The Economic Impact of Changing the Texas Medicaid Pharmacy Benefit Structure: An Analysis of the Potential Effects of Switching from a Carve-Out to a Carve-In System or Limiting Network Access

Summary of Key Results from a Study by the Perryman Group
Introduction and Overview

Given tight budget conditions, rising numbers of enrollees in Medicaid, and growing costs, Texas legislators are considering ways to reduce the cost of Medicaid. However, any such changes should be carefully analyzed to ensure they do not lead to future problems and cost escalation.

- Texas currently uses a “carve-out” method to provide pharmacy benefits for Medicaid patients.
  - Carve-out systems essentially exclude certain health and pharmacy services from Medicaid Managed Care.
  - The advantages of a carve-out method include the following.
    - A carve-out model does not require the presence of layers of bureaucracy or middlemen (such as Managed Care Organizations (MCOs) or Prescription Benefit Managers (PBMs)), which helps keep administrative costs lower. In fact, the current state-run vendor drug program operates at a low 1% administrative expense level.
    - The narrow focus on pharmacy helps optimize costs and service. Many private-sector firms cite costs and greater choice as benefits of carving out drug spending, and the majority of large employers carve out drug benefits. While Medicaid, based on its patient makeup, is very different from corporate health care, the focus solely on pharmacy-related management under a carve-out model can also be an advantage for Medicaid beneficiaries. In fact, the large percentage of cost associated with blind and disabled recipient’s likely makes it even less suited to a managed care model than many commercial groups.
    - Due to federal law, manufacturers already have to offer their “best price” for a particular drug for Medicaid fee-for-service programs. Therefore, prices on drugs under carve-out models are already as low as other systems.

- Recently, proposals have surfaced to change to a “carve-in” mechanism for funding.
  - A carve-in structure involves shifting pharmacy benefits to be included within the role of the MCOs, which contract with the State to provide health services for Medicaid programs for a set cost.
  - With pharmacy benefits “carved in,” MCOs would likely contract with a PBM, a for-profit firm which acts as administrator of the prescription drug program.
  - Proponents point to potential savings due to efficiencies under the carve-in system. However, many of these so-called advantages are illusory.
Moreover, if such an approach is adopted, it is critical that a broad network of providers be preserved.

**Overview of The Perryman Group’s Economic Impact Assessment**

- **From an economic perspective**, *reductions in fees which threaten the viability of certain pharmacies (particularly independent establishments and smaller chains operating in less populous areas)* or a switch to a carve in method with *significant network limitations as a basis for providing pharmacy benefits would lead to significant negative fallout.*
  - The Perryman Group first measured the effect on pharmacies of various cost-reduction proposals and found that pharmacy store closings would likely occur.
  - These closures would cause economic harm as well as restrict the access of Medicaid and non-Medicaid patients, leading to further potential negative effects.
  - Three scenarios were formulated to reflect the economic impacts of various potential cost-reducing actions that have been discussed:
    - Scenario I assumes the plan recently put forth by the Texas Health and Human Services Commission (THHSC) is put in place (along with fee reductions currently proposed by the Texas Legislature).
    - Scenario II reflects the fee cuts discussed by the Texas Legislature (two 1% reductions now in place and an additional $1.00 reduction being discussed), but assumes that a broad network is maintained irrespective of whether a “carve-in” or “carve out” approach is implemented.
    - Scenario III presumes the implementation of the dispensing fee policy recommendations embodied in a widely circulated study by The Lewin Group.

- **These actions (like any economic activity) would generate multiplier or ripple effects through the economy.** The Perryman Group developed a model some 30 years ago (with continual updates and refinements since that time) to describe these interactions. This dynamic input-output assessment model uses a variety of data (from surveys, industry information, and other sources) to describe the various goods and services (known as resources or inputs) required to produce another good/service.

- **In this case, for example, pharmacies regularly purchase products ranging from supplies to landscaping services.** These businesses, in turn, purchase the items necessary to produce and provide the supplies and services from other companies. In this way, the pharmacy stores’ effect on the economy ripples out through a variety of firms across a spectrum of industries. Moreover, the network of pharmacies is crucial
to ensuring adequate access for both Medicaid and Non-Medicaid patients. If access to needed medications is constrained, additional health care outlays occur, as well as additional economic disruptions.

- Impacts are expressed in terms of several different measures of business activity.
  - **Total expenditures** (or total spending) measures the reduction in dollars changing hands in the state as a result of the reduced access.
  - **Gross product** (or output) is the reduction in production of goods and services that will come about in Texas as a result of the changes. This measure is parallel to the gross domestic product numbers commonly reported by various media outlets and is a subset of total expenditures.
  - **Personal income** is dollars that end up in the hands of people in the area; the vast majority of this aggregate derives from the earnings of employees, but payments such as interest and rents are also included.
  - **Job losses** are expressed as permanent jobs (given that this will be an ongoing impact).

- Foregone economic activity, in turn, results in decreases in fiscal receipts to the State as well as to local government entities. All results are expressed on an annual basis as of 2013 in constant (2010) dollars.

- Following a discussion of the assumptions and analysis put forth in support of various plans for changing the structure of Medicaid pharmacy benefits in Texas, a summary results for key findings from the forthcoming study by The Perryman Group are presented. The full report includes further information such as disaggregation by mental and general health, results for Medicaid and Non-Medicaid patients, and industry-level detail. In addition, further detail regarding the methods used by The Perryman Group is presented.

**Scenario I: THHSC Carve-In Plan with Network Limitations**

- The recommendation to transfer the Medicaid prescription program to a managed care (carve-in) system is based on a comparative analysis that requires further evaluation. The purported net savings is entirely the result of an expected premium tax payment of $56.1 million over the next biennium. In the absence of that levy, there is a cost advantage of $11 million from implementing the cost-cutting policies put forth by the pharmacy industry within the state.

- Several assumptions in the analysis by the Texas Health and Human Service Commission (THHSC) are worthy of additional analysis. Initially, the estimates suggest an added administrative cost of only $700,000 for the biennium, which is
exactly offset by assumed improvements in utilization management. A recent analysis of the Pennsylvania program found almost $25 million per year in added administrative expenses, as well as an initial startup cost of $6.7 million for tasks such as notifying recipients of the changes. The study noted that only about one-third of this amount could be offset by enhancements in utilization management. While the same circumstances do not apply in all states, the Pennsylvania system is only about one-half the size of the Texas program. Moreover, Texas would be maintaining dual systems in that part of the program would remain fee-for-service. Similarly, even the percentage increase in administrative costs represented in the Lewin study suggests added outlay of about $61.6 million per year. These factors combined indicate that the added fees on a biennium basis in Texas could easily be many times larger than those used in the comparative analysis. This phenomenon alone could more than offset the purported savings from the carve-in model.

- Similarly, the THHSC comparison suggests that savings over the biennium from a 3% increase in generic usage would total $11.4 million. Using the cost and number of subscriptions reported in the Lewin report, the indicated savings is about $48.3 million per year (almost $100 million per biennium). Even allowing for the federal match and some lack or comparability, the savings is several times as large as that used in the comparison. Moreover, with numerous brand name drugs having patents expire in the near future, the proven success of the current approach in driving generic compliance, and the incentives available to managed care groups to use brand-name products, it seems highly likely that this level can be substantially exceeded. While there are other valid concerns (such as the failure to fully account for the effects of cost-cutting approaches on premium tax revenues), these major potential discrepancies are sufficient to illustrate the need for a more thorough investigation before adopting significant changes.

- Perhaps the greatest shortcoming of the comparison is that it does not account for the dynamic effects of a reduced network that limits access in many areas (particularly in rural regions), thus leading to complications and added health care expenses. Some of these implications, which make it imperative that any future program (whether fee-for-service or managed care) maintain a comprehensive network, are explored below.
The cost-saving measures outlined by the THHSC and the likely associated network limitations have the potential to cause notable harms to the community pharmacy sector including the loss of more than 770 (primarily independent and small chain) locations, nearly $1.6 billion in annual output (gross product) and 22,135 jobs.

The Annual Impact of the Losses in Community Pharmacy Sector Associated with the Potential Network Reductions Accompanying a “Carve-In” Approach to Medicaid Prescription Management on Business Activity in Texas (as of 2013)

- $2.725 Billion of Total Expenditures
- $1.579 Billion of Gross Product
- $0.954 Billion of Personal Income
- $1.168 Billion of Retail Sales
- 22,135 Permanent Jobs

Note: Assumes a 30% reduction in network coverage and the dispensing fee reductions currently proposed by the Texas Legislature.
Source: The Perryman Group
• The total negative effect (including these community pharmacy losses and incremental outlays for health care among Medicaid and Non-Medicaid patients) includes $3.1 billion in annual output, 42,923 permanent jobs, and $719.1 million in yearly dynamic State revenues losses and required outlays. Because of the disproportionate number of recipients in the blind and disabled category, these effects could well be even larger.

• Looking beyond even the health outcomes, the network limitations of mental health patients also lead to adverse economic consequences in the form of increased homelessness, incarceration, and unemployment rates, as well as decreases in productivity. These phenomena lead to an annual loss of about $3.8 billion in output and more than 46,500 jobs.

![Total Annual Impact on Business Activity in Texas of Community Pharmacy Losses and Incremental Outlays for Health Care Among All Patients Associated with the Potential Network Reductions Accompanying a "Carve-In" Approach to Medicaid Prescription Management](image)

Note: Assumes a 30% reduction in network coverage and the dispensing fee reductions currently proposed by the Texas Legislature. Includes both mental and general health care for both Medicaid and Non-Medicaid patients and assumes that the access effects on the general population will only be 20% as significant as those for Medicaid recipients.

Source: The Perryman Group
Scenario II: Fee Reductions as Proposed in the Texas Legislature

- Fee reductions proposed by the Texas Legislature (both the two 1% cuts that have already occurred and an additional $1.00 reduction) also lead to notable economic losses, although the consequences are far less severe if the basic pharmacy network is maintained.

- The Perryman Group estimates the reduction in annual business activity within the community pharmacy sector to include about 175 closures, $364.4 million in annual output (gross product) and 5,107 jobs.

![The Annual Impact of the Losses in Community Pharmacy Sector Associated with the Dispensing Fee Reductions Currently Proposed on Business Activity in Texas (as of 2013)](chart)

Source: The Perryman Group
The total negative effect under these assumptions includes $722.3 million in lost output (gross product) each year, 9,904 permanent jobs, and $165.9 million in dynamic State fiscal receipts and incremental outlays per annum.

Scenario III: Dispensing Fee Policy Changes as Outlined by The Lewin Group

- The Lewin study that has been widely circulated and discussed maintains that Texas could save approximately $266.3 million annually through switching to a carve-in system for Medicaid prescription management (including the federal and State portions). This analysis is flawed in numerous respects.
  - First, the majority of the savings is achieved through a dramatic reduction in fees that would reduce them to less than 20% of the actual cost of dispensing medications. A decrease of this magnitude would dramatically impact the viability of the Texas pharmacy sector and have enormous adverse consequences, essentially dismantling much of the existing pharmacy infrastructure of the state. In fact, THHSC has previously conducted extensive analysis to demonstrate the reasonableness of the current fee structure. Moreover, changes in fees can be (and, in fact, recently have been) implemented within the current structure. The economic impact of such an approach is outlined below.

![Graph showing total annual impact on business activity in Texas of community pharmacy sector losses and incremental outlays for health care (mental health and general) among all patients (Medicaid and non-Medicaid) associated with proposed dispensing fee reductions.](image-url)
The second major source of purported savings results from an increase in generic utilization. The Lewin analysis is based on the assumption that Texas has a 69% use of generics at present and would be able to increase this level through a "carve-in" program. According to the Texas Health and Human Services Commission, the current generic use is 72.3%, which is approximately the level that the Lewin study indicates could be achieved through the "carve-in" system. In reality, it has already been accomplished with the existing "carve-out" system. Thus, it is obvious that the purported benefits (1) are overstated and (2) are not dependent on a "carve-in" model. In fact, community pharmacies often achieve a higher level of generic use than Pharmacy Benefit Managers. Because of the manufacturers' rebates that PBMs can negotiate (over and above the ones that flow back to the State and federal governments), they have a specific incentive to purchase brand-name products.

Moreover, over 50% of the alleged savings are derived from prescriptions to blind and disabled recipients. Independent analysis has determined that these populations are not well suited to managed care pharmacy programs and that such initiatives are likely to result in larger outlays for medical services.

Thus, the findings from the Lewin study are not a reliable barometer of the current environment in Texas and do not form an appropriate mechanism for policy determination.
If the **dispensing fee policy as outlined by The Lewin Group** is implemented, the reduction in business activity in the state would be significant. Within the **community pharmacy sector**, such a scenario leads to losses of more than 1150 pharmacies, as well as almost **$2.4 billion** in annual output and **33,300** jobs.

The Annual Impact of the Losses in Community Pharmacy Sector Associated with the Implementing the Dispensing Fee Policy Recommendations of the Lewin Study on Business Activity in Texas (as of 2013)

- **33,330** Permanent Jobs
- **-$4.103** Total Expenditures
- **-$2.378** Gross Product
- **-$1.436** Personal Income
- **-$1.759** Retail Sales

Source: The Perryman Group
Overall losses under this scenario (including community pharmacy losses and incremental outlays by patients associated with the potential network reductions) were estimated to be $4.7 billion in output and 64,632 jobs. Yearly state revenue losses and expenditure increases were found to total about $1.803 billion.

Conclusion

- Examining potential avenues for savings is a necessary exercise, particularly when facing a budgetary shortfall. However, maintenance of a vibrant community pharmacy network throughout Texas is both cost effective and essential to providing an adequate health care delivery system.

- Proponents of a change to a carve-in system with notable network restrictions purport that such a switch would benefit the State. However, underlying analyses by The Lewin Group and the Texas Health and Human Services Commission incorporate notable flaws or omissions.
• Moreover, many aspects of these benefits are achievable and even exceeded by savings suggested or supported by pharmacy stakeholders. If a carve-in system is implemented, it is imperative that certain provisions be incorporated or excluded to avoid higher future costs. For example, restricting pharmacy access can lead to higher costs in terms of care lapses and escalation of medical problems and expenses.

• Changing the Texas system of providing pharmacy benefits to Medicaid recipients to a carve-in method or otherwise limiting access would involve substantial negative fallout and should be evaluated within a framework that fully reflects the overall consequences of policy changes. While the additional strain on the State budget is dynamic in nature and not always measured in the framework of policy debates, it is nonetheless very real (as are the associated costs to the economy and overall health and well-being of Texas citizens).