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Simple Solutions for Elderly Prescription Drugs

President Clinton has proposed a new prescription drug entitlement for people on Medicare, the program covering 39 million seniors and the disabled. However, the plan has significant problems.

For example, it would expand Medicare at a time when Medicare's unfunded liability ($8.9 trillion over the next 75 years) is twice the size of Social Security's. It would duplicate coverage that 65 percent of seniors already have — through private insurance and Medicaid. And while covering some drug costs, it would leave the elderly exposed for catastrophic expenses. Surely there is a better way.

In what follows, we propose four simple solutions that require no new taxes and no new government spending.

Solution #1: Free Medigap. The design of Medicare violates almost all the principles of sound insurance. The program pays too many small bills the elderly could easily afford on their own, while leaving them exposed to thousands of dollars of potential out-of-pocket expenses. For example, about 360,000 Medicare beneficiaries spend more than $5,000 out of pocket every year on Medicare-covered services. In addition, Medicare's failure to cover prescription drugs encourages the elderly to turn to more expensive (hospital and doctor) therapies.

In order to limit their financial exposure, about 75 percent of seniors acquire, either through a former employer or private purchase, supplemental (medigap) insurance, which pays many or all of the expenses Medicare does not.

However, federal law imposes Medicare's insurance philosophy on medigap insurers. Like Medicare, medigap policies must cover small-dollar items such as the Part A and Part B deductibles, but they need not cover the largest bills. Coverage for drugs is an option.

Were insurers given more freedom, they could create plans responsive to the needs of the market. Specifically, if insurers were free to forego coverage of many routine expenses, they could offer more generous drug coverage — with no increase in premiums (see the example below).

Four Simple Solutions

Free Medigap

Allow Medigap insurers to forego coverage for routine expenses in return for providing catastrophic coverage for expensive drugs.

Free Medicare

Allow private insurers to combine Medicare and medigap into less-expensive plans that cover prescription drugs.

Free Roth IRAs

Relax the rigid rules so seniors can use a Roth IRA as a Medical Savings Account.

Free the States

Let states use federally provided antipoverty money to fund high-risk pools for seniors needing prescription drugs.

Solution #2: Free Medicare. The combination of medigap insurance and Medicare is very wasteful. In fact, health economists estimate that seniors with both types of coverage spend about 30 percent more on health care than those with Medicare alone. Private plans could create an alternative that provides more coverage for less cost.

For example, some 16 percent of seniors have shifted out of traditional Medicare and into private-sector HMOs. These HMOs are required to cover everything that Medicare covers, but most cover much more. A recent survey found that 95 percent of Medicare HMOs provide their enrollees with a prescription drug benefit.

However, the Clinton administration and a Medicare bureaucracy hostile to any challenge to its power and authority have combined to halt and even reverse the trend. After the administration cut reimbursement rates

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to Medicare HMOs this year, many HMOs dropped out of the program, leaving some 450,000 seniors, many of whom had drug coverage, scrambling to find another HMO or return to Medicare. Another 99 HMOs intend to leave next year, affecting 325,000 more seniors.

The Clinton administration also has blocked other options for seniors. The Medicare+Choice program is supposed to give the elderly the full range of non-HMO options available to the nonelderly, including fee-for-service insurance and Medical Savings Accounts. Yet none of these options currently exist.

What could the private sector do for the elderly if given a chance? A Milliman & Robertson analysis concludes that with the average amount Medicare currently spends on each senior, a private plan could in principle establish a $1,585 across-the-board deductible and cover hospital, physician and drug costs above that deductible. Although a deductible of that size seems like a lot of money, many seniors are already spending $1,500 to $2,000 a year for medigap coverage. While medigap insurance could eliminate the deductible, a better option for seniors would be to take the money they currently spend on medigap premiums and put it in the bank. (See the next solution.)

Solution #3: Free Roth IRAs. Roth IRAs permit people to set aside up to $2,000 a year after taxes in retirement accounts that grow tax free. After age 59 ´ the funds can be withdrawn without penalty for any purpose, including medical expenses. Since the elderly by definition satisfy the age test, Roth IRAs could potentially serve as "backended" Medical Savings Accounts for the elderly.

However, there are two small problems.

First, the law prohibits taxpayers from depositing more in a Roth IRA than they receive in earned income in any year. Since only about 18 percent of those age 65 and over work (and therefore have earned income), this restriction excludes the vast majority of seniors.

Second, unless deposits are held for at least five years, the interest earned is not tax free. Clearly this restriction discourages the type of annual deposits and withdrawals that are needed for health care.

The solution is to allow seniors to deposit the maximum in their accounts (regardless of the amount they earn) and let them use the funds at any time without tax consequences — provided that the Roth IRA backs up a Medicare or (even better) a Medicare+Choice private health plan.

Solution #4: Free the States. More than half the states have high-risk pools that permit uninsured people who have been denied health insurance to obtain coverage for a reasonable premium. This concept can also be used to solve some of the problems of seniors. For example, 13 states already provide low-income seniors with prescription drug assistance and many more states are considering similar legislation.

By their nature, high-risk pools require subsidies. So where would the new money come from? A potential source is unused antipoverty money — currently restricted to food stamps, Medicaid and other welfare programs. Congress should free the states to use these funds to provide prescription drug high-risk pool insurance for the elderly poor.

Conclusion. These proposals would impose no new taxes (or "premiums") and would cost the government nothing. At a time when Medicare is in financial trouble, it makes much more sense to look at smaller, less expensive, targeted solutions for seniors who need help.

This Brief Analysis was prepared by NCPA President John C. Goodman and Vice President of Domestic Policy Merrill Matthews Jr.