CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas W. Elmendorf, Director

August 28, 2009

Honorable Dave Camp
Ranking Member
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Congressman:

As you requested, the Congressional Budget Office (CBO) has estimated the change in Medicare Part D premiums that would result from certain provisions contained in title I in division B of H.R. 3200, America's Affordable Health Choices Act of 2009, as introduced on July 14, 2009. According to CBO's estimates, enacting those changes would lead to an average increase in premiums for Part D beneficiaries of about 5 percent in 2011, rising to about 20 percent in 2019. However, beneficiaries' spending on prescription drugs apart from those premiums would fall, on average, as would their overall prescription drug spending (including both premiums and cost sharing). As with CBO's other estimates related to this bill, the following analysis remains preliminary and does not reflect any modifications or amendments made after July 14.

Under current law, the standard outpatient prescription drug benefit under Part D of Medicare has the following features: an annual deductible for which the beneficiary is responsible; a dollar range of coverage in which the beneficiary pays 25 percent of the cost of covered drugs; and a catastrophic threshold above which the beneficiary pays about 5 percent of the cost of covered drugs. In the gap between the end of the initial coverage range and the catastrophic threshold—commonly referred to as the doughnut hole—beneficiaries generally are liable for all of their drug costs. For their Part D insurance coverage, most enrollees pay premiums that finance about 25 percent of the cost of the coverage (on average); the federal government pays the remaining 75 percent. For low-income individuals, however, the federal government subsidizes a larger share of their prescription drug costs, including their premiums and their spending in the doughnut hole.

H.R. 3200 proposes several changes to the Medicare Part D program that would affect federal spending:

- First, it would create a new rebate program that, under certain circumstances, requires pharmaceutical manufacturers to pay the federal government the difference between the statutory rebate under Medicaid and the rebates paid to Medicare's prescription drug plans. Specifically, this policy would apply to covered drugs dispensed to full-benefit dual eligible individuals—beneficiaries who are enrolled in both Medicare and Medicaid. Because the statutory rebate provided under Medicaid is, on average, larger than those negotiated by the plans providing the Medicare drug benefit, this provision would reduce federal spending.[1]

- Second, it would phase out the doughnut hole by simultaneously extending the benefit's initial coverage limit and lowering the catastrophic threshold at specified rates, resulting in the elimination of the doughnut hole by 2022. This provision would increase federal spending because of the additional coverage provided.

- Third, in the years before the doughnut hole was eliminated, the legislation would require pharmaceutical manufacturers to provide to beneficiaries who are not eligible for the low-income subsidy program a 50 percent discount on their spending in the doughnut hole for covered brand-name drugs. Enrollees receiving those discounts would generally increase their use of drugs somewhat and thus would be more likely to exceed the drug benefit's catastrophic threshold.[2] The increased use of the catastrophic part of the benefit would raise federal spending during the years before the doughnut hole was eliminated, all else being equal.

According to CBO's estimate, these provisions would collectively save the federal government about $30 billion over the 2010–2019 period.[3] CBO has not estimated the impact of each provision separately because their effects are so closely connected.

Under the proposal, beneficiaries' premiums would increase for two reasons. First, with the doughnut hole phasing out and with more spending above the catastrophic threshold, prescription drug plans would be responsible for covering some costs in the doughnut hole and above the catastrophic level that they are not required to cover under current law. Because enrollees pay for about 25 percent of the cost of coverage through their premiums, premiums would also be higher. In return for those higher premiums, enrollees would receive greater protection

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[1] For a discussion of the Medicaid rebate provisions, see Congressional Budget Office, *Prices for Brand-Name Drugs Under Selected Federal Programs* (June 2005).

[2] Beneficiaries who reached the doughnut hole also would be more likely to use brand-name drugs than they are now under current law.

[3] See Congressional Budget Office, "Preliminary Analysis of America's Affordable Health Choices Act of 2009," letter to the Honorable Charles B. Rangel (July 17, 2009).

against incurring high drug costs. As a result, beneficiaries' spending on prescription drugs apart from the premiums would decrease, on average. That reduction in cost sharing would outweigh the increase in premiums, again on average, because of the subsidies provided by the federal government—so beneficiaries' total prescription drug spending would fall on average. Of course, the effect on total spending would vary among beneficiaries: Those who ended up purchasing a relatively small amount of drugs in a year would pay more in additional premiums than they would gain from lower cost sharing, while those who purchased a relatively large amount of drugs in a year would gain more from lower cost sharing than they would pay in higher premiums. CBO has not estimated the number of beneficiaries who would fall into each of those groups.

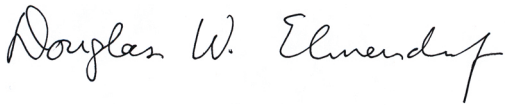
Second, CBO expects that the responses of pharmaceutical manufacturers to those three provisions of the legislation would also increase Part D premiums. Drug manufacturers would be constrained from increasing prices for existing drugs but could offset the rebates they would be required to pay for full-benefit dual eligible individuals by charging higher prices for new drugs—particularly for "breakthrough" drugs (the first drugs that use new mechanisms to treat illnesses). In addition, manufacturers would probably lower the rebates they pay to prescription drug plans. Although they would continue to have an incentive to provide rebates in exchange for having their products designated as "preferred" on the plans' formularies—which leads to higher volumes of sales—the rebates would probably decline relative to their amounts under current law because the benefit to the manufacturers of those added sales would be reduced by the new discounts and rebates they would have to provide. Those responses would lead to an increase in beneficiaries' premiums, CBO estimates, and they would also lead to an increase in beneficiaries' payments for cost sharing.

Overall, CBO estimates that enacting the proposed changes would lead to an average increase in premiums for Part D beneficiaries, above those under current law, of about 5 percent in 2011. That effect would rise over time and reach about 20 percent in 2019. Beyond the 10-year budget window, the premiums would increase slightly more until the doughnut hole was eliminated in 2022; beyond that point, enrollees' premiums would grow along with the cost for covered drugs. As already noted, the proposed changes would also reduce beneficiaries' average cost sharing and their average total drug spending. The net effect on drug spending would differ among beneficiaries depending on the amount of their purchases in a year.

I hope that you find this information useful. If you wish further details on this

analysis, CBO will be pleased to provide them. The staff contacts are Kate Massey and Rebecca Yip.

Sincerely,



Douglas W. Elmendorf
Director

cc: Honorable Charles B. Rangel
Chairman
Committee on Ways and Means

Honorable George Miller
Chairman
Committee on Education and Labor

Honorable John Kline
Senior Republican Member
Committee on Education and Labor

Honorable Henry A. Waxman
Chairman
Committee on Energy and Commerce

Honorable Joe Barton
Ranking Member
Committee on Energy and Commerce