaper sensors, simpler and more routine imaging, and regular use of now-widely available genetic analysis."

This is an incredibly difficult task for any one organization. It requires significant financial, human, and intellectual capital, as well as broad influence. Organizations may need to develop creative partnerships and coalitions for this kind of care redesign, perhaps coalitions centered on highly affected regions such as rural areas, or on vulnerable types of providers such as safety-net hospitals.

Our nation's lawmakers are showing a willingness to advance legislation that contains the possibility of negative consequences for our nation's most vulnerable people and the organizations that serve them. For America's providers, healthcare is not a political issue, but an ethical one: Hospitals will not turn away those in need of care. If Pandora's Box is opened, fulfilling this ethical imperative will require new levels of creativity, rigor, and fortitude.

Your comments are welcome. I can be reached at kkaufman@kaufmanhall.com.

A condensed version of this commentary is available on fortune.com