

Prescription costs and why they need to be lowered. Making affordable prescription drugs available to more people.

Introduction

The sharp rise of the costs of prescription drugs during the past years has been one of the pressing problems that people today face. As a result, this reality has sparked numerous debates on the issue. On one side of the debate are citizen groups and consumers who argue for the need to lower prescription drugs because of its adverse affect on the patient's and consumer's ability to access them; while on the other side are private companies and manufacturers of prescription drugs who argue against lowering prices because of its destructive effect on their business and on the pharmaceutical industry as a whole. Given such debate, this essay will argue that there is a need to effectively lower the costs of prescription drugs because it limits the ability of patients to receive proper health care.

In order to prove its point, the essay will proceed accordingly. The first part of the paper will discuss the current pricing mechanism in the pharmaceutical industry. It will tackle the price differentials within the different sectors of the society and determine who pays the most for prescription drugs; hence, shouldering most of the costs.

The next part of the paper will discuss how the patient's ability to receive proper health care is hampered through high costs of prescription drugs in terms of (1) limiting the patient's ability to access prescription drugs in particular, and healthcare in general; and (2) limiting the patient's choices of quality drugs. It will also discuss how such restrictions to patients can lead to the overall detriment of the patient's health.

After discussing how the high costs of prescription drugs limit the patient's ability to receive proper healthcare, the paper will then discuss how the current attempts to lower the costs

of prescription drugs do not effectively lower the costs, but instead simply transfer them to other sectors of society. It will also discuss how such attempts affect the end-consumer.

The paper will then enumerate arguments against lowering the costs of prescription drugs and refute these arguments to further strengthen the essay's stand. These arguments are as follows: (1) that lowering the costs of prescription drugs will also lower its quality because pharmaceutical companies will have to cut down expenses on Research and Development; (2) that lowering the costs of prescription drugs will hamper the growth of the pharmaceutical industry, affecting the economy as a whole; and (3) that the increasing costs of pharmaceutical drugs are simply the result of natural economic forces such as inflation and a higher consumption of prescription drugs. The paper will then end with its concluding remarks.

Profiting from Pain: The Pharmaceutical Sector

In order to understand why there is a need to lower costs of prescription drugs it necessary to understand how and why these drugs are priced so high in the first place. In observing the pricing mechanism in the industry, it is apparent that there is a prevailing price differential in the market. Unfortunately, patients who buy retail and pay cash for prescription drugs pay for the highest prices. A study by the Department of Health and Human Services (2000) reveals that patients who pay cash pay 14.6% higher for 200 of the most prescribed drugs than third party buyers. According to Richard Frank (2001), prescription drugs are sold at different prices towards different segments of the society because of the different price responsiveness each segment has. This price differential, as Frank explains, is deeply embedded in the pharmaceutical industry's institutional structure, which allows price discrimination to prevail towards the detriment of the end-product consumer.

Economic theory on price differential states that price differential or price discrimination permeates through an industry where the following market conditions are present: the possession of market power by sellers, the presence of market segmentation based on price responsiveness, and the absence of arbitrage (Dornbusch, et. al., 1999). In the case of the pharmaceutical industry, all three conditions are present. First, institutional structures like the patent systems and the lack of price controls, among others, allow pharmaceutical companies to have strong bargaining powers in selling their merchandise at a high price. Retail stores where cash payers buy these prescription drugs, on the other hand, are forced to take prescription drugs at the price that pharmaceutical companies and distributors give to them because they are compelled to keep inventory of a wide variety of products and brands in order to be competitive in the market – weakening their bargaining power vis-à-vis pharmaceutical companies. This strengthens the market power of manufacturers. As a result of such institutional structures, the second condition, price responsiveness of consumers is created. Since these consumers who buy prescription drugs in cash have no choice but to purchase them from retail stores, they are forced to buy the products regardless of the cost. In the case of arbitrage, the third condition, Frank argues that even though there are possibilities for arbitrage in the industry, there is little reselling occurring because while prices of prescription drugs are not regulated, its distribution is. Hence, allowing price discrimination to prevail.

These characteristics of the market, which allow price discrimination to prevail has two consequences. First, it allows prescription drugs to be sold at higher prices to cash paying consumers (composed mostly of the lower income families who do not have enough money to pay for insurance premiums and those who despite owning insurance and other benefits do not have the necessary coverage for prescription drugs). And second, it creates an industry where

artificial pricing permeates – high prices exist despite the lack of clear indication why in terms of cost of production or distribution. Since cash paying consumers compose the bulk of those who pay for prescription drugs, this is price differential poses threat to the health and well being of the population.

The Increasing Burden on Consumers

One of the direct consequences of the high costs of prescription drugs, especially for cash paying consumers who buy at retail stores, is that it limits the access of the general population for high quality health care. According to Families USA (2002), the rising prescription drug prices hurt everyone who pays for healthcare – especially the 65 million Americans who do not have prescription drug coverage insurance. Such restrictions are twofold. First, it limits access to prescription drugs. On average, the rate of increase in manufacturer prices for brand name drugs has been accelerating over the past four years with prices in 2000 slightly above the rate of general inflation, and in 2003, three times the rate of inflation.

Manufacturer's drug product price increases are typically passed on from wholesalers to retail pharmacies. Although increased wholesale acquisition costs do not necessarily translate dollar-for-dollar to similar retail price increases, the price changes documented in this analysis are expected to have a substantially similar impact on the retail prices for consumers, particularly those who pay up front for their own prescriptions. For drugs on the market during the entire four-year period analyzed in this study, the cumulative average increase in manufacturer drug prices was 27.6 percent, compared to a general inflation rate of 10.4 percent over the same period. (Gross, et. al., 2004a)

The prices of prescription drugs commonly used by older Americans are also rising faster than the rate of inflation.

The rate of the drug price increases also exceeded income growth for the 50-64 year old population, which was even, less than the general inflation rate. This

trend implies that filling the same prescriptions from year to year is taking an ever-increasing share of consumer income, particularly for older consumers who use more prescription drugs on a per capita basis than their younger counterparts. Even those consumers with prescription drug coverage will face an increasing burden because the substantial increases in drug prices are likely to be passed on by third-party payers in the form of higher premiums or increased cost-sharing. (Gross, et. al., 2004a)

Negative consequences abound in cases where the costs of prescription drugs, despite their effectiveness, become restrictive (Kass-Bartelmes, et. al., 2005). These negative consequences include patients resorting to mismanagement of drugs such as taking less than the prescribed dosage, using drugs prescribed for other people, and saving medicine for future use. Mismanagement of prescription drugs not only pose danger to the person at risk, it also creates problems for the rest of the population because it generates more expenses in terms of hospitalization and other health problems if mismanagement becomes too abusive. Thus, it is apparent that if prescription drugs continue to restrict the access of the patients who need it because of high costs, their existence, no matter how effective they are will be useless if they cannot be administered to the people who need them most.

Another problem with the high costs of prescription drugs, although indirectly, is that it limits the choices of consumers for other high quality drugs. Because of the ability of pharmaceutical manufacturers to give higher prices to their products and because of the stronger bargaining power the institutional structures within the industry has conferred to them, pharmaceutical companies who sell high cost prescription drugs monopolize the industry. Thus, it has become difficult for some high quality generic drugs to infiltrate the market and provide consumers with more choices. Expensive prescription drugs do not necessarily mean better outcomes for the patient. In most cases, less expensive generic drugs or even more dated drugs

already available in the market yield better, not to mention less costly, results for the patient (Kass-Bartelmes, et. al., 2005). This is true, at very least, in the use of antibiotics. But because of market positioning, high cost prescription drugs still dominate the industry.

The unfair market positioning of pharmaceutical companies who produce high cost prescription drugs also create a vicious cycle that allows them to dominate the market further. Through their unfair advantage in the market, they are able to reap higher profits than other companies that sell low-cost generic drugs. These profits are then used to cover the massive advertising campaigns for these companies, which further increases profits and market power.

A relatively small number of prescription drugs that were advertised to the public in 2000 contributed significantly to the increase in pharmaceutical spending in the U.S. from 1999 to 2000... Increases in the sales of the 50 drugs most heavily advertised to consumers in 2000 were responsible for almost half (47.8%) of the \$20.8 billion increase in retail spending on prescription drugs from 1999 to 2000. Increases in the sales of all other prescription drugs (numbering about 9,850 in the retail market) accounted for 52.2% of the one-year rise in retail pharmaceutical spending. (NIHCM Foundation, 2001)

There is, therefore, a correlation between the amount of advertising spent on prescription drugs and the number of prescriptions that doctors give. Consequently as the report explains, pharmaceutical companies who sell high cost prescription drugs are the ones that engage in these advertising campaigns. Hence, further increasing their advantage against other companies, to the detriment of the consumer.

Lowering Costs by Transferring the Burden

In order to curb the high costs of prescription drugs and to shield the ordinary consumer from having to shoulder all these costs the government has placed policies such as direct price

controls, rebates, and discounts. However, these current government initiatives to reduce costs of prescription drugs, although they may reduce the prices of prescription drugs, increases costs in other aspects of healthcare such as hospitalization and insurance premiums (Kass-Bartelmes, et. al., 2005). Thus, they do not really reduce the costs of healthcare for the patient; instead, they simply transfer costs to other aspects of healthcare.

In addition, these policies also place the government, at the state level, in a compromising position because they have to shoulder the unnecessary costs of healthcare brought about by the high costs of prescription drugs in the midst of budget deficits and other state level problems. States are already pressed to solve budget deficits. However, because of their obligation to provide healthcare to the public, it has made it difficult for states to deal with such problems. Furthermore, because of the ability of pharmaceutical companies to lobby against possible changes that will affect their position in the market, states are left ineffective in this case.

Thus, there is a need to limit the unfair bargaining power that pharmaceutical companies have over the issue of pricing prescription drugs in order to effectively lower them. There is a need to implement policies that will produce a more competitive and transparent pharmaceutical industry. As David Gross (2003) argues, establishing conditions for a more competitive pharmaceutical marketplace based on evaluations of quality and price will be a more effective means of reducing high prescription costs without damaging the US pharmaceutical industry or transferring costs to other consumers. The best way to limit the high costs of prescription drugs is to combine direct cost reduction reforms with market-based reforms. One example of market-based reforms is the introduction and support for generic drugs and parallel importation of drugs.

“Generic drugs are a means of helping consumers and third-party payers reduce prescription drug costs. The availability of low-cost generic substitutes is particularly important in view of rapid health care cost increases of recent years, a

substantial share of which is attributed to prescription drugs.” (Gross, et. al., 2004b)

Furthermore, generic drugs are not only less expensive than high cost prescription drugs; they also have a lower rate of price increases.

“Over one-half of the 75 widely used generic drugs examined in this analysis either had no change in manufacturer list price (34 drugs) or decreased in price (5 drugs) during the three-year period from 2001 to 2003. However, 36 generic drugs had manufacturer list price increases, typically far in excess of the annual rate of general inflation during the three-year period (2.2 percent). Of these 36 drugs, eight had average annual manufacturer list price increases of 31 to 50 percent, and three had average annual list price increases of between 50 and 120 percent.” (Gross, et. al., 2004b)

Parallel importation is also a valuable alternative that can be considered. The significantly low prices of prescription drugs in other countries provide possibilities that can benefit the local consumer. These two alternatives, and others not discussed here, only show that prescription drugs do not need to be so costly.

The Supposed Dangers of Lowering Prescription Costs

Despite the pressing need to lower the costs of prescription drugs, there are still arguments not only to maintain the current high prices, but also to further increase prices. One of the main objections against lowering the prices of prescription drugs is in the fear that it will force pharmaceutical companies to cut back on R&D expenditures. As pharmaceutical companies argue, the high cost of prescription drugs is necessary to fund R&D. This argument, however, does not necessarily follow. An analysis of the financial statements (Families USA, 2002) submitted to the Securities of Exchange Commission (SEC) from major pharmaceutical

companies show that these companies spend a significantly higher amount on advertising, marketing, and administration rather than R&D. Contrary to what pharmaceutical companies say, the increasing costs in manufacturing prescription drugs and other medicine do not come from R&D initiatives of the company. Instead, most of their expenditures go into marketing, advertising, and administrative expenses. The study also discovered that on the average, these companies only spent 11% of their revenue on R&D; while advertising, marketing, and administration – expenditures, which should not be the main focus of pharmaceutical companies – were allocated 27% of revenue on the average. In addition, the report also highlighted the fact that these pharmaceutical companies receive large tax cuts for investing in R&D. Thus, despite claims that R&D will suffer if prices of prescription drugs are lowered, this will simply not be the case.

In addition, R&D is not even as innovative as the pharmaceutical companies claim. Only 24% of drugs approved by the FDA contain innovative ingredients, and could be called “new” (Families USA, 2002). And, as previously mentioned, the new and innovative products brought into the market are not always better they are simply more costly. Not to mention the fact that new drugs are only useful insofar as the people can actually gain access to them.

Another argument against lowering the costs of prescription drugs is in the supposed effect it will have on the economy. According to Doug Bandow (2003), policy makers are making a political piñata out of pharmaceutical companies despite the benefits that it has provided the public, in general. The industry’s profitability is significantly higher than other industries in the US. Thus, reducing drug prices will not make them less profitable from other industries. Hence, it will not necessarily drive investors away (Families USA, 2002).

Lastly, arguing that the high costs of these prescription drugs are the result of natural economic forces such as inflation is simply baseless. As it was illustrated in this essay, the pricing mechanism used in the market for prescription drugs is based on price differentials that are artificially created because of the strong bargaining power of sellers vis-à-vis the consumers and retailers. There is no apparent reason why these drugs should have high costs except for the reason that luxury clothes are priced higher than regular clothes – they are heavily advertised and they carry a brand name. In addition, as the rate of increase in prescription drugs and generic drugs are compared, prescription drugs increase annually well above the rate of inflation.

Conclusion

As this essay has argued, there is a need to effectively lower the high costs of prescription drugs to give the public better access to proper health care, not only in terms of their actual access to the drugs, but also in terms of having choices as to what kind of drug – branded or generic – they would want to use in order to fit their budget. The fact that the pricing mechanism prevalent in the industry is based on an unfair advantage that a small portion of pharmaceutical companies have over the market is a clear sign that these high costs are unnecessary. If these high costs prevail, the restricted access that the public will have on health care and certain prescription drugs will lead not only to the lack of health care, but it will also force some people to mismanage the use of these drugs – a condition, which is worse than not having access to them at all.

However, just as pressing as the need to lower the costs of prescription drugs is the need to lower them effectively. Forcing lower costs through direct price controls alone will be detrimental both to the public and to the pharmaceutical industry in the long run. As this essay

has proven, these price controls only transfer costs to other sectors of the society, like the government, and to other aspects of healthcare, like insurance premiums. What is needed, instead are crucial market based reforms that will limit the unfair advantage that big pharmaceutical companies have over retailers, consumers, and other manufacturers, like those who provide generic products. Market-based reforms will allow the pharmaceutical industry to become more competitive and force it to price prescription drugs based on quality and actual demand as opposed to prices determined by bargaining power and marketing-induced demand. As Gross suggests,

...in effect, establishing conditions for a more competitive pharmaceutical marketplace based on evaluations of quality and price—fit the American political context better than price controls. Indeed, to some extent, these policies are already being adopted in the United States. (Gross, 2003)

In addition, it is also imperative to study the arguments for higher prescription costs carefully. As this essay has presented, most of the arguments against lowering the prices of prescription drugs are based on unfounded fears for the fate of the pharmaceutical industry, in general, and large pharmaceutical companies, in particular. These companies already have enough incentives to endeavor in R&D through tax credits. They also have a number of unnecessary expenses like advertising, marketing, and other administration related expenses, which they could easily hold back on before they start slashing R&D investments. Furthermore, the fact that they price prescription drugs based on artificial means through price discrimination and that their industry is healthy and profitable enough to survive lower costs of prescription drugs should not bother the industry. Conversely, it might even benefit from more competition.

John Rother, in a speech delivered at the AARP International Forum on Prescription Drug Policy enumerates five lessons that the United States must learn from the pharmaceutical industries in other countries:

...the inevitability that the U.S. should begin to address pharmaceutical price issues, but in a broader context that includes the impact on total health costs, clinical outcomes, and economic growth; the many trade-offs that exist in developing such policies; the fact that no approach can simply be “lifted” wholesale from abroad and that there is no single “magic bullet;” that tools are needed to promote use of information that compares drug efficacy and cost-effectiveness; and that the U.S. (both nationally and at the state level) is just beginning to tackle these issues and has much to learn from the evolving experience from other nations. (AARP)

Pharmaceutical industries in other nations have survived lower prices. There is no reason for the United States to not do the same. What is crucial to such endeavor is the need to constantly keep in mind that these prices should always be determined with consideration for the people who need them to get better access. The fact that 65 million Americans have either no insurance or no prescription drug coverage in their insurance shows that there is a need to make prices lower for the patient buying retail and paying through cash. Making this segment of the society pay higher costs through tax differentials is inequitable, and simply unfair. After all, these prescription drugs are only useful insofar as the public have access to use them.

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