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**How Much Are Medicare Beneficiaries
Paying Out-of-Pocket for
Prescription Drugs?**

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EXECUTIVE SUMMARY

Purpose: This issue paper presents data on out-of-pocket spending on outpatient prescription drugs by Medicare beneficiaries, and places this spending in the broader context of beneficiaries' total out-of-pocket health care spending. We examine beneficiary out-of-pocket spending on drugs from two perspectives. First, we look at variations in projected average (per capita) drug spending in 1999 by beneficiary characteristics, including sociodemographic characteristics, health status, presence of drug coverage, and supplemental insurance coverage. Second, we focus only on the characteristics of those beneficiaries with *high* or *very high* levels of annual out-of-pocket spending on drugs (with "high" defined as \$500 to \$999 and "very high" as \$1,000 or more) compared to the characteristics of beneficiaries with low to moderate drug spending (less than \$500 per year).

Background: Outpatient prescription drugs, which are not covered under Medicare, can be a substantial out-of-pocket burden for many Medicare beneficiaries. Over one-third of beneficiaries have no coverage for prescription drugs. It has been argued that because roughly two-thirds of beneficiaries have some type of drug coverage from other sources, a Medicare drug benefit for all beneficiaries is not necessary. However, recent research has identified many gaps in private drug coverage and the degree of protection it affords. This paper supplements these findings by providing data on variations in beneficiaries' out-of-pocket drug spending according to key beneficiary characteristics.

Methodology: These estimates refer to all noninstitutionalized beneficiaries, including disabled beneficiaries under age 65 as well as those age 65 and older. The 1999 estimates, derived from a microsimulation model developed for AARP by The Lewin Group, are projected from the 1995 Medicare Current Beneficiary Survey (MCBS). *Total out-of-pocket spending* includes expenses for Medicare Part B premiums and cost-sharing; private insurance premiums (including any additional premiums for drug coverage); health care goods and services not covered by Medicare, such as prescription drugs, dental, and vision care; and short-term nursing home care. It does not include the costs of home care or long-term nursing home care.

Because many analysts believe that the MCBS understates drug utilization, the estimates of *out-of-pocket drug spending* can be interpreted as reflecting a *lower bound* of the out-of-pocket burden of prescription drugs. The out-of-pocket drug estimates include only direct spending on drugs; they do not include the premium costs of drug coverage obtained through supplemental insurance.

Principal Findings:

Part I: How does average out-of-pocket drug spending vary by key beneficiary characteristics? What are total out-of-pocket health care costs for beneficiaries with these characteristics?

Among the income groups compared, beneficiaries with the *highest average out-of-pocket drug expenses* are those with modest incomes (135-200% of poverty) -- not those with low or high incomes. However, among all beneficiary income groups, those with incomes under 100% of poverty without Medicaid protection spend the largest *percent* of their income out-of-pocket on drugs.

Beneficiaries whose out-of-pocket spending on drugs is, on average, higher than that of other beneficiaries are more likely to:

- be in poor or fair health
- be severely limited in their activities of daily living
- be age 75 or older or under age 65 and disabled
- lack drug coverage
- have individually purchased supplemental insurance

Beneficiaries in the groups identified above spend, on average, from 4 to 7 percent of their annual income out-of-pocket on drugs alone, and from 21 to 30 percent of their income out-of-pocket on all health care costs, not including any home care or long-term nursing home care.

Part II: What are the defining characteristics of beneficiaries with high out-of-pocket drug spending?

Beneficiaries with high or very high out-of-pocket drug costs are not disproportionately low or high income. All beneficiaries, regardless of income, can have high out-of-pocket drug expenses.

Beneficiaries with high or very high out-of-pocket drug costs are more likely than those with low to moderate costs to have the characteristics identified in the bulleted list above (i.e., have severe functional limitations; be age 75 or older; be in poor or fair health; lack prescription drug coverage, and have individual supplemental insurance, regardless of whether or not they have drug coverage).

Although more beneficiaries with high out-of-pocket drug costs lack any drug coverage than do those with lower expenses, a surprisingly large share of those with high drug expenses (about half) do have some type of drug coverage.

Conclusions: This analysis supplements and supports other research suggesting that *private sector drug coverage is often inadequate* by showing that:

- over half of beneficiaries spending \$500 or more out-of-pocket on drugs in a given year and 42% of beneficiaries spending \$1,000 or more have some type of drug coverage.
- those with the highest out-of-pocket drug spending are disproportionately those who have individual supplemental coverage, regardless of whether or not they have drug coverage.

Second, the analysis shows that *limiting a Medicare drug benefit to beneficiaries with low incomes could exclude many beneficiaries most in need of assistance with drug costs*, including:

- beneficiaries with modest incomes (135-200% of poverty), who have higher than average out-of-pocket drug spending; our data also suggest that beneficiaries at all income levels may experience high or very high drug spending, not just those with lower incomes.
- those in poor or fair health, or with severe functional limitations, who have incomes or assets too high to qualify for Medicaid coverage.

Finally, even though a Medicare drug benefit should not be for low income beneficiaries alone, we have shown that *poor beneficiaries often face substantial out-of-pocket costs for drugs as a share of their income*:

- on average, poor beneficiaries (those with incomes below poverty) spend 9 percent of their income for drugs; and
- on average, poor beneficiaries without any protection from Medicaid (1.8 million beneficiaries, about 45% of all poor beneficiaries) spend 13 percent of their income on drugs alone.

Targeting drug benefits *only* to those most likely to incur high out-of-pocket drug costs and other health expenses would not solve the problem either. Because the sickest beneficiaries are the most expensive to insure, attempting to segment the beneficiary population by health status or level of out-of-pocket drug spending is likely to result in a drug benefit that is unaffordable. Moreover, because of unpredictable changes in beneficiaries' health status and drug spending, such a benefit would not provide adequate protection. First, only a minority of beneficiaries have high drug spending in any given year. Second, the individuals in need of drug coverage are likely to change over time. Designing a drug benefit that will protect those currently in need, as well as those who may face substantial drug costs in the future, will require coverage for all beneficiaries as well as adequate financing.

ACKNOWLEDGMENTS

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How Much Are Medicare Beneficiaries Spending Out-of-Pocket on Prescription Drugs?

Outpatient prescription drugs, which are not covered under Medicare, represent a substantial out-of-pocket burden for many Medicare beneficiaries. Although many beneficiaries are able to obtain some form of drug coverage through public or private supplemental insurance, over one-third have no coverage for prescription drugs.¹ Moreover, even those who have drug coverage can face burdensome out-of-pocket expenses because of inadequate private sector coverage. Now, for the first time in over a decade, proposals to expand Medicare to cover prescription drugs are being seriously debated by policy makers and have received significant media attention. To help inform that debate, this issue paper examines beneficiary out-of-pocket drug spending from two perspectives. First, it presents data on differences in average out-of-pocket spending on prescription drugs, by key beneficiary characteristics, and places this spending in the broader context of beneficiaries' total out-of-pocket health spending. Next, the study focuses on the characteristics of those beneficiaries with high or very high levels of out-of-pocket spending on drugs.

Background

It has been argued that because approximately two-thirds of Medicare beneficiaries have some coverage of prescription drugs, the need for a Medicare drug benefit is not as great as generally believed. Recent research, however, has shown wide variations in the scope of drug coverage and the degree of protection it affords, depending upon the source of coverage.^{2,3} Following is a brief summary of some of the gaps in private sector coverage.

- Although beneficiaries with employer-sponsored insurance are currently the largest group of beneficiaries with drug coverage, the number of firms offering retiree health coverage has declined in recent years.⁴ Employers are also increasingly asking retirees to pay a greater share of the cost of coverage.
- Although an increasing number of beneficiaries have drug benefits through Medicare managed care plans, the scope of coverage varies widely within and across markets, and the future of these benefits is uncertain.⁵ Medicare+Choice plans can decide on an annual basis whether to continue to offer a drug benefit and whether to continue to remain in the Medicare market. In addition, many plans are restructuring drug benefits in ways that increase enrollee out-of-pocket costs and limit coverage. For example, in 1999, only 21 percent of plans had an annual cap on drug benefit payments of \$500 or less; in 2000, 32 percent of plans will have a limit of \$500 or less.⁶
- Only a small proportion of beneficiaries with drug coverage (13%) have individual supplemental coverage, such as Medigap.⁷ Premiums for Medigap plans with drug coverage may not be affordable, and beneficiaries with health problems may be denied coverage. In addition, the coverage itself is limited: There is a \$250 deductible, 50% coinsurance, and benefit caps of either \$1,250 or \$3,000.

These data support the conclusion that two-thirds of beneficiaries “have pieced together some form of drug coverage, but it is not always extensive.”⁸

Introduction

Part I of this report looks at how average out-of-pocket drug spending for all beneficiaries varies by key beneficiary characteristics in order to determine which beneficiaries are likely to face higher than average out-of-pocket drug costs. In addition, because drug spending represents only a fraction of beneficiaries' overall out-of-pocket spending, we also examine their out-of-pocket spending in the context of total out-of-pocket health expenses.

Part II focuses on the characteristics of beneficiaries who report high out-of-pocket spending (defined as \$500 to \$999 per year) or very high spending (defined as \$1,000 or more).

The estimates presented here refer to all noninstitutionalized Medicare beneficiaries, including disabled beneficiaries under age 65 as well as beneficiaries age 65 and older.⁹ These estimates can be interpreted as reflecting a *lower bound* of the out-of-pocket burden of prescription drugs. The data are projected from the 1995 Medicare Current Beneficiary Survey, which many analysts -- including those at the Congressional Budget Office (CBO) and Health Care Financing Administration (HCFA) -- believe understates drug utilization, possibly by as much as 30 percent.¹⁰ In addition, these estimates do not include out-of-pocket spending by individuals in institutional settings, whose out-of-pocket drug spending can be high unless they are eligible for Medicaid.

Part I: How does average out-of-pocket drug spending vary by key beneficiary characteristics? What are total out-of-pocket health care costs for beneficiaries with these characteristics?

In the following section, we show how both out-of-pocket drug spending and beneficiaries' total health spending vary by the following characteristics:

- income level
- gender
- severe limitations in activities of daily living (ADLs)
- age
- health status
- the presence of drug coverage
- type of primary supplemental insurance coverage

Average Out-of-Pocket Health Spending on Prescription Drugs

In 1999, noninstitutionalized beneficiaries are projected to spend \$410 out-of-pocket on prescription drugs, or about 4 percent of their income, on average. *Out-of-pocket drug spending includes only direct spending on outpatient prescription drugs; it does not include any additional premiums for drug coverage through supplemental insurance.*

In that same year, they are projected to spend a total of \$2,370, or 18 percent of their income, out-of-pocket for health care, on average.¹¹ *This amount includes spending for Medicare Part B premiums and cost-sharing; private insurance premiums; balance billing charges; health care goods and services not covered by Medicare (such as prescription drugs, dental, and vision care); and short-term nursing home care. It does not include the costs of home care or long-term nursing home care.*

Income

Beneficiaries with the highest average out-of-pocket drug spending do not have the highest or lowest incomes. Table 1 shows that out-of-pocket drug spending does not tend to increase as income rises, in contrast to total out-of-pocket health spending. Rather, among the income groups compared, those beneficiaries with the highest average level of out-of-pocket spending on drugs have incomes between 135% and 200% of poverty (for individuals age 65 and over this translates to an income range of about \$10,900 to \$16,150).¹² These individuals will spend \$445, on average, out-of-pocket on drugs in 1999, out of total health spending of \$2,340 or 23 percent of their incomes.

Examining out-of-pocket spending *as a percent of income*, however, produces a different result.¹³ Not surprisingly, beneficiaries with the lowest incomes spend the highest share of their income out-of-pocket on drugs, as well as on total health care costs. As indicated in Table 1, beneficiaries with incomes below 100% of poverty spend almost one-tenth (9%) of their income out-of-pocket on drugs, on average, and almost one-third (30%) of their income on all health spending.

While these estimates suggest that drug spending is a significant burden for those with the lowest incomes, they also mask significant differences between beneficiaries with incomes below the poverty level who receive Medicaid benefits¹⁴ and those who do not. Beneficiaries with incomes below poverty who do not receive Medicaid benefits (about 1.8 million beneficiaries, or about 45 percent of all poor beneficiaries) spend, on average, \$400 out-of-pocket for prescription drugs or 13 percent of their income. Total health care costs (\$2,420) consume 46 percent of their income.

Table 1
Average Out-of-Pocket Spending and Out-of-Pocket Spending as a Percent of Income, by Income Level, 1999

	Distribution of beneficiaries *	Average out-of-pocket spending on:		Average out-of-pocket spending as % of income on:	
		<i>Health care</i>	<i>Drugs</i>	<i>Health care</i>	<i>Drugs</i>
Income as a % of Poverty:					
<100%	10%	\$1,615	\$310	30%	9%
100-135%	9%	\$2,090	\$415	24%	6%
135-200%	18%	\$2,340	\$445	23%	5%
200-400%	38%	\$2,445	\$425	17%	3%
400%+	24%	\$2,700	\$405	11%	2%

Note: The projected 1999 poverty levels for persons under age 65 are \$8,760 for individuals and \$11,334 for couples. For persons age 65 and over, the projected poverty levels are \$8,075 for individuals and \$10,185 for couples.

* Numbers may not sum to 100% due to rounding.

Source: AARP PPI analysis using the Medicare Benefits Model, Version 2.0.

Gender

As indicated in Table 2, women spend slightly more, on average, out-of-pocket on drugs than do men, and about the same percent of their income. Women face total out-of-pocket health costs that are over \$215 more than those of men, and these costs consume a higher proportion of their income.¹⁵

Table 2
Average Out-of-Pocket Spending and Out-of-Pocket Spending as a Percent of Income, by Gender, 1999

	Distribution of beneficiaries	Average out-of-pocket spending on:		Average out-of-pocket spending as % of income on:	
		<i>Health care</i>	<i>Drugs</i>	<i>Health care</i>	<i>Drugs</i>
Gender:					
Men	45%	\$2,255	\$395	17%	4%
Women	55%	\$2,470	\$430	20%	4%

Source: AARP PPI analysis using the Medicare Benefits Model, Version 2.0

Functional Status

Beneficiaries who have severe limitations in one or more activities of daily living (ADLs) face much higher out-of-pocket burdens, both for drugs and other health spending, than do other beneficiaries.¹⁶ On average, beneficiaries in this group will spend \$620 out-of-pocket on drugs in 1999, out of a total of \$4,365 on health expenses or 30 percent of their income.

Table 3
Average Out-of-Pocket Spending and Out-of-Pocket Spending as a Percent of Income, by Functional Status, 1999

	Distribution of beneficiaries	Average out-of-pocket spending on:		Average out-of-pocket spending as % of income on:	
		<i>Health care</i>	<i>Drugs</i>	<i>Health care</i>	<i>Drugs</i>
Limitations in Activities of Daily					
None	90%	\$2,155	\$390	17%	4%
One or more	10%	\$4,365	\$620	30%	7%

Source: AARP PPI analysis using the Medicare Benefits Model, Version 2.0

Age

Beneficiaries age 75 and older and disabled beneficiaries under age 65 are projected to have higher average out-of-pocket costs for drugs (\$450) than other age groups. Because beneficiaries under age 65 tend to have lower incomes, their drug costs consume a slightly larger share of income (5% vs. 4%) than that for beneficiaries age 75 and older. However, beneficiaries age 75 and older face higher total out-of-pocket health care costs (\$2,770) than younger beneficiaries, and these costs consume a higher proportion of their income (21%).

Table 4
Average Out-of-Pocket Spending and Out-of-Pocket Spending as a Percent of Income, by Age, 1999

	Distribution of beneficiaries	Average out-of-pocket spending on:		Average out-of-pocket spending as % of income on:	
		<i>Health care</i>	<i>Drugs</i>	<i>Health care</i>	<i>Drugs</i>
Age:					
Under 65	12%	\$1,950	\$450	17%	5%
65-74	47%	\$2,130	\$365	16%	3%
75+	41%	\$2,770	\$450	21%	4%

Source: AARP PPI analysis using the Medicare Benefits Model, Version 2.0

Health Status

Not surprisingly, out-of-pocket drug spending, as well as total health care spending, tends to increase as health status declines. On average, beneficiaries who report their health to be fair or poor will spend \$590 on drugs out of a total of \$2,870 (or 24 percent of their income) out-of-pocket on health care in 1999 (see Table 5). Beneficiaries with excellent health are projected to spend 62 percent less on prescription drugs and about a third less on total health care costs than do those in poor or fair health.

Table 5
Average Out-of-Pocket Spending and Out-of-Pocket Spending as a Percent of Income, by Health Status, 1999

	Distribution of beneficiaries	Average out-of-pocket spending on:		Average out-of-pocket spending as % of income	
		<i>Health care</i>	<i>Drugs</i>	<i>Health care</i>	<i>Drugs</i>
Health Status:					
Poor or Fair	27%	\$2,870	\$590	24%	7%
Good	29%	\$2,335	\$430	18%	4%
Very Good	27%	\$2,175	\$330	16%	3%
Excellent	17%	\$1,945	\$225	14%	2%

Source: AARP PPI analysis using the Medicare Benefits Model, Version 2.0

Prescription Drug Coverage

On average, drug coverage helps to protect beneficiaries from out-of-pocket drug spending, as shown in Table 6. Beneficiaries without drug coverage will spend about 85 percent more, on average, on drugs, and over one-third more on total health care costs than beneficiaries with drug coverage.

Table 6
Average Out-of-Pocket Spending and Out-of-Pocket Spending as a Percent of Income, by Presence of Prescription Drug Coverage, 1999

	Distribution of beneficiaries	Average out-of-pocket spending on:		Average out-of-pocket spending as % of income on:	
		<i>Health care</i>	<i>Drugs</i>	<i>Health care</i>	<i>Drugs</i>
Drug coverage:					
Yes	65%	\$2,110	\$320	15%	3%
No	35%	\$2,850	\$590	24%	6%

Source: AARP PPI analysis using the Medicare Benefits Model, Version 2.0

Primary Supplemental Insurance Coverage

As indicated in Table 7, beneficiaries with individual supplemental coverage face the highest average out-of-pocket costs, both for drugs and total health care costs. They are projected to spend \$650 out-of-pocket on drugs in 1999, out of a total of \$3,260 on health care expenses or 26 percent of their incomes. These beneficiaries are projected to incur higher out-of-pocket drug expenses, as well as other out-of-pocket health expenses, than will other beneficiaries, including those who have no form of supplemental insurance, for two reasons. First, nearly two-thirds of beneficiaries with individual coverage have no form of drug coverage.¹⁷ Second, for those with a drug benefit, their coverage often includes limits on the benefit as well as high cost-sharing requirements. For example, a Medigap policy with drug coverage requires 50% coinsurance and can have a benefit cap as low as \$1,250.

Beneficiaries with Medicaid have the lowest out-of-pocket drug costs (\$235), on average, as well as the lowest total health care costs (\$1,100). However, those averages obscure the large differences between those with full and partial Medicaid protection. For example, beneficiaries with full Medicaid benefits for the entire year will spend an average of \$75 per year out-of-pocket on drugs, while those who receive only Part B premium assistance or are enrolled for only part of the year will spend \$410, on average.

Table 7
Average Out-of-Pocket Spending and Out-of-Pocket Spending as a Percent of Income,
by Type of Supplemental Insurance Coverage, 1999

	Distribution of beneficiaries*	Average out-of-pocket spending on:		Average out-of-pocket spending as % of income on:	
		<i>Health care</i>	<i>Drugs</i>	<i>Health care</i>	<i>Drugs</i>
Insurance Coverage:					
Individual	25%	\$3,260	\$650	26%	6%
Employer	35%	\$2,580	\$355	16%	3%
Medicare+Choice	15%	\$1,640	\$290	12%	3%
Medicaid	15%	\$1,100	\$235	15%	4%
Medicare Only	9%	\$2,505	\$475	22%	5%

* Numbers may not sum to 100% due to rounding.

Source: AARP PPI analysis using the Medicare Benefits Model, Version 2.0

Summary of Part I Findings

Based on the data presented above, we find that:

- Beneficiaries with the highest average out-of-pocket drug expenses are not those with low or high incomes. Of the income groups compared, beneficiaries with modest incomes (135-200% of poverty, projected to be \$10,900 to \$16,150 for individuals age 65 and over in 1999) have the highest average out-of-pocket drug expenses. However, beneficiaries with incomes under 100% of poverty without Medicaid protection spend the highest percent of their income out-of-pocket on drugs.
- Women spend slightly more out-of-pocket on drugs, on average, than do men.
- Beneficiaries with one or more severe limitations in activities of daily living (ADLs) are more likely to have higher average out-of-pocket drug spending than are those with no ADLs.
- Beneficiaries age 75 and older, as well as disabled beneficiaries under age 65, have higher average out-of-pocket spending than do those age 65-74.
- Beneficiaries in poor or fair health have higher average out-of-pocket drug spending than do those with good or excellent health.
- Beneficiaries with no drug coverage have higher average out-of-pocket drug spending than do those with coverage.
- Those with individual supplemental coverage have higher average drug spending than do other beneficiaries.

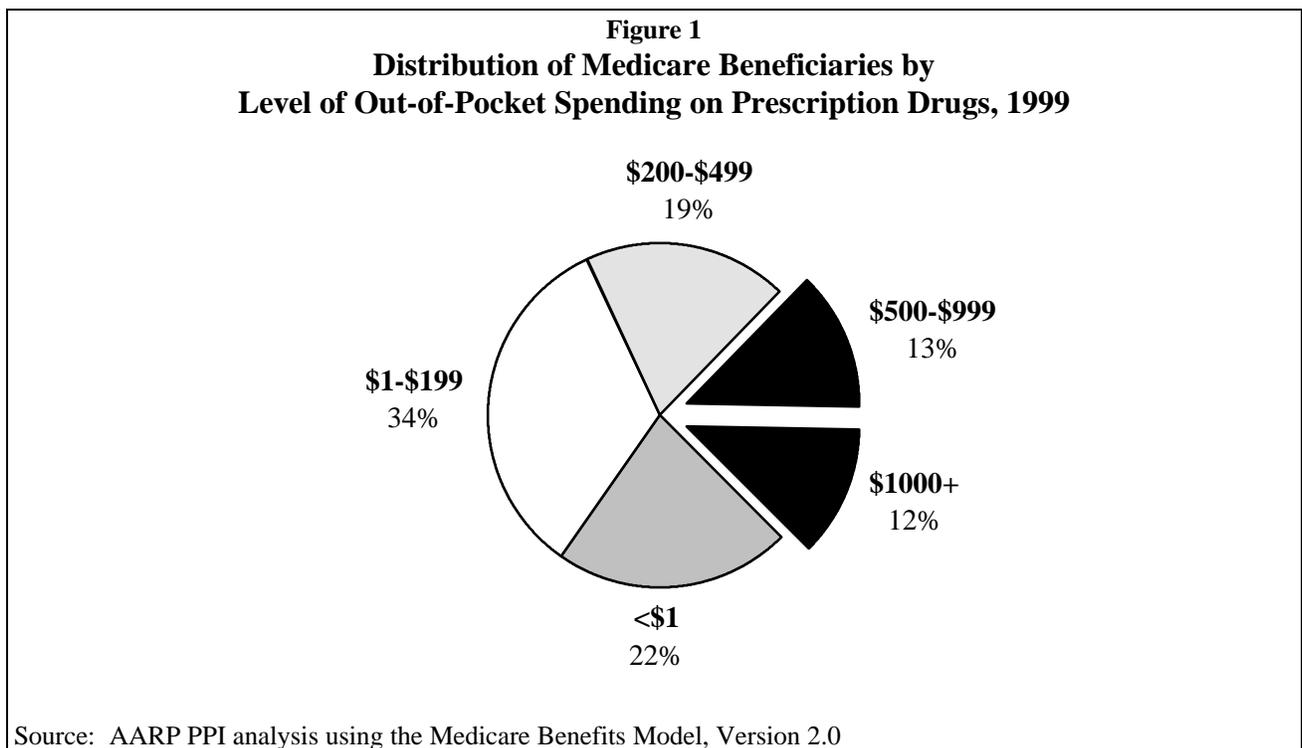
In assessing the need for a Medicare drug benefit, as well as the need for other improvements in the program, it is important to remember that, on average, the groups identified above spend from 4 to 7 percent of their annual income out-of-pocket on drugs. Yet viewing drug spending in isolation from other health care costs, of which drug spending is but one component, may present a misleading picture of beneficiaries' ability to shoulder these expenses. On average, the groups identified above spend from 21 to 30 percent of their incomes out-of-pocket on health care costs, not including any home care or long-term nursing home care.

Part II: What are the defining characteristics of beneficiaries with high out-of-pocket drug spending?

In this section of the paper, we switch the focus to describing the characteristics of beneficiaries who are projected to have high or very high out-of-pocket drug spending in 1999. We define out-of-pocket drug expenses of less than \$500 per year as “low to moderate” spending; \$500-\$999 as “high” spending; and \$1,000 or more as “very high” spending. Below, we examine the distribution of beneficiaries at these levels of out-of-pocket spending by the same characteristics examined in Part I (e.g., income, gender, ADLs).

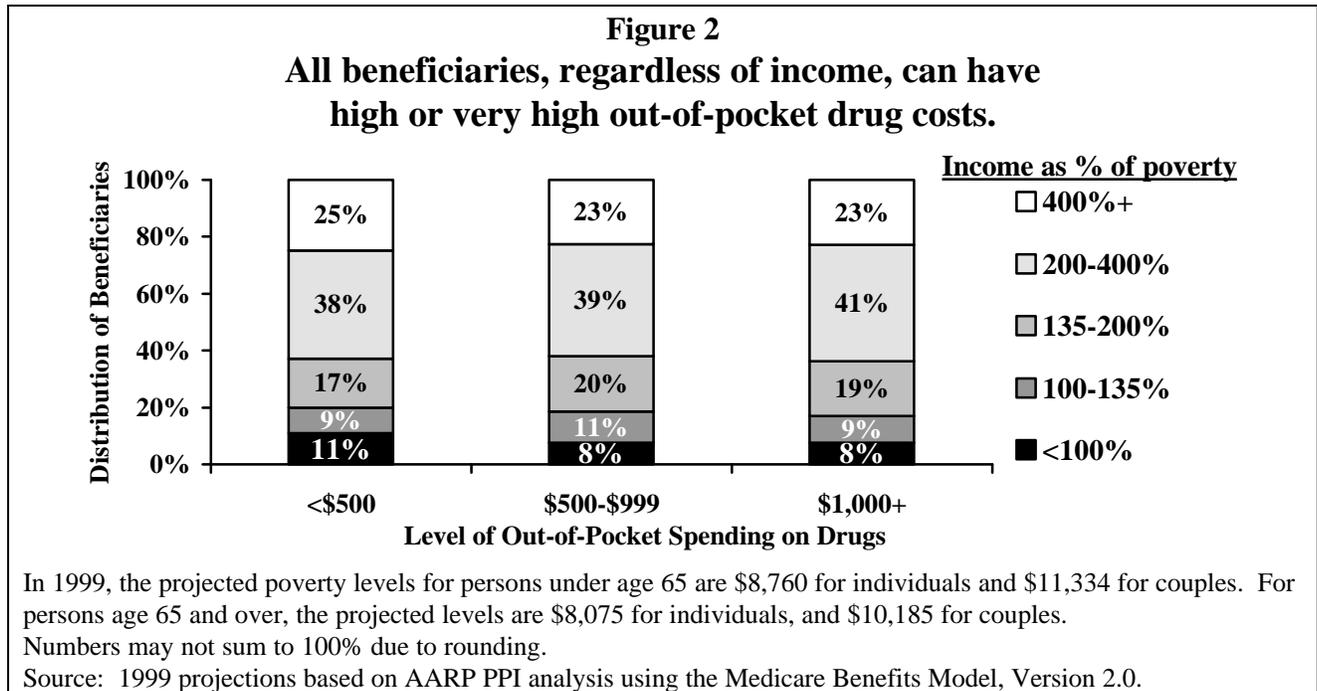
Distribution of Beneficiaries by Level of Out-of-Pocket Drug Spending

The burden of high out-of-pocket drug spending, like other health care spending, typically falls on only a small proportion of individuals *in any given year*. (The likelihood of having a serious illness or other chronic condition that results in high drug and other health care spending, of course, increases greatly over a longer time frame.) Figure 1 shows that one-quarter of Medicare beneficiaries are projected to spend more than \$500 out-of-pocket on drug expenses in 1999, with about one half of these beneficiaries (12%) spending \$1,000 or more.



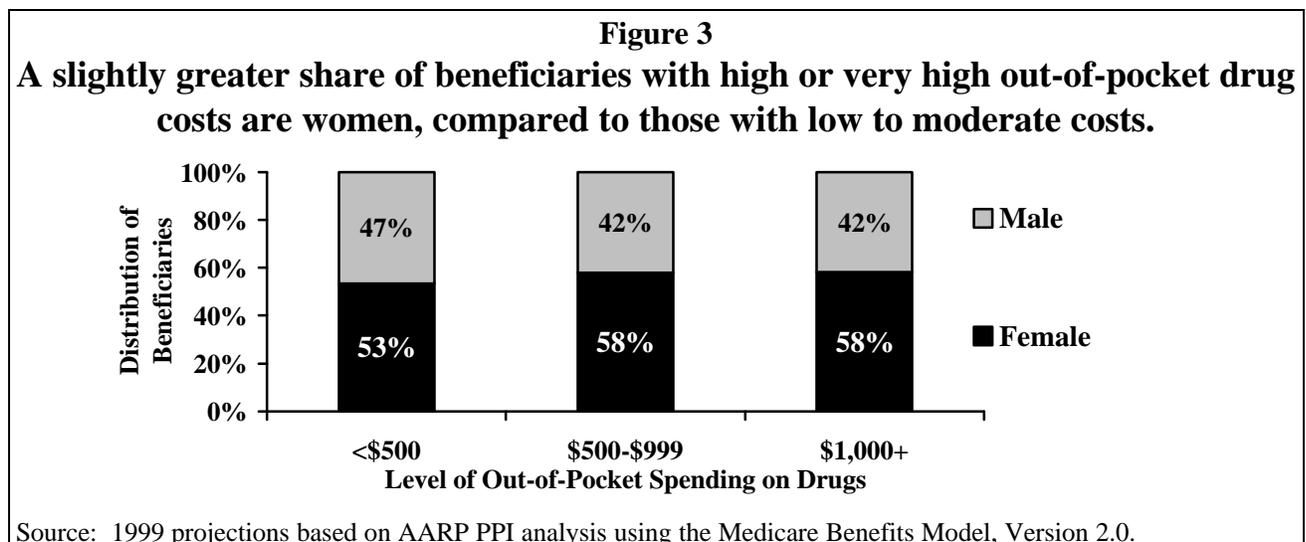
Income

As shown in Figure 2, the income distribution of beneficiaries spending high or very high amounts out-of-pocket on drugs closely parallels that of beneficiaries spending low to moderate amounts. Those with high out-of-pocket drug spending are neither disproportionately low income nor high income.



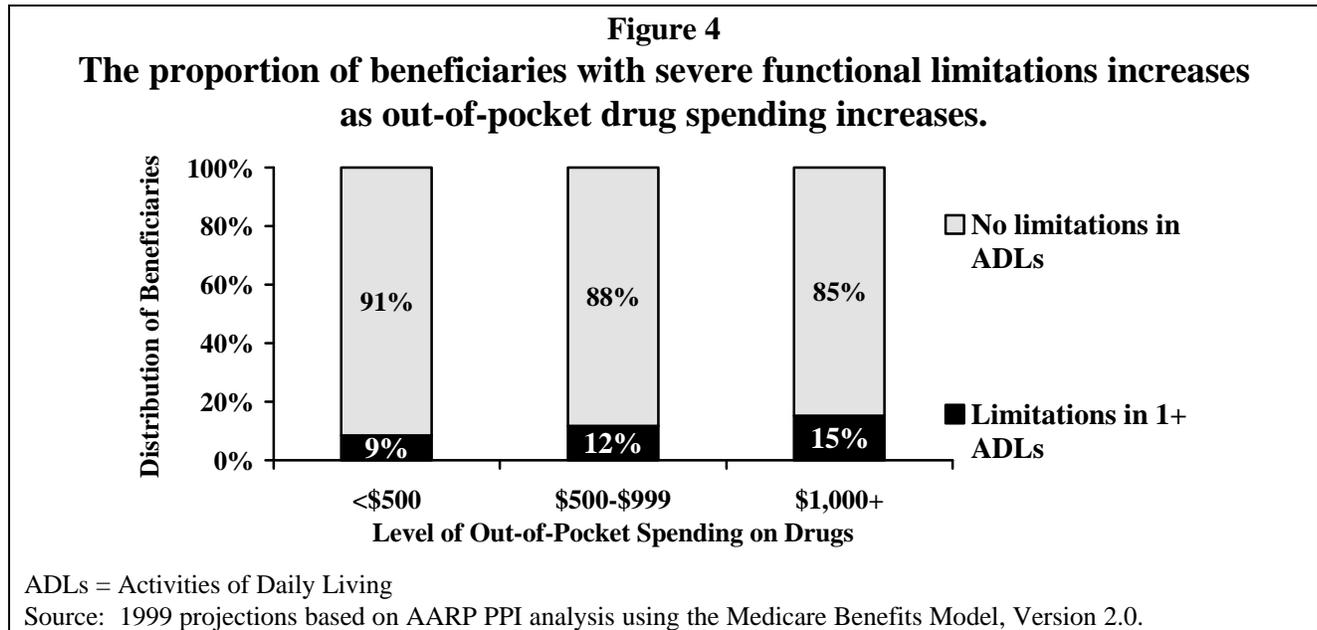
Gender

Figure 3 indicates that women comprise a slightly greater share of beneficiaries with high or very high out-of-pocket drug costs, compared to those with low to moderate costs. Women account for about 58 percent of beneficiaries spending \$500 or more on drugs, and 53 percent of those with drug costs under \$500.



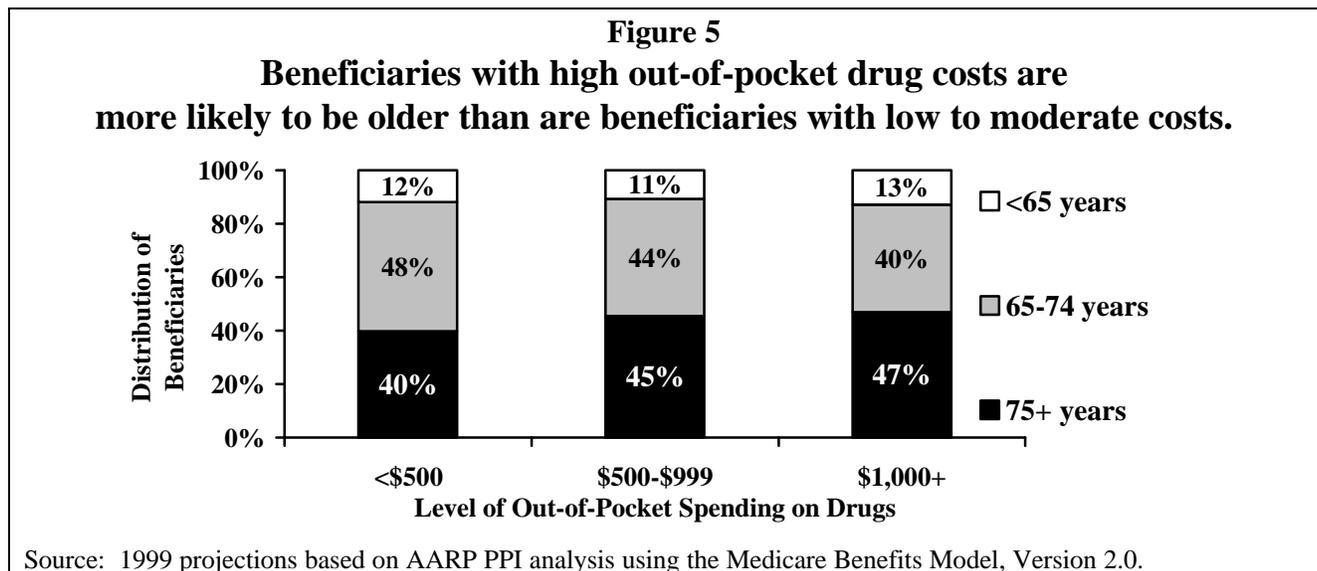
Functional Status

As indicated in Figure 4, beneficiaries with high or very high out-of-pocket expenses for drugs are more likely to have severe limitations in their activities of daily living (ADLs) than are other beneficiaries. Nine percent of those spending less than \$500 on drugs have limitations in ADLs, compared with 15 percent of beneficiaries spending \$1,000 or more.



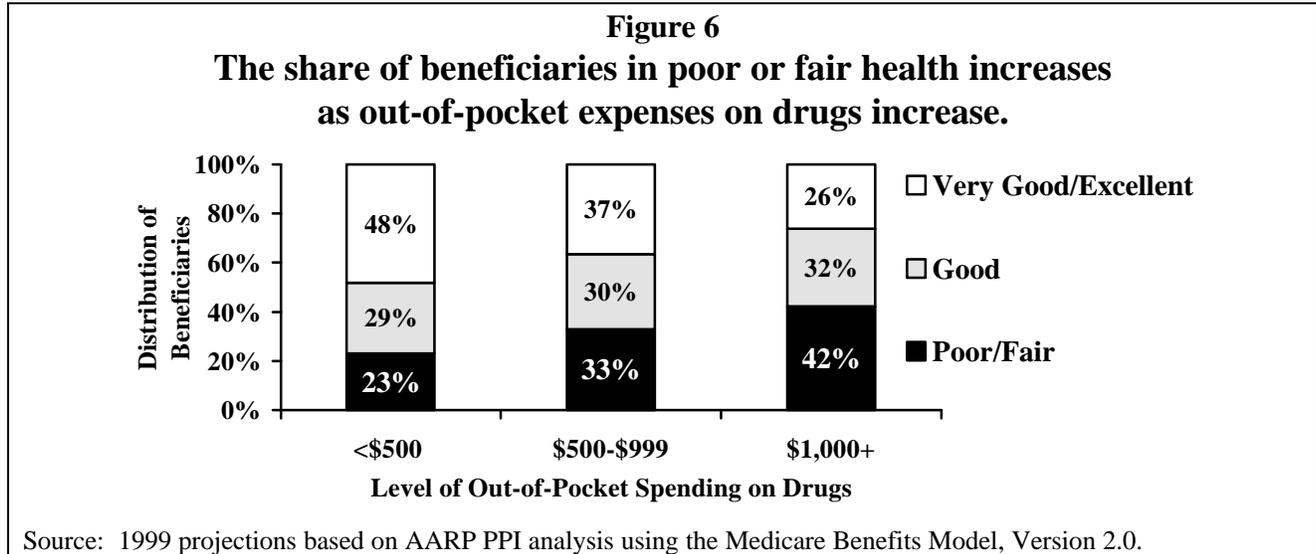
Age

Figure 5 illustrates that the share of beneficiaries age 75 and older gradually increases as the level of out-of-pocket drug spending increases. Forty percent of beneficiaries with low to moderate drug costs are age 75 and older, compared to almost half of those with very high drug costs.



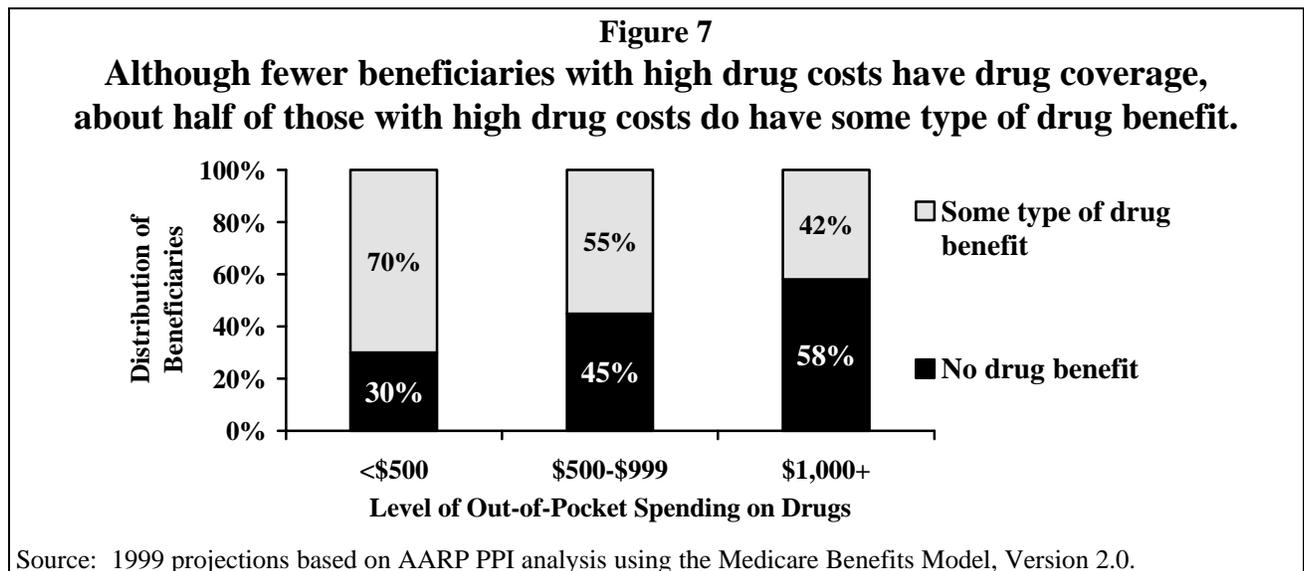
Health Status

Figure 6 shows that beneficiaries with high or very high out-of-pocket drug expenses are more likely to report being in poor or fair health than are those with low to moderate costs. One-third of those projected to spend \$500 to \$999 out-of-pocket on drugs report their health to be “fair or poor.” The percent of beneficiaries reporting fair or poor health status increases to 42 percent among those who will spend \$1,000 or more out-of-pocket on drugs.



Prescription Drug Coverage

Not surprisingly, beneficiaries with high or very high out-of-pocket drug spending are more likely to lack drug coverage than are those with low to moderate expenses (see Figure 7). However, over half of beneficiaries who will spend \$500 to \$999 on drugs have some type of drug coverage, as do four out of ten who spend \$1,000 or more.



Primary Supplemental Insurance Coverage

Beneficiaries with high or very high levels of out-of-pocket spending on drugs are much more likely to have *individual* supplemental coverage, such as Medigap, than are beneficiaries with lower levels of spending, regardless of whether they have drug coverage. Figure 8 shows that over one-third of those spending \$500 to \$999 on drugs have individual coverage, and almost half of beneficiaries spending over \$1,000 on drugs have such insurance. Unlike most employer-sponsored plans, many individual policies, such as those provided through Medigap, either do not include drug benefits or have drug benefits that require substantial cost-sharing and set annual benefit limits.

In fact, of those beneficiaries *who have a prescription drug benefit*, those with high or very high out-of-pocket drug costs are two to three times more likely to have individual insurance than those with low to moderate costs (see Figure 9). Of beneficiaries *without drug coverage*, over half of those with high drug costs have individually purchased insurance (see Figure 10).

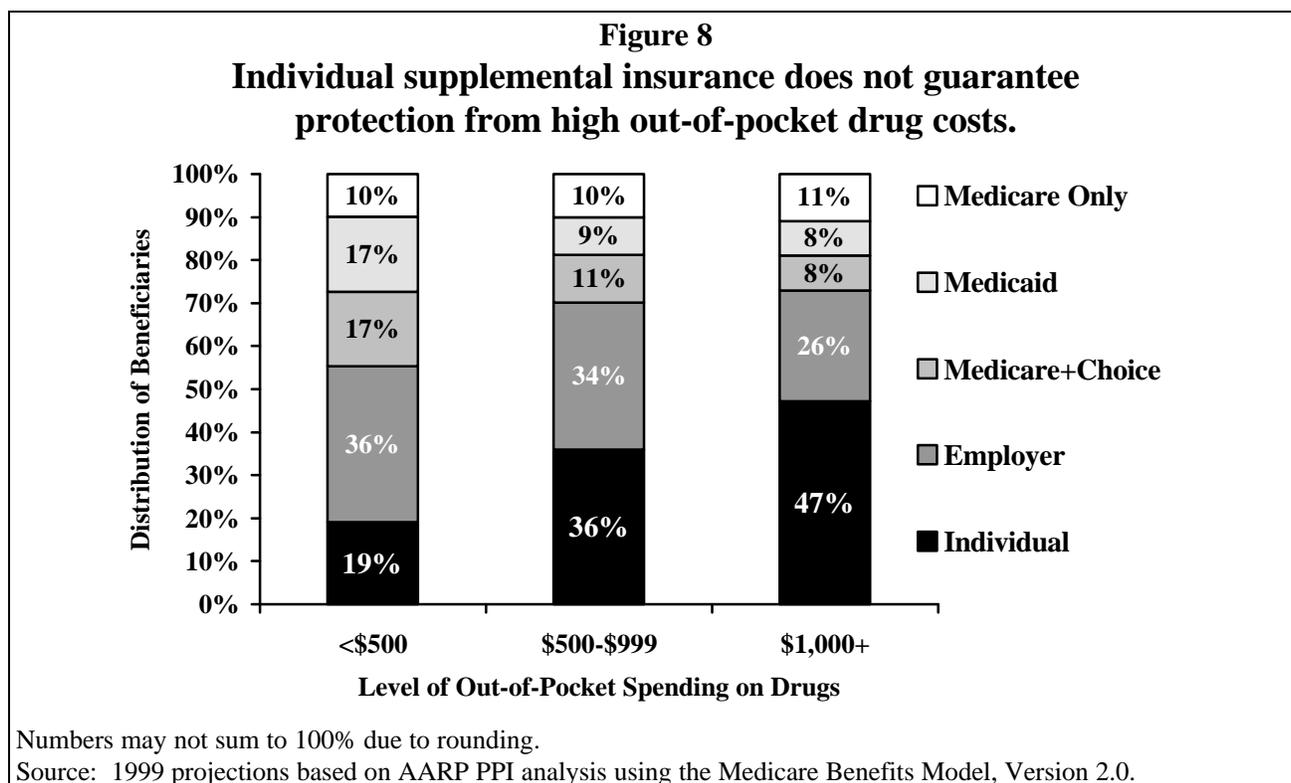
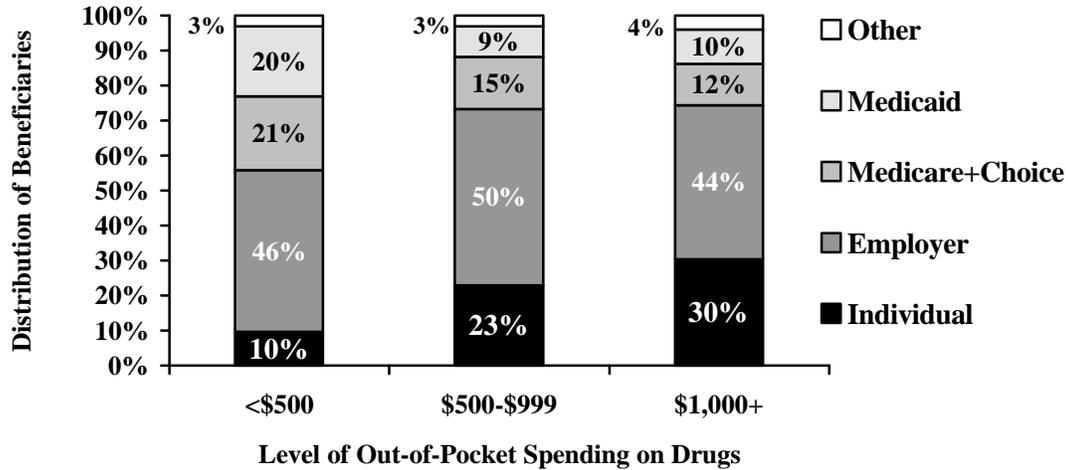


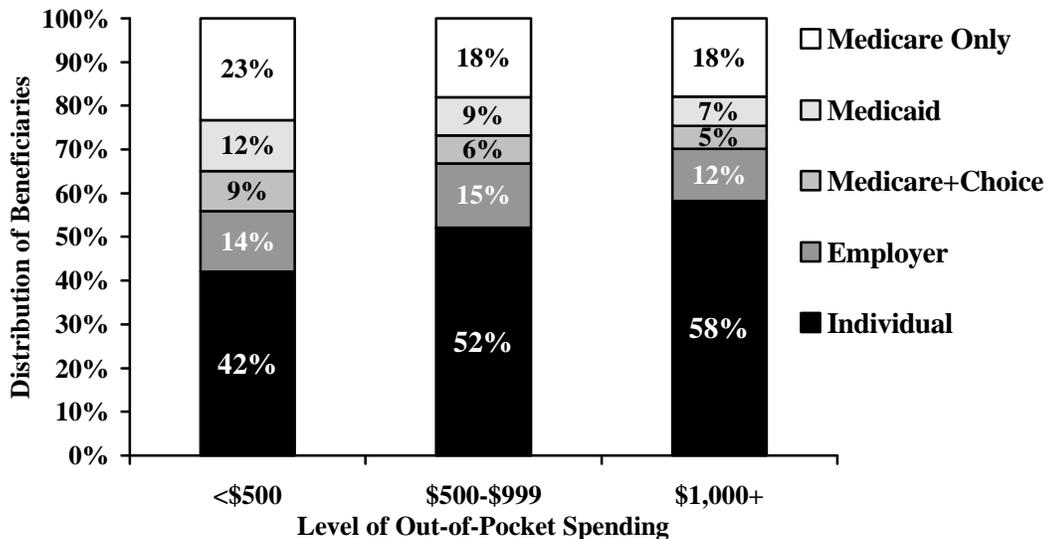
Figure 9
Beneficiaries With Drug Coverage who have high or very high out-of-pocket drug expenses are more likely to have individual insurance than are those with low to moderate costs.



Note: "Other" includes insurance coverage through Department of Veterans' Affairs, Department of Defense, and state pharmaceutical assistance programs.

Source: 1999 projections based on AARP PPI analysis using the Medicare Benefits Model, Version 2.0.

Figure 10
Beneficiaries Without Drug Coverage who have high or very high out-of-pocket drug costs are more likely to have individual insurance than are those with low to moderate costs.



Source: 1999 projections based on AARP PPI analysis using the Medicare Benefits Model, Version 2.0.

Summary of Part II Findings

We find that:

Beneficiaries with high or very high out-of-pocket drug costs are:

- not disproportionately low or high income. All beneficiaries, regardless of income, can have high out-of-pocket drug expenses.
- slightly more likely to be women.

Beneficiaries with high or very high out-of-pocket drug costs are *more likely than those with low to moderate out-of-pocket costs* to:

- have severe functional limitations
- be age 75 or older
- be in poor or fair health
- lack prescription drug coverage
- have individual supplemental insurance, regardless of whether or not they have drug coverage

Although more beneficiaries with high or very high out-of-pocket drug costs lack any drug coverage than do those with low to moderate expenses, a surprisingly large share of those with high drug expenses (about half) do have some type of drug benefit.

These findings suggest that there are multiple risk factors for high or very high out-of-pocket drug expenses, and even those who have some type of drug coverage are vulnerable to high drug costs.

Conclusions

Some have recently suggested that a Medicare drug benefit may not be needed because a significant proportion of beneficiaries already have drug coverage. Others have proposed restricting the benefit to beneficiaries with low incomes. This analysis provides evidence that counters both of these perspectives.

First, this analysis supplements and supports other research suggesting that *private sector drug coverage is often inadequate* by showing that:

- over half of beneficiaries spending \$500-\$999 out-of-pocket on drugs in a given year and 42% of beneficiaries spending \$1,000 or more have some type of drug coverage.
- those with the highest out-of-pocket drug spending are disproportionately those who have individual supplemental coverage, regardless of whether or not they have *drug* coverage.

Second, the analysis shows that *limiting a Medicare drug benefit to beneficiaries with low incomes could exclude many beneficiaries most in need of assistance with drug costs*, including:

- beneficiaries with modest incomes (135-200% of poverty), who have higher than average out-of-pocket drug spending; our data also suggest that those at all income levels are vulnerable to high or very high drug spending, not just those with lower incomes.
- those in poor or fair health, or with severe functional limitations, who have incomes or assets too high to qualify for Medicaid coverage.

Finally, even though a Medicare drug benefit should not be for low income beneficiaries alone, we have shown that *poor beneficiaries often face substantial out-of-pocket costs for drugs as a share of their income*.

- on average, poor beneficiaries (those with incomes below poverty) spend 9 percent of their income for drugs alone; and
- on average, poor beneficiaries without any protection from Medicaid (about 1.8 million beneficiaries or 45 percent of poor beneficiaries) spend 13 percent of their income on drugs alone.

Targeting drug benefits *only* to those most likely to incur high out-of-pocket drug costs and other health expenses would not solve the problem either. Because the sickest beneficiaries are the most expensive to insure, attempting to segment the beneficiary population by health status or level of out-of-pocket drug spending is likely to result in a drug benefit that is unaffordable. Moreover, because of unpredictable changes in beneficiaries' health status and drug spending, such a benefit would not provide adequate protection. First, only a minority of beneficiaries have high drug spending in any given year. Second, the individuals in need of drug coverage are likely to change over time. Designing a drug benefit that will protect those currently in need, as well as those who may face substantial drug costs in the future, will require coverage for all beneficiaries as well as adequate financing.

¹ For discussion of prescription drug coverage among Medicare beneficiaries, see D. Gross and N. Brangan, *Medicare Beneficiaries and Prescription Drug Coverage: Gaps and Barriers*, AARP Public Policy Institute, June 1999. See also M. Davis et al., "Prescription Drug Coverage, Utilization, and Spending Among Medicare Beneficiaries," *Health Affairs* (Jan./Feb. 1999), pp. 213-243.

² J. Poisal et al., "Prescription Drug Coverage and Spending for Medicare Beneficiaries," *Health Care Financing Review*, Spring 1999, Vol. 20. No. 3.

³ D. Gross and N. Brangan, op. cit.

⁴ For example, the share of employers offering supplemental health coverage to Medicare-eligible retirees fell from 40 percent in 1994 to 30 percent in 1998. See William M. Mercer, *Mercer/Foster Higgins National Survey of Employer-Sponsored Health Plans 1998: Report of Survey Findings* (New York: William M. Mercer Companies LLC).

⁵ Barents Group, "Analysis of Benefits Offered by Medicare HMOs, 1999: Complexities and Implications." Kaiser Family Foundation, August 1999.

⁶ Health Care Financing Administration, *Medicare+Choice: Changes for the Year 2000, An Analysis of the Medicare+Choice Program and How Beneficiaries Will Be Affected by Changes*, September 1999.

⁷ D. Gross and N. Brangan, op. cit.

⁸ J. Poisal et al., op. cit.

⁹ The out-of-pocket spending estimates were derived from a microsimulation model developed for AARP by The Lewin Group, Inc. This model projects 1999 out-of-pocket health care spending from the 1995 Medicare Current Beneficiary Survey Cost and Use files. The Medicare Benefits Model, Version 2.0 projections do not reflect the most recent projections of national health expenditures for 1998-2008 produced by the U.S. Health Care Financing Administration, Office of National Health Accounts. For a general discussion of the methodology used in making these projections, see D. Gross, et al., *Out-of-Pocket Health Spending by Medicare Beneficiaries Age 65 and Older: 1997 Projections*, AARP Public Policy Institute, 1997.

¹⁰ Personal communication with Lisa Alexcih, of The Lewin Group, Inc., based on her discussions with analysts at CBO and HCFA.

¹¹ For beneficiaries age 65 and older only, total out-of-pocket health care spending is projected to be \$2,430, or 18% of income, in 1999. See D. Gross and N. Brangan, *Out-of-Pocket Health Spending on Health Care by Medicare Beneficiaries Age 65 and Older: 1999 Projections*, AARP Public Policy Institute, forthcoming, October 1999.

¹² In 1999, the projected poverty levels for persons under age 65 are \$8,760 for individuals and \$11,334 for couples. For persons age 65 and over, the projected levels are \$8,075 for individuals, and \$10,185 for couples.

¹³ The average spending-to-income ratio is computed as the average of each individual beneficiary's spending-to-income ratio. It is *not* calculated as average health spending for the entire Medicare population divided by average income for the entire Medicare population. Income is defined as the beneficiary's share of household spending. See Gross et al. (1997) for a more detailed analysis of the derivation of these estimates.

¹⁴ Medicaid enrollees include beneficiaries with full Medicaid benefits for the entire year; those enrolled in the Qualified Medicare Beneficiary Program (QMB), who receive assistance with Medicare premiums and cost-sharing; those in the Specified Low income Medicare Beneficiary program (SLMB), who receive assistance with Medicare premiums only; and those enrolled in Medicaid for only part of the year.

¹⁵ M.J. Gibson and N. Brangan, *Out-of-Pocket Spending on Health Care by Women Age 65 and Over in Fee-for-Service Medicare: 1998 Projections*. AARP Public Policy Institute, November 1998.

¹⁶ A beneficiary is considered here to have a limitation in an activity of daily living (ADL) if he or she requires help, supervision, or cueing to perform the activity. This definition of functional limitation is quite narrow compared to that used in many other studies, and it captures only those with more severe limitations.

¹⁷ See D. Gross and N. Brangan, *Out-of-Pocket Spending on Health Care by Medicare Beneficiaries Age 65 and Older: 1999 Projections* (1999) for a discussion.