

WHY IS AMERICA SUBSIDISING THE ENTIRE
WORLD BY BUYING PHARMACEUTICALS
FAR ABOVE THE WORLD PRICE?

A POLICY WHITE PAPER REGARDING THE
MEDICARE DRUG BENEFIT AND A PROPOSAL FOR
FIXING THE SOCIETAL EQUITY ISSUE
AND THE NATIONAL BUDGET ISSUE

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BACKGROUND

In 2003 Congress enacted a Medicare Prescription Drug benefit for elderly Americans or Senior Citizens as they are also referred to. This legislation was proposed and advocated for by the administration of President George W. Bush.

There are several things that have been identified in this legislation that the author considers to be problems. They will be outlined below:

1. The political process used to pass the legislation caused the Congress to pass the legislation on the basis of incorrect information. Some examples:
 - A. The administration failed to provide an accurate estimate of the cost of the program. The actuary who calculated the initial cost over the first few years predicted that the cost to the taxpayers would be \$540 Billion dollars over the first few years.
 - B. The same actuary was threatened with the loss of his job if he reported to Congress that the cost would exceed the administration estimate of \$400 Billion.
 - C. In the first administration budget after the legislation was passed, the cost estimate in the budget was revised upward to \$720 Billion, or 80 per cent more than the figure that was used to influence Congress to enact the legislation.
2. There are problems with the legislation and the legislative process itself:
 - A. It requires that consumers of the drug benefit select from among approximately 40 different and competing drug programs with different prices for different drugs, and a Byzantine process necessary to select the provider of the drug delivery.
 - B. There is no assurance that the consumer has picked the best provider.
 - C. In some cases, spouses need to pick different providers due to the differing formularies and prices of competing providers.
 - D. There is a significant "doughnut" in the program in which the consumer of the service receives a benefit up to a certain level of total drug expenditure, then for the next level, the consumer is required to pay the entire cost of the drugs up to another triggering level. The consumer receives the subsidy up to a

cap level, and after that level is reached, the program pays the entire cost of all drugs beyond that point. This system has some problems of its own:

- i. The “doughnut” is very costly for low income seniors, forcing in some a choice between life-saving drugs or food and rent.
 - ii. The complexity of the provider selection process has caused some seniors to opt out of the program or miss deadlines for entry, creating additional costs for them.
- E. The legislation **prohibits** the agency in charge of the program from negotiating the price of the drugs with pharmaceutical manufacturers, which permits the drug companies to charge the US government full list price. This practice is not used by the Veterans Administration. It certainly is not done by large drug retailers like Wal-Mart, CVS Pharmacies, or Revco Pharmacies, or the private insurers who dispense drugs by mail to their patient/consumers. The failure to negotiate prices would be commercial suicide by these private entities.
- F. The Medicare Prescription Drug program, which creates one of the largest, if not the very largest drug buying organization on Earth, and this failure to negotiate by law creates the opportunity for the pharmaceutical companies to charge excess margins to the federal government. This policy in effect subsidizes every other industrialized nation, all of which have prescription drug programs for their citizens, and these nations ALWAYS negotiate drug prices. **The evidence from around the world indicates clearly that Americans pay far more for medications, and because they do, the margins created by Americans in effect subsidize the world.** If Medicare negotiated down to the world price, the effect on the world price would be to go up marginally, as the increase would be necessary for the pharmaceutical companies to maintain their overall margins and profitability, which is necessary for them to have the necessary financial incentive to continue to develop and market new drugs.
- G. The legislative process necessary to pass this legislation, and particularly the process used in the House of Representatives, is indicative of a conflict of interest between the pharmaceutical industry, its lobbyists, the administration and Congress. Several provisions in the law noted above create the conditions that cause American consumers and the American government to allow excess profits to the pharmaceutical companies appear to be a *quid pro quo* payoff for tens of millions of dollars paid to various political campaign coffers, political party campaign funds, and the presidential campaign. It should be noted that both parties have some culpability in this situation, but since the Republican Party is in power and has been for quite some time most of the *quid pro quo* guilt falls on their members and their party.

PROPOSAL TO REPAIR THE PROBLEMS AND CREATE EQUITY IN THIS PROGRAM FOR THE FIRST TIME SINCE THE PASSAGE OF THE PRESCRIPTION DRUG BENEFIT PROGRAM

The first item in the proposal is to eliminate the complex system of finding a provider of the service, and to have a simplified program, with government administration, perhaps at the state level. The federal program should identify a common process between states, and the cost of the drugs should be uniform across the entire country, such that if an eligible person is traveling, no cost penalty or delay in obtaining prescriptions is encountered.

Second, the doughnut should be eliminated or minimized. This is a major source of inequity in the program. It is also very confusing to the consumers, and as people age, confusion sometimes accompanies the aging process making seniors amenable to making bad decisions based on fear or a good sales pitch that may not be in the best interest of the consumer.

Third and most important, the Medicare program administrators **must be compelled by legislation to negotiate**, in a verifiable fashion that drugs used in the program **MUST be purchased at the world price**. The effect on world prices outside the United States is that the world price will have to go up marginally in order for the pharmaceutical manufacturers to maintain the same profit margin overall and provide the financial incentive for them to continue to develop new and improved medications for more and more diseases. This is not intended to limit patent protection for new drugs, and will not lessen the market forces that provide higher margins on independent drugs that are being produced while on patent.

Fourth, the formulary must be opened up to all drugs, including generics, which will force the on patent drugs to be subjected to improved market forces, and the expected effect of this would be downward pressure on the price of patented prescription medications with some upward pressure on prices of generics. With an open formulary, no pharmaceutical company will enjoy an artificially created monopoly position. **This creates a true market economy in prescription drugs, which is a position always advocated by Nobel winning economist Milton Friedman.** The market will set the prices. The Medicare program will be forced to buy at the market price. The market may create a bubble in demand for certain drug during times of shortage or a new public health crisis, but the long term effect will be beneficial to all due to lower prices.

FINANCING THE PROPOSED CHANGES

The bulk of the cost of improving the program will come to the American taxpayers in the form of lower costs to purchase the drugs initially. Based on observations from people who have been purchasing their medications in Canada, and illegally importing them, the savings can be substantial, perhaps by as much as half for some medications.

It is expected that the savings realized from opening the formulary up to all competing drugs, including generics, and making all manufacturers compete equally in the world market will force enough savings to both eliminate the doughnut and drive the cost of the program back in the direction of the original cost estimate without the need to raise additional tax money to pay for the program. The elimination of the doughnut may also permit a small increase in the consumer co-pay on the medications, but still save our senior citizens significant costs over the current system.

The benefit of having the program administered completely by the state governments limits the need to have the wasteful, confusing and misleading options associated with the selection from among 40 separate private providers of drugs. This single payer system will work by providing a set fee to the pharmacy or pooled resource pharmaceutical provider network for each prescription dispensed. **The pharmacy that provides the service most efficiently will wind up being rewarded most. Economies of scale can be achieved.** This is preferable to a government dispensing pharmacy, which would decimate the pharmacy business, which is not a goal of this proposal.

Again under this system, the free market will decide who dispenses the most prescriptions. Under this program, a small pharmacy will have the same access to drugs dispensed under the Medicare program at the same world price that the drug

stores with massive market power, reducing somewhat the advantage those companies have in the marketplace. This system of a level payment that permits a fair profit to the dispensing pharmacy for the filling of the prescription is similar in concept to the Diagnostic Related Groups (DRG) that provided a means for Medicare and Medicaid to contain rapidly rising hospitalization costs. **Again, the hospitals that provided the service most efficiently were rewarded with the most business.**

The 40 companies involved in the current program will be free to compete in other areas, instead of receiving government subsidies created by catering to captive markets. **Once again, the market will provide incentives to these companies to seek other profitable business. They just will lose taxpayer subsidies, and the Medicare program will locate more savings.**

THE CURRENT SITUATION

It has been reported recently that some of the 40 private pharmacy companies engaged in the delivery of medications are suffering economic dislocation and poor cash flow because the Federal Government is a slow paying funder. They are reporting low profit margins caused by the need to borrow money to meet their expenses of buying medications, paying salaries, rent on facilities and the like. It has been reported that several of the companies are considering dropping out of the plan. If they are forced out of the plan, the remaining companies will be fighting for a larger piece of the pie, and those companies with the most financial power, and money in the bank will over time be in a position to monopolize or create an oligarchy (few suppliers, many customers), which can create the opportunity to charge higher prices for consumers.

It has also been reported recently that significantly higher prices will be charged **FOREVER** if seniors miss an artificially established cutoff date for program enrollment. For several months, after May of 2006, entry into the program is closed completely, and the enrollment program re-opens in January, 2007, and fees will be substantially higher for new enrollees.

Therefore, the Medicare Prescription Drug Program is unintelligible to many seniors, has a large "doughnut" where seniors will be compelled to pay full price for drugs, to the tune of over \$1,000.00, then a period of co-paying for the next \$1000.00 or so, and then after about \$3,000.00 worth of medications, they are to be delivered at no additional charge, then the process starts over on January 1 of the next year. This can be prohibitively expensive for low income seniors on fixed (and low) incomes. This situation may put the senior in the position to decide between life-saving medications or food or rent. This is not an equitable program, and as structured, it is not in the best interest of our Senior Citizens, many whom have defended America in World II, Korea and soon, Viet Nam. This shows callus disregard for our seniors, and it is immorally run. **No option to purchase these drugs in Canada will be possible, since the entire donut must be purchased from the American plan provider, providing a massive subsidy to the pharmaceutical industry. Assume a \$1000 per year mandatory purchase at inflated prices for 44 Million people. This amounts to \$44,000,000,000.00 (forty-four Billion dollars) of potential revenue. This does not appear on the budget of the United States because it comes right out of the pocket of our seniors. This windfall happens each and every year. Not all seniors use that much medication, but the potential exists, particularly as baby boomers retire and come into the Medicare system.**

The deadline for joining the program is May 15, 2006. Enormous pressure is being applied to seniors to join. Bad decisions may be made in the face of this pressure. **If the federal government negotiates down an artificially high price, without truly negotiating to the world price, then the American consumer and the American**

taxpayer winds up subsidizing the entire world's pharmaceutical market. The Center for Responsive Politics has reported that the pharmaceutical industry has donated \$70 Million to the campaign coffers of both parties, just since 2000. In effect the drug industry is buttering the bread of both parties, and most particularly Republicans, since they are in the position to create commercial opportunities and monopolistic profits for them.

CONCLUSION

For the reasons outlined above, I recommend implementing the changes suggested in the proposal section, as a means to reduce the impact on our seniors, force the pharmaceutical industry to compete in a free world marketplace, and end the practice of having the American taxpayer subsidize the entire world. The proposal will reduce the confusion factor, free up the current 40 providers to pursue more profitable business, and by changing the dynamics of the entire world market, cause the pharmaceutical industry to earn its margin in a competitive market.

In no way can a free worldwide marketplace, where each company is forced to become more competitive in their quest to earn a normal profit, which is entirely legitimate, hurt either the drug companies or consumers around the world, and especially in the United States of America.

Our Senior Citizens will benefit the most by the delivery of a simple, understandable program where no one can gain an unfair advantage over any other. This kind of plan would have been better from the start.

It is up to Congress to implement a more equitable and cost-effective Prescription Drug Program. The American Taxpayer demands it, and the American Senior Citizen needs it.