

Medicare Drug Plans: Don't Mess with Success

Issue Brief No. 140

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February 2014

The Affordable Care Act (ACA) will have a negative impact on seniors. A portion of ACA funding is derived by cutting \$716 billion from the Medicare program over the next decade — which could reduce seniors' access to care. One provision includes a 25 percent fee reduction for physicians who treat Medicare enrollees.



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Another provision — the Independent Payment Advisory Board — will have the power to reduce Medicare spending even if it adversely impacts the providers who treat Medicare enrollees.

ObamaCare is also slated to cut funding for Medicare Advantage (MA) plans, which cover about one in every four seniors. Compared to traditional Medicare, MA plans provide approximately \$825 annually in added benefits to its mostly moderate-income enrollees.

Yet another potential shock to seniors' pocketbooks has nothing to do with the ACA. The Centers for Medicare and Medicaid Services (CMS) wants to block seniors' access to Medicare Part D drug plans that offer lower premiums (and lower copays) in return for patronizing a *preferred pharmacy* network. (More on this below.)

The Medicare Modernization Act (MMA) of 2003 provides drug benefits and employer retiree drug plan subsidies to nearly 39 million Medicare beneficiaries. Of these, nearly 36 million are enrolled in a program known as Medicare Part D.¹ [See Figure I.]

Largely due to Medicare Part D, only about 10 percent of seniors lack drug coverage today compared to one-fourth of seniors prior to the MMA — a 60 percent reduction in the portion without coverage.

How Medicare Part D Works. The Medicare drug program is administered by private drug plans, which vigorously compete for seniors' patronage. Seniors participating in Medicare Part D pay about one-fourth of the cost of their drug plan, while the government subsidizes about three-fourths of the cost. Part D drug plans use a variety of techniques to control drug costs, including preferred-drug lists, tiered formularies, use of mail-order drug suppliers, negotiated prices with drug companies and drug distributors, and contracting with exclusive preferred pharmacy network providers.

Seniors choose from a wide range of plans. Nationwide, 1,169 Part D plans compete in 34 regions for seniors' business. The number of plans available to seniors varies from a low of 28 in Alaska to a high of 39 in Pennsylvania and West Virginia.²

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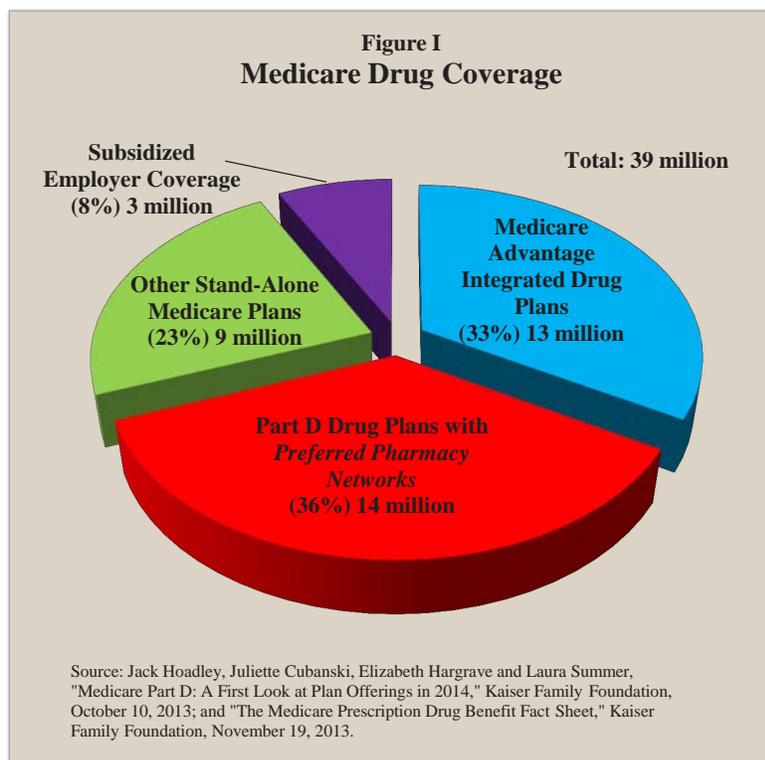
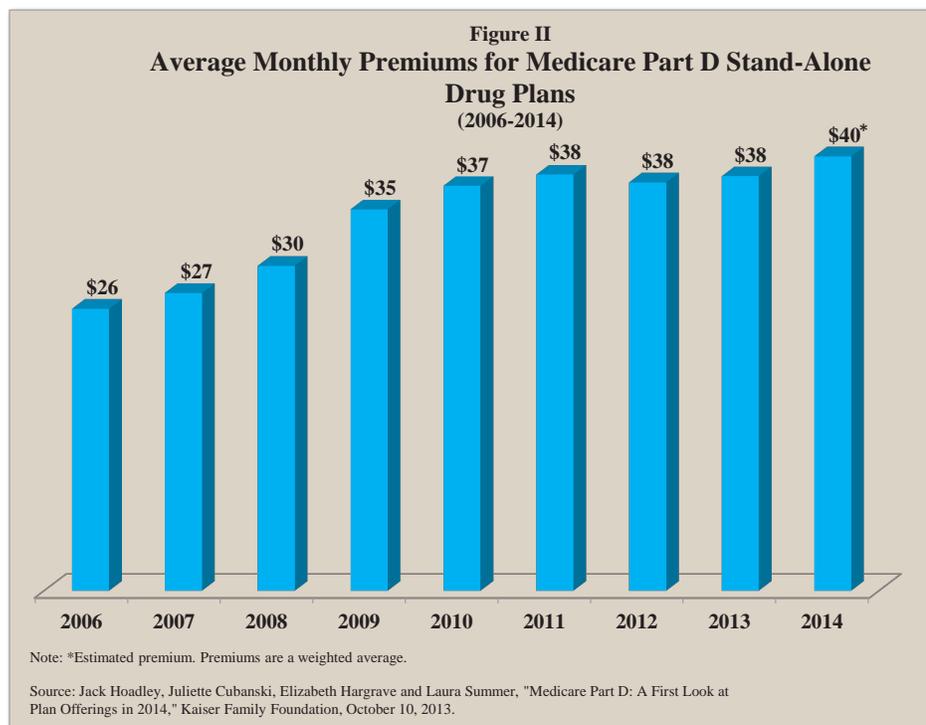
Seniors can choose from plans that feature low premiums but more cost-sharing; or they can choose more expensive plans that have little out-of-pocket costs. The least expensive plan is \$15 per month, although most seniors choose plans costing more than double that amount. On average, seniors choose plans with monthly premiums of about \$38.³ [See Figure II.]

By virtually all measures, Medicare Part D has been a great success. Seniors' satisfaction rates average about 90 percent to 95 percent.⁴ Though subsidized by Medicare, the premiums seniors pay are a function of the plan they choose — and ultimately of total program expenditures. Premiums have remained affordable because drug spending per member has been far lower than projected. As Figure III shows:

- Nearly a decade ago the Medicare Trustees projected a per capita benefits cost of \$1,971 in 2006, rising to \$3,047 by 2013.
- But the actual per capita cost in 2013 was only \$1,846 — a savings per enrollee of nearly 40 percent.

Back in 2006, the Social Security and Medicare Trustees projected the program would cost about \$127 billion by 2013. Yet the cost in 2013 was only about \$72 billion.⁵ [See Figure IV.]

Reasons for the Success of Medicare Part D. Medicare Part D has come in under budget and held seniors' drug



plan premiums in check for one primary reason: vigorous competition among numerous competing plans. Seniors select the plan that best meets their needs, so plan sponsors are constantly looking for ways to earn their patronage. Flexibility of plan design is another reason for Medicare Part D's popularity. Part D Plans are designed to appeal not just to seniors with high drug costs, but also those who spend little but want affordable protection against unanticipated drug bills. The Medicare Part D standard plan provides a significant benefit for enrollees at all levels of drug spending. Most important, premiums are low enough that healthy seniors find the premiums affordable, while those with high health costs can expect significant coverage after reaching a spending benchmark.

Since implementation in 2006, only a few plans have retained their original design. Most Part D plans have evolved to preferred networks, with tiered formularies and incentives for enrollees to choose lower-cost generic drugs and preferred brand drugs.

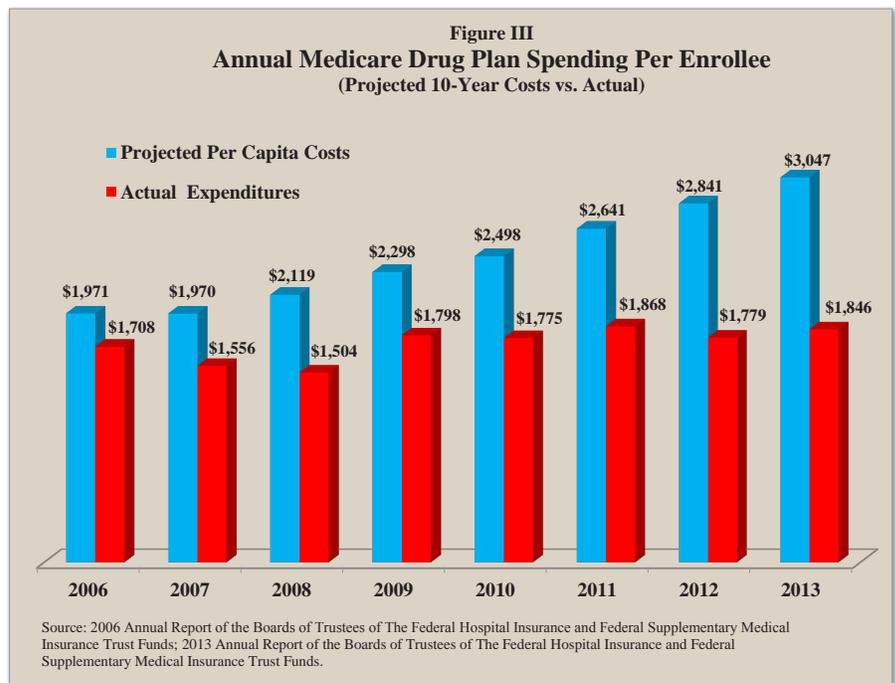
Generic Drugs. Some experts have argued that costs have been held in

check primarily due to the large number of blockbuster drugs that have lost patent protection during the past decade. Even more important, however, are the incentives Medicare Part D plans use to encourage seniors to take advantage of these newly-available generic drugs.

Preferred Pharmacy Networks.

Increasingly, Medicare Part D drug plans have adopted exclusive or “preferred pharmacy” networks, giving them leverage to negotiate lower drug prices from pharmacies competing to become one of the exclusive network drug providers.⁶ Nearly 60 percent of Medicare Part D stand-alone plans feature preferred pharmacy networks that offer seniors lower prices in return for patronizing exclusive pharmacy networks and mail-order drug delivery.⁷

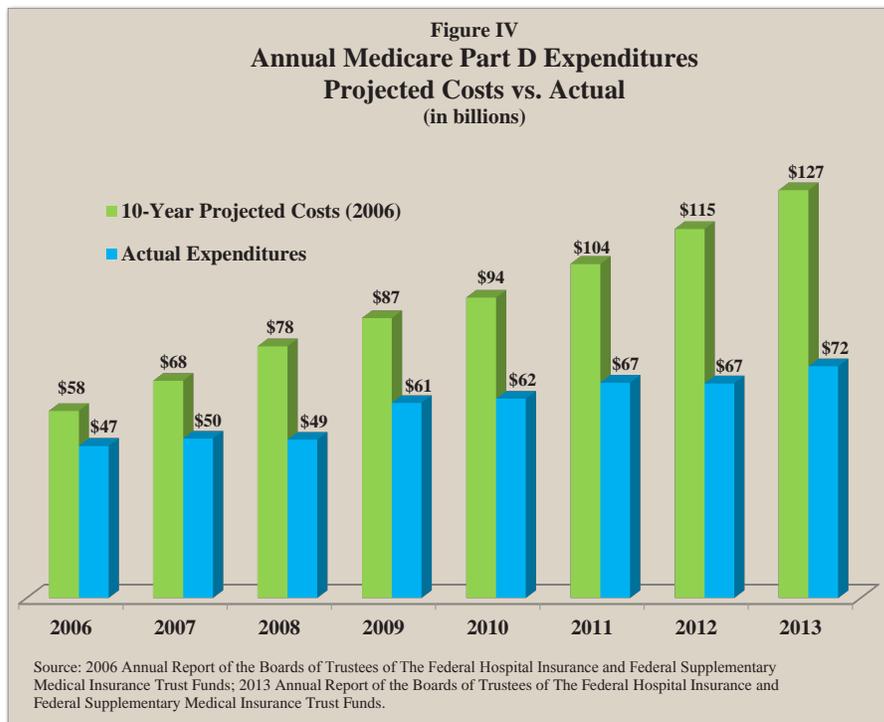
Opponents of this practice argue that “open” pharmacy networks offer enrollees more choices, more convenience and promote competition. However, drug plan sponsors counter that the preferred pharmacy networks agree to deeper discounts in return for the additional business. When drug plans create pharmacy networks they negotiate for the lowest possible prices. Negotiated prices are the result of bargaining power — the ability of the drug plan to deny business to a firm if their bid isn’t favorable.⁸



Reducing Seniors’ Choices. The Obama Administration wants to ban the practice of offering seniors lower premiums in return for patronizing a preferred network. Medicare reasons that this occasionally costs taxpayers more for selected drugs. An analysis of preferred and nonpreferred Medicare networks found that about one-fourth of preferred networks occasionally charge slightly higher (that is, ranging from 2 percent to 11 percent higher) prices.⁹ But this phenomenon would likely dissipate over time as seniors switch to more competitive plans.

Paradoxically, the method that Medicare proposes to remedy this perceived shortcoming is to prevent drug plans from excluding the “losing bidders” in contract negotiations from participating in a drug plan if the losing bidders are willing to abide by the contract terms of the winning (pharmacy network) bidder. In other words, those pharmacy networks that charge higher prices could not be precluded from participating in a drug plan.

Bad Solution to a Problem that Doesn’t Exist. Since its inception, the MMA included an anti-interference clause. The Medicare program would not take sides in negotiations among marketplace participants. Contract negotiations between drug makers, pharmacy networks and drug plan sponsors were left



strictly to the respective parties. However, the proposed CMS regulations would weaken drug plans' bargaining power.¹⁰ Without the knowledge that a "losing bid" risks losing out on virtually all business from seniors enrolled in a given Medicare drug plan, pharmacy networks will have little reason to offer their lowest prices during contract negotiations. Thus, the incentive will be to bid higher, knowing a losing bid will boost the prices seniors (and their drug plans) pay, without reducing the number of customers walking through the door.

Conclusion. Seniors seem to appreciate lower priced preferred pharmacy networks. Indeed, an estimated 75 percent of seniors in Part D stand-alone plans (meaning, they are not integrated with a Medicare Advantage health plan) are enrolled in a drug plan that features a preferred pharmacy network.¹¹ That's a significant jump from 2003, when only about 43 percent were in such a plan.¹² All told, nearly 14 million seniors with Medicare Part D will lose their plan if preferred networks are banned for 2015.¹³ As a result, the losers will be seniors — and taxpayers.

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Endnotes

¹ "The Medicare Prescription Drug Benefit Fact Sheet," Kaiser Family Foundation, November 19, 2013; available at <http://kff.org/medicare/fact-sheet/the-medicare-prescription-drug-benefit-fact-sheet/>; and Jack Hoadley, Juliette Cubanski, Elizabeth Hargrave and Laura Summer, "Medicare Part D: A First Look at Plan Offerings in 2014," Kaiser Family Foundation, October 10, 2013; available at <http://kff.org/medicare/issue-brief/medicare-part-d-a-first-look-at-plan-offerings-in-2014/>.

² Ibid. See also Glenn M. Hackbarth and members of the Medicare Payment Advisory Commission, "Medicare Payment Policy: Report to the Congress," Medicare Payment Advisory Commission, March 15, 2013. Available at http://www.medpac.gov/documents/Mar13_entirereport.pdf.

³ Jack Hoadley, Juliette Cubanski, Elizabeth Hargrave and Laura Summer, "Medicare Part D: A First Look at Plan Offerings in 2014."

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⁶ "As Pharmacy Networks Slim Down, Payers Have a Lot to Chew On, Suggest Experts," *Drug Benefit News*, Vol. 13, No. 12, June 22, 2012.

⁷ Adam J. Fein, "CMS Wants It That Way: Big Medicare Part D Pharmacy Changes," *Drug Channels* (Pembroke Consulting) January 09, 2014. Available at <http://www.drugchannels.net/2014/01/cms-wants-it-that-way-big-medicare-part.html>.

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¹⁰ "Improving Health Care: A Dose of Competition," Federal Trade Commission and the U.S. Department of Justice, July 2004.

¹¹ Adam J. Fein, "For 2014, 3 out of 4 Seniors Choose a Narrow Network Medicare Drug Plan—and Humana, UnitedHealthcare Win Big," *Drug Channels*, January 17, 2014. Available at <http://www.drugchannels.net/2014/01/for-2014-3-out-of-4-seniors-choose.html>.

¹² Jack Hoadley, Laura Summer, Elizabeth Hargrave and Juliette Cubanski, "Medicare Part D Prescription Drug Plans: The Marketplace in 2013 and Key Trends, 2006-2013," Kaiser Family Foundation, December 11, 2013. Available at <http://kff.org/medicare/issue-brief/medicare-part-d-prescription-drug-plans-the-marketplace-in-2013-and-key-trends-2006-2013/>.

¹³ Ibid.

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