How Is the Prescription Drug Market Changing?

The Kaiser Family Foundation recently analyzed trends and indicators in the market for prescription drugs, and reported that:

♦ While coverage for prescription drugs has increased substantially, 23% of the non-elderly and 31% of Medicare beneficiaries have no coverage.

♦ National expenditures for prescription drugs have been one of the fastest growing components of health care spending in the past decade, increasing 15% from 1997 to 1998, although they represent a small proportion (9%) of total personal health care spending.

♦ Several factors affect the increase in drug expenditures, including increased use (accounting for 43% of overall growth), changes in the types of drugs used (39%), and increased prices for existing drugs (18%).

♦ Between 1992 and 1998, drug utilization increased by 37%, compared to a 6% growth in the U.S. population.

♦ Retail prices have increased 6.7% per year since 1991, exceeding both general inflation and medical care inflation, with prices for brand name drugs increasing more rapidly than for generic drugs.

These data have received considerable attention in recent years, particularly as Congress debates whether to add a prescription drug benefit to Medicare and considers how to address the issues of health plans pulling out of Medicare and decreasing their drug benefits for seniors. For many conditions, drug therapy represents a cost-effective alternative to more costly and invasive surgical procedures, but for individuals without drug coverage, drug therapy may be prohibitively expensive. The U.S. tends to pay higher prices for drugs than other countries, and does not impose price controls on the industry, as do other nations.

How Does the Pharmaceutical Industry Price Drugs and Promote Innovation?

The Pharmaceutical Research and Manufacturers of America (PhRMA) has argued that keeping product pricing and distribution decisions private is essential to the industry’s long-run viability. Pharmaceutical companies believe that controls on prices and attendant reductions in profits would threaten their ability to innovate. These companies make a substantial annual investment in the research and development of drugs to prevent and cure infectious, chronic, and genetic diseases. The industry also spends about $8 billion per year to promote these drugs, a rapidly increasing share of which is for direct-to-consumer advertising, which is affecting the number and types of drugs prescribed.
PhRMA supports expanding drug coverage through programs targeted to low-income and elderly populations, but views the proliferation of price control legislation and the establishment of restrictive formularies as potentially depriving patients of access to new and innovative medicines.

**What Strategies Are Being Implemented in Other States to Control Prescription Drug Costs and Increase Access?**

While expanded access and pricing issues are debated at the federal level, states are also focusing attention on these issues because their budgets are affected by rising prescription drug expenditures in several ways. Currently, all states offer outpatient prescription drug coverage through their Medicaid plans to many low-income individuals, both young and old. As another means to increase access to affordable drug coverage, many states have implemented pharmaceutical assistance programs that provide coverage for low-income, elderly, and disabled persons not covered by Medicaid. Typically these programs pay the difference between an enrollee copayment - usually between $3 and $12 - and the cost of the drug. Some programs include deductibles and / or impose maximum annual benefits. States, including California, also have established AIDS Drug Assistance Programs (ADAPs) to provide AIDS medication to individuals who otherwise could not afford it. California’s program was established in 1987.

States are also considering ways to lower the prices that they or their residents pay for prescription drugs. According to the National Conference of State Legislatures, as of 2000 at least 28 states have considered or passed legislation to address this issue. Such legislation generally proposes to create statewide programs that use the current “lowest available price” or the Medicaid rebate or discount rates as a basis for the retail price. Earlier in 2000, Maine enacted a law to establish a regional drug-buying pool that will allow the state to leverage price discounts from drug companies for its residents whose prescriptions are not covered by insurance, for its Medicaid population, and for participants in its drug program for the elderly. The law created a commission to monitor drug prices, with a three-year period, ending in July 2003, within which to determine whether the state should establish drug price limits. PhRMA has recently filed a lawsuit to challenge Maine’s new law, arguing that it is unconstitutional because it conflicts with the federal Medicaid program and would regulate transactions outside the state.

**What Are the Current Laws and Proposals to Control Costs and Increase Access to Prescription Drugs in California?**

With the passage of SB 393 in 1999, California became one of four states to implement a measure requiring that the prescription drug price charged to Medicare recipients by a pharmacy not exceed the Medicaid reimbursement rate. The law took effect on February 1, 2000.

California legislators have proposed a number of other bills to implement state-based prescription drug policy, including:

- **SB 1880** (Sher) would require the state to design a consolidated purchasing program for individuals for whom the state purchases prescription drugs, Medicaid and Medicare beneficiaries, state employees, and uninsured and underinsured people age 65 and older.
- **SB 2075** (Speier) would require the Department of Health Services to report to the Legislature on a method to establish a system of price regulation requiring drug manufacturers and wholesalers to sell drugs in California at a price no greater than the price at which they sell the same drugs in Canada.
- **SJR 29** (Speier) would ask the U.S. Food and Drug Administration to reverse its decision allowing pharmaceutical companies to advertise their products to the public.
- **AB 1722** (Gallegos) would prohibit health plans from increasing the copayment amount or deductibles for patients who are already taking a drug covered under their plan.
- **SB 1601** (Perata) would establish a program to provide Medicare beneficiaries with financial assistance to purchase supplemental prescription drug coverage, until such a benefit is provided by the Medicare program.

**How Do Health Plans Control Prescription Drug Expenditures and Utilization?**

The health plan industry cites rising drug costs as the primary driver behind recent premium increases, and argues that plans should be free to modify coverage rules and medical management policies to adjust to emerging pharmaceutical trends. Efforts within the industry to control pharmaceutical costs and utilization are well underway. One major structural evolution has been the growth of pharmacy benefit managers (PBMs), which utilize such techniques as pharmacy networks, negotiated discounts and rebates, lists of preferred drugs, and utilization review. Health plans have adopted other cost-management techniques including increasing enrollee copayments for brand name drugs, using a tiered copayment system, encouraging generic and therapeutic substitution, and establishing formularies, which are lists of drugs identified as the preferred treatment for specific diseases.

Health plans have also undertaken efforts directed toward altering physician behavior, including educating them about therapeutic alternatives, altering their prescribing choices, and creating financial incentives to make physicians price sensitive in their decisions. Plans can encourage or require physicians to use a formulary’s list of the most cost-effective drugs and to substitute generic for brand name drugs. Health plans are concerned, however, that implementing these tools will not fully stem the tide of rising drug spending.

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