Backgrounder

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What Seniors Will Lose with a Universal Medicare Drug Entitlement

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Millions of American seniors have worked hard their entire lives in the belief that they would receive health insurance benefits, including coverage for prescription drugs, from their employer after retirement. But if Congress does create a universal Medicare drug entitlement based on bills now before a House–Senate conference, the retiree drug coverage many seniors were promised by their employers will be in peril.

- **Millions of seniors will lose their existing employer-provided drug coverage.** If the House and Senate agree to create a universal Medicare drug entitlement, the Congressional Budget Office (CBO) estimates that roughly one out of three seniors with employer-based coverage would lose it. The CBO has estimated that under the Senate bill, at least 37 percent of seniors with existing drug coverage would lose it, while 32 percent of seniors with existing drug coverage would be dropped from their current drug coverage under the House-passed legislation.[1] This means that between 3.8 million and 4.4 million seniors could be dropped from their existing private coverage if Congress passes the pending Medicare drug benefit legislation.[2]

1. Congressional Budget Office, "H.R. 1: Medicare Prescription Drug and Modernization Act of 2003 and S. 1: Prescription Drug and Medicare Improvement Act of 2003," *CBO Cost Estimate*, July 22, 2003, p. 22.

- Passage of the Medicare drug entitlement would place millions of seniors at risk of losing their existing employer-provided drug coverage.
- Seniors who do not completely lose their drug coverage will find their coverage significantly scaled back or reduced.
- Millions of seniors have foregone thousands of dollars in compensation in return for employer-provided drug coverage that may never materialize if the Medicare drug entitlement passes.
- Millions of seniors will lose tens of thousands of dollars in superior private drug coverage if the Medicare drug entitlement becomes law.
- A typical worker will forego wage increase between $6,475 and $9,710 in exchange for the promise of prescription drug coverage during retirement.

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- **Millions of seniors who do not lose their existing drug coverage will find it significantly scaled back.** According to a recent Heritage Foundation analysis of the incentives found in the House and Senate bills, employers are likely to respond by scaling back or drastically reducing the drug benefit that they currently offer their retirees and provide some form of coverage to supplement the entitlement.[3] However, many seniors could lose their existing coverage altogether because, according to a recent CBO report on the pending legislation, "some employers likely would see enactment of a Medicare drug benefit as an opportunity to reduce the costs and risks of providing drug coverage and *would choose not to supplement [the Medicare drug] benefit.*"[4]
- **Millions of seniors have foregone thousands of dollars in compensation for employer-provided drug coverage that may never materialize.** Many seniors are wondering how they can lose benefits that supposedly were promised to them when they began working for their employers two or three decades ago. This is especially true given that employers have often pointed to retiree health benefits as a reason for not increasing cash compensation during contract negotiations. They reasoned that any increases in wages would lead to cutbacks in current and future health benefits. But in offloading the cost of these benefits onto taxpayers, employers would also effectively be cutting the prescription drug benefits for which retirees passed up thousands of dollars in compensation during their working lives.
- **Millions of seniors will lose tens of thousands of dollars worth of superior private drug coverage in the future.** Not only would the average retiree who is dumped into a Medicare drug benefit lose the value of his or her current private drug coverage, but that retiree would also miss out on as much as $110,000 in future prescription drug benefits over the course of his or her retirement.

According to recent analyses of drug coverage among seniors by the CBO,[5] the Centers for Medicare and Medicaid Services (CMS),[6] and the Joint Economic Committee (JEC) of the U.S. Congress,[7] three-quarters or more of Medicare beneficiaries already have prescription drug coverage. According to the JEC, 34 percent of seniors on Medicare with prescription drug benefits receive that coverage through former employers.[8]

The hard truth is that in the vast majority of cases, employers have the right to alter, cut, or even eliminate health benefits previously promised to their employees. Given the huge, largely unfunded liabilities that these benefits often represent, as well as continuing increases in health care costs, many corporations have already begun to scale back the health benefits that they provide to their retirees.[9]

2. Edmund F. Haislmaier, "How Congress's Medicare Drug Provisions Would Reduce Seniors' Existing Private Coverage," Heritage Foundation *Backgrounder* No. 1668, July 17, 2003.
3. *Ibid.*, p. 2.
4. Congressional Budget Office, "H.R. 1: Medicare Prescription Drug and Modernization Act of 2003 and S. 1: Prescription Drug and Medicare Improvement Act of 2003," p. 21 (emphasis added).
5. Douglas Holtz-Eakin, Director, Congressional Budget Office, testimony on prescription coverage and Medicare's fiscal challenges before the Committee on Ways and Means, U.S. House of Representatives, April 9, 2003.
6. Center for Medicare and Medicaid Services projection based on 2000 Medicare Current Beneficiary Survey (MCBS), at *www.cms.gov.*
7. Joint Economic Committee, U.S. Congress, "Medicare Beneficiaries' Link to Drug Coverage," April 10, 2003.
8. *Ibid.*, p. 1
9. For more information on trends in retiree health benefit coverage, see U.S. General Accounting Office, *Retiree Health Benefits: Employer-Sponsored Benefits May Be Vulnerable to Further Erosion*, May 2001; Frank McArdle *et al.*, *The Current State of Retiree Health Benefits: Findings from the Kaiser/Hewitt 2002 Retiree Health Survey,* Henry J. Kaiser Family Foundation and Hewitt Associates, December 2002; and *National Survey of Employer-Sponsored Health Plans: 2002 Survey Report*, Mercer Human Resource Consulting, 2003.

Passage of the pending Medicare drug entitlement would exacerbate this unfavorable trend.

What Current Law Says about Retiree Health Benefits

While many American employers provide health benefits to their employees and retirees, they are not required by law to do so. Where employers do provide these benefits, they must abide by certain fiduciary and administrative standards codified in the Employee Retirement Income Security Act of 1974 (ERISA). Employers are required, for example, to provide plan participants and beneficiaries with a summary plan description (SPD) that is "written in a manner intended to be understood by the average plan participant" and describes both the rights of the health plan participant and the "circumstances under which the health plan can be modified or terminated."[10]

Many employers specifically reserve their right to alter or terminate retiree health benefits in official plan documents or collective bargaining agreements. Thus, federal courts generally have sided with employers attempting to cut back, modify, or terminate the health benefits they provide to their retirees. The courts have also ruled that retirees "cannot rely on oral communications or representations that benefits would be maintained for life or without reduction."[11] In other words, the terms of the written plan documents take precedence over any verbal promises that may have been made by employers to retirees with respect to their health benefits.[12]

Retirees from unionized employment who receive health benefits under collective bargaining agreements may also have little recourse against former employers that cut back or terminate their benefits. According to a 2001 General Accounting Office (GAO) report, "[a]bsent a finding that the parties intended that the health benefits were to be maintained for the retiree's life or some period beyond the expiration of the agreements, courts generally view [retiree health] benefits as ending at the expiration of the agreements."[13] The expiration of a past collective bargaining agreement might result in the revocation of previously promised retiree health benefits. Thus, it would be inaccurate to assume that unionized retirees from private-sector employment are not at risk of losing their retiree health benefits simply because they worked under collective bargaining agreements.

Current law and tax policy tie health benefits to one's place of work. Although health policy analysts at The Heritage Foundation and other policy research institutions have long argued for a change in existing tax and regulatory policy in favor of creating a consumer-based market in which individuals would own and control their own health insurance policies, Congress has yet to act.[14] Given that retiree health benefits represent a significant financial burden to employers across America, they have a tremendous incentive to curtail or even eliminate these benefits.

Junking Retiree Health Benefits

Escalating health care costs and the impending retirement of the baby-boom generation have led many American employers to look for a way out of providing health benefits to their retirees. Retiree health benefits are something of a "double whammy" for employers' bottom lines and thus are especially problematic from a financial perspective. First, employers are required to account for current spending on retiree health benefits, which affects their financial statements.

10. GAO, *Retiree Health Benefits*, p. 30.
11. *Ibid.*, p. 31.
12. "[T]he written terms of the plan documents control and cannot be modified or superseded by the employer's oral undertakings." See *In re: Unisys Corp. Retiree Medical Benefit "ERISA" Litigation*, 58 F.3d 896, 902 (3d Cir. 1995), *cert. denied sub nom Unisys Corp v. Pickering*, 517 U.S. 1103 (1996).
13. GAO, *Retiree Health Benefits*, p. 32.
14. See Stuart M. Butler and Grace-Marie Arnett, "Solving the Health Insurance Problem for Working Americans," in Stuart M. Butler and Kim R. Holmes, eds., *Priorities for the President*, A Mandate for Leadership Project (Washington D.C.: The Heritage Foundation, 2001), pp. 165–182.

But it does not stop there: A rule adopted in 1993 by the Financial Accounting Standards Board (FASB) requires employers to "report annually on the liability represented by the promise to provide retiree health benefits to current and future retirees."[15] These future—in most cases unfunded—liabilities have the potential to affect public impressions of the profitability and overall financial health of a corporation, and therefore its value to investors.

As a result of the financial burden represented by retiree health benefits, more and more employers over the past several years have taken steps to limit both the current and future liabilities created by these benefits. For example, many employers have increased the financial burden that retirees themselves must shoulder for their health benefits by increasing beneficiary co-payments, deductibles, and premiums. A 2002 survey conducted by the Kaiser Family Foundation in conjunction with the Health Research and Educational Trust (HRET) found that 37 percent of large firms (200 or more workers) and 60 percent of jumbo firms (5,000 or more employees) sampled have increased the share of health insurance premiums paid by retirees.[16]

Other employers have terminated retiree health benefits entirely. The Kaiser/HRET survey notes that the percentage of all large firms (200 or more workers) offering retiree health benefits has declined from 66 percent in 1988 to 34 percent in 2002.[17] A 2002 survey conducted by Mercer Human Resource Consulting contained similar findings. According to Mercer's 2002 *National Survey of Employer-Sponsored Health Plans*, the percentage of employers in their sample offering health benefits to Medicare-eligible retirees declined from 40 percent in 1993 to 27 percent in 2002.[18]

Government Control. This contraction of private coverage has broader implications for health policy. Many Members of Congress, particularly those who favor some form of national health insurance managed by the federal government, generally favor the progressive substitution of public coverage for private coverage through expansion of programs such as Medicare and Medicaid. It is no surprise, therefore, that the passage of a Medicare prescription drug entitlement would conveniently coincide with their long-term objectives by spurring employers to drop or significantly scale back the retiree health benefits they currently provide. Moving millions of retirees from private coverage into a Medicare drug benefit program would also allow the government to exercise unprecedented control over a large portion of the prescription drug market.

New Taxpayer Burdens. Many employers, especially those with the greatest retiree health benefit liabilities, stand to gain from the enactment of a universal Medicare drug entitlement. For example, Goldman Sachs analyst Gary Lapidus recently estimated that passage of the drug entitlement bill would reduce General Motors' annual drug spending by $150 million and overall unfunded health care liabilities by $2.3 billion.[19] Ford Motor Company would also benefit significantly: Passage of the pending Medicare drug legislation would save Ford $55 million per year in drug costs and reduce its overall unfunded health care liabilities by $1.2 billion.[20]

Thus, the enactment of a Medicare drug entitlement would shift the costs and liabilities of retiree drug coverage from corporations to taxpayers. As one analyst writes, "While your congressman will tout his support for Grandma with the proposed

15. GAO, *Retiree Health Benefits*, p. 4.

16. Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits: 2002 Annual Survey* (Menlo Park, Calif.: Henry J. Kaiser Family Foundation), p. 143. Other survey data reveal similar trends among employers. For example, a survey conducted by Hewitt Associates and the Kaiser Family Foundation found that between 2000 and 2002, about 44 percent of large private employers who were sampled increased retiree contributions to premiums, while 36 percent reported increasing some form of retiree cost-sharing generally. See McArdle *et al.*, *The Current State of Retiree Health Benefits*.

17. Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits*, p. 144.

18. Mercer Human Resource Consulting, *National Survey of Employer-Sponsored Health Plans*.

19. Gary Lapidus and Jason Cuttler, *Automobiles: United States* (New York: Goldman Sachs Global Equity Research, 2003), p. 1. Many of the figures from the Lapidus–Cuttler report are cited in Sarah Webster, "Medicare Drug Plan May Save Carmakers Millions: Retiree Health Bills in Congress Likely to Affect UAW Talks," *Detroit Free Press*, July 8, 2003.

20. *Ibid.*

prescription drug entitlement, third-party payers, like the automakers, are eligible and will be big beneficiaries as well."[21]

Other corporations also stand to gain from passage of a Medicare drug entitlement. An April 2002 GAO study attempted to identify the "other postemployment benefit obligations" (OPEB) of major corporations in the airline, automobile, and steel/metal industries as of December 31, 2002.[22] It is important to note that these OPEB figures include not just liabilities from retiree health benefits, but also liabilities from any other post-employment benefits, including life, dental, and other fringe retiree benefits.[23] They do not, however, include any pension obligations that corporations might have. Pension liabilities are reported separately.

The OPEB liabilities of major corporations in the airline and steel/metal industries, for example, are staggering. The GAO found that American Airlines, Inc.,[24] reported OPEB obligations of $2.8 billion as of December 31, 2001, while Alcoa, Inc.,[25] had OPEB obligations exceeding $3.2 billion.

Thus, congressional enactment of a massive drug entitlement would give many employers extra incentive either to scale back prescription drug coverage to current and future retirees significantly or to eliminate coverage entirely. It would allow employers to eliminate, in one fell swoop, some (or even all) of their unfunded health benefit liabilities. As always, the American taxpayer would be left to foot the bill for these liabilities.

What Seniors Would Lose

Although many employers stand to strengthen their financial position with enactment of the pending Medicare drug entitlement, seniors with existing private drug coverage have much to lose. Many current retirees with private drug coverage have foregone wage increases or other forms of compensation in return for the promise of employer-provided retiree health benefits. With the pending enactment of a Medicare drug entitlement threatening to force millions of seniors out of their existing private drug coverage, many retirees are rightly concerned over just how much they have sacrificed for retiree health benefits that may never materialize.

Retirees with existing private drug coverage face a "double whammy" of their own. Not only do they face the prospect of losing a benefit for which they gave up additional compensation, but they also risk losing the entire future value of their employer-provided prescription drug benefit. Because employer-provided retiree health benefits are often very generous and provide significant, if not full, coverage for prescription drugs, seniors stand to lose tens of thousands of dollars in future employer-provided benefits if a Medicare drug entitlement becomes law.

Foregone Compensation. A preliminary analysis of the available data can provide an estimate of the amount of compensation retirees have foregone over their working lifetimes for the promise of a retiree prescription drug benefit.[26] Because most employers do not fund health benefits for their

21. *Ibid.*, p. 3.
22. Kathryn G. Allen, U.S. General Accounting Office, "Retiree Health Benefits: Examples of Employer-Reported Obligations in Selected Industries," letter to Sam Johnson (R–TX), Chairman, Subcommittee on Employer-Employee Relations, Committee on Education and the Workforce, U.S. House of Representatives, April 29, 2002.
23. The GAO notes that it is very difficult to compare OPEB obligations across corporations or industries because "employers have latitude in how they calculate postemployment benefit obligations." In other words, because companies are able to rely on idiosyncratic information (e.g., employee demographics and health care coverage decisions) in the calculation of their OPEB obligations, a significant variance between different companies' calculations of their obligations is likely.
24. American Airlines' OPEB obligations include health and life insurance.
25. Alcoa's OPEB obligations include health and life insurance.
26. Data on average retiree health benefit costs provided by Mercer Human Resource Consulting and historical health insurance premium trend data found in the 2002 Kaiser/HRET *Survey of Employer Health Benefits*, as well as National Health Expenditure data from the Center for Medicare and Medicaid Studies, are used to arrive at these estimates. For a more detailed explanation of how these estimates are derived, see the Appendix.

retirees on an ongoing basis, employees are often asked to forego wage increases for the *promise* of future retiree health benefits. Thus, calculations of foregone compensation assume that, without these promised future benefits, the employee would earn a higher wage or would be compensated in some other way.[27]

Based on an analysis of the data, a person who retired in 2002 and worked 30 years with the same employer to secure retiree health coverage has foregone a total of approximately $16,183 in wages for the promise of that coverage. Similarly, a person who retired in 2002 after 20 years with the same employer has foregone approximately $14,816 in promised benefits.

According to the GAO, from 40 percent to 60 percent of employer spending on retiree health benefits goes toward prescription drugs.[28] On that basis, the average retiree who retired in 2002 after working 30 years has foregone approximately $6,473 to $9,710 in wages for a retiree prescription drug benefit. The average retiree who retired in 2002 after 20 years has foregone $5,926 to $8,890 in wages for a retiree prescription drug benefit.

Lost Benefit Value. In addition to foregone compensation lost, retirees stand to lose the value of future prescription drug benefits from their employer if the pending Medicare drug entitlement is passed into law. The prescription drug benefits provided by employers are quite generous, resulting in minimal out-of-pocket costs for retirees. Thus, the value of the future drug benefit that retirees stand to lose with the enactment of a Medicare drug entitlement is significant.

Utilizing retiree health benefit cost data provided by Mercer and a CBO baseline projection of the rate of growth in per capita prescription drug spending by Medicare beneficiaries, one can calculate the value of future retiree health benefits that would be lost by the average retiree who retired in 2002 at the age of 65 if the pending Medicare drug entitlement is signed into law.[29] Assuming that the retiree has a life expectancy of 85, and using the GAO's calculation that anywhere from 40 percent to 60 percent of employer spending on retiree health benefits is on prescription drugs, the average retiree would lose $73,599 to $110,398 in future drug benefit value if his or her employer dropped the private drug coverage that the employer currently provides.

The news is even worse for future retirees. Several factors are likely to drive the estimated lost benefit values even higher in the years to come. For example, increasing use of pharmaceuticals in lieu of inpatient hospitalization will increase total spending on prescription drugs. Furthermore, the newer and more effective pharmaceuticals available to the retiring baby boomers are likely to be increasingly expensive, raising the cost of drug coverage for these future retirees. Thus, not only would future retirees lose the benefits of superior private coverage, but they may also face a tightening of the availability of new medicines in a Medicare entitlement burdened with rapidly rising costs.

Under these circumstances, current and future retirees have good reason to be concerned about the impact of the pending Medicare drug entitlement on their future private prescription drug benefits and the foregone compensation that helped to finance those benefits. After all, millions of seniors have already individually foregone thousands of dollars over their working careers for the promise of a retiree drug benefit and may have to sacrifice tens of thousands of dollars more in future benefits if the Medicare drug entitlement is signed into law.

Many Seniors Will Lose Private Drug Coverage

There is a debate among health policy analysts over whether and how many seniors would lose their existing private coverage under pending Medicare drug benefit legislation. Some analysts predict a relatively modest impact on seniors.[30] While it is very difficult to predict employer behavior, and therefore the exact number of Medicare beneficiaries

27. Given a competitive labor market, economists generally agree that employers base their wage and benefit decisions on total compensation; thus, any savings received in benefit costs are presumed to be passed back to employees in the form of higher wages or salaries.

28. GAO, *Retiree Health Benefits*, p. 15.

29. For a more detailed explanation of how these estimates are derived, see the Appendix.

that would be dropped from their existing private coverage, the analyses reported by the CBO and The Heritage Foundation point toward a significant number of retirees at risk.[31]

As noted earlier, the CBO has estimated that 3.8 million to 4.4 million seniors would lose their existing private drug coverage if the pending Medicare drug entitlement proposals become law. A recent CBO cost estimate of both the House and Senate legislation concluded that either bill "would provide a clear financial disincentive for employers to supplement the [Medicare drug] benefit."[32]

Conclusion

The vast majority of seniors already have prescription drug coverage from a variety of sources: former employers, private Medigap plans, Medicaid coverage, and other supplemental health insurance. Policymakers should focus on providing prescription drug coverage to the minority of Medicare beneficiaries who really need it rather than on creating perverse incentives for employers to drop the health benefits promised to current and future retirees.

Current law makes it quite easy to change existing retiree health benefit policies, and this places millions of seniors and their beneficiaries at risk of losing their current private coverage. Passage of a universal Medicare drug entitlement would only hasten and accelerate the decline in employer-sponsored retiree health benefits—quality health benefits on which many retirees depend.

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30. See, for example, Dallas L. Salisbury and Paul Fronstin, "How Many Medicare Beneficiaries Will Lose Employment-Based Retiree Health Benefits If Medicare Covers Outpatient Prescription Drugs?" Employee Benefit Research Institute, *EBRI Special Analysis*, 2003.
31. See Haislmaier, "How Congress's Medicare Drug Provisions Would Reduce Seniors' Existing Private Coverage," and Congressional Budget Office, "H.R. 1: Medicare Prescription Drug and Modernization Act of 2003 and S. 1: Prescription Drug and Medicare Improvement Act of 2003."
32. Congressional Budget Office, "H.R. 1: Medicare Prescription Drug and Modernization Act of 2003 and S. 1: Prescription Drug and Medicare Improvement Act of 2003," p. 21.

Appendix

Methodology for Calculating Foregone Compensation

Millions of working Americans have voluntarily given up or "foregone" a certain amount of compensation (in the form of wages or salaries) in return for the *promise* of future retiree health benefits. The author's goal in this paper was to estimate the average amount of compensation (in 2002 dollars) that an employee retiring in 2002 has foregone over a 20-year or 30-year working career in return for the promise of future retirement health benefits.

Although neither workers nor their employers are *actually* paying for retiree health benefits over the course of their working lifetimes, the calculation of foregone compensation assumes that they are foregoing or sacrificing a certain amount of wage in return for the *promise* of future benefits. The goal is to determine the value of these foregone wages over the entire course of an employee's time in the workforce.

It is important to note that these foregone wages are not held in some sort of account until the employee retires. Rather, the wages that an employee foregoes are effectively used to subsidize the benefits of those currently in retirement, who are already drawing on those benefits. Thus, the goal of a calculation of foregone compensation is to determine the average amount of money that an active employee would forego while in the workforce for the promise of future benefits.

To accomplish this goal, it is necessary to determine the average cost of retiree health and prescription drug benefits per active employee at private-sector firms offering these benefits over the 20-year period from 1982–2002 and the 30-year period from 1972–2002. All estimates of foregone compensation are calculated in 2002 dollars and assume that employer savings from lower benefit costs in a competitive labor market are returned to the employee in the form of higher wages or compensation.

The cost of employer-provided health benefits for Medicare-eligible retirees ($3,180 per year per retiree) is based on the 2002 Mercer Human Resource Consulting *National Survey of Employer-Sponsored Health Plans*. This amount was trended back to 1972 using two sources.

First, for the period from 1987–2002, health premium increase data were found in or interpolated from the 2002 Kaiser Family Foundation/Health Research and Education Trust (HRET) *Employer Health Benefits* annual survey.

Second, because the Kaiser/HRET trend data stop at 1987, the period between 1972 and 1987 is trended using average annual increases in personal health care costs paid by private insurance found in National Health Expenditure data from the Center for Medicare and Medicaid Services.

While a continuous time series of data reflecting average annual premium or private health expenditure increases from 1972 through 2002 would have been preferable, the method used reflects the best available data at the time this paper was prepared.

The trended yearly employer-provided health benefit costs were averaged for two periods: 1972–2002 (30 years) and 1982–2002 (20 years). The resulting averages ($1,205 per year per retiree for the 30-year period and $1,655 per year per retiree for the 20-year period) were used as the baselines for calculations of foregone compensation.

The slightly higher average for the 20-year period reflects higher yearly health benefit costs during that period. The estimation of foregone compensation per retiree per year was limited by the unavailability of time series data on both the number of private-sector retirees with health benefits and the number of private-sector employees of firms offering retiree health benefits. Thus, the author utilized the most recent available data on the size of these populations in his calculations.

The average cost of prescription drug benefits per retiree per year was calculated as follows:

First, the average benefit costs determined above were multiplied by the number of retirees with private-sector employer-sponsored insurance in 2000. The number of Medicare beneficiaries with employer-sponsored insurance (12.6 million) was obtained from the 2000 Medicare Current Beneficiary Survey and includes non-institutionalized beneficiaries that have only employer-sponsored private

insurance or employer-provided sponsored private insurance *and* individually purchased private insurance (Medigap plans). This number was then adjusted for the number of Medicare beneficiaries that receive retiree health benefits from public-sector employers (at the federal, state, and municipal levels). This adjustment is based on an Employee Benefit Research Institute estimate that 39 percent of persons over 65 with coverage in their own name through a former employer retired from the public sector. Thus, approximately 7.7 million Medicare beneficiaries are currently covered by private-sector retiree health benefits.

Second, based on the average benefit cost calculated above, private-sector employers are calculated to have spent an average of $9.3 billion in retiree health benefits per year over the 30-year span (1972–2002) and $12.8 billion each year over the 20-year span (1982–2002). To determine the average cost per active worker per year, this number is then divided by the total number of active employees working for private-sector firms that offer retiree health benefits, which is based on the most recently available data from the Bureau of Labor Statistics (BLS).[33] Although the BLS has published data on employee benefits in the private sector that are more recent than the previously mentioned reports, the 1997 data for medium and large firms and 1996 data for small firms are the most recent data to detail the percentage of employees that worked for firms offering retiree health benefits. Given recent cutbacks in employer-sponsored retiree health benefits, the number of active employees that qualify for these benefits is likely lower today than it was when the BLS data were published. However, given the available data, the most accurate estimate of the number of active employees that qualify for private-sector retiree health benefits is 17.2 million. Thus, the average benefit cost per active employee per year for private-sector employer-sponsored retiree health benefits is $539.45 over the 30-year period and $740.80 over the 20-year period.

Finally, the average prescription drug benefit cost per active employee per year is calculated using the GAO estimate that 40 percent to 60 percent of employer spending on retiree health benefits is attributable to prescription drugs. Thus, each retiree that has worked for 30 years has foregone an average of $215.78 to $323.67 per year in compensation for the promise of a retiree prescription drug benefit. Similarly, each retiree that has worked for 20 years has foregone an average of $296.32 to $444.48 per year in compensation. These figures are then multiplied by 30 years and 20 years, respectively, to arrive at the estimates used in the paper.

Methodology for Calculating Lost Future Benefit Value

Lost future benefit value was calculated using the 2002 Mercer per capita estimate of employer retiree health benefit cost ($3,180). To isolate the value of the employer-sponsored retiree prescription drug benefit, this amount was adjusted based on the GAO's estimate that 40 percent to 60 percent of employer spending on retiree health benefits is attributable to prescription drugs. Thus, the estimated baseline per capita value of prescription drug benefits per retiree in 2002 ranged from $1,272 to $1,908.

These amounts were then trended forward using an estimated rate of growth in average per capita prescription drug spending for Medicare beneficiaries in a March 2003 CBO baseline projection. The CBO projections cover growth rates between 2004 and 2014. The author assumes a conservative per capita annual growth rate in prescription drug spending of 8.4 percent (the estimated rate for 2014) where data are not available and beyond the CBO baseline period. This rate of growth is reasonable given the decline in the growth of per capita prescription drug spending of Medicare beneficiaries due to the retirement of the baby boomers over the 20-year period beginning in 2004.

The resulting forecasted yearly amounts were then summed to determine the total value of lost prescription drug benefits over the period between 2002 and 2022.

33. U.S. Department of Labor, Bureau of Labor Statistics, *Employee Benefits in Medium and Large Private Establishments, 1997*, and *Employee Benefits in Small Private Establishments, 1996.*