Medicare and Prescription Drugs

March 2000

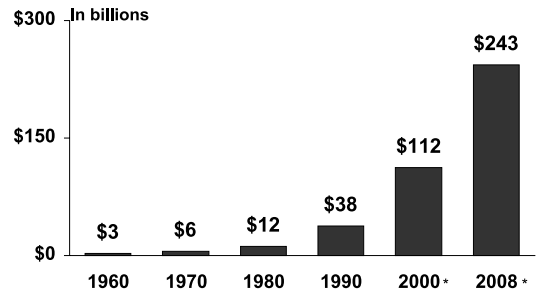
Overview

Prescription drugs are an essential tool for treating and preventing many acute and chronic conditions, but Medicare does not generally cover them on an outpatient basis. When Medicare was first enacted in 1965, pharmaceutical therapies were not as commonly available as they are now. Today, however, they are a primary form of medical care and often substitute for more costly therapies like hospitalization and surgery.

Pharmaceuticals are the fastest-growing component of national health expenditures. In 2000, national drug spending increased by an estimated 11% compared with 7% for physician services and 6% for hospital care. Since 1990, national spending for prescription drugs has tripled. By 2008, that figure is expected to more than double from an estimated $112 billion today to $243 billion by 2008 (Figure 1).

Figure 1

National spending for prescription drugs



Source: Health Care Financing Administration, Office of the Actuary.
*Projected

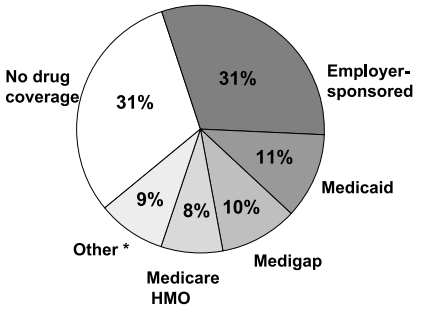
The growing importance and increased use of prescription drugs have had a disproportionate effect on the elderly, who account for 13% of the population but over a third of the nation's total drug expenditures. Lack of drug coverage for some, and limited and diminishing drug coverage for many others, can expose beneficiaries to high out-of-pocket spending that, in turn, may result in under-utilization of prescribed medications and adverse health outcomes.

Sources of Prescription Drug Coverage

Nearly 70% of all Medicare beneficiaries (26 million) had some form of drug coverage through employer-sponsored health plans, Medicaid, Medicare HMOs, and Medigap in 1996, the most recent year for which national data are available (Figure 2). Among those with drug coverage, one in four were covered for only part of the year (Stuart et al., 2000). Drug coverage available to beneficiaries varies widely across plans, is often limited, and is expected to decline in the future.

Figure 2

Prescription Drug Coverage of Medicare Beneficiaries, 1996



Total = 37 million Medicare beneficiaries

Source: Poisal, J.A. and Chulis, G.S., *Health Affairs*, March/April 2000.
Note: Data are based on the noninstitutionalized population.
*Includes people who changed coverage during the year and those with Medicare and "other" coverage.

Employer-sponsored health plans are the leading source of drug coverage, assisting nearly one in three Medicare beneficiaries, generally those with higher incomes. Drug benefits offered by employers, particularly large employers, tend to be relatively generous. Among large employers offering retiree drug benefits, drugs currently account for about half of all health care spending for retirees 65 and older, according to Hewitt Associates. With the rapid increase in retiree health costs generally, and prescription drug costs specifically, there has been a steady and continuing erosion of retiree health benefits. Employers are expected to take more stringent steps to control rising drug costs in the future.

Medigap is a source of drug benefits for approximately 10% of all beneficiaries. There are 10 standard Medigap policies (plans A - J), three of which include prescription drugs. Policies with prescription drug benefits have a $250 deductible and cover 50% of drug costs up to $2,500 (plans H, I) or 50% up to $6,000 (plan J). Premiums for policies that cover prescription drugs have increased rapidly in recent years and tend to be substantially higher than policies that lack drug benefits.

Medicaid plays an important role in providing access to affordable drugs for the poorest segment of the Medicare population, helping more than one in nine pay for their medications. Medicare beneficiaries generally qualify for Medicaid assistance with drug costs if they receive cash assistance under the Supplemental Security Income (SSI) program. However, less than half of all Medicare beneficiaries with incomes below the federal poverty level are covered by Medicaid, and many near poor Medicare beneficiaries are not eligible for Medicaid.

Medicare HMOs assisted 8% of all beneficiaries with their drug costs in 1996. Because Medicare requires plans with costs below the Medicare payment level to return savings to beneficiaries, many HMOs have been able to offer supplemental benefits, like drug coverage, to enrollees. About eight in 10 Medicare HMO enrollees are in plans that offer prescription

drugs. Medicare HMOs generally impose copayments for drugs and a growing number of plans have limits on drug benefits. In 2000, three of four plans cap drug benefit payments at or below $1,000, while nearly one in three limits drug benefits to $500 or less (HCFA, 2000).

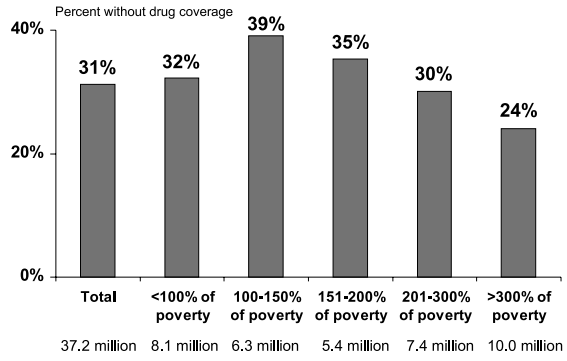
Characteristics of Beneficiaries Lacking Drug Coverage

While two-thirds of beneficiaries have some form of drug coverage, nearly a third (12 million) lack coverage and must pay for their medications out-of-pocket. Some without drug coverage may have some assistance through state pharmacy programs (in 16 states).

In many respects, beneficiaries without drug coverage look similar to the overall Medicare population. Over half of all beneficiaries without drug coverage have incomes above 150% of poverty and more than one in four are in fair or poor health. Still, lack of drug coverage disproportionately affects the near-poor, the oldest-old, and those living in rural areas (Poisal and Chulis, 2000). For example, 39% of beneficiaries with incomes between 100% and 150% of poverty lack drug coverage, compared with 24% of those with incomes above 300% of poverty (Figure 3). Beneficiaries 85 and older are more likely to lack drug coverage than their younger counterparts 65 to 74 (38% vs. 29%). Likewise, beneficiaries in rural areas are far more likely than those in non-rural areas to be without drug coverage (43% vs. 27%).

Figure 3

Medicare Beneficiaries Without Prescription Drug Coverage, by Poverty Level, 1996



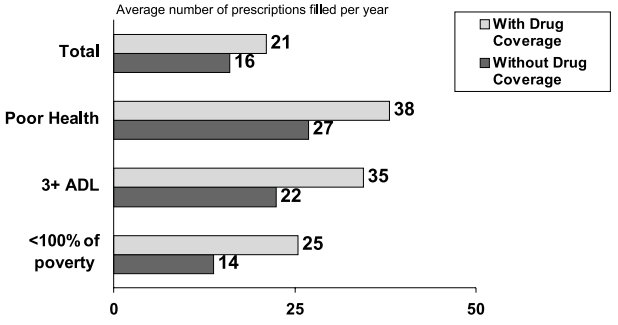
Note: 1996 federal poverty level was $7,740 for individuals; $10,360 for couples.
Source: Poisal, J.A. and Chulis, G.S., *Health Affairs*, March/April 2000.

Why Does Drug Coverage Matter?

Eight out of 10 Medicare beneficiaries report using pharmaceuticals on a regular basis, filling 19.5 prescriptions, on average, in 1996. Having drug coverage significantly influences whether Medicare beneficiaries fill their prescriptions. Beneficiaries without drug coverage average five fewer prescriptions per year than those who have coverage (Figure 4). The disparities are even wider among those in poor health: those who lack coverage average 11 fewer medications than their insured counterparts. Consistently lower utilization levels among those without drug coverage may indicate under-use of prescribed medications, which could have a negative effect on health.

Figure 4

Average Number of Prescriptions Filled by Medicare Beneficiaries, With and Without Drug Coverage, by Selected Characteristics, 1996



Note: ADL = Activity of Daily Living
Source: Poisal, J.A. and Chulis, G.S., *Health Affairs*, March/April 2000.

Total and Out-of-Pocket Spending

Total annual per capita drug spending in 1996 averaged $673 but was lower for Medicare beneficiaries without drug coverage ($463) than for those with drug coverage ($769) (Poisal and Chulis, 2000). Average spending on drugs rose as health status declined, for those with and without drug coverage. Still, beneficiaries in poor health who lacked coverage had substantially lower costs than those with coverage ($749 vs. $1,340).

Out-of-pocket spending for pharmaceuticals is related to a variety of factors, including beneficiaries' health needs, their access to drug coverage and the generosity of that coverage, and price. Average out-of-pocket spending for drugs in 1996 was $318 (Poisal and Chulis, 2000). As might be expected, those with drug coverage in 1996 spent, on average, less for their medicines than those without it ($253 vs. $463). Disparities in out-of-pocket spending between those with and without coverage were even wider among those in poor health ($423 vs. $749).

Out-of-pocket spending for pharmaceuticals is projected to rise in the future, with the continued introduction of new, high-priced breakthrough drugs, increases in direct-to-consumer advertising, and plans imposing higher cost-sharing requirements and caps on drug benefits.

Outlook for the Future

The lack of drug coverage for nearly one in three Medicare beneficiaries, the erosion of drug coverage for many others, and the dramatic increase in drug use and expenditures have focused national attention on proposals to help people on Medicare with medication costs. While the need to assist the elderly and disabled is widely recognized, complex and controversial issues are likely to be debated. For example, should assistance with drug costs be targeted to specific populations or universally available? What strategies should be used to control drug costs? How should new benefits be financed? The outcome of this debate will have significant implications for the nation's aging population.