

The Medicare Drug Benefit & Pharmaceutical Companies' Financial Well-Being

February 2004

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Outline

- Immediate Effects
 - Price / Volume Tradeoffs
 - Managed Care Gains Negotiating Power
- Eventual Effects
 - Government Transitions from Price Taker to Price Maker
 - Generic Biologics

- U.S. Seniors' relative drug consumption spans a very broad range
- '06 narrows this range by both increasing consumption of un-insured, and lowering the consumption of those presently insured

	<u>% of US Seniors with Drug Coverage From a Particular Source*</u>	<u>Total Annual Spending According to Source of Cov'g**</u>	<u>Effective Price Relative to Those With No Drug Coverage</u>	X	<u>Volume Relative to Those With No Drug Coverage</u>	=	<u>Spending Relative to Those With No Drug Coverage</u>
Medicaid	10%	\$ 2,864	0.8		2.6		2.1
Employer-Sponsored	28%	2,775	0.9		2.2		2.0
Other Public	2%	2,513	0.8		2.3		1.9
Medigap ***	7%	2,091	0.9		1.7		1.5
Medicare HMO ***	15%	2,091	0.9		1.7		1.5
No Coverage	38%	1,356	1.0		1.0		1.0
Wtd. Avg.		\$ 2,089					

* Laschober et al., Health Affairs, Feb 2002
 ** Kaiser Family Foundation Medicare and Prescription Drug Spending Chartpack, June 2003
 *** The Kaiser study lumps these two together for purposes of reporting avg. annual spending

Worst-case, seniors' consumption equalizes, total \$ sales to seniors fall 12%, even though unit consumption rises

		% of US Seniors with Drug Coverage From a Particular Source*	Total Annual Spending According to Source of Cov'g**	Effective Price Relative to Those With No Drug Coverage	X	Volume Relative to Those With No Drug Coverage	=	Spending Relative to Those With No Drug Coverage
formerly	Medicaid	10%	\$ 1,838	0.8		1.7		1.4
"	Employer-Sponsored	28%	1,838	0.8		1.7		1.4
"	Other Public	2%	1,838	0.8		1.7		1.4
"	Medigap ***	7%	1,838	0.8		1.7		1.4
"	Medicare HMO ***	15%	1,838	0.8		1.7		1.4
"	No Coverage	38%	1,844	0.8		1.7		1.4
	Wtd. Avg.		\$ 1,840					

* Laschober et al., Health Affairs, Feb 2002
 ** Kaiser Family Foundation Medicare and Prescription Drug Spending Chartpack, June 2003
 *** The Kaiser study lumps these two together for purposes of reporting avg. annual spending

- **Critical to the price / volume question are employers' actions with respect to retirees**
- **Even with subsidies, it's cheaper for employers to cancel generous coverage**
- **Subsidies can't offset employers' financial motive -- \$1480 / senior savings to employers is greater than government's per-senior expense**

	<u>Annual Expense</u>	<u>Annual Savings</u>
current annual drug cost per retiree	\$ 1,900	
after 28% subsidy for costs between \$250 and \$5000	1,438	\$ 462
cost of putting retiree into Medicare and paying his/her premiums	420	1,480

If 1/2 of retirees go to Medicare, industry breaks even; more than 1/2, industry loses \$'s

	Per-Senior \$ <u>Consumption</u>	Change in Per-Senior <u>Consumption</u>	Change in US Retail <u>\$ Market</u>	Change in US Retail <u>Volume</u>	Change in US Retail <u>Gross Profit</u>
all retirees stay	\$ 2,274	9%	3.4%	6.1%	2%
half retirees go to Medicare plan	\$ 2,130	2%	0.7%	4.2%	0%
3/4ths retirees go to Medicare plan	\$ 2,071	-1%	-0.3%	3.4%	-1%
all retirees go to Medicare plan	\$ 2,014	-4%	-1.4%	2.7%	-2%
all seniors consume at the estimated Medicare amount	\$ 1,840	-12%	-4.5%	0%	-4%
memo:					
current situation	\$ 2,089				

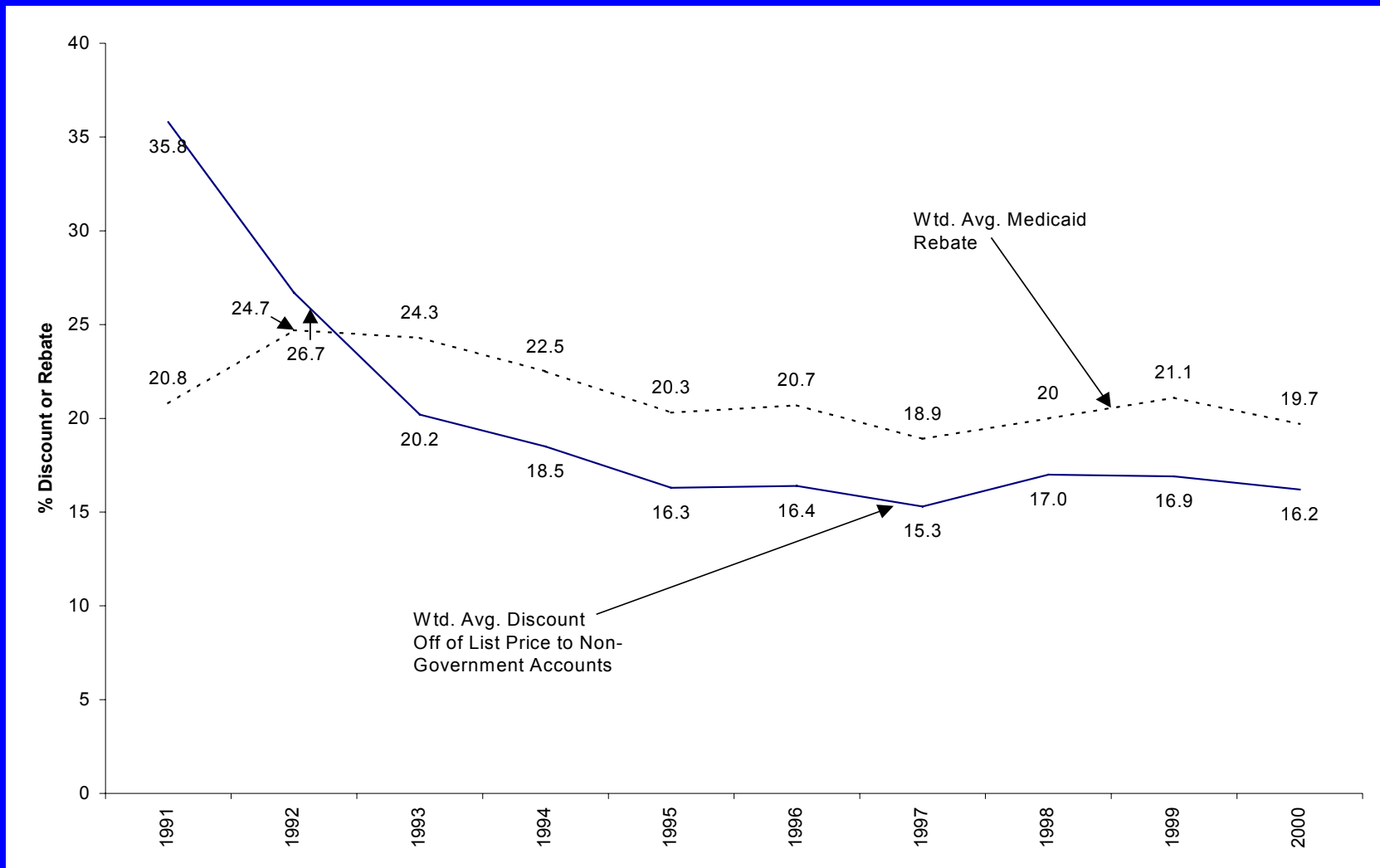
* Laschober et al., Health Affairs, Feb 2002
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Immediate Effects - Managed Care Gains Negotiating Power

- **Industry may have as much to fear from themselves as from government**
- **States by law get 15.1% off of list, or best price, whichever is lower**
- **States today are 16% of U.S. retail purchases; the largest non-gov't buyer is 4%**
- **Individual non-gov't buyers have difficulty getting manufacturers to break best price; profit gained by 'saving' an account is lost to increased rebates owed the states**

Immediate Effects - Managed Care Gains Negotiating Power

The history of drug rebates post-Obra '90 illustrates the inflationary effect of Medicare best price provisions on drug pricing to non-gov't buyers



Source: Anna Cook, PhD, Mathematica Policy Research; Secondary from CBO and HHS

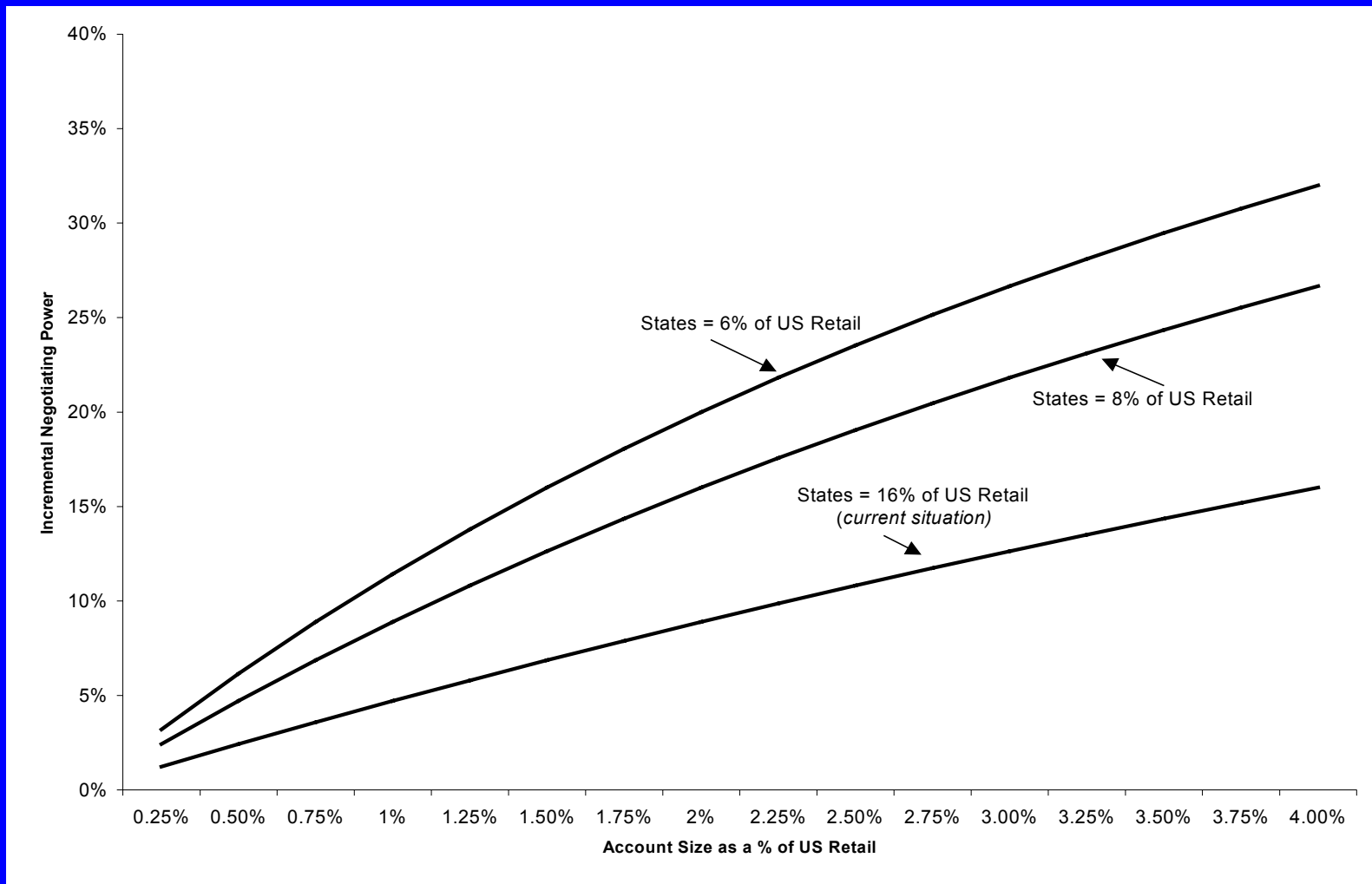
Immediate Effects - Managed Care Gains Negotiating Power

When the drug benefit goes live in '06, seniors drug coverage moves from Medicaid to Medicare, reducing states' purchase share to 6-8% ... much closer to the level of non-gov't buyers

	Total Membership (millions)	Share of Total Membership	Implied Share of US Retail
BCBS System	58	30%	13%
United Health Group	18.3	9%	4%
WellPoint	14	7%	3%
Aetna	13	7%	3%
Anthem	11.8	6%	3%
CIGNA	11.8	6%	3%
Kaiser	8.4	4%	2%
Humana	6.6	3%	2%
HealthNet	5.3	3%	1%
WellChoice	4.8	2%	1%
PacifiCare	2.9	1%	1%
Coventry	2.4	1%	1%
Mid-Atlantic Medical	2	1%	0%
Oxford	1.6	1%	0%
Sierra Health	1.2	1%	0%
United American Health	0.2	0%	0%
Other	31.6	16%	7%
Total	193.9	100%	45%

Immediate Effects - Managed Care Gains Negotiating Power

As states' purchases shrink, so does the cost of breaking best price ---
meaning the average non-gov't buyer can demand a bigger discount



Government becomes a dominant buyer in '06, moving from 16% purchase share to roughly 45% --- and from price taker to price maker

	<u>Gov't Purchase Share of US Retail \$ Market</u>	<u>cumul.</u>
present situation	16%	
<i>add uninsured seniors</i>	14%	30%
<i>add Medicare HMO, Medigap, and Other Public</i>	9%	40%
<i>add Retirees</i>	11%	50%

Eventual Effects - Gov't as a Price Maker

- Why do we care? Innovation is 1/2 of industry's growth -- selling new tech at a premium to outdated tech
- Dominant buyers (e.g. Western Europeans, Japan) classically have exerted buyer power by limiting re-imburement for new tech, thus lowering the innovation premium

Change in # Persons:	0.95%	←	US Census Middle Series Projections
Change in # Pills / Person:	2.2%		
<i>Aging Effect:</i>	0.40%	←	Milliman USA, Bernstein Analysis
<i>Innovation Effect:</i>	0.90%	←	historic average sum for these two is 1.8%
<i>Elasticity Effect:</i>	0.90%	←	
Change in \$'s / Pill	8.4%		
<i>List Price Change:</i>	5.7%	←	20 yr. Average
<i>Innovation:</i>	5.6%	←	20 yr. Average
<i>Patent Expirations:</i>	-3.0%	←	20 yr. Average
Total Growth:	12%		

- **Today government buys 16% of US retail; the fact that biologics have perpetual exclusivity is a nuisance, but not a legislative priority**
- **In '06, gov't buys 45% (and rising) of US retail; the fact that an increasing proportion of these products are biologics, and that they commoditize slowly, if ever, is a legislative priority**
- **Obvious and complex technical challenges, but the economic motive to tackle those challenges is enormous**

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