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# Prescription Drugs and Medicare Reform

**By John C. Goodman and Sean R. Tuffnell**

Should the elderly have insurance for prescription drugs? Almost everyone says "yes" and it's not hard to understand why. Drugs not only are increasingly important to health care, they may be about the best buy available in the medical marketplace. New drugs are the main reason medical science has made amazing progress in recent years against cancer and heart disease. They have converted AIDS from a death sentence into a chronic illness. A 1996 study by the National Bureau of Economic Research shows that every dollar spent on prescription drugs is associated with a decrease of four dollars in hospital expenses.

President Clinton and some on Capitol Hill are proposing a costly prescription drug benefit for the elderly that could create huge new burdens for taxpayers. Fortunately, there is a way to solve the problem without costing taxpayers a single dime.

## Savings to Seniors Who Enroll in Comprehensive Private Plans

| Senior Costs Today: | Current | Current |
|---|---|---|
| Average Out-of-pocket Expense | $1,161 | $1,161 |
| Medigap Premium | 1,611 | 1,611 |
| Total | $2,772 | $2,772 |
| **Senior Costs With Private Insurance:** | **HMO** | **Fee-for-Service** |
| Average Out-of-Pocket Expense | $503 | $1,489 |
| Private Premium | 1,764 | 226 |
| Total | $2,267 | $1,715 |
| Average Savings From Switch to Private Plan: | $505 | $1,057 |

Source: Mark Litow, "Defined Contributions as an Option in Medicare," Milliman & Robertson, Inc., September 17, 1999.

**Medicare's Shortcomings.** Despite its political popularity, Medicare violates almost all principles of sound insurance. It 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, including the cost of their drugs. Each year about 360,000 Medicare beneficiaries spend more than $5,000 out-of-pocket.

**Medigap's Shortcomings.** To prevent financial devastation from medical expenses, about two-thirds of Medicare beneficiaries acquire supplemental insurance, either through a former employer or by direct purchase. Although some Medigap policies cover prescriptions, most do not, and among those that do, coverage is often incomplete. Ironically, the poorest seniors often have the best drug coverage because they qualify for Medicaid, the federal-state health program for the poor.

Where prescription drug coverage is incomplete or nonexistent, doctors and patients may turn to more expensive therapies — for example, opting for surgery for heart disease instead of treating it with drugs — because insurance will pay the bills. Health economists estimate that seniors with both Medicare and Medigap spend about 30 percent more on health care than those with Medicare alone.

**A Better Approach.** The elderly could have better health care coverage — including a prescription drug benefit — if they were allowed to combine their Medicare funds with the money they currently spend on private insurance and pay one premium into a comprehensive private plan. Medicare will spend about $5,800 on each beneficiary this year. Add to that about $1,600 — the amount seniors are already paying for the most popular Medigap policy — and the combined sum should be enough to buy the same kinds of health insurance coverage the nonelderly now have, including prescription drug coverage. That's the conclusion of a study prepared for the National Center for Policy Analysis by Milliman & Robertson, Inc., the nation's leading actuarial firm on health benefits. The accompanying table shows two examples:

- With the money Medicare would have spent plus the cost of the most popular Medigap policy, plus another $150 a year, an average senior could get comprehensive coverage from an HMO, comparable to the coverage nonelderly HMO members have.
- The senior would have to make small copayments to discourage abuse, say $10 for a doctor visit or a drug

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purchase, but he or she could expect to save about $500 a year in out-of-pocket costs while avoiding the potentially unlimited out-of-pocket expenses of the current system.

- Seniors who want more choices could enroll in a fee-for-service plan with a high deductible and a Medical Savings Account, usually for a lower premium than they currently pay for Medigap insurance; the out-of-pocket cost should average about $1,500 a year — far less than the unlimited exposure most seniors now face.
- On the average, seniors who choose a private fee-for-service plan over the current Medicare/Medigap arrangement would save more than $1,000 a year in out-of-pocket costs.

**Medicare+Choice.** Congress thought it was allowing seniors to use their Medicare money to join private health plans when it passed Medicare+Choice in 1997. The program was supposed to give the elderly the full range of health insurance options currently available to nonseniors: HMOs, MSAs, fee-for-service plans, doctor-run plans, etc. However, the federal Health Care Financing Administration (HCFA), which regulates Medicare, is hostile to private insurance, hostile to competition and hostile to choice. As a consequence, the program is saddled with so many rules, regulations and constraints that seniors have few of the options originally promised. For example:

- Seniors currently have no access to private fee-for-service plans, MSA plans or doctor-run plans; the one option that has survived is the Medicare HMO.
- Although 16 percent of seniors shifted out of traditional Medicare and into HMOs, HCFA cut the reimbursement rates to HMOs last year, forcing many insurers out of the program.
- This left almost half a million seniors, many of whom had drug coverage, scrambling to find another HMO or return to traditional Medicare.
- Another 99 HMOs have announced their intent to leave the Medicare program this year.

**Bipartisan Attempts at Reform.** Last year the National Bipartisan Commission on the Future of Medicare led by Sen. John Breaux (D-La.) and Rep. Bill Thomas (R-Calif.) proposed making it easier for seniors to enter a wide variety of private plans. Under their proposal, the government would subsidize the premiums of low-income seniors more generously than those of high-income seniors. More recently, Sens. Breaux and Bill Frist (R-Tenn.) introduced a similar approach. Like the commission's proposal, the Breaux-Frist bill calls for Medicare to be restructured using the federal employees health plan as a model. Beneficiaries would be subsidized by the federal government (as they are today) and allowed to join one of a number of competing private plans. Depending on the plan they chose, seniors could pay as little as nothing or up to $45.50 a month extra for more comprehensive coverage. The bill also has subsidies for the neediest enrollees.

**Obstacles to Reform.** The biggest obstacle is the Clinton administration. The recommendation of the Medicare commission went nowhere when the president refused to endorse it and members of his administration actively tried to sabotage it. The president has also signaled his opposition to the bipartisan Breaux-Frist bill. Instead, President Clinton proposed a modest drug benefit under Medicare last year that would have done little to help those with really high prescription costs. More recently, the president added money for catastrophic drug costs. However, the coverage is far from complete and the proposal does nothing to fundamentally solve the problems of Medicare.

**Conclusion.** We cannot solve the problem of prescription drug coverage for the elderly without addressing the structural problems of Medicare. Structural reform can be accomplished by building on the Medicare+Choice program that is already in place. The Milliman & Robertson study shows that seniors could use the combined funds from Medicare and supplemental insurance to enroll in comprehensive private health plans to obtain better insurance, including prescription drug coverage, with less out-of-pocket cost.

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