COVID-19 Part 1: How Can the Macroeconomic Effects of COVID-19 Impact Medicaid Liabilities and Accrual Forecasting?

Undoubtedly, COVID-19 will leave an unprecedented impact on our economy for months, if not years, to come. While the life sciences industry is on the front lines of battle against COVID-19 working on vaccinations and treatments to combat the virus, manufacturers must understand and prepare for the potentially significant financial implications to their Government Programs.

Given the many moving parts associated with the COVID-19 threat, it is challenging to synthesize the impact they will have on life sciences manufacturers. At Riparian, our mission is to reduce turbidity with outside-the-box thinking; we identify challenges that may be less obvious and develop novel solutions. With that in mind, we identified a few significant strategic considerations related to Government Programs ("GP") that can assist life sciences manufacturers in avoiding some potential pitfalls ahead. In Part 1 of this article, we will first explore some important considerations and challenges and their impact on Medicaid liability forecasting.

Medicaid Rebate Liability Forecasting: Medicaid Drug Rebate Program ("MDRP") liability is determined on the basis of a unit rebate amount ("URA") and the volume of Medicaid utilization. To properly forecast MDRP liability, we must analyze both the URA and the utilization. The URA is, in part, dependent on inflation. The government measures allowable commercial price increases by a comparison of price increases over time to the change in the Consumer Price Index for All Urban Consumers ("CPI-U"). Manufacturers are penalized for increases in drug prices in excess of the CPI-U (a.k.a. "CPI-U Penalty").

One of the economic effects of COVID-19 is large swings in prices of "consumer goods," which will impact the CPI-U over the coming months, and possibly years. Likewise, utilization certainly will be impacted by the significant changes in healthcare coverage (e.g., Medicaid vs. Commercial payors). Accurate Medicaid forecasts will require recognizing and understanding the pending volatility in the CPI-U and Medicaid utilization. The following provides potential scenarios to consider and model when calculating financial forecast ranges:

1. **Deflation**. Deflation, or negative inflation, is a possibility and not unprecedented. What is unprecedented, however, is that recently, an oil benchmark plunged below $0 per barrel which could indicate or impact deflationary pressures. Previously, during periods of deflation, the change in CPI-U went negative, causing a compounding effect on Medicaid liability. If these effects are replicated, even if drug manufacturers do not increase prices, deflation means that manufacturers would still pay a Medicaid CPI-U penalty, increasing their overall MDRP liability.

   In 2008, the CPI-U was 218.873 in September and decreased to 210.228 in December which artificially increased MDRP liabilities irrespective of price increases.

2. **Inflation**. The current situation has resulted in closures in meat factories and increases in demand for paper goods. These decreases in supply and increases in demand drive inflation. Additionally, the Federal stimulus packages are increasing the money supply, but without a corresponding increase in real output, stimulus money will also exacerbate inflation. While inflation may be partially offset by the plunge in the oil benchmark, the net effect may still be an increase to the CPI-U, especially over time because of potential disruptions to the supply chain for other common consumer products for an extended period of time. Accordingly, it is arguably possible that manufacturers will experience an overall reduction in Medicaid liability as a result of inflation.

3. **Volatility**. As noted, in the short term, it is likely that there will be increased volatility in the CPI-U. It also is likely that volatility will be the norm for Medicaid utilization. The rise in unemployment may lead to a decrease in commercial utilization and increases in Medicaid utilization. While there is also the possibility of short-term decreases in utilization in general during periods where patients have gaps in coverage, this ultimately may lead to utilization spikes due to pent-up demand. As utilization changes will not correspond in time with CPI-U changes, spikes in demand during periods of deflation could compound Medicaid liability.

In summary, accurate accrual for Medicaid liability may be subject to greater challenges in the coming periods, especially for manufacturers that rely upon historic Medicaid liability as the basis for their accrual. Given the current economic situation, it is crucial that the accrual methodology and ranges include modeling of both macroeconomic indicators and forecasted utilization by product to develop realistic estimates.

References:

1. Department of Labor Statistics. April 2020. https://www.bls.gov/cpi/

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David S. Chan is the Co-Founder and CEO of Riparian LLC, which provides software, outsourcing and consulting solutions to Life Sciences manufacturers. David has overall responsibility for the strategic direction, product development, sales, operations and specific client initiatives. David brings 20 years of experience leading revenue management and contracting teams in the life sciences.

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