



## Testimony

# Testimony Before the Senate Committee on Finance on Drug Pricing

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[Read a PDF of the testimony here.](#)

Chairman Grassley, Ranking Member Wyden, and members of the committee, thank you for the opportunity to testify today on the matter of drug prices. I hope to make four basic points:

1. The term “rising drug costs” is riddled with ambiguity; list prices, net prices, out-of-pocket prices, development costs, and total spending on drugs have displayed very different patterns over time.
2. There is rising demand for pharmacological therapies driven by an aging population, chronic disease and the development of specialty drugs.
3. In the face of rising demand, the only way to reduce prices is to increase supply and heighten competition.
4. In thinking about policy actions, it is important to recognize first existing policies that exacerbate price increases. In addition, many popular proposals are unlikely to be beneficial.

Let me discuss these further.

### Introduction

Over the past several years the public’s attention has increasingly been focused on the cost of health care, and specifically the contribution of prescription medications to those costs. With 55 percent of the U.S. population using prescription drugs as of 2017,<sup>[1]</sup> expensive sticker prices on certain new medications, the pricing revelations at Turing Pharmaceuticals and other companies, and the EpiPen episode have fed these concerns and led policymakers to consider addressing drug prices through legislation and regulation. Policymakers, however, should first clearly identify the actual problem they’re trying to address.

### Identifying the Problem: Patterns in Drug Costs

There is little consensus in the term “rising drug costs,” making it difficult to determine if there is an actual

policy problem, its size, or its scope. The first step in identifying whether there is a problem is to differentiate between prices, costs, and spending, which are related but not identical.

For example, “rising drug costs” might refer to a narrow definition focused on the sales prices (or “list price”) set by drug developers and manufacturers. Alternatively, the problem might not be with all drugs, but instead the high prices of some drugs. Finally, the problem may be the increasing cost of prescription drugs borne by individuals at the pharmacy counter, which has resulted from an increase in high-deductible health plans.

Rising drug costs could also mean an increase in overall prescription drug expenditures, whether in dollar figures or as a percentage of National Health Expenditures (NHE). Because spending is a function of both price and quantity, this could result from increased utilization due to rising national reliance on prescription drugs or broader access to them.

### *Pharmaceuticals as a Share of National Health Expenditures*

The first important fact to consider is that prescription drug spending as a percent of NHE has remained steady at about 10 percent since 2000, the same percentage it was in 1960. There was a dip in prescription drug spending as a share of NHE in the years between 1960 and 1980, as advances in technology and expanded insurance coverage of hospital visits contributed to a shift in NHE towards hospital stays. [2] In the 1980s, that trend began to reverse as new pharmaceuticals became widely available for the treatment of many of the most prevalent diseases in American society. The availability of advanced pharmacological treatments is highly correlated with reduced expenditures for hospitals and other health professionals.[3] As pharmaceutical growth began to level out to roughly the same levels as the 1960s, so did other NHE categories.[4] Viewed from this national perspective, there appears to be little support for a radical rise in drug spending in the data, although national averages can mask the variance among subpopulations and the most current NHE data is more than a year old.

### *Drivers of Drug Spending*

To the extent that drug expenditures are increasing or will begin to increase in the near future, a key factor is utilization. Annual growth in pharmaceutical spending in November 2018 was 5.1 percent,[5] but annual pharmaceutical price growth was only 0.6 percent.[6] On a per capita basis, real net spending has grown by only 1 percent since 2007 and actually declined by 2.2 percent in 2017.[7]

Still, Americans are getting older, living longer, and are increasingly burdened with chronic disease. As of this year, 60 percent of the United States’ adult population had been diagnosed with at least one chronic health condition, and 40 percent had two or more chronic conditions.[8] Managing these chronic conditions is an expensive proposition that relies primarily on medication. Eighty-six percent of all health care spending is for patients with one or more chronic disease; 98 percent of Medicare and 83 percent of Medicaid spending goes towards providing care for the chronically ill.[9] [10] Specifically, over 75 percent of U.S. health care spending goes towards treatment of chronic disease.[11] As these trends continue, the financial burden of maintaining a high quality of life with chronic conditions will inevitably disproportionately increase the growth of pharmaceutical health care spending.

### *Drivers of Drug Prices*

Developing new treatments is an expensive prospect in terms of both capital and time. A Tufts University study

in 2016 found that the average cost for each drug successfully brought to the market is nearly \$2.9 billion.[12] Data from the Organisation for Economic Co-operation and Development also shows that the amount of spending per new drug approved has been growing for decades.[13] It takes an average of 15 years from the time a drug developer first begins testing a new formula until the Food and Drug Administration (FDA) approves it.[14] Only 1 in 1,000 drug formulas will ever enter pre-clinical testing, and of those, roughly 8 percent will ultimately receive FDA approval.[15]

Additionally, the last decade has seen a significant shift towards the use of “specialty drugs.” While there is no precise definition of a specialty drug, this term typically refers to drugs with at least one of the following characteristics: requires special handling, must be administered by a doctor, requires patient monitoring or follow-up care, is used to treat complex, chronic conditions.[16] As a result, these drugs tend to be quite expensive.

In fact, by 2016, about half of the top 80 most expensive drugs nationally were specialty drugs, and that number is increasing annually.[17] In 2010, the United States spent just over \$11.5 billion on the top 25 specialty drugs. By 2017, net spending on specialty medicines reached \$151 billion, accounting for 46.5 percent of all expenditures on medicines, despite accounting for just 2 percent of the volume.[18] Specialty drugs are often more expensive to develop and typically treat small patient populations with very specific and otherwise untreatable diseases, they tend to have higher prices. Over time, the cost of new specialty drugs per patient will likely continue to be higher as the target population for each new drug will grow smaller with the development of treatments for less common diseases.

### *List Versus Net Prices*

An important aspect of the discussion is the difference between list price and net price. List prices for brand-name drugs, on average, have increased between 7 and 13.5 percent over the past six years, yet the average net price of these drugs has grown between 1.9 and 4.7 percent, with the trend being downward sloping.[19] In fact, price growth for prescription drugs over the course of 2018 was the lowest growth rate since 2013, and even dipped into negative territory between December 2017 and early 2018.[20] So while the average list price of brand name drugs rose 35 percent between 2013 and 2017, average out-of-pocket (OOP) costs for those drugs remained unchanged at \$30.33.[21] Similarly, generic list prices rose 7 percent during this time period, but patient OOP costs declined more than 9 percent as a result of discounts and rebates. The increasing difference between list and net price points to the growing use of discounts and rebates. Understanding the role of these incentives in price determination is an area worthy of careful consideration to ensure resources are being allocated as desired.

### *Out-of-Pocket Prices*

From a patient perspective, many anecdotally report that OOP costs are climbing and the increased frequency of high-deductible health insurance plans is cited as the reason. But the data show that average patient OOP costs at the pharmacy counter have actually declined since 2013. Nearly one-third of all medicines were available in 2017 for zero OOP costs, and 97.5 percent were available for \$50 or less, with the average OOP cost equaling \$8.69. Only 2.5 percent of prescriptions filled had a co-pay of more than \$50. But for the small share of very costly drugs, the expense adds up fast: 3.4 million prescriptions (0.1 percent of all prescriptions filled in 2017) had an OOP cost of more than \$500, with an average cost of \$1,502; total OOP expenditures for these drugs was \$5.2 billion.<sup>[22]</sup> It is likely also true that a number of prescriptions that would have cost at least that much were never filled because the patient simply could not afford it (or chose not to spend the money). The abandonment rate for brand-name drugs reached 21 percent in 2017.<sup>[23]</sup>

## **A Review of Possible Solutions**

Like the leading principle of the Hippocratic Oath, policymakers should “first, do no harm.” The myriad mandatory discount programs and industry taxes collectively result in higher list prices and cost-shifting to the private market as companies look for ways to offset the lost revenue. These programs don’t reduce the cost of the drug; rather, they distort the health care market (beyond just the prescription drug market) and force some to pay more so others can pay less.

### *Medicaid Drug Rebate Program*

The Medicaid Drug Rebate Program (MDRP) requires drug manufacturers to pay a rebate for all drugs dispensed to Medicaid beneficiaries, ultimately ensuring Medicaid receives the best price for prescription drugs. As a consequence, because there was no exception for charitable donations of medicines, such donations ceased, and Congress responded by creating another program: the 340B drug discount program. 340B similarly requires drug manufacturers to provide their drugs at a statutorily determined discounted rate to all eligible entities for qualified patients (though, the program does not require those discounts be passed on to the patient receiving the medicine). The Affordable Care Act (ACA) both expanded the MDRP and increased by 53 percent the mandatory rebate that drug manufacturers must provide for all Medicaid beneficiaries.<sup>[24]</sup> Consequently, drug manufacturers paid an estimated \$80 billion in rebates between 2011 and 2015.<sup>[25]</sup> The average Medicaid rebate is now greater than 50 percent of a drug’s cost. The ACA also dramatically expanded the 340B prescription drug discount program, and the value of drugs subject to the program’s mandatory discount nearly doubled from \$6.4 billion in 2011 to \$12 billion in 2015.<sup>[26]</sup> Further, the ACA required drug manufacturers to begin rebating 50 percent of the price of all brand-name drugs provided in the Medicare Part D coverage gap. Between 2011 and 2016, these rebates cost the industry \$24.6 billion.<sup>[27]</sup> Finally, the ACA imposed a new tax on all manufacturers and importers of brand-name prescription drugs that cost the industry \$14.1 billion over those five years.<sup>[28]</sup> The ACA’s provisions cost drug manufacturers more than \$100 billion in just five years. It should not be surprising that drug prices simultaneously increased.<sup>[29]</sup>

### *340B Drug Discount Program*

The 340B program is in dire need of reform. While the program was created to resolve an unintended consequence of the Medicaid Drug Rebate Program, it has created its own unintended consequences.<sup>[30]</sup> The 340B discount incentivizes hospitals to acquire physician practices. This consolidation reduces the number of community practices and consequently drives up the cost of care for all services at those facilities, relative to the cost of the same services provided in non-hospital-owned physician offices. Studies have shown that consolidation among hospitals and other health care facilities leads to higher costs at hospitals, often by as much as 20 percent and sometimes by as much as 40 percent.<sup>[31]</sup> Further, the program suffers from a lack of clear

guidance and requirements regarding the use of savings generated. One change that could help ensure the program's discounts are passed on to the beneficiaries it is intended to serve is to reduce Medicare reimbursements for such drugs. The Centers for Medicare & Medicaid Services (CMS) implemented such a policy in 2018, through regulation, by changing the reimbursement for Part B drugs obtained through 340B from Average Sales Price (ASP) + 6 percent to ASP – 22.5 percent.[32] Congress could codify such a change by amending the ASP calculation to include discounts obtained through 340B. Congress should reform the 340B program to restore its original intent, ensure program integrity, and eliminate the harmful market distortions caused by it. Without such reforms, the program is unsustainable and the rest of the health care market will continue to suffer.

### *Medicare Part D*

The Part D program is also in need of reform. Though the program has generally been quite successful, recent trends detailed [here](#) have highlighted the need for structural reforms. The current program structure—namely the minimal liability on plans for high-cost enrollees (particularly after the changes made by the Bipartisan Budget Agreement of 2018[33]), the coverage gap discount program and the counting of those manufacturer rebates towards a beneficiary's True Out-of-Pocket (TROOP) calculation, and the existence and nature of the risk corridors—does not incentivize plans strongly enough to control the cost of high-cost drugs and even allows plans to shift more costs to the federal government beyond what was intended.[34]

Medicare Part D reinsurance expenditures have grown rapidly for the federal government over the past several years, primarily because of a significant increase in both the number of beneficiaries reaching catastrophic coverage and the costs that each of them incur. This rapid growth has caused reinsurance expenditures to increase from less than one-third of the federal government's overall subsidy of the Part D program in 2007 to more than two-thirds of the subsidy in 2016. Further, a recent investigation by *The Wall Street Journal* found that plan sponsors have leveraged the program's risk corridors to contain their losses and increase their profits, resulting in \$9.1 billion in extra subsidies.[35]

One way to realign incentives is a [restructuring](#) of the program's benefit design proposed in a recent American Action Forum study: increase insurer liability in the catastrophic phase to roughly 70 percent while simultaneously reducing the government's liability to 20 percent. Move the drug manufacturer rebate program from the coverage gap to the catastrophic phase to cover the remaining costs. These changes will significantly increase the incentive for both insurers and drug manufacturers to control costs. Further, provide beneficiaries with true financial protection by imposing an OOP cap. Plan sponsors and beneficiaries will also benefit from a simplified benefit structure since the coverage gap will be eliminated and beneficiary co-insurance will be held steady at 25 percent above the deductible until reaching the catastrophic threshold. Such reforms should encourage behavioral changes that reduce overall program costs for all stakeholders.

There are a number of proposals that are frequently mentioned as ways to reduce drug prices. A bit of reflection suggests that none is likely to be successful, however.

### *Government Negotiation*

Some have argued that the best way to reduce drug costs, in Part D or otherwise, is to allow government negotiation. Although government negotiation is expressly prohibited in Medicare Part D, the program is rich with price negotiations. In fact, the Part D plan sponsors negotiate directly with drug manufacturers, and this is a cornerstone of the program's success. Part D beneficiaries have access to 27 different plans, on average,

enabling individuals to choose a plan that is tailored to their needs.[36]

Government negotiation of drug prices could only be effective if the government were willing and able to impose a drug formulary (like the Part D plan sponsors already do) and to restrict access to medicines for which the price is “too high.”[37] Doing so, however, would fundamentally change the Part D program. The government would have to impose a single formulary in order to leverage the negotiating power advocates claim it has, which would eliminate the key differentiator between plans. Suddenly, beneficiaries’ choices would drop from 27 plans to 1. Beneficiaries would no longer be able to shop for the plan that’s best for them; rather, they would have to simply hope the government was able to negotiate a good deal for the drug(s) they need.

### *Drug Re-importation*

Drug companies don’t want their drugs sold for the lower prices available in other countries; of course they often sell at that low price because a low price is better than nothing. They will certainly not sell excess drugs to those countries to allow for a supply to be available for re-importation into the United States. And those countries, not having any excess supply, are going to provide the limited number of drugs they do have to their own people before they allow them to be sold back to the United States. Even if the United States were to allow drug re-importation, the economics make it very unlikely that it would have any impact on the availability of cheaper medicines in the United States. And that’s saying nothing of safety concerns, which are legitimate.

### *International Reference Pricing*

The Trump Administration recently proposed establishing a demonstration program for drugs covered through Medicare Part B, under which reimbursement would be tied to an International Pricing Index (IPI). While the administration’s objective to reduce the cost of drugs and increase Americans’ access to necessary medicines is laudable, the solution that has been proposed here is not likely to achieve that objective, and in fact, could result in significant undesirable repercussions. The most likely consequences are restricted access to existing medicines and reduced innovation for future advancements and new medicines; cost-shifting to the private sector insurance markets; an undermining of the administration’s goal to move to value-based payments; and harm to U.S. trade objectives. That said, addressing the reality that the United States spends substantially more on pharmaceuticals, and supports the industry’s ability to innovate more than similarly developed economies is worthy of policy experimentation. A key concern with this particular proposal is that it is unlikely to achieve the goals of reducing drug prices and maintaining patient access to innovative treatments.

The 14 countries that CMS has proposed referencing in this IPI model, on average, have access to only 48 percent of the new drugs developed in the past eight years, and it took an average of 16 months after their initial global launch for those drugs to become available in those 14 countries. The U.S., on the other hand, has gained access to 89 percent of new medicines within three months.[38]

Also of concern are the indirect effects and implications of adopting a reference pricing model. Of the 14 countries under consideration for this reference pricing model, 11 use reference pricing themselves to control their prices. Between four and six of these 11 countries reference each of the following countries in determining their own price: Cyprus, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, and Spain. By referencing the price of drugs in countries that reference the prices in other countries, we would indirectly be referencing the prices of those other countries. The average gross domestic product (GDP) per capita in these countries listed was \$18,685 in 2017, while the GDP per capita in the United States was \$59,532—more than



three times greater. The estimated age-standardized mortality rate for all cancers in these countries is 123.47, compared with a rate of 91 in the United States. The average life expectancy in these countries is nearly a year shorter than that of the United States. It is not appropriate for the U.S. to reference the prices paid in countries so different than ours.

Adopting the non-market prices of other countries, and thus the punitive and authoritative policies used to obtain those prices, will likely also mean adopting for American patients similar levels of restricted access to new medicines as experienced in other countries. Worse yet, this demo may result in new medicines never being developed in the first place. Americans highly value their access to and choice of new treatment options. The reduced innovation that will likely occur as a consequence of the reduced manufacturer revenues that will result from this model will have significant ramifications. Further, referencing the prices paid for drugs in countries that do not adequately reflect the value of medicines is inconsistent with the administration's goal of adopting a value-based payment system.

Finally, this model will undermine American trade policy which may have repercussions far beyond the pharmaceutical industry. The United States should instead work to strengthen intellectual property rights in other countries and fight compulsory licensing in trade agreements to end the coercive practices that allow countries to force manufacturers to provide their drug for less than it's worth; this is the only way to get other countries to pay more so that we may hopefully pay less without risking reduced innovation.

There are, however some proposals that would be successful in reducing prices.

### *Competition and Increased Supply*

History has proven the best way to reduce the price of a good for which there is growing demand is to increase its supply through competition. For drug pricing, that means bringing generics and biosimilars to market to compete with brand-name drugs.

A now-classic example of this phenomenon is the Hepatitis C treatment, Sovaldi, which contributed over \$3 billion to 2014 expenditures alone.<sup>[39]</sup> While the drug was quite expensive, it is important to note two things. First, Sovaldi—and its eventual competitors—provided a cure for what had been up until that point a costly-to-manage chronic disease. Second, as competitors came into the market, the price of Sovaldi was cut in half. Where there is competition, prices come down.

The FDA is doing its part by approving a record number of generic drugs and biosimilars.<sup>[40]</sup> But other barriers to unlocking robust market competition remain.

### *Barriers to Entry*

Manufacturers of innovator drugs rightly and understandably want to protect their market share as long as possible. As discussed, bringing a drug to market is a rather risky and expensive endeavor, and investors need the promise of a formidable profit to be incentivized to make that investment. And there can be no generic without first having the expensive innovator drug. The needs of the investors to receive a return, however, must be balanced with the needs of the consumers and taxpayers in order for the market system to remain sustainable. There are obvious incentives for brand-name manufacturers to extend the length of their market exclusivity

through various means. Congress can scrutinize the opportunity to create entry barriers, such as brand-name manufacturers allegedly abusing the REMS system and, if appropriate, legislate to help even more generics come to market quickly.[41] (One such example is the CREATES Act.)

### *Legal Enforcement of Competition Policy*

Another challenge is the case of single source generics. Often, once a generic drug has been on the market long enough, it acquires enough of the market share that the brand-name manufacturer stops producing its version of the drug. In many cases, the price reaches a low enough point that other generic competitors also exit the market, leaving a sole manufacturer. In some high-profile cases we see what amounts to abuse of monopoly power—that sole manufacturer taking advantage of its position and dramatically increasing its price once there is no more competition and consumers have no choice but to purchase the now high-priced drug. In these cases, it should be treated as the abuse that it is and prosecuted where appropriate.

### **Conclusion**

Fundamentally, there is no broad prescription-drug pricing crisis. Indeed, in most instances, things are working just fine. Rather what we face are more nuanced challenges. For example, the price of specialty drugs and biologics, which are expensive to develop and manufacture and frequently treat a limited population. In these instances, particularly with oncology drugs, it is important to make sure that the cost of the treatments correlates to the value. Remember that the goal is not low cost, it is high value. It is easy to have low-cost drugs; they, however, may not do much good. Conversely, it might make sense to spend more for a drug if its therapeutic benefits are high enough.

While the U.S. market has long been an environment where manufacturers are willing to invest in necessary research and development in hopes of a financial return later, more and more government regulations and taxes are reducing that incentive. Programs such as the Medicaid Drug Rebate Program and the 340B drug discount program interfere with the market incentives and shift, rather than reduce, the high cost of drug development. A more effective solution to high prices is greater competition in the supply and greater financial incentives on behalf of the payers and manufacturers to keep costs and prices down.

### Notes

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[2] <https://www.americanactionforum.org/research/understanding-pharmaceutical-drug-costs/>

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[4] <https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/index.html>.

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