

# Causes and cost control for rising drug prices



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Prescription drug cost is a major concern in the United States as it has been rising radically during the past years. In the article "High drug prices, the U. S. elderly, and drug expenditure control policies" published in Business Perspectives, it was stated that among the Organization for Economic Cooperation and Development (OECD) countries, the United State has spent approximately 15% of its Gross Domestic Products (GDP) on health care (Okunade). Rising prescription drug cost is one of the main factors to the increasing cost of overall health care expenditure. "According to the Washington, D. C.-based National Institute for Health Care Management, Americans spent an average of \$154. 5 billion on prescription medications since 2001. In 1997, they spent \$78. 9 billion" (Isaacs). There are various causes for the soaring prescription drug cost; they include increasing demand on drugs, overutilization and the problem of "moral hazard," and patent protection on branded drugs, etc. To tackle the problem of high drug cost, the government, as well as health insurance companies, is putting great effort into controlling the prescription cost. Attempts such as the Proposed Medicare Outpatient Prescription Discount Cards Policy, utilization management, generic substitution, targeted disease intervention and the new health care plan put forward by President Obama seeks to reduce government expenditure on healthcare as well as promoting universal health care. The major causes and possible solutions of the high drug prices will be discussed in detail in this paper.

### Causes for Increasing Drug Cost in the United States

In order to control the rising drug prices, one should fully understand its causes. There are three major factors to the problem, namely, increasing

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demand for drugs, overutilization and “moral hazard,” and patent protection on branded drugs.

#### - Increasing Demand for Drugs

Drug therapy is at all times a central way used by doctors and physicians because it is effective and efficient. “Drug treatments, although expensive, are most effective for treating mental disorders” (Okunade). The use of drug is relatively convenient compared to hospitalization and complex surgeries. Consequently, many patients prefer drug therapy to other therapies. In addition, pharmaceutical manufacturers spend a lot of money on advertising new drugs, and many consumers are attracted by those advertisements. “[Increasing] discovery and aggressive marketing by drug firms and growing utilization of highly expensive biotechnology drugs and procedures for treating life-threatening illness ... raise drug costs” (Okunade). Physicians as well as patients are interested in the latest, most modern drugs. Besides, the Medicare-aged population segment, i. e. the elderly, is growing in the U. S., and the elderly are the largest users of prescription drugs in the States. As the Medicare-aged population sector is mounting, more drugs are demanded. In the drug market where the market supply curve is upward sloping, with the market demand curve downward sloping, an increase in demand for drugs will cause the entire demand curve to shift right. As a result, the equilibrium price and quantity for prescription drugs increase. This is illustrated in the following graph.

Overutilization and “moral hazard”

When a patient buys medical insurance, he or she is paying less for medical care because it is fully or partially covered. According to the law of demand, one will consume more of a product when its price is lower, and vice versa. This turns out that the insured individual will consume more health care products than those who have to pay the full expenses of the products. Since the early 1980, the growth of health insurance has been extremely rapid; especially managed care plans such as Health maintenance organizations (HMOs). As more and more people are enrolled in such health insurance programs, the problem of overutilization becomes severe. "Moral hazard" refers to the risk that insured patients increase their consumption of the insured services because the insurance coverage lowers their out-of-pocket prices. Some insured patients in fact do not need to take drugs at all but they do so just because they can acquire the drugs at cheaper prices, regardless of any possible effects, either efficacious or detrimental, on their health. Overutilization of health care and moral hazard directly increase the demand for drugs, and thus, causing the drug prices to increase.

#### - Patent Protection on Branded Drugs

Most innovative and branded drugs in the market are protected by patents, and this is obviously an obstacle to the market entry of generic drugs. Generic drugs are bioequivalent to their branded counterparts. The patent protection of branded drugs allows branded drug companies to exercise monopoly power to a certain extent, and hence, increase the price of branded drugs. Generic drugs are much cheaper than the branded ones, and the use of generic drugs would surely decrease the drug costs. "While doctors may have a sense of which medications are most costly, they may

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not have a strong incentives to prescribe lower cost drugs unless the patient specifically asks them to”

(Isaacs). However, patients have limited access to generic drugs information as they are not well informed, and they are more confident in branded drugs. Moreover, most doctors are not responsible for providing patients with drugs; so they would not have motivations to prescribe low cost drugs. This causes the drug cost higher than it should be.

### Cost Control on Drug Cost

As drug cost keeps rising, the government and pharmacy benefit managers (PBMs) are trying a wide variety of strategies to control the cost. Four possible cost control methods are listed below.

- The Proposed Medicare Outpatient Prescription Discount Cards Policy

As the United States was the only advanced country lacking a Universal Health

Insurance plan, there is no guaranteed access to medical care and prescription drugs for the uninsured. Consequently, the poor elderly cannot afford expensive but necessary drugs. Under the program, private groups that meet specific federal criteria to negotiate significant discounts with drug manufactures issue drug discount cards to the public (Okunade). Drug costs are likely to decrease if the program is successfully implemented. However, it is believed that the increased access to cheaper outpatient prescription may raise the total drug spending because consumers may buy more drugs

than they need when the drug prices are lower. In other words, they will abuse the

discounted price. The policy may cause “moral hazard”. Therefore, this policy may increase senior citizens’ access to cheaper prescription drugs on the one hand, while encourage overutilization on the other hand.

#### - Utilization Management

Employers and health plan sponsors may restrict their employees and plan enrollees to drug utilization in order to avoid the problem of overutilization. A large amount of money may be saved when inappropriate and redundant prescriptions are abridged. When the number of prescriptions is limited, the insured patients are likely to buy the drugs they really need. John D Jones, the vice president of Legal and Regulatory Affairs, Prescription Solutions, gave supporting evidence for the effect of managing utilization in his article “Developing an effective generic prescription drug program.” He said, “Specifically, an employer with 500 employees, paying the national average of \$35 for each of the eight prescription filled, will save \$175, 000 per year simply by eliminating inappropriate use of medication by an average of one prescription per employee.” In this regard, restricting number of prescription is an effective way to control drug expenditure.

#### - Generic Substitution

A generic drug program can remarkably reduce the high drug prices. “On average, generic drugs cost between 30% and 60% less than their branded counterparts, according to the Food and Drug Administration (FDA)” (Jones).

Therefore, an elimination of patent protection on branded drugs will certainly promote the generic drugs market, and directly trim down the towering drug expenses. The market entry of generic substitution was proposed to be accelerated, as it is believed that the branded drug manufactures have been manipulating the patent laws to inhibit the competitive market entry of generic drugs (Okunade). Besides reducing the patent length of branded drugs, an efficient generic program should also include educating the physicians and patients on generic drugs. Many patients prefer branded drugs because those drugs are extensively advertised, and the quality is guaranteed. In this sense, education programs or propaganda should be introduced to doctors and the general public in order to make them understand that cheaper generic drugs are bioequivalent to their branded counterparts.

Then, more generics will be prescribed, leading to a drop in expensive drug costs.

#### - Targeted Disease Intervention

One of the strategies used by PBMs is “targeted disease intervention.” A large amount of health care expenditures are spent on chronic diseases such as diabetes, cardiovascular diseases, and asthma. Targeted disease intervention is a procedure that identifies patients with such diseases, and ensures them to receive appropriate treatments and get suitable drugs. This would be effective in avoiding unnecessary health care expenses (Jones). After pharmacy and medical data are reviewed, health care plan sponsors

may have ideas on the matches between specific patients and specific treatments.

Hence, PBMs may recommend certain programs that are suitable for specific patients. In

this way, patients can receive appropriate treatments and drugs. Not only can this

program effectively reduce drug cost, but it can also improve patients' health condition.

(New Possibilities brought by Obama's Health Care Bill)

Effectiveness of the proposed solutions

Controlling the soaring drug costs is always a main concern for government and insurance companies because it contributes to the increasing health care expenditure. Pharmacy benefit managers are working hard on lowering such cost. Since the above cost control strategies are targeting the causes of expensive drug prices, they are feasible and effectual. Although one may argue that drug control policies and strategies are a failure in the long run due to moral hazard, these policies and strategies are at least successful in the short run. For instance, " Manatee County's prescription costs only rose 4. 3% in the 12 months after it began its drug management program, compared to 21. 8% in the 12 months before the program. Additionally, after Multnomah County reorganized its health plan and began using a PBM three years ago, it saved \$5. 5 million in one year" (Isaacs). These statistics show that drug control policies and strategies are having prominent effects on

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drug spending. It is hoped that more useful and helpful tactics will be introduced, and the drug costs in the US would stop rising.