ThirdWay

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TO: Interested Parties

FROM: Rob Keast, Senior Policy Advisor

RE: Warning Flags on Medicare Part D Direct Negotiation

One major piece of the new House Leadership's "First 100 Hours" agenda is to require the federal government to enter into direct negotiations with drug companies, with the goal of driving down the cost of prescription drugs under the Medicare Part D. Under the current system, private health plans work with pharmaceutical companies to determine prices, and direct negotiation by the government is barred by the Medicare Modernization Act (MMA).

Third Way strongly supports efforts to lower the costs of prescription drugs and of Medicare generally. However, we caution that direct negotiation is by no means a silver bullet solution to high drug and health care costs, either for the government or for seniors themselves. Indeed, the entire debate about Part D has been distorted and disjointed, and serious policy and message pitfalls abound. We offer the following cautions and recommendations in approaching the debate about Part D:

Important Points to Remember About Part D

Medicare Part D is popular, and change might be unpopular. Despite serious problems in its launch and early months, Part D has become a very popular program among those using it and the public at large. Various polls show that nearly 80 percent of Part D's participants are happy with the program,[i] and a majority of the general public say they have positive perceptions of the benefit.[ii] In one poll commissioned by AARP, 67 percent of enrollees say they are saving money through the program.[iii] In another poll commissioned by the Medicare Rx Education Network, 69 percent of seniors say they are better off now than before they enrolled in Part D and nearly four out of five say their total out of pocket costs are reasonable.[iv] Other "satisfaction" polls point in the same direction, with a Marttila Communications survey saying that 77 percent of seniors would recommend Part D to others.[v]

There are some substantial lingering doubts about Part D—particularly among those opting out of the program and enrollees who have encountered the "donut hole"—and general attitudes may shift if the recent open enrollment period went poorly. However, its current relatively smooth operation and high levels of public satisfaction means that anyone seeking to change Part D must be certain that change will bring positive results. If, for example, direct negotiation severely limits

formularies and access to medication, that could have substantial policy and political consequences.

Proponents of direct negotiation often point to the Department of Veterans Affairs, which negotiates downward from a statutory price ceiling and is able to obtain lower prices than those currently obtained by Part D plans.[vi] While this is true, the VA's plan offers a very narrow choice of drugs. Such a restricted formulary would be unacceptable to the majority of beneficiaries in Part D.

It is unclear how much could be saved through direct negotiation. There are varying estimates for how much might be saved if the federal government were required to directly negotiate with drug companies. Proponents argue it could be as high as $190 billion over a decade, but the Congressional Budget Office (or at least the CBO of the 109th Congress) says that direct negotiation would not reduce federal spending by a significant amount,[vii] and the chief actuary of the Centers for Medicare and Medicaid Services (CMS) more or less says the same thing.[viii] Since there is not wide consensus on what savings will be realized, we counsel caution about promises of savings, and who the savings will benefit (the government or Part D enrollees).

The donut hole will not be closed with savings from this proposal. Many proponents of direct negotiation have promised to use any potential savings to "plug" the donut hole. Even allowing for the best-case estimates, there would still not be enough money to close the $427 billion hole, so these promises will likely prove illusory. [ix]

Guidelines for Approaching Part D Reform

In general, Third Way recommends that those seeking to change Part D acknowledge the early success of the program, and, when appropriate, take credit for helping to craft and improve it. Moreover, we believe that it is important for anyone seeking to reform Part D also make the following points:

Make it about broader health care cost reform. By only focusing on direct negotiation, proponents run the risk of letting this be seen as their sole solution to the health care cost crisis in the United States. We recommend a much broader approach, one that includes other cost containment ideas, like health care IT.

Put direct negotiation into the larger context of Medicare Part D improvement. Part D is still in its early stages. Anyone seeking to change it should approach change in terms of making the program better—cheaper and easier for seniors and less expensive for the government.

Put the blame where it belongs. Critics of Part D often point to the drug companies in their attack on the program. However, the focus of their ire should actually be the Bush administration, which badly bungled the roll-out of the program, confusing and frightening seniors in the process. While there also have been some problems fairly attributable to the insurance companies administering

some of the plans, most residual issues are due to government—not private sector—missteps.

Focus on policies that significantly shrink or close the donut hole. Those seniors who have encountered the "donut hole"—the large gap in coverage for most seniors once they have purchased more than $2,250 in prescriptions—no doubt have significantly dimmer views about the program. As the population ages, the number of those hitting the donut hole will go up. We believe reformers should focus their efforts on shrinking or closing the donut hole, a policy that carries no risk of alienation from the program (like the risk that direct negotiation will lead to stricter formularies).

Medicare Part D is a massive new federal program, and it would have been surprising if there were not areas ripe for reform after its first year. Still, the most prominent reform proposals, including direct negotiation, should be approached cautiously. Proponents must be careful not to harm a fundamentally useful and popular program and not to over-promise about the results of their efforts.

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[i] Medicare Rx Education Network/KRC Research, survey of 802 seniors enrolled in Medicare, September 1–7, 2006; AARP/International Communications Research, 1,513 seniors enrolled in Medicare, March 9–April 3, 2006.

[ii] Penn, Schoen & Berland Associates, 2006 PhRMA Exit Poll, 2,097 nationwide interviews among American who voted in the 2006 midterm election, November 7, 2006.

[iii] AARP/International Communications Research, survey of 1,513 seniors enrolled in Medicare, March 9–April 3, 2006.

[iv] Medicare Rx Education Network/KRC Research, survey of 802 seniors enrolled in Medicare, September 1–7, 2006

[v] Marttila Communications, National Voter Survey on Medicare Part D, national survey of 1,097, August 20–31, 2006.

[vi] Families USA, *Big Dollars, Little Sense: Rising Medicare Prescription Drug Prices*, June 2006.

[vii] Letter from Douglas Holtz-Eakin, former Director, CBO, to Sen. Bill Frist, January 23, 2004.

[viii] *Chicago Tribune*, "A Medicare Gamble?," Editorial, December 3, 2006.

[ix] CBO, *Budget Options*, February 2005. CBO's estimate is for 2007–2015.