

## Q&A Explains Dangers of Price Controls on Drugs

Editor's note: The House Democratic leadership is campaigning to seize control of the House in the fall elections running on a platform of government action to "bring down" the price of prescription drugs by directing the government to "negotiate" prices for those covered by Medicare. Nobody wants to pay more, so what could be wrong with that?

Actually, a great deal is wrong, as the following Q & A will make clear. The results of such proposals are, in fact, no less than a matter of life and death.

**Q:** What do drug prices have to do with NRLC's core issues of abortion, infanticide, and euthanasia?

**A:** Since its inception, the National Right to Life Committee (NRLC) has been committed to protecting the right to life from conception until natural death. We have fought just as strongly against infanticide and euthanasia as we have against abortion. In particular, we have strongly opposed involuntary denial of lifesaving medical treatment through rationing.

In 1994 we opposed the Clinton Health Care Plan's proposed insurance premium price controls because they would have forced rationing. In 1995-2003, during the congressional debate over Medicare restructuring, we successfully fought for the ability of older Americans to add their own money, if they choose, to government payments for health insurance premiums in order to obtain insurance plans that are less likely to ration care.

Now, NRLC is opposing legislative changes in Medicare that would have the effect of imposing rationing of lifesaving drugs through drug price controls.

**Q:** Why would drug price controls cause rationing?

**A:** The explanation begins with the fact that drug price controls have a devastating effect on the development of new lifesaving drugs. Research and development is financed by investors who buy stock or provide venture capital. Investment in pharmaceutical development is risky. Many promising leads fail to work out and never make it to the market.

**Q:** How risky is new drug development?

**A:** On average, of 5,000 potential new drugs tested, only one is eventually approved for patient use. Of all new drugs brought to market, only 30% recover their research and development costs.

A 2003 study by the Tufts University Center for the Study of Drug Development determined that the average pre-tax cost of new drug development is \$802 million. The only thing that induces investors to face such a risk is the prospect of a high return if they do invest wisely and luckily. Think of it this way.

Say the price of a ticket for a \$100 lottery is \$1. Even if the odds are 100 to 1 against winning, a person might buy the ticket because of the possibility of the high payoff. However, if the odds of winning remain 100 to 1 but the lottery payoff falls to \$2 or \$3, one would be very unwise if you buy a \$1 ticket! Few would do so.

Those who say drugs are overpriced often compare the high price of an innovative, breakthrough drug with the low cost of its production. They conclude that, even taking into account the cost of research and development for that particular drug, the patient is being "gouged" to produce "windfall" profits.

This perspective fails to recognize that given the high odds against any given potential drug ever getting to the market and then actually making money, only the possibility of that high rate of return on a drug that does succeed can induce investors to invest.

Further, for each new drug a company successfully brings to market there are many, many others that fail during research and development. The high research costs of the many drugs that fail to make it to market must be covered by the profit made on the few drugs that are successful. If not, the drug company will go bankrupt and out of business.

**Q:** What drug price controls are being proposed?

**A:** Medicare has a new prescription drug benefit that went into effect this year. Should Democrats take control of the House as a result of the fall elections, the House Democratic leadership is promising to change a key provision of that law. That provision says that the government may not interfere in price negotiations between drug providers, on the one hand, and insurance companies, on the other. Instead, Democrats want the government to take over and “negotiate” prices for all drugs under the Medicare prescription benefit directly with the drug providers. In fact, these “negotiations” would be one-sided, and the government would effectively control the drug’s prices.

**Q:** What is wrong with the federal government negotiating better prices by leveraging the collective buying power of 41 million Medicare enrollees?

**A:** To understand why “government negotiation” isn’t really negotiation, but rather drug price control, we must begin by understanding how the Medicare prescription drug benefit, which first took effect in 2006, is currently set up to work.

At present, older Americans may either choose to have their standard Medicare benefits (hospitalization and doctor’s services) provided through the traditional government fee-for-service Medicare or they can instead pick from a variety of private Medicare plans ranging from private fee-for-service to various forms of managed care.

This year, if older Americans choose a private plan for their basic Medicare benefit, prescription drug coverage will generally be included as part of the plan. If instead they choose the traditional government fee-for-service plan for standard Medicare benefits, they will have the option of picking from a number of competing “stand-alone” private drug plans.

Thus, prescription drug coverage will not be provided directly through the federal government, but indirectly through private insurance companies. Part of the premium will be covered by the federal government and part will be paid by the Medicare enrollee.

Medicare drug prices are now set by the private insurers negotiate prices with the drug companies. Normally they hire “Pharmacy Benefit Managers” (PBMs) who put together groups not only of Medicare enrollees but also of those covered by employer-paid insurance. The objective is to get large numbers of patients to enable them to negotiate discounted rates with drug companies.

As noted, the current Medicare law prevents the federal government from interfering in these negotiations or directly imposing prices. This is the provision the House Democratic leadership is now trying to repeal.

So, under current law, Medicare drug prices will be negotiated by competing private insurers, not simply accepted at a level set by the drug companies. However (as we will see below), there are checks and balances on these negotiations by private parties that help prevent them from driving prices so low as to result in rationing and harm to new drug development. These checks and balances are not present when the government sets prices.

**Q:** If private insurance companies can negotiate drug prices without devastating the research and development of lifesaving drugs, why shouldn’t the federal government be able to do the same thing? Wouldn’t it be driving a better bargain because it’s negotiating on behalf of all the Medicare beneficiaries at once?

**A:** The reality is that under the proposed “negotiation” amendment, the government wouldn’t really “negotiate” prices—it would set them. Here’s why.

First, normal price negotiations occur when there is competition. In a market economy there are both suppliers competing against each other to sell, and buyers competing against each other to obtain, goods or services. Most people are familiar with how such a market is distorted when one supplier has a “monopoly.” A monopoly exists when the only way to get a particular good or service is from that supplier, who can then set a price much higher than is the case in a competitive market. Buyers who really need the product have no alternative source.

However, the reverse is also true. If there are multiple suppliers but only one buyer, the one buyer can set a price much lower than in a competitive market. Suppliers who need to sell their good or service have no alternative market. Even when there are multiple buyers, there is almost the same effect if one buyer dominates the marketplace. The

government already effectively sets drug prices for poor people covered by Medicaid, those in the armed forces, veterans treated in veterans' hospitals, and other, smaller groups, totaling about 20% of the domestic drug market. With the addition of Medicare beneficiaries, fully 60% of the U.S. drug market will be sold to or through the U.S. government. The federal government would have the ability to set "take it or leave it" prices during "negotiations"—effectively imposing price controls.

It was precisely because policymakers recognized this, and feared its impact on the ability to develop new lifesaving drugs, that the 2003 Medicare bill set up the prescription benefit in a way so as to break up the negotiating process for drug prices among a variety of insurance plans, and prohibited the federal government from interfering in those negotiations.

**Q:** Even if drug price controls would prevent the discovery of some lifesaving drugs, how can our society afford constantly rising drug prices?

**A:** Understandably, people focus on the larger and larger amounts they are spending for drugs and other health care expenses. It's easy to miss the reality that, due to productivity increases, year-after-year, over the long term American incomes are rising faster than average prices.

Indeed, the cost of many things that improve Americans' lives, like computers and other electronics, has been steadily falling. The combined result is that, on average, Americans have more money to spend on other things. This includes drugs and other health care. For example, over the past 60 years, what we have saved on food alone makes up for the increasing amount we have spent on health care.

In fact—strange as it may seem—we are spending more on drugs and health care not because we're being forced to do so by rising drug prices, but because we're able to do so thanks to rising productivity. Much as we groan over our pharmacy bills, when it really comes down to it, they are a worthwhile expenditure. Of course we'd rather spend our money on vacations, sports tickets, and home theaters. But, to put it bluntly, you can't take a vacation if you're dead. [Generally speaking.]

It is important to understand that spending money on expensive drugs may actually save money in the long run. Often, use of such drugs eliminates the need for still more costly hospitalization or surgery. Moreover, the costs of caring for those who have been denied the benefits of the drugs may greatly exceed the cost of their research and development. Even from a purely economic perspective, consider the enormous savings in assisted-living, nursing home, and home care expenses if, before the baby boom retires, even a very expensive research and development process were to produce a very costly drug that prevented or cured Alzheimer's disease!