

medicaid and the uninsured

The Financing of Pharmacy Plus Waivers: Implications for Seniors on Medicaid of Global Funding Caps

In early 2002, the Bush Administration announced the Pharmacy Plus waiver initiative, which allows states to secure federal Medicaid matching funds for the cost of operating prescription-only programs for seniors who otherwise would not be eligible for Medicaid.¹ States have expressed considerable interest in Pharmacy Plus waivers because they offer the opportunity to respond to seniors' call for help with prescription drug costs pending the outcome of the congressional debate over adding a drug benefit to Medicare. In addition, 26 states already operate state-funded prescription drug programs that are separate from Medicaid and an additional eight have authorized them, creating a fiscal incentive for these states to alleviate their budget crises by securing federal Medicaid matching funds for some of the cost of their existing prescription drug programs. As of March 2003, four states had received approval for "Pharmacy Plus waivers" (Florida, Illinois, South Carolina, and Wisconsin) for prescription drug programs for seniors and eleven additional states had submitted applications.²

Caps on Federal Medicaid Funding for Seniors Resulting from Pharmacy Plus Waivers

To secure a Pharmacy Plus waiver, the Department of Health and Human Services requires states to place all of their expenditures on elderly Medicaid beneficiaries under a global funding cap, including the cost of providing seniors on Medicaid with the following:

- Prescription drugs, lab and x-ray services, and durable medical equipment
- Home and community-based care services
- Nursing home care
- Payment of Medicare premiums and cost-sharing obligations

Although much of the discussion about Pharmacy Plus waivers has focused on the prescription drug coverage they provide to low-income seniors, these waivers also include a major change in the financing of care for all seniors on Medicaid -- states must accept a cap on federal Medicaid funding for all services that they provide to seniors on

¹ States also can use Pharmacy Plus waivers to extend prescription-only coverage to the disabled, but, if they do so, they must accept a global funding cap on expenditures for all disabled Medicaid beneficiaries.

² On April 10, 2003, the Department of Health and Human Services issued a press release announcing it had approved Indiana's Pharmacy Plus application. The Indiana waiver was not treated as approved for purposes of this policy brief because the terms and conditions of its waiver were not public as of May 1, 2003 when the brief was completed. Even though it has secured a waiver to use federal Medicaid matching funds for a small pharmacy program for seniors, Maryland also is not included in this analysis because it amended an existing Medicaid managed care waiver -- rather than securing a new Pharmacy Plus waiver -- as the vehicle for its expansion.

Medicaid as part of the Pharmacy Plus waivers. As a result, these waivers have the potential to alter the fundamental landscape within which states make decisions about providing care to elderly people under Medicaid.³

Pharmacy Plus Waivers Require States to Accept Capped Funding for All Medicaid Spending on Seniors

Although it is not required by statute, the federal government has a long-standing practice of requiring that major Medicaid waivers be “budget neutral,” which means the waiver will not cost the federal government any money above what it would spend in the absence of the waiver. The Department of Health and Human Services (HHS) has broad flexibility to decide how to ensure that Medicaid waivers are budget neutral. In the case of Pharmacy Plus waivers, HHS has decided to require states to forego their guarantee to open-ended federal Medicaid matching funds for *all* elderly Medicaid beneficiaries and replace it with a limited or “capped” amount of federal Medicaid funds.⁴ Essentially, the caps require that the cost to the federal government of providing matching funds for a state’s prescription drug program must be offset by reductions in spending on elderly Medicaid beneficiaries.

The size of a state’s Pharmacy Plus caps is based on an estimate of the total amount (state and federal) the state would spend on elderly Medicaid beneficiaries in the absence of the Pharmacy Plus waiver over the five-year life of the waiver. The federal government will match all of a state’s spending on its Pharmacy Plus program and its Medicaid program for the elderly until its total spending reaches the cap. After a state reaches its cap, the federal government no longer will match its spending regardless of whether the state needs the funds for its Pharmacy Plus program or for the cost of providing Medicaid to seniors. In such circumstances, the state will need to decide whether to cut back its Pharmacy Plus prescription drug program and/or its Medicaid program for seniors, or whether to finance any spending in excess of the cap entirely with state funds.

The fundamental theory behind Pharmacy Plus waivers is that prescription drug programs for seniors will pay for themselves over time by generating offsetting savings in Medicaid. The waivers assume that enrollment in a prescription drug program will keep a substantial number of low-income seniors healthier and reduce their long-term care and other medical bills, making it less likely that they will become poor enough to qualify for Medicaid coverage and more likely to require fewer services if they end up on Medicaid.

³ This Policy Brief reviews some of the key aspects of the financing of Pharmacy Plus waivers. For a more detailed discussion of this topic, see *The Financing of Pharmacy Plus Waivers: A Background Paper*, prepared by the Kaiser Commission on Medicaid and the Uninsured, May 2003.

⁴ Some states, for example, have suggested that the federal government should consider the offsetting savings to Medicare, rather than just Medicaid, associated with providing a prescription drug benefit to seniors when evaluating the budget neutrality of their Pharmacy Plus waiver requests. For a detailed discussion of the alternative strategies available for establishing the budget neutrality of Pharmacy Plus waivers, see Appendix A, *The Financing of Pharmacy Plus Waivers: A Background Paper*, prepared by the Kaiser Commission on Medicaid and the Uninsured, May 2003.

Variation in Pharmacy Plus Funding Caps

Because each waiver is negotiated between a state and HHS, the generosity of Pharmacy Plus funding caps varies widely across the four states with approved waivers. As shown in Table 1, the average annual rate at which the four states can increase their Medicaid spending on the elderly and their Pharmacy Plus prescription drug programs over the next five years without reaching their cap ranges from a low of 7.4 percent in South Carolina to a high of 10.8 percent in Illinois. States, such as Illinois, that negotiate a relatively generous cap may be at low risk of reaching their cap and, thus, free to act largely as if they still have access to open-ended entitlement funding for elderly Medicaid beneficiaries. Even in these states, however, the cap could prove a deterrent to expansions in Medicaid eligibility for seniors or improvements in the coverage that they receive. Other states with tighter caps may have even greater difficulty.

**Table 1:
States' Funding Caps Under Pharmacy Plus Waivers**

State	Size of cap over 5-year life of waiver (billions)	Average annual growth rate allowed under cap	Historical Growth Rate in Elderly Medicaid Spending		
			Last Year	Last three years	Last five years
Florida	\$16.67	8.0%	9.2%	8.9%	8.0%
Illinois	\$14.05	10.8%	4.2%	7.4%	7.0%
South Carolina	\$4.96	7.4%	7.8%	11.1%	n/a
Wisconsin	\$8.37	8.4%	10.3%	7.2%	5.4%

Notes: Funding caps are set in terms of total, rather than federal expenditures. States can increase their own spending above the level allowed under the cap, but the federal government will not match such spending. CMS enforces budget neutrality over the five-year life of a state's waiver, not in any given year.

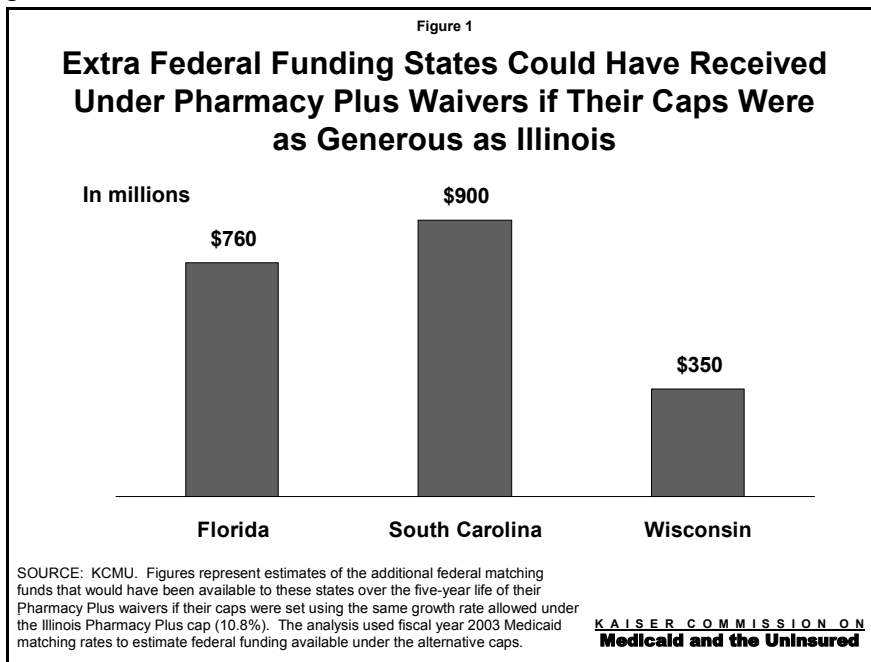
Source: KCMU analysis of data provided by states to CMS. Historical growth rates reflect data available to states at the time they submitted their Pharmacy Plus applications.

The Congressional Budget Office expects Medicaid expenditures on benefits for the elderly to increase nationally at an average annual rate of 8.6 percent over the next five years.⁵ CBO's estimates, however, address only the cost of providing Medicaid to elderly beneficiaries, not the cost of providing Medicaid to elderly beneficiaries *and*

⁵ Based on March 2003 CBO estimates of growth in federal Medicaid spending on the elderly between fiscal year 2003 and fiscal year 2007; this figure does not include increases in Medicaid spending on the elderly due to UPL arrangements, DSH payments, or administrative costs. A small portion of the 8.6 percent growth rate may be attributable to the cost of Pharmacy Plus waivers themselves, which CBO anticipates will not be fully budget neutral to the federal government. In January of 2002, prior to the Administration's announcement of the Pharmacy Plus waiver initiative, CBO projected that federal Medicaid spending on seniors would grow 8.3 percent between fiscal year 2002 and fiscal year 2007.

financing a prescription drug program for seniors. Rates of increase also vary by state; some of the states with Pharmacy Plus waivers have experienced more rapid growth in their Medicaid expenditures on the elderly in recent years. For example, South Carolina's expenditures on the elderly grew at an average annual rate of 11.1 percent over the past three years, but under its Pharmacy Plus waiver it will be ineligible for additional federal Medicaid matching funds if the cost of providing Medicaid to seniors and operating its prescription drug program grows 7.4 percent a year or more; any spending growth above that level must be financed entirely by state funds.

As shown in Figure 1, the variation in the generosity of Pharmacy Plus funding caps has significant implications for the amount of federal Medicaid funds available to a state to finance care for seniors on Medicaid and prescription drug programs. For example, Florida would have been eligible for an additional \$760 million in federal Medicaid matching funds over the five-year life of its waiver if it were allowed to increase its expenditures at the same rate as Illinois.



Risk of Reaching Funding Caps

It is difficult to assess whether the states with Pharmacy Plus waivers have negotiated caps that are generous enough to avoid the risk of running out of federal Medicaid matching funds. Medicaid has long operated as an open-ended entitlement in part because it is so challenging to project with accuracy what will happen to Medicaid expenditures. In recent years, states and the federal government routinely have underestimated the rate of growth in Medicaid spending, in part because the cost of some of the services used most heavily by the elderly -- prescription drugs and long-term care -- have risen more rapidly than expected. Given that some states face caps that deny them federal matching funds if their expenditures continue to grow at current rates, it appears that they are at risk of reaching their caps unless the underlying reasons for their recent expenditure growth have changed.

States also are at risk of reaching their caps if their assumptions about the extent to which Pharmacy Plus program will divert seniors from becoming impoverished

enough to qualify for Medicaid are overly optimistic. Although the existing research on this question is limited, it suggests states may find that their prescription drug programs divert only a tiny number of seniors, if any, from Medicaid enrollment. The one methodologically rigorous study of the issue found that *fewer* than one in 333 seniors on a state-funded prescription drug program for seniors in Pennsylvania were diverted from Medicaid coverage. There is some evidence that prescription drug programs can reduce hospitalizations, but Medicare, rather than Medicaid, generally pays for the hospital costs incurred by seniors. Although states have asked the Department of Health and Human Services to consider Medicare savings when evaluating their Pharmacy Plus waiver request, it has declined these requests to date.

Despite the existing research, states with Pharmacy Plus waivers have assumed that substantial numbers of their prescription drug enrollees will be diverted from Medicaid enrollment. The most conservative state (Wisconsin) assumes that one in 11 seniors on its prescription drug program will be diverted from Medicaid in the final year of its waiver, while the most optimistic state (South Carolina) assumes that two in three enrollees in its prescription drug program will be diverted (see Box). As a result of their diversion rate assumptions, Pharmacy Plus states are expecting dramatic declines in their Medicaid caseloads for seniors relative to projected levels (Table 2). Wisconsin and South Carolina even expect that they will have substantially fewer seniors on Medicaid in five years than they currently enroll.

Will Prescription Drug Programs Pay for Themselves? South Carolina's Assumptions

Like the other states with Pharmacy Plus waivers, South Carolina has assumed that its prescription drug program for seniors will pay for itself by diverting a significant number of seniors from Medicaid enrollment.

South Carolina's waiver allows it to provide prescription-only coverage to up to 66,000 seniors below 200 percent of the poverty line. Since South Carolina already provided state-funded coverage to 38,000 seniors before securing its waiver, it effectively will cover up to 28,000 new seniors. Seniors in the state's pharmacy program must meet a \$500 deductible and generally are limited to receiving four prescriptions per month (some exceptions may apply). Despite the modest size of its expansion and the limitations imposed on its prescription drug benefit, South Carolina is assuming its Pharmacy Plus program will dramatically reduce the extent to which seniors in the state are impoverished and, therefore, eligible for Medicaid.

- The state assumed that eventually 22,000 of the 28,000 new seniors it covers under its Pharmacy Plus program – two out of three new enrollees -- will avoid poverty and Medicaid eligibility because of the prescription drug coverage that they receive.
- By the fifth year of its waiver, the state assumed its Pharmacy Plus program will reduce the number of seniors on Medicaid by 25 percent compared to the number the state has projected otherwise would enroll.
- For this caseload decline to occur, the state must see the number of seniors on Medicaid fall substantially below its current enrollment levels. In 2000, the most recent year for which it had actual enrollment data when submitting its Pharmacy Plus application, the state provided Medicaid to 84,790 seniors. In the fifth year of its waiver, the state expects to provide Medicaid to only 68,000 seniors, a decline of more than 20 percent from the 2000 level.

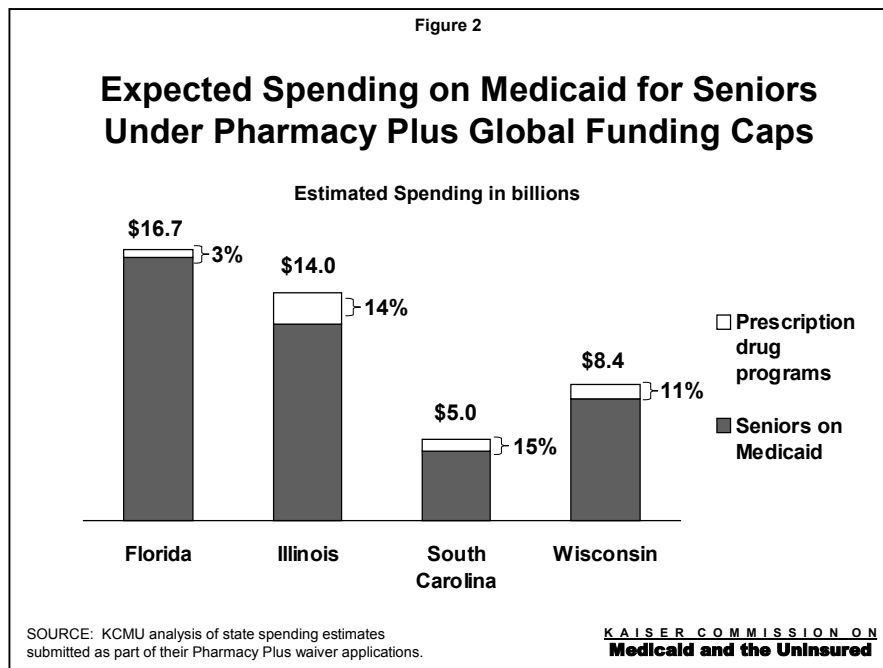
For states that hit their caps, officials in some states with Pharmacy Plus waivers have suggested that the Department of Health and Human Services would potentially increase their caps if they were to run out of federal Medicaid matching funds. Although CMS has the authority to re-negotiate Pharmacy Plus funding caps, it may be risky for states to rely on this outcome. In the past, states with other kinds of Medicaid waivers have had to adopt cuts in order to live within the budget neutrality requirements of their waivers.

Implications of Pharmacy Plus Funding Caps

Pharmacy Plus waivers provide states with new resources for prescription drug programs for seniors, but also may change the fiscal implications of a state's decisions about care for seniors on Medicaid. Under Medicaid's open-ended matching rate structure, a state can expand eligibility for low-income seniors, raise nursing home payment rates, or implement new home and community-based care waivers and receive federal Medicaid matching funds for these additional costs even if these expansions increase the rate of spending. If prescription drug or long-term care costs rise more rapidly than expected, the federal government automatically matches any resulting increase in state Medicaid spending. In contrast, a state at risk of reaching a Pharmacy Plus cap cannot rely on additional federal dollars for support of new initiatives or to assist with higher than expected Medicaid spending.

In the current budget environment, states may face new fiscal incentives to reduce expenditures on the elderly because a cut in Medicaid spending on the elderly reduces the risk of reaching a cap and can be used to re-finance or expand a state-funded prescription drug program. Pharmacy Plus waivers do not provide states with new options for reducing Medicaid spending on seniors, but states already have broad flexibility under current law to do so. States, for example, can scale back optional expansions of Medicaid coverage for seniors; drop or reduce optional benefits used heavily by seniors; reduce the number of slots for seniors in home and community-based waivers; or reduce payments to nursing homes. The threat of hitting a cap may make states more likely to use these existing options.

States at risk of reaching their caps also could cut back on their Pharmacy Plus programs by limiting enrollment, increasing cost-sharing, or reducing the value of the benefits provided, although the Pharmacy Plus programs are a minor component of spending subject to the cap. In the states with approved Pharmacy Plus waivers, the estimated share of spending under the cap attributable to the prescription drug program ranges from a low of three percent in Florida to a high of 15 percent in South Carolina (Figure 2, on next page). A state, thus, might dramatically scale back or even eliminate its Pharmacy Plus program and nevertheless finding itself at risk of reaching its cap because spending on elderly Medicaid beneficiaries has risen more rapidly than expected.



CONCLUSION

Pharmacy Plus waivers offer states the opportunity to extend prescription drug coverage to seniors, as well as to secure some fiscal relief. However, the budget neutrality requirement in these waivers that imposes funding caps has potentially serious implications for state budgets and for elderly Medicaid beneficiaries.

- Funding caps apply to all spending on elderly Medicaid beneficiaries, not just their Pharmacy Plus prescription drug programs.** As a result, states may face new fiscal incentives to reduce coverage for seniors if they are at risk of hitting their caps. States may be at risk if the cost of serving seniors on Medicaid or of operating their Pharmacy Plus programs rises more rapidly than anticipated, or if their assumptions that Pharmacy Plus programs will pay for themselves turn out not to be true.
- The generosity of funding caps varies markedly across states, but they are generally quite tight.** A function of the waiver negotiation process, the generosity of Pharmacy Plus funding caps varies markedly across the states with approved waivers. Most states are facing caps that limit the rate at which they can increase spending on seniors on Medicaid and Pharmacy Plus programs to below the rate at which national Medicaid spending on seniors is expected to grow and, in some cases, to below their current growth rates.
- It is unlikely that prescription drug programs for seniors will pay for themselves.** The existing research suggests broad-based prescription drug programs for low and moderate-income seniors generate little, if any, savings in Medicaid. States may find that their assumption that Pharmacy Plus programs will pay for themselves turned out to be overly optimistic, increasing the risk that they will run out of federal Medicaid funding under their caps.

This Policy Brief was prepared by Jocelyn Guyer of the Kaiser Commission on Medicaid and the Uninsured. She would like to thank the state officials who reviewed the brief, as well as her colleagues at the Kaiser Family Foundation for their comments and assistance.

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