WASHINGTON POLICY CENTER

LEGISLATIVE MEMO

Analysis of bills to impose price controls on prescription drugs

By Roger Stark, Health Care Policy Analyst February 2020

Key Facts

1. **There is a great deal of confusion and misunderstanding in the United States about drug pricing, manufacturing, marketing, and the impact of government regulations.**

2. **Manufacturers do not set the final price of their drugs. Pharmaceutical pricing goes through a series of steps before drugs actually reach patients.**

3. **A number of bills designed to impose price controls on prescription drugs have been introduced in Washington state's 2020 legislative session.**

4. **Several of the drug pricing bills in the 2020 legislative session deal with controlling the price of insulin, a critical drug in the treatment of diabetes.**

5. **There are several reasons why insulin is so costly, mainly because there is no free market between patients and manufacturers.**

6. **The government, through patent laws, also contributes to the high pricing of insulin. The basic drug has not changed in 100 years, yet manufacturers "tweak" the formula to extend the patent on the original drug.**

7. **Price controls lead to less competition and ultimately shortages, even in the case of insulin.**

8. **Government officials can bring down costs by streamlining the drug approval process, by modifying patent laws, by promoting investment in pharmaceutical research, and by encouraging price transparency.**

Introduction

There is a great deal of confusion and misunderstanding in the United States about drug pricing, manufacturing, marketing, and the impact of government regulations. There is a growing opinion that the government should impose price controls on drugs.

Even if they worked, top-down price controls would have little effect on the cost of health care. In 2017, prescription drug costs accounted for only 10 percent of overall health care expenses in the United States.[1] Yet the prices of certain categories of drugs, for example insulin, have increased faster than the price of pharmaceuticals in general.

Congress has several pending bills that would place price controls on prescription drugs. Because of the current political climate in Washington, D.C., it is doubtful that any of these bills will become law this year.

Similarly, a number of bills have been introduced in the 2020 Washington State Legislative session designed to place controls on prescription drug prices. Given the clear one-party control in the state capitol, these price-control bills have a better chance of becoming law.

Experience shows that price controls don't work. In economics, setting price limits on goods and services always results in scarcity, with fewer of the price-controlled products being produced and made available to consumers. This has been confirmed by the disastrous centrally-planned economies of communist countries. Similar distorting effects and shortages would occur if government officials sought to control prescription drug prices.

1 "National Health Expenditures 2017 Highlights," Spending by Type of Service or Product, Centers for Medicare and Medicaid Services (CMS.gov) at https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/NationalHealthExpendData/Downloads/highlights.pdf.

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This Legislative Memo reviews several bills introduced in the Washington Legislature that would impose price controls on access to prescription drugs.

Drug price control bills introduced in 2020 legislative session

- SB 6087, to impose cost-sharing requirements for coverage of insulin products.[2]
- SB 6088, to establish a prescription drug affordability board.[3]
- SB 6113, to create a central insulin purchasing program.[4]
- HB 2662, to reduce the total cost of insulin.[5]
- HB 2464, to protect patients from excess prescription medication charges.[6]

Drug pricing is overly complex

Manufacturers do not set the final price of their drugs. Pharmaceutical pricing goes through a series of steps before drugs actually reach patients. Depending on whether people buy their medicines directly from a pharmacy or through their insurance, several transactions and multiple layers of profit are built into the system.

As seen in the graphic in Appendix A, manufacturers, in general, sell to wholesalers who then sell to pharmacies. Most, if not all, insurance companies use pharmacy benefit managers (PBMs) to negotiate the best pricing from manufacturers. Drug wholesalers and PBMs provide a service, but this comes at an added cost to the consumer.

Wholesalers and PBMs will argue that they obtain better prices from manufacturers, but these contracts and the supposed benefits are not transparent. Actual contract pricing and rebates are usually closely guarded as trade secrets and not readily available to the public. What is known is that PBM companies, in general, have higher profit margins than drug manufacturers.[7]

Drug wholesalers and pharmaceutical benefit managers may have a role in the drug market, but only if they add value for patients. Their contracts and pricing should be transparent, so consumers can decide the amount of value added and whether these middle steps in gaining access to affordable medicines are worthwhile.

Case study: The cost of insulin

Several of the drug price-control bills introduced in the 2020 legislative session would impose price-controls on the price of insulin, a critical drug in the treatment of diabetes. The body normally produces insulin to regulate the amount of glucose or sugar circulating in the blood stream.

There are two types of diabetes.[8] Patients with type 1 do not make any insulin and are completely dependent on insulin injections to survive. No substitute drug exists. Type 2 diabetics produce an insufficient amount of insulin and can usually be treated with non-insulin medications. Type 2 diabetes is often directly related to other medical conditions, such as obesity and an inactive lifestyle.

2 "SB 6087, imposing cost-sharing requirements for coverage of insulin products," Washington state legislature, introduced December 18, 2019, at https://app.leg.wa.gov/billsummary?BillNumber=6087&Initiative=false&Year=2019.

3 "SB 6088, establishing a prescription drug affordability board," Washington state legislature, introduced December 18, 2019, at https://app.leg.wa.gov/billsummary?BillNumber=6088&Initiative=false&Year=2019.

4 "SB 6113, creating a central insulint purchasing program," Washington state legislature, introduced December 24, 2019, at https://app.leg.wa.gov/billsummary?BillNumber=6113&Initiative=false&Year=2019.

5 "HB 2662, reducing the total cost of insulin," Washington state legislature, introduced January 16, 2020, at https://app.leg.wa.gov/billsummary?BillNumber=2662&Initiative=false&Year=2019.

6 "HB 2464, protecting patients from excess prescription medication charges," Washington state legislature, introduced January 14, 2020, at https://app.leg.wa.gov/billsummary?BillNumber=2464&Initiative=false&Year=2019.

7 "Profits in the 2016 Fortune 500: Manufacturers vs. Wholesalers, PBMs, and Pharmacies," by A.J. Fein, Drug Channels, June 21, 2016, at https://www.drugchannels.net/2016/06/profits-in-2016-fortune-500.html.

8 "Diabetes: The differences between types 1 and 2," by H. Nichols, Medical News Today, March 25, 2019, at https://www.medicalnewstoday.com/articles/7504.php.

In 2017, 623,000 adults had diabetes in Washington state with over 90 percent in the type 2 category. An additional 4,500 children under the age of 20 years suffered from diabetes, with most of them in the type 1 category.[9]

Artificial insulin was first manufactured in the 1920s and continues to be produced in essentially the same form. Currently, there are only three companies that manufacture insulin. The retail price of insulin has tripled since 2002 and has increased by over 60 percent since 2014.[10]

Current list price for a single vial of insulin can reach $300 to $400, although the manufactured cost is just three to six dollars per vial.[11] A number of public subsidy programs for insulin are available. All three manufacturers appear to increase prices by similar amounts at the same time.

Why is the retail price of insulin so high?

There are several reasons why insulin is so costly, beginning with the fact that there is no competitive free market between patients and manufacturers. As noted above, insurance companies, pharmaceutical benefit managers, employers, and retail pharmacies all contribute to the high price of insulin that patients actually pay.

Unlike other economic areas, patients cannot act as true consumers and shop directly for the best prices. Patients are at the mercy of whatever discount price their insurer or PBM is willing to negotiate or whatever the near-monopoly, non-competitive retail price is.

The government, through patent laws, also contributes to the high pricing of insulin. The formula of the basic drug has not changed in nearly 100 years, yet manufacturers continue to "tweak" the formula, which extends the patent on the original drug. This manipulation of the patent system effectively blocks generic drug manufacturers from entering the market place with a cheaper alternative and thus severely limits competition. The government determines patent laws and the original manufacturers are simply allowed to exploit this loophole.

Alternatives to insulin price controls

In a positive development, competition in the marketplace is getting started. One of the three manufacturers, Eli Lilly, has voluntarily dropped its price of insulin by 50 percent to $137 per vial.[12] It is hoped that the other two manufacturers will also drop their prices.

The Juvenile Diabetes Research Foundation also provides a list of charity organizations that offer deeply discounted or subsidized pricing on insulin for low-income patients.[13]

Walmart now offers a non-traditional form of insulin called ReliOn at an affordable price.[14] The drug works a bit differently than the traditional manufactured insulin, so patients need to consult with their doctors for appropriate doses and frequency of use.

Policy analysis – price controls would not solve the problem

Putting price controls on drugs would not solve the fundamental problem of our health care delivery system. Unlike other economic markets, in health care a third party, either the government through Medicare, Medicaid and

9 "Diabetes Epidemic Action Report," Collaborative report to the Washington state legislature from the Department of Health, Department of Social and Health Services, and State Health Care Authority on proviso on 2015 Senate Bill 6052, 2017, at https://www.doh.wa.gov/Portals/1/Documents/Pubs/345-349-DiabetesEpidemicActionReport.pdf.

10 "The rising price of insulin," by J. Rosenfeld, Medical Economics, April 3, 2019, at https://www.medicaleconomics.com/article/rising-price-insulin.

11 "Insulin prices could be much lower and drug makers would still make healthy profits," by E. Silverman, Business Insider, September 26, 2018, at https://www.businessinsideyr.com/insulin-prices-could-be-much-lower-and-drug-makers-would-still-make-healthy-profits-2018-9.

12 "The rising price of insulin," by J. Rosenfeld, Medical Economics, April 3, 2019, at https://www.medicaleconomics.com/article/rising-price-insulin.

13 Ibid.

14 "ReliOn Insulin: Everything You Need to Know," by E. Almekinder, The Diabetes Council, September 15, 2018, at https://www.thediabetescouncil.com/relion-insulin-everything-need-know/.

Obamacare, or employers through insurance companies, pays for the majority of health care in the United States. Drug wholesalers and pharmaceutical benefit managers may negotiate better drug pricing, but this comes at a cost that is not readily transparent.

Patients, as consumers of health care, and doctors as providers, are isolated from the actual costs of drugs and treatments. Price transparency is mandatory for patients to become true consumers of health care. Forcing drug manufacturers to compete on both quality and price would drive patient-costs down, just as competition has driven down the price of computers, cell phones, food and other essentials of modern life.

In contrast, imposing price controls would make the situation worse. Price controls lead to less competition and ultimately shortages, even in the case of insulin. On the other hand, government officials can bring down costs by streamlining the drug approval process, by modifying patent laws to prevent "tweaking" by the largest companies (which adds nothing to the effectiveness of the original drug), by promoting investment in pharmaceutical research, and by encouraging price transparency.

Conclusion

Throughout our economy, a vigorous and creative free market, without third party interference, results in better products at cheaper prices every day, with constant improvement for consumers.

Allowing patients, in consultation with their providers, to decide which drugs are best clinically and financially for them should be the goal of health care reform, not damaging price controls.

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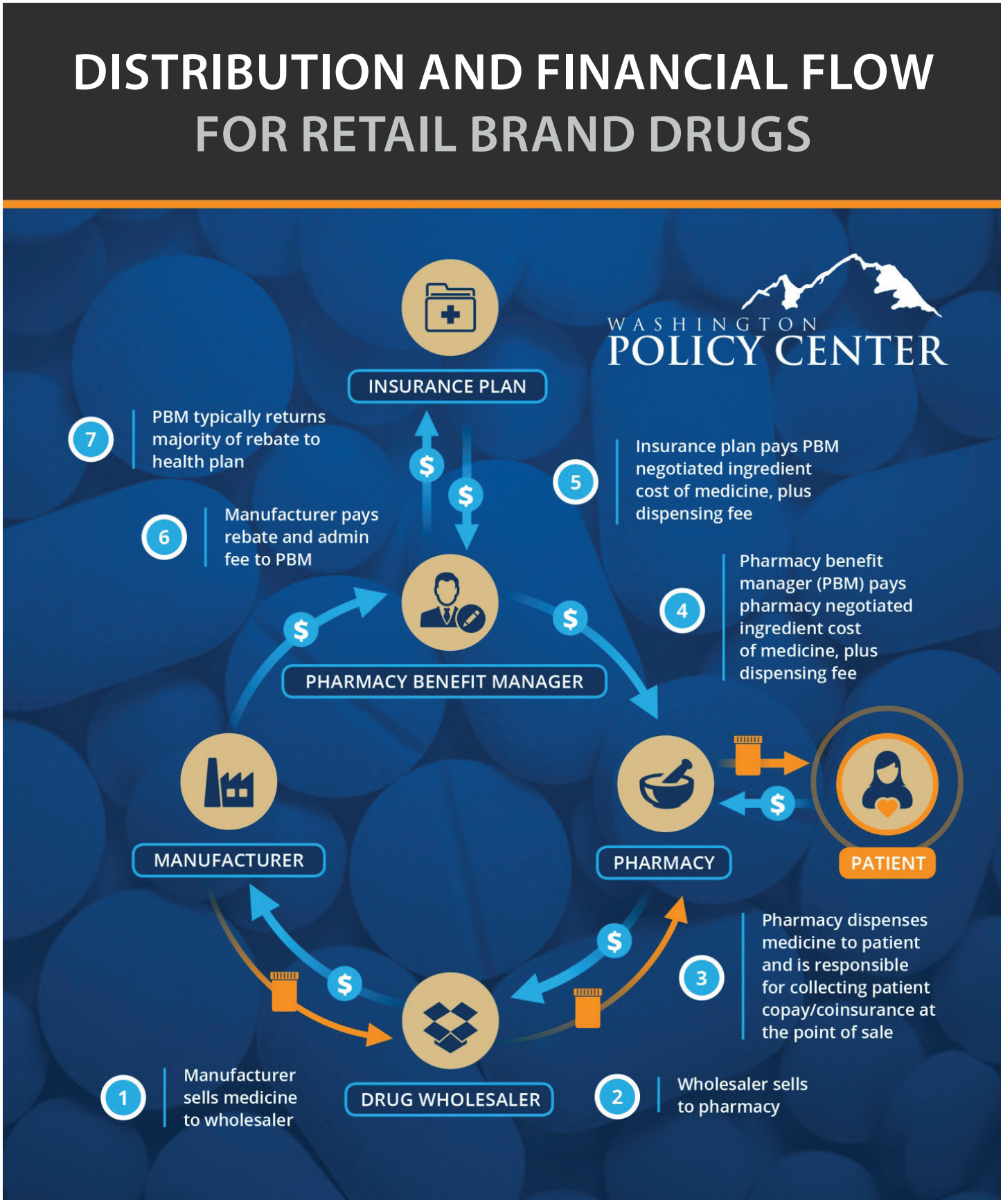
Appendix A



This graphic originally appeared in the 2017 Policy Note: *Prescription Drug Pricing - A complex, poorly understood issue.*