Estimating the Cost of the Medicare Drug Benefit

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Outline of Presentation

- Overview of CBO's Cost Estimate
- Background on Drug Spending
- Key Estimating Issues
- Components of CBO's Estimate
- Main Differences from Administration's Estimate

Overview of CBO's Estimate for the Medicare Drug Benefit

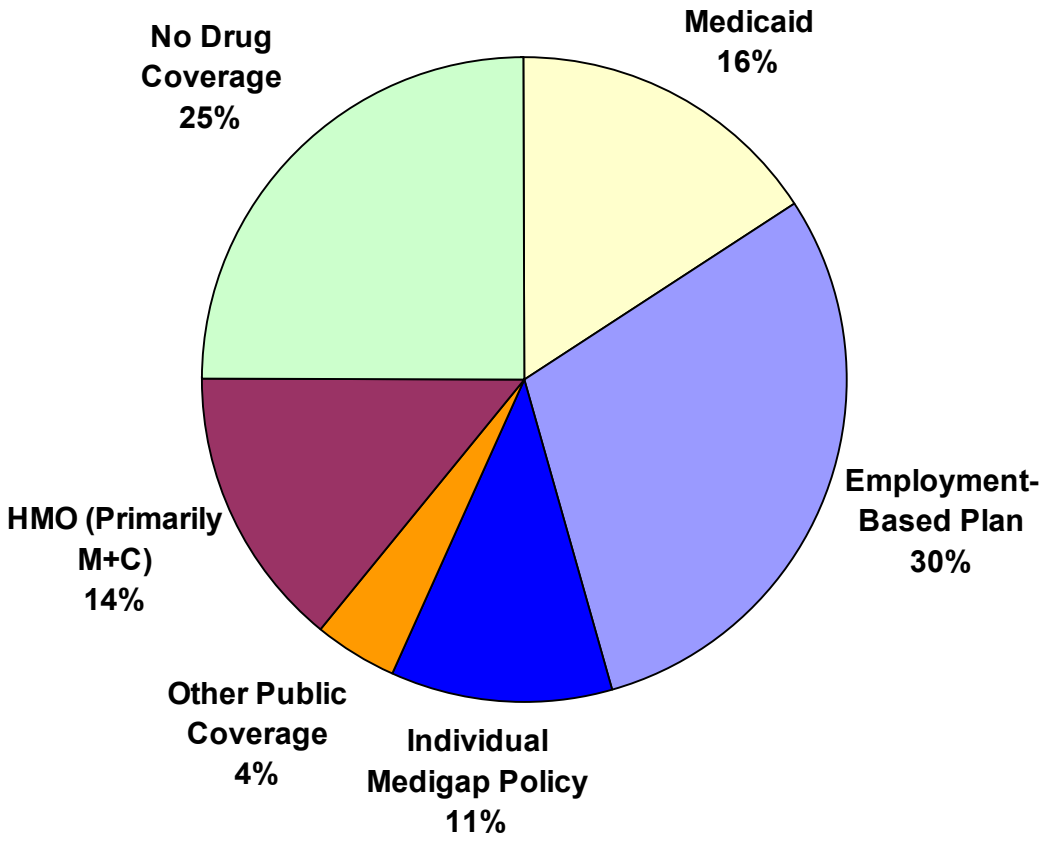
	Mandatory Spending FY 2004-13 ($ Billions)
Payments to Medicare Drug Plans for Basic Drug Benefits	507
Beneficiary Premiums	-131
Employer Subsidies	71
Low-Income Subsidies	192
Net Federal Savings	-230
TOTAL, Drug Benefit	**409**
Net, Other Provisions	-14
TOTAL, PL 108-173	395

SOURCE: Congressional Budget Office

Drug Spending of Medicare Population

- Used most recently available data on coverage, drug spending, and projected growth rates to determine “baseline” with no Medicare benefit
- Total outpatient drug spending:
  - $1.8 Trillion, 2004-13
  - $1.6 Trillion 2006-13
  - Excludes spending covered by Medicare today
- Average drug spending projected at $3,155 in 2006 but wide variation
- 75% of beneficiaries obtain coverage from various sources; about 25% have no drug coverage during the year.

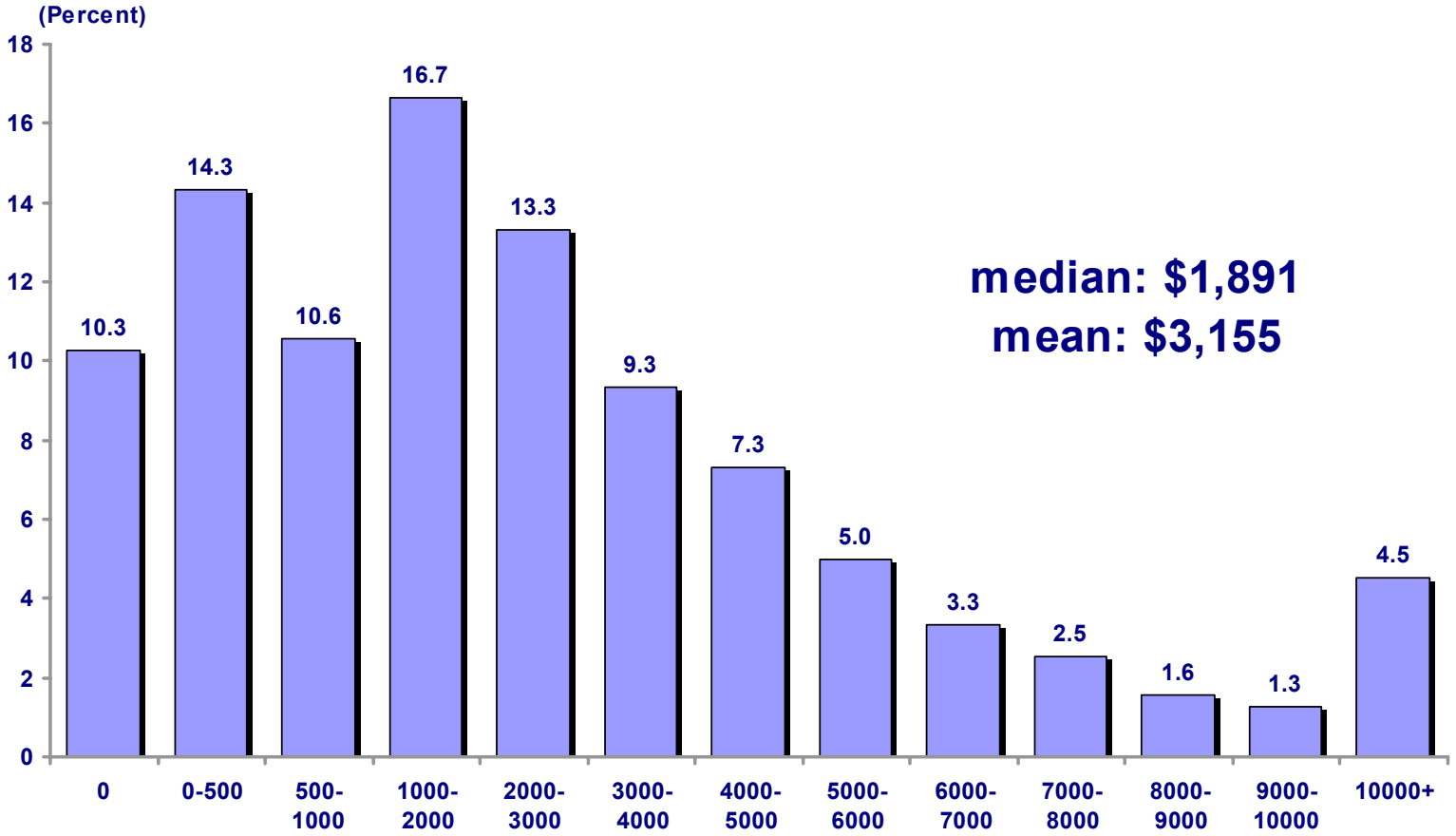
Sources of Drug Coverage for Medicare Beneficiaries, 1999



SOURCE: Congressional Budget Office, based on Medicare Current Beneficiary Survey

Distribution of Drug Spending in 2006

(Percentage of beneficiaries with spending in the dollar range)



SOURCE: Congressional Budget Office, based on Medicare Current Beneficiary Survey

Key Estimating Issues

- Beneficiary Enrollment
- Financial Risk and Plan Participation
- Financial Risk and Cost Management
- “True Out-of-Pocket” (TROOP) and Reinsurance
- Employer Response

Voluntary Enrollment

Achieving Near-Universal Enrollment Requires:

- Significant premium subsidy (at least 50%)
- One-time only enrollment or meaningful late-enrollment penalty
- Default enrollment (or higher subsidy)
- Low-income benefit

Financial Risk and Plan Participation

Despite concerns about adverse selection and "insurance for haircuts," CBO assumed plans would participate and bear financial risk

- Premium subsidy, late-enrollment penalty, reinsurance, and risk corridors
  - Federal reinsurance covers most high-end costs
  - Plans could obtain private reinsurance

Financial Risk and Cost Management

- Plans bearing more financial risk have greater incentive to manage costs
- Requires tools to be available (e.g., formularies, tiering, pharmacy networks)
- Needs competitive environment (so beneficiaries see premium differences)
  - If not at risk, problems would arise using bids to set premiums or send “price signals” to enrollees
- Higher administrative costs (risk premium)

TROOP Provision and Reinsurance Subsidies

- Only costs paid by beneficiary count toward catastrophic threshold
- Reinsurance subsidies linked to reaching catastrophic threshold
- Targets Federal assistance at those without supplemental coverage
- “Penalizes” supplemental coverage

Employer Response

- Assumed same share would have employer coverage if no Medicare benefit was enacted (but cost sharing would increase over time)
- Under MMA, 3 broad employer options:
  - Wrap around a Medicare drug plan
  - Provide own drug plan
  - Drop coverage; retirees enroll in Medicare plan
- Benefit generosity, differential subsidies, and administrative flexibility drive employer response

Components of CBO's Estimate

	Mandatory Spending FY 2004-13 ($ Billions)
Payments to Medicare Drug Plans for Basic Drug Benefits	507
Beneficiary Premiums	-131
Employer Subsidies	71
Low-Income Subsidies	192
Net Federal Savings (Medicaid)	-230
TOTAL, Drug Benefit	**409**

SOURCE: Congressional Budget Office

Enrollment in Basic Benefit

- Substantial premium subsidy (74.5% on average)
- Substantial penalty for late enrollment
- Assumed 87% of Medicare beneficiaries will enroll (via Medicare plan or employer)
  - About 37 million enrollees in 2006
- Exceptions: active workers & some federal retirees; those who decline Part B

Total Drug Spending Per Enrollee

- Start with projected spending with no Medicare benefit
  - Based on MCBS and NHE projections
- Model insurance effects ("moral hazard")
  - Slightly higher average drug prices due to insurance protection
  - Use of drugs affected by out-of-pocket costs (elasticity of demand)
- Adjust to reflect *"cost management factor"*
- Take "best price" exemption into account

Cost Management Environment

- Plans would face meaningful financial risk
  - Modeled unexpected variation in costs
  - Risk reduced in initial years by risk corridors
- Some limits on use of “tools” to manage costs
  - Reflects tradeoff between cost control and access
  - Benefit and formulary design, appeals language provide some constraints
  - Broad flexibility to vary reimbursements and cost sharing for network/non-network, mail-order/retail
- Competition on premiums

Cost Management Assumptions

- Assumed “gross drug savings” of 20-25% compared to unmanaged benefit
  - Recent proposals ranged from 10% to 30%
- Reflects all forms of cost management, not just price discounts for given drugs
- For those with some form of management now, only an incremental effect
- For those in reduced-risk or fallback plans, lower gross savings (but lower admin costs)

Standard Benefit Design

- Along with premium subsidy, the most important determinant of Federal costs per enrollee
- For 2006:
  - $250 deductible
  - $25% Coinsurance up to $2,250 in total spending
  - 100% Coinsurance in “Doughnut Hole” up to $3,600 in Out-of-Pocket Costs (or $5,100 in total spending if no supplemental coverage)
  - About 5% coinsurance thereafter
- Provisions indexed to per capita drug spending, so benefit covers same share of costs over time

Illustrative Monthly Costs, Subsidies, and Premiums for 2006

DOLLARS PER ENROLLEE PER MONTH

		Lower Cost Plan	Average Cost Plan	Higher Cost Plan
	Expected Total Costs (Benefits + Administrative Costs)	$127	$137	$147
Minus	Expected Reinsurance Payments	-$38	-$41	-$44
Equals	Plan's Bid	$89	$96	$103
Minus	"Direct" Federal Subsidy	-$61	-$61	-$61
Equals	Beneficiary's Premium	$28	$35	$42
	Premium as Share of Total Costs	22.0%	25.5%	28.5%

SOURCE: Congressional Budget Office

Basic Employer Options

OPTION 1

- Retirees sign up with Medicare drug plan (PDP or MA)
- Employer contracts with plan to supplement coverage
- PDP/MA plan gets direct subsidy but little reinsurance (due to TROOP provision)

OPTION 2

- Employer provides drug benefit
- Medicare pays 28% of total drug costs in specified range
- About the same $$ as Option 1 on average, but more flexibility
- Subsidy is tax-free but employer can still deduct its costs

OPTION 3

- Retirees sign up with PDP/MA plan for drug coverage
- Employer does not supplement (“drops”)
- Much larger Medicare subsidies on average, but less generous benefit

Employer Responses

- Estimated that about 23% of non-federal retirees with generous drug coverage would see employer "drop" that coverage due to the MMA
  - Represents 17% of all Part B enrollees with employer-sponsored drug coverage
  - About 2.7 million individuals in 2006
- Assumed nearly all remaining retirees would see employer take 28% subsidy
  - Payment is instead of, not on top of, other Medicare $$
  - Tax expenditure limits recoupment of the $71B through tax system, doesn't add to it

Low-Income Subsidies

- Two groups of benefits and beneficiaries:
  - Those below 135% of poverty with low assets and all dual eligibles pay no premium, low cost sharing
  - Those below 150% of poverty with somewhat higher assets pay reduced premiums and cost sharing
- Take-up estimated based on historical enrollment in QMB and SLMB programs
- $192B estimate includes cost of $$ on drug card

Net Federal Savings

$230B in net savings has three major sub-components:

- $152B in Federal Medicaid *savings* on drug spending for Medicare beneficiaries
- $88B in Federal *savings* from “clawback” mechanism
- $14B in net Federal Medicaid *costs* (mostly due to higher enrollment in QMB and SLMB)

Recap of CBO's Estimate

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Differences from Administration's Estimate

	Mandatory Spending FY 2004-13 ($ Billions)
CBO Estimate for PL 108-173	**395**
Payments to Medicare Drug Plans and Employer Subsidies	+32
Low-Income Subsidies	+47
Net Medicaid Savings	+18
Net, All Other Provisions	+42
Administration Estimate for PL 108-173	**534**

Key Uncertainties

- Drug Spending Growth / Baseline
- Beneficiary Enrollment
- Plan Formation and Costs/Savings
- Employer Response
- Low-Income Subsidy Participation
- Regulations
- (Future Legislation)

Additional Information

- Reports, Estimates and Letters available at www.cbo.gov
- Some key documents:
  - Nussle Letter (February 2004)
  - Nickles Letter (November 2003)
  - Cost Estimate for H.R.1 & S. 1 (July 2003)
  - "Issues in Designing . . ." (Oct 2002)
- Explanation of Cost Estimate for Enacted Drug Benefit Forthcoming