

# Winning Affordable Medications for All Americans: The Easiest Problem to Solve in the United States

Testimony of

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**Disclaimer:** As always, I write and speak only for myself,  
not on behalf of Boston University or any of its components.

Acknowledgment: This testimony rests heavily on analyses  
conducted with my colleague, Deborah Socolar.

Mr. Chairman and members of the Subcommittee on Health—

Good afternoon.

My name is Alan Sager and I am a professor at the Boston University School of Public Health. I am honored by your invitation to appear before you today.

Together, we face two challenges.

- making all needed medications affordable for all Americans, while
- building a durable financial foundation under drug research and delivery in the U.S.

I am convinced we can do both of these. One reason is that we already spend enough money to do so. But not if we continue business as usual.

### ***What is the nature of the problem?***

Many Americans can't afford needed prescription drugs because they lack insurance, suffer low incomes, and can't afford high American prices.

Today, 70 million Americans of all ages have no insurance for prescription drugs. Additional millions have skimpy coverage. Yet American prescription drug spending per person this year will be the world's highest. And total prescription drug spending will be over \$120 billion this year, or about ten percent of overall U.S. health spending.

Worse, people without insurance typically pay the world's highest prices for prescription drugs. That's because average American prices are highest in the world, and uninsured Americans pay prices above the average.

So it is not surprising that 17 percent of all Americans—and 42 percent of uninsured Americans—reported not filling prescriptions for financial reasons.<sup>1</sup>

And these are the economy's fat years, to paraphrase what Joseph told Pharaoh.

The drug cost problem will probably worsen. Drug spending in the U.S. has been rising about three times as fast as overall health care spending.

Perhaps 1,000 new drugs are in the overall pharmaceutical pipeline.<sup>2</sup>

If too few of these medications work, we will have a lot of disappointed investors.

But what if a great number of them do work?

Then, many more patients will have to choose between their money and their lives. And still other patients will not even have this choice, because they will lack the money.

Will medical miracles be affordable for all or merely profitable for some?

If we fail to make vital drugs available to all who need them, how great will be the public fear and anger? Reasonable action today will prevent over-reaction tomorrow.

Together, we face three choices:

- Many of us could suffer and die for lack of needed medications, but that is intolerable.
- We could spend more public or private money—or both—to buy needed drugs, but that is both unaffordable and unnecessary.
- We could secure more drugs from manufacturers for the amount we already spend.

***What are the causes of the problem of unaffordable medications?***

To make sense these problems and to devise solutions to protect the biotechnology industry specifically, we must examine the prescription drug industry generally.

1. High U.S. drug prices make drug insurance unaffordable for many.
2. U.S. prices are high mainly because, alone in the world, our government does not protect us from the world's drug makers. This year, Americans will pay between \$20 and \$50 billion extra for drugs. This is an invisible subsidy to other rich nations that don't pay their fair shares of the drug makers' costs. It constitutes the world's least-well-targeted foreign aid.
3. The drug makers paralyze government action by claiming
  - that today's prices and profits are legitimate products of a free market;
  - that high U.S. prices and profits are needed to finance vital research; and
  - that even moderate restraint on prices or profits will collapse the drug makers' fragile financial house of cards.

These three claims are false. The drug makers' prices and profits can't be sustained at current or hoped-for levels.

During the 1990s, the nation's big drug makers' returns on equity were two and one-quarter times the average for all U.S. industries. It is unrealistic to expect that American patients can or will continue to pay prices high enough to sustain these profits.

The United States government emphatically rejects PhRMA's claims by taking a 40 percent (or so) price discount for medications for the V.A. and military, and by taking an 18 percent (or so) price cut for the Medicaid program. This is the sort of thing foreign governments have long done for all their citizens.

But unlike governments elsewhere, our government has protected only itself alone. In so doing, it leaves the drug makers free to raise prices on the rest of us in order to reach their revenue targets.

The drug makers claim they set prices to cover research costs. That is not true. They set the prices that they believe will maximize profits, and that's what their stockholders expect. In 1998, the drug makers' profits averaged more than one and one-half times their research costs.

And the drug makers are unwilling to identify any ceiling whatsoever on their profits—the level of profit beyond which no more money is needed to finance vital research. Similarly, the drug makers are unwilling to identify any floor on their profits—the level of profit below which vital research would suffer. Their position is simple: more is better. That would make sense only if the drug makers operated in a competitive free market.

The drug makers' returns are unnaturally high and are not justified by legitimate market forces. Sadly, few signs of a living free market can be detected in the drug industry—outside the retail pharmacy sector. (The evidence for this position is detailed in the July 1999 report to the U.S. House of Representatives Prescription Drug Task Force that I co-authored with my colleague, Deborah Socolar.) Without either functioning free markets or effective government action, we have only one thing—anarchy. And anarchy allows the strong to earn unwarranted profits.

That is why PhRMA, the drug makers' trade association, spreads a fog of fear—PhRMA's Fog of Fear—to try to paralyze public action and to preserve anarchy.

But the drug makers themselves sometimes pay a price for this anarchy. Some individuals connected with the biotech and prescription drug industries have worried aloud about the instability of biotech stock prices in 1993-1994 and again in recent months. They have condemned legislative efforts to contain prices or improve coverage, claiming that these efforts would impede the flow of capital to the industry. But their position amounts to condemning a symptom. As long as many Americans cannot afford needed medications, we will see repeated attempts to lower prices and improve coverage. The industry cannot wish away this simple reality. Unless all patients win equitable and affordable access to medications, investors will be denied relaxed enjoyment of drug profits. The challenge is to win both.

Drug makers claim that sky's-the-limit prices and profits are needed to finance drug research. But excessive prices and profits are more likely to damage the very research the drug makers profess to care about.

Insisting on unnaturally high drug prices and profits—in a nation where growing numbers of patients suffer for lack of needed medications—could lead an angry future Congress to legislate harsh price and profit controls. And that is the real threat to sustained research funding. Moderate action and compromise today will protect both Americans and our vital drug research community tomorrow.

### ***What solutions are possible—to win affordable medications for all Americans?***

Some drug makers' magical solution is to promise that new drugs will reduce costs of hospital and doctor care. That's easy to promise but hard to deliver, on average. Some short-run savings may be possible in some instances. While preventing or treating one disease is a blessing, doing so will inevitably expose patients to other diseases. This means that any dollar savings are one-time only.

Prudence demands that we plan against the contingency that drug breakthroughs will fuel higher spending.

Legislation to mandate lower drug prices for seniors has been introduced, as has legislation to offer prescription drug benefits under Medicare. We need to weave these two approaches together because helping vulnerable people will be very costly unless it is coupled with restraints on spending. And no market will restrain spending safely or adequately. Recall the experience that an unrestrained Medicare program had with hospital and physician spending in the late 1960s and early 1970s.

We can protect all people without spending more money, and in ways that provide fair and adequate financing for research to develop new and effective drugs.

We can do so because we are blessed with at least four rich opportunities.

First, U.S. drug prices and drug spending per person are the highest in the world. This means that all of us together already spend enough to buy the medications all Americans need.

Second, Americans together generate between one-quarter and one-third of the world's drug makers' revenues.

Third, once the research is performed and the factories are built, the marginal cost of manufacturing additional volumes of medications—more capsules, pills, and suspensions—is very low. We estimate it at 5 cents on the retail dollar. That means that manufacturers can make drugs worth \$20 billion to Americans (at retail) at a cost to them of only \$1 billion.

Fourth, the price elasticity of demand for medications may be very substantial. For example, researchers at Merrill-Lynch estimated last year that even a 40 percent price cut for Medicare patients would result in only a 6 percent loss of revenue—or even a slight revenue gain.<sup>3</sup>

Several specific approaches could be used to meet these capitalize on these opportunities. Here are a few:

I. ***Internationally***, negotiate a drug price peace treaty. All wealthy nations would agree to pay the same fair prices for prescription drugs, and to subsidize sick people in poor nations. Our government would have to take the lead. This is probably worth doing no matter what domestic approaches are taken.

II. **Domestically**, I see only two alternatives. Either:

A. We could engage in years or decades of increasingly mean-spirited and fragmented fights over drug prices, profits, and coverage. Anger and threats would be the highlights. So would corporate stock price instability.

OR

B. We could sit down to negotiate a comprehensive package deal. By focusing on the two real bottom line issues—affordable medications for all plus fair returns on invested equity and adequate financing for research, this approach could short-circuit angry trench warfare fights about the details. The package could include these eight elements:

1. Private and public payors and drug makers negotiate fair returns on drug makers' equity. This would be the rate adequate to finance needed research and retain needed capital. Adequate overall profits would be combined with generous rewards to those who develop valuable medications.
2. In exchange, drug makers produce and distribute enough medications to fill all prescriptions written by physicians for Americans. Drug makers would find it inexpensive, on average, to provide the increased volumes (higher than today's production levels) required to protect all Americans. That is because drug makers face high fixed costs but very low marginal or incremental costs to make additional amounts of most medications.
3. To make the deal real:
  - Drug prices would be lowered in the private market.
  - Public money could be used to buy medications for people unable to afford even the discounted prices.
  - The drug makers would win enough total revenue to achieve negotiated profit and total revenue targets.
  - The targeted total spending on prescription drugs this year would be pegged at about the expected \$120 billion-plus.
4. To make medications more affordable, drug makers would be encouraged to cut wasteful marketing and advertising costs.
5. Physicians need better evidence on each drug's benefits and costs. Studies to obtain this information should be financed, compiled, and disseminated by objective parties, not by industry.
6. To encourage better use of medications, patients deserve improved information about proper drug use.
7. To protect patients, pharmacists need to be assured of payments adequate to cover the time of both patient counseling and accurate dispensing.

8. It may also be desirable to target scarce public and private research dollars down paths that are more likely to develop medications that are both effective and affordable for all.

Evidence supporting the findings and conclusions presented in this testimony is found in Alan Sager and Deborah Socolar, *Affordable Medications for Americans: Problems, Causes, and Solutions*, presented to the Prescription Drug Task Force, United States House of Representatives, 27 July 1999. It is available from [www.house.gov/berry/prescriptiondrugs/](http://www.house.gov/berry/prescriptiondrugs/). Refer to “studies of interest.”

(A summary of that report is incorporated into this testimony; it appears on the following pages.)

Thank you for the opportunity to present these views. I will be happy to respond to your questions, either today or subsequently.

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## NOTES

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<sup>1</sup> Karen Donelan, Robert J. Blendon, Cathy Schoen, Karen Davis, and Katherine Binns, “The Cost of Health Care System Change: Public Discontent in Five Nations,” *Health Affairs*, Vol. 18, No. 3 (May – June 1999), pp. 206-216, exhibit 6.

<sup>2</sup> Neil Munro, “Technology: Frontier Ethics,” *National Journal*, 4 June 99.

<sup>3</sup> Merrill Lynch, Pharmaceuticals: A Medicare Drug Benefit: May Not Be So Bad, 23 June 1999.