



March 4, 2005

Honorable Joe Barton  
Chairman  
Committee on Energy and Commerce  
U.S. House of Representatives  
Washington, DC 20515

Dear Mr. Chairman:

Today the Congressional Budget Office (CBO) released its analysis of the President's budget for fiscal year 2006, which includes an update of our baseline projections for the 2006-2015 period. In preparing those projections, we have revised our estimates of spending for Medicare, including the new Part D prescription drug program. I am writing to describe CBO's current estimate for that program.

**CBO's Original Estimate for the Medicare Modernization Act (MMA)**

In November 2003, CBO estimated that the MMA (Public Law 108-173) would result in additional direct spending totaling about \$395 billion over the 2004-2013 period. That amount was the net of a number of different types of expenditures and receipts that would result from the legislation. It included an estimated \$552 billion in mandatory spending for Medicare Part D—consisting of \$771 billion in payments for benefits and mandatory administrative costs, offset by \$219 billion in premiums paid by beneficiaries and payments by states. (Those payments by states represent part of their share of the savings from shifting some Medicaid spending for prescription drugs to Medicare.) Those costs were further offset by net savings of almost \$13 billion from changes to Parts A and B of Medicare and estimated savings of almost \$145 billion in Medicaid and other federal programs because the Part D benefit would reduce spending in those federal programs (largely by shifting some spending for prescription drugs from those programs to Medicare).

### **Subsequent Revisions to CBO's Baseline Projections**

Since enactment of the MMA, CBO's baselines have included explicit projections of Medicare spending for the Part D program (the \$552 billion component of the original estimate). CBO's baseline projections for Medicare Parts A and B, Medicaid, and other federal health programs incorporate the effects of the MMA on spending by those programs. However, those effects—the \$157 billion of offsetting savings in the original estimate—are not readily identifiable, and we do not project them separately.

CBO currently estimates that net Medicare spending for the Part D program will total \$593 billion over the 2004-2013 period. That is an increase of \$41 billion over the original \$552 billion estimate of net Medicare spending for Part D (see attached table). That change results from increases of:

- \$5 billion because of the slightly higher inflation rates in CBO's current economic projections (that change was incorporated in the January 2005 baseline);
- \$8 billion in the net cost of the basic Part D benefit reflecting provisions in the final rule that differ from what CBO had anticipated in the original estimate;
- \$11 billion in the net cost of the basic benefit resulting from the use of new data and other refinements of CBO's estimating methodology; and
- \$17 billion in the cost of the low-income subsidy and transitional drug assistance, reflecting more current data on the characteristics of Medicare beneficiaries, the final rule governing eligibility for the low-income subsidy, and other revisions.

Most of these revisions result from technical or economic changes in estimating assumptions or methodology. Less than \$14 billion is the result of the final rule for the Medicare prescription drug program, which was issued by the Centers for Medicare & Medicaid Services on January 28, 2005. In preparing the cost estimate for the MMA, CBO made numerous assumptions about how the legislative language would be implemented and about how implementation decisions would affect federal spending. Most of those

assumptions were confirmed by the final rule, or the difference from what CBO originally assumed does not have a substantial effect on our spending projections.

CBO's original assumption, however, differs from the guidance in the final rule regarding the formulary requirements plans must satisfy to be approved for participation in the Part D program. CBO had assumed that, in general, plans would be permitted to establish restrictive formularies to manage spending. However, the formulary guidance makes it clear that the Secretary will rely heavily on a comparison of the proposed formulary to "industry best practices" in deciding whether to approve a plan's application. As a result, CBO now expects that prescription drug plans will be slightly less effective at controlling drug spending than we had previously assumed.

In addition, before the final rule was issued, CBO had assumed that the measure of family income used to determine eligibility for the low-income subsidy would include the income of dependents and would count dependents in determining family size. However, the rule states that the income test will count dependents but disregard their income. That provision, in conjunction with other refinements in how we estimate the number of individuals who meet the SSI income rules, produced an increase in our estimate of the number of participants in the low-income subsidy, resulting in a \$6.5 billion increase in the projected cost of that subsidy.

CBO does not separately project the offsetting savings to Medicaid and other programs from shifting some spending for prescription drugs from those programs to Medicare. It is likely, however, that those savings will be larger than the \$145 billion in CBO's original estimate—both because of higher inflation projections and because our current estimate of the number of Medicare beneficiaries who are enrolled in Medicaid is higher than we previously projected. Thus, the increase in the estimated cost of establishing the Part D program over the 2004-2013 period would likely be less than \$41 billion.

The 10-year projection period that CBO uses for its budget projections has changed since the MMA was enacted; it now spans fiscal years 2006 to 2015 instead of 2004 to 2013, thus encompassing two more years of prescription drug benefits. Adding more years to the period covered by the estimate would, of course, add to the total cost being discussed, even if the original estimate

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had not changed at all. By CBO's estimate, net mandatory spending for Medicare Part D will total about \$258 billion during those two additional years.

I hope this information is helpful to you. The staff contact for further information is Tom Bradley.

Sincerely,

Douglas Holtz-Eakin  
Director

Attachment

cc. Honorable John D. Dingell  
Ranking Member

Identical letters to the Honorable William "Bill" M. Thomas and the Honorable Charles E. Grassley

## Comparison of CBO's March 2005 Medicare Prescription Drug Baseline and the CBO Estimate for the MMA

(By fiscal year, in billions of dollars)

### CBO's Estimate of Drug Provisions in the Medicare Modernization Act

See Table 1 in "A Detailed Description of CBO's Cost Estimate for the Medicare Prescription Drug Benefit"

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2004-13</u>
Benefits and Mandatory Administrative Costs	0.6	1.5	46.8	74.8	84.2	92.0	101.3	110.6	122.8	136.8			771.3
Part D Premiums	0.0	0.0	-9.1	-12.8	-14.3	-15.5	-17.0	-18.5	-20.6	-22.9			-130.6
Payments by States	<u>0.0</u>	<u>0.0</u>	<u>-5.7</u>	<u>-9.1</u>	<u>-10.0</u>	<u>-10.8</u>	<u>-11.7</u>	<u>-12.6</u>	<u>-13.7</u>	<u>-14.9</u>			<u>-88.5</u>
Subtotal, Medicare Part D Offsetting Receipts	0.0	0.0	-14.8	-21.9	-24.3	-26.3	-28.7	-31.1	-34.2	-37.8			-219.1
<b>    Subtotal, Net Medicare Part D Outlays</b>	<b>0.6</b>	<b>1.5</b>	<b>32.1</b>	<b>52.9</b>	<b>59.9</b>	<b>65.7</b>	<b>72.6</b>	<b>79.5</b>	<b>88.5</b>	<b>98.9</b>			<b>552.2</b>
Savings to Medicaid and Other Federal Programs /1	0.0	0.0	-6.6	-14.2	-15.6	-17.4	-19.3	-21.4	-23.8	-26.4			-144.7
Net Changes to Federal Spending from Drug Provisions	0.6	1.5	25.5	38.7	44.3	48.3	53.3	58.1	64.7	72.5			407.5
Other Spending Effects	3.2	4.5	2.0	1.5	-0.3	-1.8	-3.5	-5.1	-6.0	-7.0			-12.5
Net Cost of MMA	3.8	6.0	27.5	40.2	44.0	46.5	49.8	53.0	58.7	65.5			395.0

### CBO's March 2005 Part D baseline

Benefits and Mandatory Administrative Costs /3	0.4	2.0	47.4	77.0	88.9	97.7	108.8	119.6	133.7	148.8	167.7	188.2	824.2
Part D Premiums /3	0.0	0.0	-8.6	-13.1	-15.1	-16.6	-18.6	-20.5	-23.2	-26.0	-29.6	-33.4	-141.6
Payments by States	<u>0.0</u>	<u>0.0</u>	<u>-6.0</u>	<u>-9.0</u>	<u>-9.9</u>	<u>-10.8</u>	<u>-11.7</u>	<u>-12.7</u>	<u>-13.9</u>	<u>-15.1</u>	<u>-16.5</u>	<u>-18.0</u>	<u>-89.2</u>
Subtotal, Medicare Part D Offsetting Receipts	0.0	0.0	-14.6	-22.0	-25.0	-27.4	-30.4	-33.2	-37.1	-41.1	-46.1	-51.4	-230.8
<b>    Total, Net Medicare Part D Outlays</b>	<b>0.4</b>	<b>2.0</b>	<b>32.8</b>	<b>55.0</b>	<b>63.9</b>	<b>70.3</b>	<b>78.4</b>	<b>86.4</b>	<b>96.6</b>	<b>107.7</b>	<b>121.6</b>	<b>136.9</b>	<b>593.4</b>
Savings to Medicaid and Other Federal Programs	Not Separately Identifiable												
Other Spending Effects	Not Separately Identifiable												

- /1** Medicare Part D spending is larger than the effect on the federal budget of establishing the Medicare prescription drug benefit, because it includes some spending that, under prior law, would have been incurred by Medicaid and other federal health programs. That "prior law" spending is no longer separately identifiable.
- /2** Differences in 2004 and 2005 reflect actual spending for the drug card in 2004 and revised projections for the drug card in 2005. Differences in 2006 and subsequent years reflect revised estimates based on the Part D final rule.
- /3** CBO's original estimate and this table present premiums paid by the low-income subsidy program both as outlays (on the benefits line) and receipts (on the premium line). The Administration presents outlays for the low-income subsidy net of the premium payments. To conform to how spending will be reported in the future, CBO will adopt that presentation for all purposes except this table. CBO projects that premiums paid by the low-income subsidy will amount to \$43 billion over the 2006-2013 period. Therefore, other presentations of projections in the March 2005 baseline will show outlays that are \$43 billion lower over the 2006-2013 period, and premium receipts that are \$43 billion lower for the same period. The change in presentation has no effect on the estimate of net spending by the Part D program.