



CONGRESSIONAL BUDGET OFFICE  
U.S. CONGRESS  
WASHINGTON, DC 20515

Dan L. Crippen  
Director

September 1, 2000

Honorable Frank R. Lautenberg  
Ranking Member  
Committee on the Budget  
United States Senate  
Washington, DC 20510

Dear Senator:

This letter responds to your request for information on assumptions underlying CBO's estimates of several proposals to establish a Medicare prescription drug benefit. Those proposals are the President's *Mid-Session Review* plan (MSR); the Medicare Outpatient Drug Act sponsored by Senator Robb, as printed in the *Congressional Record* on June 22, 2000 (S. 2758); the Medicare Rx 2000 Act as reported by the House Committee on Ways and Means (H.R. 4680); and the Medicare Prescription Drug and Modernization Act as modified by the sponsors, Senators Breaux and Frist (S. 2807).

**Number of Uninsured.** You asked several questions about insurance status under current law and the number and percentage of Medicare beneficiaries who would participate in 2003 in the federally subsidized prescription drug benefit offered under each proposal. CBO's estimates of those participation rates are summarized in the attached table.

CBO estimates that there will be 38.4 million enrollees in Part B of Medicare in 2003. CBO estimates that, under current law, about 60 percent of Part B enrollees (22 million people) will have prescription drug coverage and 40 percent (16 million people) will not.

CBO estimates that an additional 2.6 million people will be enrolled in Part A but not in Part B. CBO has not estimated how many of those individuals will have prescription drug coverage in 2003. However, CBO expects that a substantial number of those enrollees will have drug coverage through employer-sponsored plans or Medicaid.

For each of the proposals, CBO assumes that all Medicare enrollees who, under current law, have drug coverage that is not federally subsidized (as well as Medicare beneficiaries who have coverage through Medicaid) would participate in the benefit to take advantage of the federal subsidy. Likewise, CBO assumes for each proposal that all beneficiaries who decline Part B—which has a 75 percent federal subsidy—would also decline to participate in the drug benefit.

The estimates of participation differ only for those who purchase Part B but do not have drug coverage under current law. CBO estimates that all of those enrollees would participate in the drug benefit programs under the MSR and S. 2758 proposals; about two-thirds would participate under S. 2807, and about half would participate under H.R. 4680.

**Employer Coverage.** Under the President's *Mid-Session Review* proposal and S. 2758, employer-sponsored plans that offer qualified drug coverage would receive a smaller subsidy than other participating plans, and beneficiaries covered by employer-sponsored plans would not pay a Part D premium. H.R. 4680 and S. 2807 would treat qualified employer-sponsored plans the same as other qualified plans. Therefore, CBO distinguished between participants in employer-sponsored drug plans and in other drug plans in estimates of the President's MSR proposal and S. 2758 but made no such distinction in estimates of the other proposals. CBO estimates that about 25 percent of beneficiaries with employer-sponsored prescription drug benefits would be in plans in which the employer would take the subsidy offered under the MSR proposal and S. 2758. CBO has not estimated the proportion of employer-sponsored plans that would take those subsidies.

**Discount Rate.** For each proposal, we apply a discount factor that seeks to measure how spending under the proposed plan would compare to spending for prescription drugs by an uninsured beneficiary buying retail. The discount factor takes into account the price, quantity, and mix of drugs consumed. Thus, the discount is affected by many factors, including price discounts, rebates, and the effects of utilization management and therapeutic substitution.

We estimate the discount factor by taking into account:

- the tools plans are permitted to use, or prohibited from using, to create market power and to use that market power as leverage in dealing with everyone in the distribution chain—from manufacturers through physicians and consumers—and
- the incentives plans are given to use those tools.

Because the discount factor depends on both the freedom of a plan to use tools as they evolve and the incentives it has to use those tools, we cannot assign a specific discount to any particular tool.

CBO concludes that the discount factor for the President's MSR proposal (10 percent) would be significantly lower than the discount factor for H.R. 4680 and S. 2807 (25 percent). The MSR proposal would significantly limit the tools available to plans—for example, by limiting the ability of plans to restrict formularies or limit the number of pharmacies in their network and by permitting physicians to automatically override formularies—and it gives plans little incentive to use permitted tools to hold down spending. By contrast, H.R. 4680 and S. 2807 would place few limits on the tools that plans could use, and, by subjecting them to financial risk, would give those plans substantial incentives to use those tools to hold down spending for drugs.

The discount factor is a measure of only one component of the cost of a drug benefit. It reflects certain administrative costs—such as claims processing—that would be incurred by plans under all of the proposals we have analyzed to date. However, the discount factor does not reflect certain other costs that might be borne by plans (and which would be passed onto beneficiaries and the government). We characterize those other costs as marketing expenses and a risk premium.

Marketing expenses depend on whether plans compete for enrollees. If they do, we assume a fixed amount that does not vary across proposals; otherwise, we include no marketing expenses.

Based on a Hay-Huggins survey of underwriting practices, we assume a risk premium of 7.5 percent of benefit costs if plans bear substantial risk; otherwise, we apply no risk premium.

**Private Plans' Participation and Federal Fallback Plan.** In the context of H.R. 4680 and S. 2807 (which emphasize providing the prescription drug benefit through risk-bearing entities), CBO considers the existence of a fallback plan—in which the federal government ensures that a prescription drug benefit is available to every Medicare enrollee—essential to the timely, nationwide implementation of the prescription drug benefit. CBO has not analyzed a proposal that involves risk-bearing entities and no fallback plan. Therefore, CBO has come to no conclusions regarding the number of Medicare enrollees who would have access to a prescription drug plan under such a proposal.

Neither H.R. 4680 nor S. 2807 provides a detailed description of the fallback plan. CBO's estimates assume the government would contract with private entities on a non-risk-bearing basis, similar to the system proposed by the President.

H.R. 4680 and S. 2807 put few limits on the ability of plans to use tools to control drug spending, but the non-risk-bearing entities in the federal fallback program might have little incentive to achieve a large discount. On the other hand, they would also not have the marketing expenses or risk premiums that risk-bearing entities would incur. On balance, CBO assumes that the cost of the benefits under H.R. 4680 or S. 2807 would not depend significantly on the extent to which the benefits would be administered by the plans in the federal fallback program or by risk-bearing entities. Therefore, CBO has not attempted to estimate the share of participants who would be in a federal fallback program or in risk-bearing entities.

Honorable Frank R. Lautenberg  
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I hope this information is helpful to you. The CBO staff contact is Tom Bradley.

Sincerely,

Dan L. Crippen  
Director

Attachment

Identical letter sent to Senator Daniel Patrick Moynihan

cc: Honorable Pete V. Domenici  
Chairman  
Committee on the Budget

Honorable William V. Roth  
Chairman  
Committee on Finance

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**Assumptions About Medicare Enrollment and Participation in CBO's Estimates of  
Several Proposals to Establish a Medicare Prescription Drug Benefit, in Fiscal Year 2003**

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|                                                                                                | President's<br>Mid-Session<br>Review | S. 2758    | H.R. 4680   | S. 2807     |
|------------------------------------------------------------------------------------------------|--------------------------------------|------------|-------------|-------------|
| <b>Medicare Enrollment (Millions of enrollees)</b>                                             |                                      |            |             |             |
| Part B                                                                                         | 38.4                                 | 38.4       | 38.4        | 38.4        |
| Part A, but not Part B                                                                         | <u>2.6</u>                           | <u>2.6</u> | <u>2.6</u>  | <u>2.6</u>  |
| Total                                                                                          | 41.1                                 | 41.1       | 41.1        | 41.1        |
| <b>Participation in Prescription Drug Benefit (millions)</b>                                   |                                      |            |             |             |
| Participants in federally overseen benefit                                                     | 35.9                                 | 35.9       | 30.6        | 32.6        |
| Participants in federally subsidized<br>employer-sponsored plans                               | <u>2.5</u>                           | <u>2.5</u> | <u>n.a.</u> | <u>n.a.</u> |
| Subtotal, participants                                                                         | 38.4                                 | 38.4       | 30.6        | 32.6        |
| Nonparticipants enrolled in Part B                                                             | 0                                    | 0          | 7.8         | 5.9         |
| Nonparticipants not enrolled in Part B                                                         | <u>2.6</u>                           | <u>2.6</u> | <u>2.6</u>  | <u>2.6</u>  |
| Subtotal, nonparticipants                                                                      | 2.6                                  | 2.6        | 10.4        | 8.5         |
| <b>Participation in Prescription Drug Benefit<br/>(as a Percentage of Medicare enrollment)</b> |                                      |            |             |             |
| Participants in federally overseen benefit                                                     | 87                                   | 87         | 75          | 79          |
| Participants in federally subsidized<br>employer-sponsored plans                               | <u>6</u>                             | <u>6</u>   | <u>n.a.</u> | <u>n.a.</u> |
| Subtotal, participants                                                                         | 94                                   | 94         | 75          | 79          |
| Nonparticipants enrolled in Part B                                                             | 0                                    | 0          | 19          | 14          |
| Nonparticipants not enrolled in Part B                                                         | <u>6</u>                             | <u>6</u>   | <u>6</u>    | <u>6</u>    |
| Subtotal, nonparticipants                                                                      | 6                                    | 6          | 25          | 21          |

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SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable

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