Highlights of 4/12/04 Response

How Much Would Drug Makers' Profits Rise under a Medicare Prescription Drug Benefit? A Response to PRI/PwC's Undocumented and Disjointed Critique of Our 10/31/03 Report

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In October 2003, we estimated drug makers' new profits under the proposed Medicare bills. We found that the proposed $400 billion in new federal spending for a Medicare drug benefit *would raise drug manufacturers' profits by $139.2 billion over 8 years*. PricewaterhouseCoopers disputed that estimate in a March 2004 critique commissioned by the Pacific Research Institute.

In an April report, we identified the PRI/PwC critique's main failures. It did not undermine our analyses of the 3 main aspects of the legislation that would steeply raise drug makers' profits:

- Drug makers' prices would not be restrained under the new law, we concluded. PRI/PwC agree that private plans now average 15% discounts for employers but claim, without supporting evidence, that they will win Medicare discounts of "around 25%."
- The volume of drugs sold would rise substantially, we predicted. The critique vastly underestimates the likely volume rise when Medicare patients are covered.
- Drug makers' added costs are very low, we emphasized. Most Medicare revenue would be profit, as most costs are already covered. PRI/PwC ignore drugs' low incremental costs.

The bill's inadequate benefits and high costs reflected too much money going to drug makers' profits, because prices were not controlled. If the PRI/PwC critique were accurate, the overwhelming share of money under the bill would apparently replace existing spending on prescription drugs, and very little would aid patients who do not get needed drugs today.

A. COST – (1) PRI/PwC ignore half of the equation, "profit = revenue minus costs." They ignore drug makers' very low real incremental costs of making more pills for Medicare patients.

B. VOLUME – (2) PRI/PwC underestimate how many people on Medicare have no drug benefits by one-third or more and seem unaware of how limited coverage is for many others.
(3) The critique underestimates effects of coverage and lower prices. It relies on irrelevant data, a 30-year old price-elasticity estimate from a study of *non-Medicare* patients—a source inappropriate for at least 6 reasons. (We instead considered use rates of Medicare patients with and without drug coverage.) PRI/PwC also ignore the recycling of price discounts—that savings would likely go to buy more medications, thereby helping to maintain drug makers' revenue.
(4) The critique rests on a circular argument. And without evidence, it implausibly claims that insurance covered 58% of drug costs for Medicare beneficiaries in 2003.
(5) It fails to identify the new rx/replacement rx split, central to effect on profits and patients.
(6) Many of the critique's central calculations are hidden, notably on drug use rates.

C. PRICES – (7) PRI/PwC claim implausible discounts and rebates: Estimates that private plans with fragmented buying power will save Medicare more than they now save employers are unsupported. PRI/PwC may assume use of very restrictive (and unpopular) formularies.

D. PROFITS – (8) PRI/PwC and anonymous industry sources claim implausible effects—that $400 billion in new Medicare funds will yield a *drop* in drug maker revenues or only a tiny rise.
(9) Refusing to estimate profits: PRI/PwC address only change in revenues. *But we are grateful that PRI/PWC noted that $139 billion in projected new profits means a rise of 31% over 8 years, not 38%. (We had understated drug makers' expected profits absent the law.)*

E. OTHER – (10) Ignoring our range of estimates and their conservatism. (11) Not questioning CBO estimates. (12) Ignoring need for new solutions, and assuming high prices can persist.