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DRUG DATA BRIEF

Windfall Profits Despite Discounted Price: Small Manufacturing Cost for Cipro Yields Estimated $70 Million Windfall

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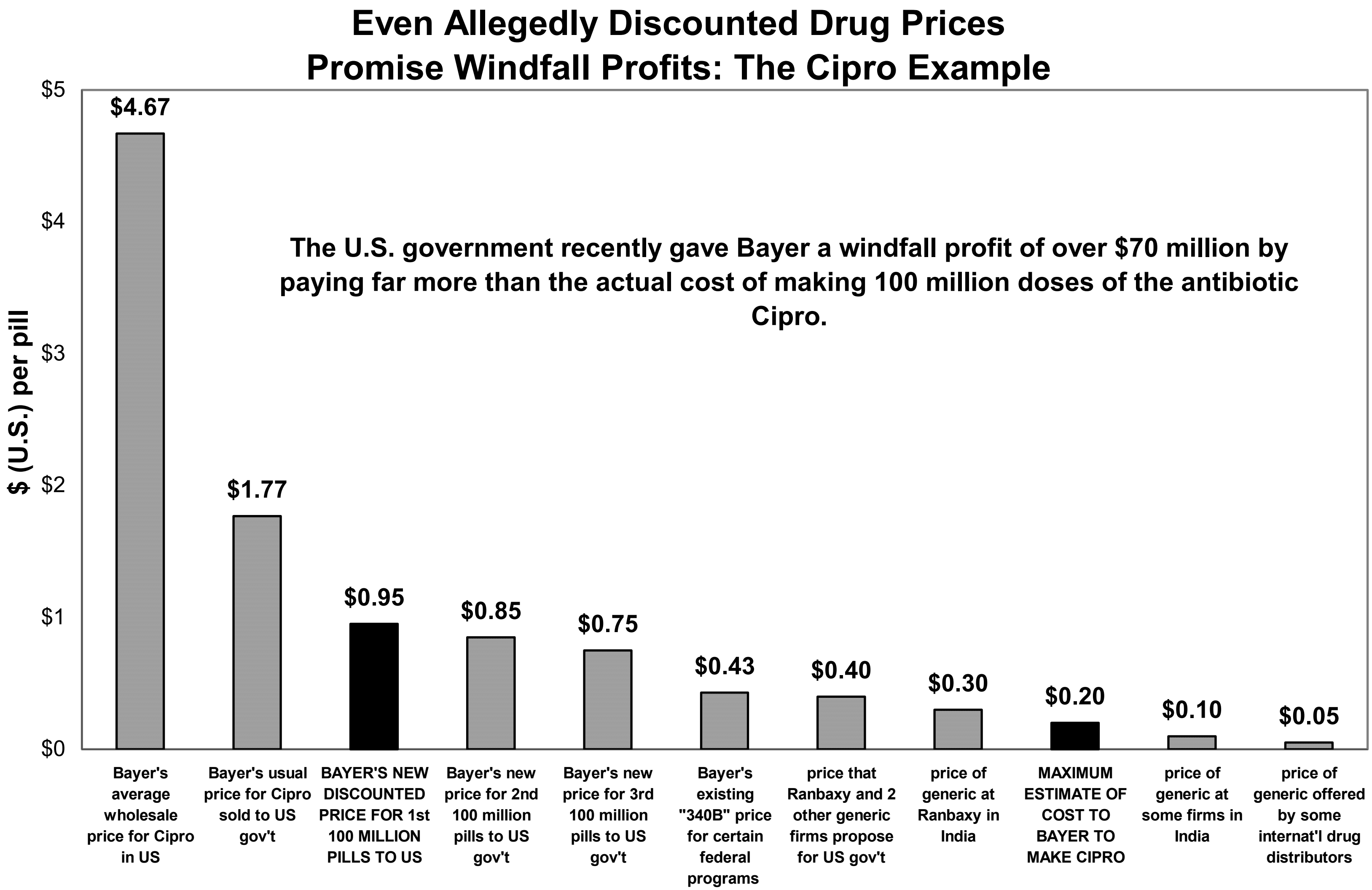

Cipro prices and cost.xls Chart3

Sources: G. Harris, “Bayer’s Cipro Will Be Profitable, Even on Discount Deal With U.S.,” *Wall St. Jnl*, 10/26/01.
S. Vedantam, “HHS’s Varying Costs for Cipro Criticized,” *Washington Post*, 10/26/01.

ALTERNATIVE CAPTIONS FOR USING ONLY THE CHART:

LONG CAPTION

Rx windfall profits: The very low actual cost of manufacturing prescription drugs—after the research is done and the factories are built— lets brand name drug makers offer seemingly low prices and still grab huge profits. Boston University School of Public Health researchers Deborah Socolar and Alan Sager estimate that on Bayer's recent $95 million sale of the anthrax drug Cipro to the U.S. government, the company's profit exceeds $70 million. Those low actual costs of additional pills are also evidence that the U.S. can easily solve the prescription drug affordability problem.

SHORT CAPTION

Low cost, high profit: Boston University School of Public Health researchers show that, when volume rises, very low manufacturing costs let brand name prescription drug makers grab huge profits even on apparently discounted prices —for example, at least $70 million for Bayer on the federal purchase of Cipro.

Sources: G. Harris, "Bayer's Cipro Will Be Profitable, Even on Discount Deal With U.S.," *Wall St. Jnl*, 10/26/01.
S. Vedantam, "HHS's Varying Costs for Cipro Criticized," *Washington Post*, 10/26/01.

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Low Real Costs Mean Even Discount Drug Prices Yield Huge Profits

Deborah Socolar and Alan Sager, Directors
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The low real cost of making and distributing the anthrax antibiotic Cipro, and most drugs, lets brand name prescription drug makers grab huge profits even when they set presumably discounted prices. This evidence on real costs suggests a way to finance needed drugs for all—by paying only the actual cost of rising sales volume.

Low costs and rising volume yield windfall profits

On Bayer's recent $95 million sale of Cipro to the federal government, we estimate that the company's profit exceeds $70 million.

This reflects the wide disparities in Cipro prices and costs reported widely last fall:

- Bayer's usual discounted price for the U.S. government, **$1.77** per pill, is about 40 percent of what's called Cipro's "average wholesale price" of **$4.67**.[1] (Highlighted prices, as reported in the *Wall Street Journal* and elsewhere, are shown in chart.[2])
- Bayer eventually cut that government price by almost half when federal officials sought to buy large Cipro supplies after last fall's anthrax attacks. The new price ranges from **95 cents to 75 cents** per pill (95 cents each for the first 100 million pills, dropping if the U.S. buys a second or third 100 million pills)[3]—"an excellent deal," Health and Human Services Secretary Tommy Thompson reportedly said.[4]
- But the newly discounted government prices are about double what some federal programs already paid, news reports have noted, [5] and double the prices that three generic drug makers offered U.S. officials last fall (**40-43 cents** per pill).[6]
- Bayer committed to providing 100 million pills by the end of 2001. Assuming it did, our government has spent $95 million. If the U.S. decides to buy all 300 million discounted pills, it will pay Bayer $255 million. Yet other firms said they could make a profit selling 300 million identical pills without the brand name for 40 cents each [7] —or $120 million. U.S. officials chose to pay over twice as much.
- Industry observers say that making Cipro costs under **20 cents** per pill, less than one-fourth of Bayer's newly discounted price. Further, some international sellers offer generic equivalents (*ciprofloxacin*) priced as low as **5 cents**.[8] Since pills are small, costs to ship them to a few government stockpiles also are modest.

With the new discounted price of 95 cents per pill on the initial federal government purchase, and with total costs likely below 20 cents per pill, Bayer can expect profits of 75 cents or more per pill. Therefore, of Bayer's first $95 million sale of Cipro to the U.S. government, over 79 percent—over $70 million—appears to be pure profit.

Further, from Americans who paid $4.67 per pill out-of-pocket, Bayer took an estimated 95 percent of their payments as profit.

Price gaps expose lack of free market

Today's drug price chaos–with buyers paying wildly differing prices–exposes the lack of a free market for prescription drugs. In a free market, competition would force prices to converge.

Instead, in the market for prescription drugs, numerous factors—patents, mergers, suppression (possibly illegally) of generic competition,[9] barriers to imports, and more—give drug makers monopoly pricing power. That enables drug makers to keep prices high and to gain unjustified profits. When a market is not free, high profits tend to reflect market manipulation, not efficiency.

The market for prescription drugs is cannot be free, resting as it does on government-granted patent monopolies. So further government action is essential to protect patients by offsetting the drug makers' power to extract excessive prices and profits.

Cipro case reveals low cost of expanding coverage

Most plans to expand drug coverage—for Medicare enrollees and others—would yield enormous windfall profits for drug makers because business-as-usual prices far exceed the actual cost of making additional pills. This makes traditional plans for expanding coverage very expensive.

<u>But the Cipro case helps show how the U.S. can easily make prescription drugs affordable to all</u>. Because the real cost of additional pills is so low for most drugs—after the research is done and factories built—drug makers do not need huge additional payments to finance large increases in volume.

Confirming this are recent announcements from two drug makers—Pfizer and Eli Lilly—offering a flat retail price of $12 or $15 per month for each of their prescription drugs for low-income people on Medicare who lack drug coverage.[10] Pfizer, which set a flat $15 price for eligible patients, asserts that the average retail price of its drugs is about $65 per month.[11] Although Pfizer did not reveal the share that pharmacies retain as a dispensing fee, the discount would presumably cut Pfizer's revenue on these prescriptions to a fraction of what it receives now from patients who pay full price. Pfizer apparently calculated, however, both that the new program will boost volume (in part by attracting patients who could not pay those full prices) and that even these discounted prices will cover its low real cost of making more pills. Indeed, despite the discount plan, Pfizer predicts it will have the industry's highest profit rates.[12]

Such evidence suggests the basis for negotiating a solution to the drug affordability problem and protecting interests of all parties—a new prescription drug price Peace Treaty.[13] Prescription drug financing could be arranged to protect drug companies' current level of profits while paying them the *real* incremental (marginal) costs of making and distributing all the added prescription drugs that all Americans need.

Many drug makers may hope that a Medicare benefit will yield tremendous windfall profits if they sell a greatly increased volume at prices only slightly discounted. Today, however, drug makers' high prices and the resulting vast cost of proposed Medicare benefits are the major obstacles to passage of a Medicare drug program.

By averting that unjustified windfall—and without cutting into drug makers' profits—the U.S. could meet the needs of both patients and payors. As the evidence from Bayer, Pfizer, and Lilly suggests, simply paying drug makers' actual costs can make hundreds of millions of additional needed prescriptions affordable for all.

Sager and Socolar, directors of the Health Reform Program at the Boston University School of Public Health, have been analyzing prescription drug cost and coverage problems since 1993. Selected reports and Congressional testimony on a drug Peace Treaty and other issues are at www.healthreformprogram.org

NOTES

[1] See, for example, Gardiner Harris, "Bayer's Cipro Will Be Profitable, Even on Discount Deal With U.S.," *Wall Street Journal*, 26 October 2001. Bayer stated that $1.77 is the usual government price in "Bayer, HHS Complete Cipro Agreement," 24 October 2001, www.bayerpharma-na.com/news/co0260.asp. Note: an "average wholesale price" (AWP) for a prescription drug in the U.S. is a figure that drug makers report and use to set prices for certain buyers, but it need not reflect the actual average of wholesale prices at which the drug sells.

[2] Most prices cited here are from Gardiner Harris, "Bayer's Cipro Will Be Profitable, Even on Discount Deal With U.S.," *Wall Street Journal*, 26 October 2001. The existing 43 cent price for Cipro in certain federal programs was reported in, for example, Shankar Vedantam, "HHS's Varying Costs for Cipro Criticized," *Washington Post*, 26 October 2001.

[3] See, for example, Gardiner Harris, "Bayer's Cipro Will Be Profitable, Even on Discount Deal With U.S.," *Wall Street Journal*, 26 October 2001.

[4] Quoted in Keith Bradsher, "Bayer Halves Price for Cipro, but Rivals Offer Drugs Free," *The New York Times*, 26 October 2001, http://www.nytimes.com/2001/10/26/business/26CIPR.html.

[5] The existing 43 cent price for Cipro in certain federal programs was reported in, for example, Shankar Vedantam, "HHS's Varying Costs for Cipro Criticized," *Washington Post*, 26 October 2001.

[6] See, for example, Gardiner Harris, "Bayer's Cipro Will Be Profitable, Even on Discount Deal With U.S.," *Wall Street Journal*, 26 October 2001.

[7] Gardiner Harris, "Bayer's Cipro Will Be Profitable, Even on Discount Deal With U.S.," *Wall Street Journal*, 26 October 2001.

[8] See, for example, comments of Agnes Varis, president of Agvar Chemicals, cited in Keith Bradsher, "Bayer Halves Price for Cipro, but Rivals Offer Drugs Free," *The New York Times*, 26 October 2001, http://www.nytimes.com/2001/10/26/business/26CIPR.html. See also William Haddad, CEO of United States Research and Development Corp., cited in Gardiner Harris, "Bayer's Cipro Will Be Profitable, Even on Discount Deal With U.S.," *Wall Street Journal*, 26 October 2001.

[9] For example, a Federal Trade Commission anti-trust investigation is underway into a 1997 arrangement between Bayer and generic drug maker Barr Laboratories. Bayer agreed to pay Barr about $30 million yearly from 1997 to 2003, and Barr then dropped its challenge to Bayer's patent on Cipro. (See, for example, Kristen Hallam, "Cipro Debate Prompts Approval of Generic Drug Bill," Bloomberg Financial News, 18 October 2001; see also excerpt of Barr Laboratories' SEC filing, posted at http://www.cptech.org/ip/health/cl/cipro/.) Patient advocacy groups sued to have that agreement declared illegal, along with similar Bayer pacts with other generic firms. (See, for example, Prescription Access Litigation Project, "Unlawful Conspiracy Restricted Production of Cipro, Consumers Charge…," press release, 24 October 2001, http://www.communitycat.org/index.php3?fldID=124.)

[10] Pfizer, "Pfizer to Provide Health Benefits, Including $15 Flat Fee …," press release, 15 January 2002, http://www.pfizer.com/pfizerinc/about/press/sharecard.html. See also, for example, Scott Hensley, "Pfizer Plans to Offer Seniors Prescription Drugs at Flat Fee," *Wall Street Journal*, 16 January 2002; Julie Appleby, "Lilly offers prescription card to low-income seniors," *USA Today*, 5 March 2002.

[11] Pfizer, "Questions and Answers: The Pfizer for Living Share Card Program," 15 January 2002, http://www.pfizer.com/pfizerinc/about/sharecard/sharecardqa.html

[12] See Question 15 in Pfizer, "Questions and Answers: The Pfizer for Living Share Card Program," 15 January 2002, http://www.pfizer.com/pfizerinc/about/sharecard/sharecardqa.html. See also Pfizer, "Pfizer Expects Industry-Leading Performance Through 2004…," press release, 18 December 2001, http://www.pfizer.com/pfizerinc/investing/analystrelease2001.html.

[13] See Alan Sager and Deborah Socolar, *A Prescription Drug Peace Treaty: Cutting Drug Prices to Make Prescription Drugs Affordable for All and to Protect Research*, Boston: Health Reform Program, Boston University School of Public Health, 5 October 2000; and Alan Sager, *Americans Would Save $38 Billion in 2001 if We Paid Canadian Prices for Brand Name Prescription Drugs*, testimony to U.S. Senate Commerce Committee, Subcommittee on Consumer Affairs, 5 September 2001, http://dcc2.bumc.bu.edu/hs/ushealthreform.htm. See also, for example, Alan Sager and Deborah Socolar, "Face-Off: Let's Seek a Prescription Drug Price Peace Treaty," *AARP Bulletin*, June 2001.