

## Prescription Drugs and the Elderly: Policy Implications of Medicare Coverage

Since outpatient prescription drug use is not covered by Medicare, it is a major source of out-of-pocket expenditures for the elderly. By one estimate, severely disabled elderly persons spend more than half their out-of-pocket health expenditures on outpatient prescription drugs. What makes this financial burden all the more daunting is that half the elderly population has no insurance coverage for prescription drugs.

Given this burden, it is not surprising that policymakers have considered expanding Medicare benefits to cover prescription drug costs a number of times. For example, the Medicare Catastrophic Act of 1988, which contained a prescription drug benefit, was passed into law but repealed before it became effective, and during the health debate in 1993, administration proposals would have added the benefit to Part B of Medicare. New proposals are circulating again.

Still, despite the potentially catastrophic nature of prescription drug expenses and the desire to address the problem through policy, surprisingly little is known about how much the financial burden is, how much coverage might increase demand for prescription drugs, and how much such coverage might cost.

Researchers Jeannette Rogowski, Lee Lillard, and Raynard Kington addressed these issues using data from the 1990 Elderly Health Supplement to the Panel Study of Income Dynamics (PSID). Begun in 1968, the PSID is a nationally representative longitudinal survey of 7,000 elderly households and 21,000 individuals; the supplement collects detailed information on health status, insurance, and health care costs.

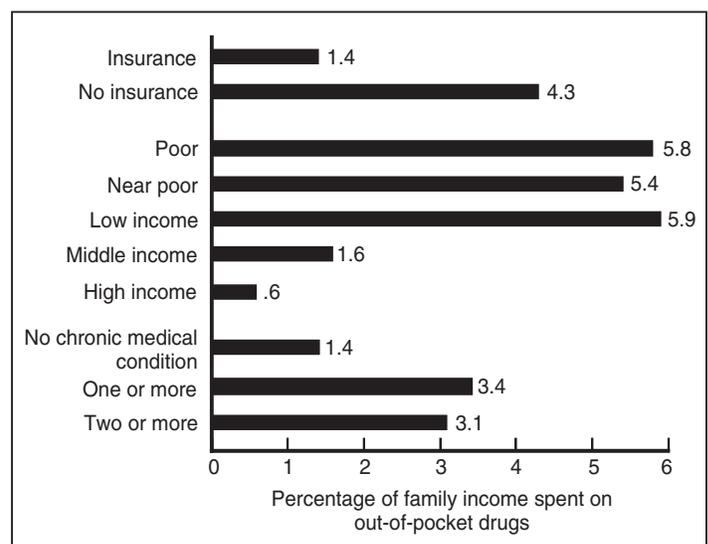
### HOW MUCH IS THE FINANCIAL BURDEN?

Among the elderly who used prescription drugs in 1990, a large fraction of drug cost (67 percent) was paid for out of pocket. As a result, the elderly spent an average of 3.1 percent of their household income on prescription drugs. Some elderly households, however, have much higher levels of expenditures and financial burden than

others. For instance, 3.4 percent of elderly persons had total annual expenditures that exceeded \$2,000, and 1 percent spent in excess of \$2,000. The resulting distribution of financial burden is highly skewed. Although 55 percent of elderly persons who used prescription drugs spent 1 percent or less of their household income on them, the “tail” of the distribution is long: 7 percent spent at least 10 percent, and 1 percent spent over one quarter of their household income. For those in the tail, such expenditures are potentially catastrophic.

While such numbers tell us much about the aggregate level of the burden, they tell us little about which groups bear most of the burden. The figure provides some answers to this question for the PSID group surveyed.

Those without private insurance bear nearly three times the burden of those with it. Similarly, elderly persons in poor, near-poor, and low-income households have much higher levels of burden than those in middle- and higher-income households. On average, lower-income individuals have burden levels more than three times as high as middle-income elderly people and almost 10 times as high as the high-income elderly. This is related not only to income but also to the presence of private health insur-



ance, since the likelihood of having private insurance that covers drugs rises as income rises.

Finally, drug expenditures and burdens vary by whether the elderly have a chronic medical condition, such as diabetes. Those having one or more such conditions bear 2.5 times the burden as those who have no chronic medical conditions. The presence of a second common chronic condition, while raising total expenditures, has little additional effect on out-of-pocket expenses or burden levels.

Using multivariate analyses, the researchers showed that insurance coverage, income, and health status primarily determine the financial burden. Insurance coverage decreases the fraction of household income spent out of pocket by 50 percent once these other factors are controlled for.

### **HOW DOES COVERAGE AFFECT DEMAND?**

While insurance coverage for drugs decreases the financial burden on the elderly, it may also increase spending on drugs. Since half the elderly have no insurance coverage for drugs, such an increase could be important in estimating the effects of adding coverage to the Medicare budget. To understand this issue, the researchers used multivariate analyses to examine the role of insurance coverage in using drugs, as well as the amounts spent for them. They found that persons with insurance coverage were more likely to have any use of drugs. However, among persons with use, insurance coverage did not increase the total amount spent for prescription drugs. Thus, overall, insurance coverage increases expected spending on drugs, primarily by increasing the number of persons with any use.

### **HOW MUCH WOULD ADDING COVERAGE COST?**

Given this demand response, the researchers conducted policy simulations to determine the potential budgetary effect on Medicare if prescription drug benefits were added to the program. The policy simulations assume that elderly persons without prescription drug coverage will receive drug coverage similar to the average private benefit. The groups with prescription drug coverage now (either through private insurance or Medicaid) have no change in insurance coverage in the simulations.

Overall, providing drug coverage under Medicare would increase expected annual spending on prescription drugs by \$83 per elderly beneficiary in 1990 dollars, but this effect is significant only at the .10 level. The likelihood of having any use of prescription drugs across all beneficiaries would rise by 4.8 percent, which is significant at the .01 level. Given the approximately 31 million elderly beneficiaries in 1990, the expected spending for prescription drugs would have increased by \$2.6 billion if all elderly persons had had insurance for drugs. Since expenditures for prescription drugs among the elderly were approximately \$12.4 billion in that year, total drug spending, including the effect of this increased demand, would have been \$15.0 billion. This represents approximately a 20 percent increase in overall spending on drugs by the elderly. Compared to the \$89.6 billion in Medicare outlays in 1990, total spending on drugs if all beneficiaries had insurance coverage would represent approximately 17 percent of existing program outlays. The actual budgetary effect would depend on the structure of the benefit, including the size of potential copayments, deductibles, or annual limits on benefit amounts. Medicare would also be likely to negotiate discounts on drug prices, which would lower total program outlays relative to the estimates presented here.

### **IMPLICATIONS**

Although the policy simulations show only a 20 percent increase in overall spending on drugs for the elderly, the largest shift would be from elderly households to Medicare, since (as shown earlier) the elderly paid 67 percent of their drug costs out of pocket. Such a shift would significantly decrease the financial burden associated with prescription drug purchases among the elderly.

Given the high burden of paying for prescription drugs, some form of Medicare expansion seems almost inevitable. However, with the Medicare budget already strained, policymakers may want to consider targeting benefits. This research shows that aside from insurance, health status and income are the most important determinants of the financial burden. Thus, those with low incomes and those in poor health would benefit the most if drugs were covered under Medicare.

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*RAND research briefs summarize research that has been more fully documented elsewhere. This research brief describes work done in RAND's Labor and Population Program as part of the Center for the Study of Aging, supported by a grant from the National Institute on Aging. Research results are described in detail in two articles: Jeannette Rogowski, Lee A. Lillard, and Raynard Kington, "The Financial Burden of Prescription Drug Use Among Elderly Persons," *The Gerontologist*, Vol. 37, No. 4, 1997, pp. 475-482; and Lee A. Lillard, Jeannette Rogowski, and Raynard Kington, "Insurance Coverage for Prescription Drugs: Effects on Use and Expenditures in the Medicare Population," *Medical Care*, Vol. 37, No. 9, 1999, pp. 926-936. Abstracts of RAND documents may be viewed on the World Wide Web (<http://www.rand.org>). RAND® is a registered trademark. RAND is a nonprofit institution that helps improve policy and decisionmaking through research and analysis; its publications do not necessarily reflect the opinions or policies of its research sponsors.*

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