The Daily Dish

Peeling the Drug Policy Onion

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Eakinomics: Peeling the Drug Policy Onion

Sometimes policy development is transparently simple. The president wants lower interest rates; he says so, and also pushes to place his partisans on the Federal Reserve Board. Progressives want a clean environment, universal health care, guaranteed jobs, affordable housing, food security and free college; they promise a "new deal" — which turns out to be the same-old writing government checks — to make it happen. But other times it is much more intricate.

This past Friday, the Centers for Medicare and Medicaid Services (CMS) announced a voluntary demonstration project ("demo") for prescription drug plans (PDPs) under Part D of Medicare. Specifically, if a plan enrolls in the demo and CMS finalizes its rule eliminating rebates to insurers (and pharmacy benefit managers or PBMs) then the risk corridors in Part D will be reduced from 5 percent to 0.5 (one-half) percent. What does this mean?

Let's peel this onion. First, risk corridors (like the risk corridors in the Affordable Care Act) insulate PDPs from big mistakes in projecting their spending. If spending comes in 5 percent higher than expected (and thus profits are lower), Medicare shares 50 cents of each additional dollar of spending until spending ends up 10 percent higher than expected. At that point Medicare picks up 80 cents of every dollar of additional spending. There is a symmetric "tax" on the PDP, however, if spending comes in lower than expected. The tax is 50 percent when spending comes in 5 percent below expectations and rises to 80 percent when spending is 10 percent below (or more).

Risk corridors are insurance (or, reinsurance) against aggregate risks that every pool of beneficiaries is more or less expensive than expected. One reason this could occur is if CMS changes the Part D rules, which is exactly what is in play at the moment. Notice that CMS is saying that if it changes the rules, then the insurance begins to kick in almost immediately

— 0.5 percent in higher spending versus the usual 5 percent.

The interesting thing is that nobody thinks the so-called “rebate rule” will lower the costs for PDPs. The rule would eliminate any rebate that is not passed directly to the consumer. If nothing else changes, the reduced costs for beneficiaries means that insurers will be picking up a larger share of the costs. The only way they could avoid this is if drug manufacturers cut their list prices, and there is certainly no guarantee this will happen. (It would be more likely if rebates were also outlawed in the commercial market.) The demo is a way that firms can voluntarily avoid most of this impact.

In the absence of the demo, the necessary reaction of PDPs will be to charge higher premiums to offset these higher costs. And there’s the rub: Politicians hate the idea of premiums going up. Even worse, as PDPs formulate their bids, they might build in higher premiums in case CMS goes ahead with the rebate rule.

So there you have it. The voluntary demo is intended to keep PDPs from taking the sensible step of raising premiums now in case CMS goes ahead with the rebate rule later. And, in the final plot twist, this would take away any incentive for Congress to intervene and stop the proposed CMS demo.

Just what you thought, right?