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Budget Sequestration's Impact on Obamacare Subsidies

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Many Americans could face a rude awakening when they discover that the subsidies they thought they were getting to offset their health care costs are less than what they were promised. Some claim that the Obamacare subsidies are exempt from the spending reductions established by the Budget Control Act (BCA), but that is only half right.[1]

The BCA exempts only the premium subsidies, not the cost-sharing subsidies, from upcoming cuts. Regrettably, the Obama Administration has not taken steps to inform the American people of this fact as they navigate coverage options in the government exchanges.

The Sequester's Impact on Obamacare Subsidies. Obamacare provides two forms of subsidies:

1. **Premium subsidy.** Section 1401 provides that individuals with incomes under 400 percent of the federal poverty level ($94,200 for a family of four) who do not have access to "affordable" employer-based coverage and meet other relevant criteria are eligible to receive refundable tax credits for coverage purchased in the exchanges.
2. **Cost-sharing subsidy.** Section 1402 provides cost-sharing subsidies to reduce maximum out-of-pocket expenses for households with incomes below four times the federal poverty level. Other language in Section 1402 directs cost-sharing subsidies to increase the actuarial value—the average amount of expected health expenses paid by insurance—for households with incomes below 250 percent of the poverty level.

The BCA exempted the premium subsidies from sequestration—not explicitly but by definition. The sequester mechanism in the BCA was largely based on formulae developed by the Gramm–Rudman–Hollings Act of 1985, which exempts refundable tax credits under the Internal Revenue Code from any federal sequestration.[2] Because Obamacare structured the premium subsidies as refundable tax credits, they remain exempt from the BCA sequestration.

However, with regard to sequestration's spending reductions, the cost-sharing subsidies under Section 1402 of Obamacare are distinct from the premium subsidies under Section 1401 of the law in at least two significant ways:

1. The language authorizing Obamacare cost-sharing subsidies is included as part of the Public Health Service Act (Title 42 of the U.S. Code). The sequester exemption for refundable tax credits requires that they be "made pursuant to provisions of Title 26" of the Internal Revenue Code.[3]
2. Obamacare specifically requires the Secretary of Health and Human Services to "make periodic and timely payments to the issuer" of the insurance

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> policy reflecting the increased cost-sharing. The sequester exemption in Gramm–Rudman–Hollings for refundable tax credits provides that only "payments to individuals," not to insurance companies, are exempt from sequester reductions.[4]

For these reasons, the Congressional Research Service (CRS) has concluded that the cost-sharing subsidies under Section 1402 of Obamacare "appear to be fully sequestrable" under the BCA.[5]

Administration Confirms Cuts but Has No Plan. The Administration has likewise agreed that the cost-sharing subsidies are subject to sequestration spending reductions. An Office of Management and Budget (OMB) report issued in May 2013 categorized the cost-sharing subsidies as mandatory spending subject to sequestration.[6]

The report further estimated that a 7.2 percent cut in these subsidies, as required by sequestration, would reduce spending by $286 million in fiscal year 2014—a period that covers the first nine months of Obamacare's coverage expansions, from January through September 2014.[7]

However, the Administration has not been similarly forthcoming about how the 7.2 percent spending reductions will be applied. Centers for Medicare and Medicaid Services (CMS) Administrator Marilyn Tavenner acknowledged that CMS had not communicated to officials who are operating exchanges, both federal and state, how this sequestration will be applied to the cost-sharing subsidies. However, she pledged to do so "before open enrollment, which starts on October 1, 2013."[8] To date, no guidance has been released by either CMS or OMB.

Limited Options. It is impossible to predict how CMS intends to implement the required sequestration reductions. In the absence of clear guidance from the Administration about the impact of sequestration, one can envision two possible scenarios.

Scenario 1: Consumers Pay. Under this scenario, the individuals eligible for cost-sharing subsidies would face higher cost-sharing. Eligible individuals would face some combination of higher co-payments, higher deductibles, higher co-insurance, or the loss of some benefits to make up for the reduced cost-sharing subsidies.

The structure and requirements of sequestration place a high emphasis on regulatory guidance from CMS. The sequestration law requires that spending reductions "shall apply to all programs, projects, and activities within a budget account."[9] But it remains unclear how the Administration will implement this requirement. For instance, CMS could decide to reduce all eligible individuals' cost-sharing subsidies by an equal 7.2 percent. Alternatively, the Administration could try to implement the reductions on a sliding-scale basis so that households with lower incomes face a smaller-scale reduction.

However, because the Administration has not issued any form of guidance, the cost-sharing information currently published on the exchanges does not accurately reflect the impact of sequestration on the cost-sharing subsidies.[10] Thus, for those few individuals who have actually enrolled in subsidized health insurance on exchanges, their co-payments and cost-sharing may increase next year. Accurate information cannot exist until CMS publicly states how it intends to implement the required sequestration reductions.

1. See, for instance, Ezra Klein, "Democrats Should Surrender on Taxes," Bloomberg, October 16, 2013, http://www.bloomberg.com/news/2013-10-16/democrats-should-surrender-on-taxes.html (accessed October 24, 2013).
2. 2 U.S. Code 905(d).
3. Ibid.
4. Ibid.
5. C. Stephen Redhead, "Budget Control Act: Potential Impact of Sequestration on Health Reform Spending," Congressional Research Service *Report for Congress*, May 31, 2013, Table 4, p. 22, http://www.fas.org/sgp/crs/misc/R42051.pdf (accessed October 24, 2013).
6. Office of Management and Budget, *Revised Sequestration Preview Report for Fiscal Year 2014,* May 20, 2013, p. 23, http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/fy14_preview_and_joint_committee_reductions_reports_05202013.pdf, (accessed October 24, 2013).
7. Ibid.
8. Marilyn Tavenner, "PPACA Pulse Check," testimony before the Committee on Energy and Commerce, U.S. House of Representatives, August 1, 2013, http://energycommerce.house.gov/hearing/ppaca-pulse-check (accessed October 24, 2013).
9. 2 U.S. Code 906(k)(2).
10. Tavenner, "PPACA Pulse Check."

Scenario 2: Insurers Pay. A second possible scenario would see insurers being forced to absorb the costs of the sequester reductions in cost-sharing subsidies themselves. CRS, examining Obamacare's statutory requirements on insurers to provide cost-sharing reductions, considered this scenario a likely outcome:

> The impact of sequestration is unclear. [Obamacare] entitles certain low-income exchange enrollees to coverage with reduced cost-sharing and requires the participating insurers to provide that coverage. Sequestration does not change that requirement. Insurers presumably will still have to provide required coverage to qualifying enrollees but they will not receive the full subsidy to cover their increased costs.[11]

This scenario would see insurers absorbing $286 million in losses in the law's first nine months alone—losses that would grow over time. Citing estimates from the Congressional Budget Office and the Joint Committee on Taxation, CRS noted that the federal government is scheduled to spend $149 billion on cost-sharing subsidies between 2014 and 2023.[12] Given that sequestration is scheduled to remain in place through 2021, the reductions in cost-sharing subsidies under current law would likely total several billion dollars at a minimum.

The scale of the numbers at issue raises questions about whether and under what circumstances insurance companies would actually continue to offer exchange coverage, knowing they would be guaranteed to incur losses if they do so.

More Than a "Glitch." While Obamacare's defenders are fond of claiming that "glitches" are the only thing holding back the law's implementation, the Administration's failure to confront the impact of BCA cuts signed into law two years ago is no mere "glitch." Either individuals who endure an arduous process to sign up for insurance on balky exchanges will face a "bait-and-switch," with cost-sharing levels higher than advertised, or insurers will face the prospect of billions of dollars in losses. Neither option is acceptable.

The Administration that promised to be the "most transparent and accountable" in history has neglected to inform the American people about the impact of sequestration on its prized accomplishment.

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11. Redhead, "Budget Control Act," p. 15.
12. Ibid., Table 4, p. 23.