Stock Watch  
Making It Up on Volume

By Rebecca Thomas
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THE WAR against unaffordable medicine is intensifying with the election season. As politicians take up arms on behalf of consumers, big drug makers have fortified their defenses. Slash drug prices, the industry threatens, and you’ll wipe out the research that produces innovative medicines. Meanwhile, investors in pharmaceuticals have taken cover.

But a new study by Boston University’s School of Public Health is calling on both sides to lay down their weapons. Consumers and drug companies alike can emerge victorious, the study argues: "Americans can win much lower drug prices and make all needed medications affordable for all citizens without harming drug makers' research — or even their profits."

Talk about having your pills and affording them too.

California Congressman Pete Stark, a Democrat, praised the study’s findings in a statement Thursday. "This report directly refutes drug industry claims that to solve the problem of high drug prices would negatively impact their profitability and ability to continue life-saving R&D," he said. "I urge my colleagues on the other side of the aisle to take notice of these important new findings."

The study, titled "A Prescription Drug Peace Treaty," is the brainchild of Alan Sager, professor of health services, and research analyst Deborah Socolar. "My colleague and I decided that [making prescription drugs affordable] was the easiest problem to fix in the United States," says Sager — a statement that


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seems counterintuitive to anyone who heard the presidential candidates belabor the problem in their first debate. "We are extreme moderates who wanted to draft a peace treaty that works affordably for everyone."

The researchers believe that prescription drugs should be made affordable for all of the more than 69 million Americans (25% of the population) without prescription-drug insurance. While drug coverage for seniors has more political appeal, a Medicare drug benefit would cover only one in five of all Americans who don't currently have drug coverage, explain Sager and Socolar. Left out in the cold, meanwhile, would be the 44.9 million who lack any health insurance and about 12 million people under age 65 who have insurance that doesn't cover prescription drugs.

It's not hard to understand why the government has shied away from providing universal coverage. It looks like a surefire way to break the bank. Total U.S. spending on prescription drugs per capita is currently the highest in the world. This year, private insurers, the government, hospitals, nursing homes and citizens will pay drug manufacturers $96.5 billion for name-brand drugs, according to the researchers. The increase in spending has been attributed not only to higher prices for existing drugs but also to increased overall use of pharmaceutical drugs and a shift to new, costlier medications.

But partial measures to bring down the cost of prescription drugs are unworkable, argue Sager and Socolar. A government-controlled Medicare benefit, as proposed by Vice President Al Gore, would probably prove too costly unless the government strictly controlled prices. Conversely, they say, relying on the insurance industry to offer a drug benefit, as Republicans suggest, is risky because there's no guarantee HMOs would write policies for a benefit that's likely to be most popular with the sickest. Regardless, all forms of subsidy would just put more dough in the drug industry's already bulging coffers.

Attempts to lower prices indirectly would be even less effective, argue the researchers. While legislation that would permit the reimportation of American-made drugs from abroad — where prices are government controlled and, therefore, significantly cheaper — is "well-intentioned," it's unlikely to work, they say. Drug makers can easily circumvent this reform by, among other things, exporting less medicine, thereby reducing the quantity available for reimportation.

Direct, government regulation of U.S. drug prices is a better solution, the study concludes. Under the plan proposed by Sager and Socolar, prescription-drug prices would be slashed by 36.6% to levels now paid by the Veterans Administration and several other federal programs under the Federal Supply Schedule. Everyone would pay the same price for a drug, regardless of their insurance policy.

It's easy to see why consumers might like such a plan. But what could possibly be in it for the drug companies? After all, the industry has argued that price controls would devastate revenues and destroy any incentive to innovate. When prices are cut, "the lights go out in the labs," according to the industry's trade group, the Pharmaceutical Research and Manufacturers Association, or PhARMA.

But Sager and Socolar argue that "lower prices are compatible with research and profits." Simply put, they believe that pharmaceutical companies can benefit from the discounter's paradox: Someone who charges lower prices can make more money because of higher volume.

As drug prices fall, more people will be able to afford to fill their prescriptions.
analysis by Merrill Lynch estimated that a 40% price cut for Medicare beneficiaries lacking drug coverage would result in a 45% surge in volume. The firm concluded that such a price reduction would result in a 3.3% revenue loss — at the most. But even that small revenue loss could be recovered if the government starts or expands programs that subsidize drug coverage for those who can't afford even substantially cheaper drugs. While aggregate spending by public and private sectors would remain the same, many more people would have access to lifesaving medicines.

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Alan Sager and Deborah Socolar  
Authors, "A Prescription Drug Peace Treaty"

The Boston University study recognizes that the manufacturing costs of producing more drugs must be considered. Fortunately, these incremental costs are relatively low. Sager and Socolar estimate the marginal cost of additional volume to be just 5% of each retail dollar. If that’s indeed the case, it would cost manufacturers only $50 million to make drugs with a retail value of $1 billion. To compensate drug makers for producing more pills, the peace treaty proposes that public and private payers guarantee drug makers the extra costs of manufacturing and distributing additional volume.

The drug industry isn’t buying the argument, though. "We don’t think government-mandated price controls work," says PhARMA spokesman Jeffrey Trewhitt. "They haven’t worked in the past." Sager’s and Socolar’s conclusion might be correct if pharmaceutical research were easy and predictable, he says, but "regrettably it is not." The industry, he explains, never really knows how much it will need to spend in a given year on research and development, so it’s always trying to maximize its return on investment.

However, the study counters that drug makers could preserve both research spending and profit margins if they shaved spending on "excessive" marketing and advertising. Sager and Socolar suggest drug makers cut back on direct-to-consumer spending, as well as in-house marketing staff, which amounted to 34% of total drug-industry employment in 1999. "In a reasonable world, it should be less costly to inform physicians about which drugs are effective and worth the money," they say.

Sager and Socolar also favor rewarding companies that develop breakthrough medications. The U.S. government, they say, could learn something from the British government, which has sought to provide bonus profits to manufacturers that do just that. At the same time, the partners suggest limiting incentives (perhaps by shortening patent lives) for so-called copycat drugs, which confer few clinical advantages over drugs already on the market.

Sager and Socolar aren't antiprofits. Drug makers, they argue, need not choose between slimmer profits and fewer clinical studies. "We respect the legitimate needs of all parties," says Sager. In protecting patients and drug makers, "we can protect shareholders at the same time."

If, as the researchers suggest, affordable medicine, innovative research and high profits are all compatible, why not give peace a chance?