Making dollars and sense out of drug prices

By Dr. Roger Stark, MD, FACS

Presidential candidates Hillary Clinton and Bernie Sanders, as well as many other elected officials, are demanding that the government impose price controls on medicines as a way to bring down health care costs. In 2013, prescription drug costs accounted for just nine percent of overall health care expenses. In economics, setting price limits on goods and services always results in scarcity, with fewer of those things being produced and made available to consumers. This has been confirmed by the disastrous centrally-planned economies of communist countries.

There is a great deal of confusion and misunderstanding about drug pricing, manufacturing, marketing and the impact of government regulations in the United States. This confusion has only been made worse by the recent egregious behavior of Turing Pharmaceuticals which raised the price of Daraprim, a drug that fights parasitic infections, by 4,100 percent.

Only five percent of drugs make it through clinical trials and go on to be marketed and make money for their manufacturers. Over 95 percent of research on new drugs fail to produce treatments and lose money. The final pricing of the successful drug must make up for all the money spent on the research and development (R&D) of all the previous failures.

On average, the ten largest drug manufacturers spend 16 percent of their total revenue on R&D. A better comparison across industries is the percent of sales spent on R&D. According to the National Science Foundation, in 2013 the average of sales profit across all industries spent on R&D was 3.3 percent. The pharmaceutical industry spent 10.3 percent of total sales profit on R&D, about the same as the computer and electronic industry which was 10.6 percent.

Drug companies are heavily criticized for their large advertizing budgets. However, research shows that there is a substantial range for what pharmaceutical manufactures spend on marketing. According to the BBC News, in 2013 the ten largest drug companies spent between 17.9 percent and 28.4 percent of total revenue on advertiseing. The average was 23 percent. Compare that to the 21 to 23 percent that IBM and Microsoft spend on marketing.

Just as professional athletes command large salaries because of their time-limited careers, innovative drug manufacturers have a limited amount of time to earn a profit on a drug before the patent expires. Once a drug goes “off patent,” it must compete with generic drugs. Generic manufacturers have a definite role in the health care system and can offer good prices, but they don’t have the added expense of R&D.
Government price controls not only limit the supply of a product, they also limit the interest of financial investors in a company. Seattle biopharmaceutical companies experienced this recently when their stock prices dropped 13 percent in one week (falling six percent in one day!) simply because of Secretary Clinton’s price-control announcement. Fewer investors mean less money for life-saving new drugs and less competition in developing those drugs.

The high prices of new pharmaceuticals must also be weighed in comparison to the cost of treating a patient without that drug. For example, Sovaldi is a drug that treats hepatitis C and costs $84,000 for a curative three month treatment. The alternative, a liver transplant, costs over $300,000 and is associated with a great deal of pain and suffering, assuming a donor liver is even available.

If politicians really want to bring prices down and increase competition in the drug industry, they should focus on streamlining the drug approval process to decrease the time and money manufacturers spend on bringing a new drug to market. Depending on the study, the average cost of bringing a drug to market today is $2.5 to $5 billion and takes 10 to 15 years to get through the government regulatory process.

Putting price controls on drugs will not solve the fundamental problem of our health care delivery system. Unlike the electronics or computer markets, in health care a third party, either the government through Medicare, Medicaid and Obamacare, or employers through insurance companies, pays for the majority of health care in the United States.

Throughout our economy, the free market, without third party interference, results in better products at cheaper prices. 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.