WHY SHOULD AMERICANS PAY MORE?
CUTTING PRESCRIPTION DRUG PRICES
TO FOREIGN LEVELS
WILL SAVE LIVES AND MONEY

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*** DRAFT ***
17 August 1995
The Access and Affordability Project gratefully acknowledges financial support from The Boston Foundation, The Mable A. Horne Trust/Bank of Boston Charitable Trusts, the Raytheon Company, and the Erna Yaffe Foundation. The evidence, analysis, and recommendations in this report are entirely the responsibility of the Project and do not necessarily represent the views of the Project's financial supporters.

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SUMMARY

THREE PROBLEMS

1. Americans Pay More For Prescription Drugs

Prescription drug manufacturers charge U.S. buyers far higher prices than the same companies charge in other countries for the identical drugs. The people of the United States would win very substantial savings if we could buy prescription drugs from manufacturers at the prices they charge in other nations.

We estimate that U.S. savings this year would range from $12.4 billion to $35.0 billion, depending on whether the Canadian, British, Swedish, or Australian price standard is used. These savings equal between 24.2 and 68.4 percent of the $51.2 billion that we estimate prescription drug manufacturers will garner from the U.S. market in 1995. Using a less conservative calculation method, dollar savings would be 13.5 percent higher.

Savings in Massachusetts would be particularly high because we have the nation's second-highest level of spending on retail prescription drugs.

In Massachusetts alone, residents and employers could expect to save between $353 million and $994 million on prescription drugs in 1995 if the prices charged by manufacturers to people in other nations prevailed here. (We estimate conservatively that, at current prices, manufacturers' revenues from Massachusetts prescription sales this year will total $1.454 billion.)

Building on U.S. General Accounting Office studies of Canadian and British drug prices, the Access and Affordability Monitoring Project added data on Australia. For 29 specific commonly-dispensed prescription drugs, manufacturers' prices in all three other countries were lower than prices in the U.S. for the vast majority of drugs, and generally were much lower. The median price differences in the sample were large, with U.S. prices one and one-third times the Canadian price; two and one-half times the British price; and over three times the Australian price.

For five of the 29 drugs reviewed, manufacturers' prices in the U.S. were ten or more times the price in Australia in 1992, and prices here were higher than the Australian prices for all but one.

The price gap is growing. Pharmaceutical prices in the U.S. have been rising at more than twice the general inflation rate, while in several European nations, inflation-adjusted prescription prices have fallen.
Because prescription drug prices are so much higher in the U.S. than abroad, Americans provide a disproportionate share of drug company profits and subsidize drug research costs for the entire world. Wealthy nations buy most prescription drugs, so this subsidy— from all who pay prescription bills in the U.S.— can be seen as one of the country's least-well-targeted foreign aid programs.

The value of this underground foreign aid program is hard to measure, but it is probably at least $12.4 billion annually, 13.8 percent more than the entire official U.S. program of non-military foreign aid. That $12.4 billion conservatively estimates the savings if Americans bought drugs at prices found by the U.S. General Accounting Office in Canada— the nation with prices nearest to ours. Americans pay more mainly because American and foreign drug makers have found it easier to shift costs to the U.S. than to ask other nations to pay their fair shares of drug research costs.

One result is that the cost of living and of doing business is higher in the United States.

Another result is that the U.S. balance of payments position is weakened. U.S. drug companies are able to charge only relatively low prices abroad, while foreign drug companies can charge relatively high prices here. Both earn disproportionate shares of their revenue from Americans.

2. Americans Use Fewer Prescription Drugs

Perhaps the greatest single harm caused by high prescription drug prices is that many Americans are unable to afford the medications they need. Others skimp on food and heat to pay for needed drugs. High prices and lack of insurance coverage result in avoidable injury.

Per person, Americans seem to use fewer medications than do people in many other high-income industrial democracies.

Estimated 1989 drug spending (prescription and over-the-counter) per person in the United States was nine percent above the average for 21 nations in the Organization for Economic Cooperation and Development (OECD), ranking ninth highest. This probably results from a combination of very high prescription drug prices but relatively low use rates here. The Italians, French, and Germans spend more per person on drugs than people in the U.S., but those sums buy two to three times as many prescriptions. Some patients in nations with high use rates may be consuming some unnecessary or ineffective medications. But lower prices in the U.S. would enable many Americans to enjoy the proven benefits of modern pharmaceuticals.
There is a great disparity between U.S. drug spending and overall health spending. Total U.S. health spending per person in recent years has persistently been double the average of the wealthier OECD nations.

It is difficult to determine the right level of prescription drug use. Some Americans undoubtedly take too many drugs—perhaps because they lack primary care physicians or pharmacists who review their overall drug use.

But it is reasonable to suspect that many more Americans do not get enough of the medications that would relieve pain, counter disabilities, prevent chronic problems from becoming acute, and push back premature death. Why? Owing to the combination of high average drug prices, low rates of insurance coverage, and unfair cost-shifting. About half of prescription drug costs are paid out-of-pocket. The combination of high prices and low coverage makes prescription drug costs a burdensome tax, one levied privately by drug companies on sick Americans.

Low drug use may be associated not only with avoidable suffering, but also with higher overall health care spending, if problems that could be prevented or treated less expensively with medications grow to become more costly owing to lack of needed prescription drugs.

At the state level, we estimate that at least one million people in Massachusetts lack public or private insurance coverage for prescription drugs—at least one out of every six state residents. Yet Massachusetts has no safety net for prescription drugs comparable to the state’s hospital free care pool. Assuring coverage for, and the affordability of, outpatient prescription drugs is becoming increasingly important as care moves out of hospitals.

This national problem is particularly serious in Massachusetts. Retail prescription drug expenditures per person rose faster here from 1980 to 1991 than in any other state—rising from below average to be second-highest in the nation, 23 percent above the national average.

This rise in prescription spending in Massachusetts occurred even as the state’s HMO enrollment rate rose to first place. In Massachusetts, it appears, managed care and prescription price discounting to private insurers have failed to control drug spending—whatever the cause of the increases.

3. Payment for Prescription Drugs Is Unfair

The problem of high U.S. prescription prices overall is compounded by the unfair cost-shifting and price discrimination that prevail within the U.S. Americans with chronic illnesses, seniors, and people with lower incomes tend to lack insurance coverage for prescription drugs but, because of cost-shifting, they also tend to be the ones paying the highest prices.
As a U.S. Senate committee noted, three types of drug price cost-shifting plague Americans. First, drug manufacturers charge higher prices in the United States, shifting costs from other wealthy nations. Second, manufacturers give discounts to hospitals, HMOs, and other selected buyers, by class of trade, offsetting them with higher prices to community pharmacies. This shifts costs to people who use those pharmacies. Third, costs are shifted from people who have insurance--and usually pay lower prices, as negotiated by insurors--to people who must pay with their own money at pharmacies. In sum, these cost-shifts mean that Americans who lack prescription coverage, including millions of seniors, arguably pay the world's highest drug prices.

CAUSES OF THE PROBLEMS

Americans suffer these high prices despite our substantial buying power--Americans purchase 31.5 percent of the pharmaceuticals sold within the 24 nations of the Organization for Economic Cooperation and Development.

The main reason that manufacturers' prices are lower in other countries than in the U.S. is not any inherent differences in production or other costs between the countries, but rather that other governments have taken action to lower prices--mainly through price regulation and concerted buying power.

Other nations recognize that the pharmaceutical market can never be competitive one--largely because of the long-term patent protection that prescription drugs receive. Also, competition among prescription drugs occurs not across the industry, but only among treatments for a particular medical problem, in market niches often dominated by one or two companies.

Other nations understand that if there is to be only one seller (or a few sellers), its (or their) power in the market has to be matched by creating only one buyer, a public authority, to negotiate prices with the drug companies.

The U.S. does not respond to this reality. Federal and state governments have failed to act to bring down prices by the techniques employed successfully in other nations. Because our purchasing power remains fragmented, we let drug companies generate disproportionate shares of their worldwide revenues here by charging prices much higher than those prevailing elsewhere.

Government inaction here reflects in part the American preference for relying on competitive markets whenever possible. Indeed, the rising use of generic drugs and pharmaceutical benefit managers (PBMs) did put some
competitive pressure on drug makers for a while. But major drug companies have responded by acting to limit that pressure by buying up PBMs and over 70 percent of generic drug makers.

Government action is also stalled by divide-and-conquer methods used (intentionally or accidentally) by the drug companies when they shift costs among classes of trade and groups of patients. Drug companies’ ability to charge substantially different prices to different purchasers in the U.S. illustrates their monopoly pricing power and the lack of a free market. But people who believe they are getting a better deal under current arrangements will fight to retain them, even though the public as a whole would enjoy much lower prices through concerted government action.

SOLUTIONS

There are several reasons we should solve the problems of prescription drug affordability and coverage. People suffer needlessly today. Medication tends to be a cost-effective form of medical treatment. Drug manufacturers charge Americans unfairly high prices. And Massachusetts and most other states lack a secure and comprehensive safety-net to protect people against the cost of prescription drugs. (In Massachusetts, with our free care pool which protects hospital patients, this is increasingly salient as care moves outside the hospital.)

We can solve these problems is that prescription drug spending represents a relatively small share--eight to ten percent--of total health care costs. The scale of the problem is manageable. Also, this problem is separable--pharmaceuticals are a backwater of the huge financial river of hospitals, physicians, health maintenance organizations, and insurance companies.

A second reason we can solve this problem is that higher overall spending on pharmaceuticals does not appear necessary to buy the prescription drugs needed by all Americans. Rather, public action to win lower prices from manufacturers seems to be indicated, along with reallocation of some of the savings won through that public action--to purchase medications for people who could still not afford them even at any conceivable lower prices government might win.

Government action in health care may be more acceptable in other nations than in the U.S. because citizens elsewhere may be more sympathetic to regulation in general. Alternatively, people in other nations may look with favor on government action to contain health cost and cover everyone because governments elsewhere have acted more intelligently, effectively, and successfully in the health arena to better the lives of their citizens.
Past government efforts in health care in the United States have been discredited because they have usually amounted to clumsy regulatory micro-management responses, putting band-aids on the wounds caused by reliance on competition in a market that does not work according to free market principles. Government is not good at this sort of thing.

The experience of governments elsewhere in containing prescription drug prices suggests that only narrow and strategic government action would be required in the United States—action to obtain drugs from manufacturers at lower prices. Once this is done, there would be no need to interfere with the competitive forces at the wholesale and retail levels, which, in the U.S., operate to distribute medications efficiently.

Manufacturers threaten that drug price reductions would undermine vital research on new treatments, so people would suffer or even die for want of the breakthrough drugs that the companies hope to invent. The industry does make medicines that relieve pain and save lives, but today’s high drug prices can be killers. Americans now suffer or die because they cannot afford (or must forgo essentials such as food and heat) to buy the drugs that already exist.

In arguing that price reductions would harm research, drug manufacturers tend to overstate their research spending, overstate its financial riskiness and degree of innovation, and overstate the connection between drug prices and research. Also, strong research operations do thrive in nations where government action has won much lower drug prices.

If governments in the United States secured for Americans the blessings of lower pharmaceuticals prices, drug companies could find more money for research in several ways—by negotiating with other nations to make them pay fair shares of research costs, by reducing their very substantial marketing budgets, or by settling for slightly lower profits—long the highest of any U.S. industry.

It is drug company total revenues, rather than prices themselves, which (with many other factors) affect research and development investments. U.S. reforms that expand coverage for prescription drugs and restrain prices without markedly reducing drug makers’ total revenues in the United States may therefore be attractive to manufacturers—or at least acceptable. The low marginal cost of producing additional drugs makes it realistic for manufacturers to make all the medications Americans require.

Given pharmaceuticals’ high value relative to their weight, only one price should prevail among all developed nations—as is the case with precious metals. This price should probably be close to an average of the very different prices
currently charged. Winning prices as low as Australia's may be difficult for the U.S. because drug companies can more easily afford them in that small market. But prices at Canadian, British, or other intermediate levels are achievable here.

SPECIFIC STEPS

Efforts to rein in prescription drug spending in the U.S. should focus on prices. Both current price and use rates, and their recent trends, point to this conclusion. American prices are very high. Our use rates are currently relatively low. Further, the U.S. General Accounting Office found that prescription drug use in the U.S. has risen much more slowly than drug prices, suggesting that price increases are the bigger factor in the continuing growth in pharmaceutical spending.

A number of specific techniques have employed elsewhere to lower prescription drug prices and total spending. (Many of them can be adapted for use in the United States.) They include:

-- Centralized national bargaining and purchase of prescription drugs, to take advantage of concentrated buying power.

-- Regulatory price setting for drugs.

-- Limits on the profits that can be earned on drugs sold to a nation.

-- Grouping drugs by therapeutic ingredients and setting "reference prices" to encourage manufacturers' price cuts and price-conscious prescribing by caregivers.

-- Automatic price cuts for older drugs to encourage innovation.

-- National caps on annual prescription spending, which mean automatic unit price reductions if consumption exceeds the cap.

Other nations also are developing useful tools for discouraging unnecessary prescribing and for identifying and encouraging use of the most cost-effective prescription drugs.

Recognizing that federal government action is unlikely soon, a number of states are now considering legislation aimed at making prescription drugs more affordable. Proposals considered seriously elsewhere include measures to limit manufacturers' cost-shifting by prohibiting discounts that are unrelated to efficiency, and creation of an authority to purchase-- or negotiate prices for-- all prescription drugs sold in a state.
In Massachusetts, with the nation's highest health care costs, we need to take every opportunity to contain those costs. With the second-highest per capita drug spending of any state—as well as a rapidly growing uninsured population—efforts to assure the affordability of prescription drugs in the Commonwealth are especially vital.

One method of securing lower prescription drug prices and better coverage simultaneously is embodied in legislation introduced by State Rep. Patricia Jehlen this year. That bill would empower the state to negotiate with drug manufacturers to obtain substantial discounts to reduce prices for individuals and employers paying for prescription drugs in the Commonwealth. Manufacturers would also rebate equal sums into a new state-managed trust fund, which would pay for medications for people who cannot afford them even after price reductions. This approach would end cost-shifting in drug prices and, without new spending or tax dollars, it would provide the financing for expanded prescription drug coverage.

Among those who would benefit from lower prescription drug prices and better coverage, nationally or in this state, are citizens who now suffer avoidably because they cannot afford needed drugs; seniors struggling to afford Medigap coverage to pay for medications; other people, such as those with chronic illness, who need large quantities of drugs; owners and customers of community pharmacies, who now face high manufacturers' prices as a result of cost-shifting; anyone who would gain new insurance coverage if drug costs were reduced; and employers and all others who pay health insurance premiums that cover prescription drugs—especially for retiree plans, in which prescriptions may represent up to 40 percent of the cost.

The economy as a whole would gain. In addition to employers facing lower health insurance costs, many businesses would benefit if money now spent on prescription drugs instead purchased other goods or services. Finally, fair international pricing would reduce U.S. payments to foreign manufacturers and increase foreign payments to U.S. manufacturers, improving the nation's balance of trade.