Medicare Part D and the Financial Security of the Elderly

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The Medicare Modernization Act of 2003, better known as the legislation that added the Part D prescription drug benefit to the Medicare program, represents the single most significant expansion of public insurance programs in the U.S. in the past 40 years. This program expanded the costs of the Medicare program by over 10% in order to provide, for the first time, prescription drug coverage to enrollees.

Despite the size of this new program, however, we know very little about its effectiveness. The effectiveness of the program can be measured along several dimensions. A primary dimension is the success of this program in providing financial security for elders in the U.S. If Part D covered prescription drug spending which was putting elders at financial risk previously, then there may be large welfare gains from the associated consumption smoothing. But if Part D simply served to “crowd out” existing insurance arrangements, then the welfare gains may be much smaller.

In this paper, we estimate the extent of Part D crowd-out of prescription drug insurance coverage and expenditures on prescription drugs, and the evaluate the gain in the financial security provided by the Part D program. We do so using detailed information from two data sources, the Health and Retirement Survey (HRS) and the Medical Expenditure Panel Survey (MEPS), right before and after the implementation of this program. These surveys contain rich data not only on insurance coverage but also on out of pocket prescription drug expenditures, allowing us to carefully model the impact of the Part D program on the distribution of expenditure risk.

We address three separate questions. First, we use the HRS and MEPS to examine whether the passage of Part D was associated with increased prescription drug coverage among the elderly, compared to the near-elderly below age 65. We find that prescription drug coverage did increase dramatically among the elderly; our central estimates suggest that there was a 12% increase in drug coverage. But this figure represents only 35% of the number of elders enrolled in Part D, suggesting that there was enormous crowd-out (around 65%) of other forms of prescription drug coverage.

Second, we use the MEPS to examine how the passage of Part D affected total drug spending by source of insurance coverage for the elderly, compared to the near-elderly below age 65. We find that overall expenditure rose dramatically among the elderly; our central estimates suggest that there was an overall increase of $1,100 per year
spent on drugs as a result of Part D. Part D spending crowded out other sources of
spending by 35%, the bulk of which came from private insurance plans. The large
increase in spending was driven a large increase not in the fraction of elderly taking
prescription drugs (the extensive margin), but instead the number of prescriptions filled
(the intensive margin). In particular, elderly under Part D filled on average 11 more
prescriptions.

Third, we use the MEPS to examine the impact of Part D on the distribution of
out of pocket prescription drug spending among the elderly. We find that the Part D led
to only a modest decline in out-of-pocket spending, and that this decline was
concentrated in the top of the expenditure distribution. We then follow compute the
certainty equivalent of the increased insurance provided by this program. Our estimates
suggest that the welfare gains from the increased insurance provided by Part D were
relatively small.