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In cooperation with Dean Baker, Ph.D.

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Executive Summary:

Legislation that would allow Medicare to use its bulk purchasing power to negotiate for lower prescription drug prices could save American taxpayers and seniors more than $30 billion annually. About $10 billion of these savings would accrue to American seniors in the form of cheaper prices. This is very significant, as the whole purpose of Part D was to help American seniors access vital prescription drugs. The median per capita income for American retirees is only $14,664[1] yet seniors require the most prescription drugs of any group of Americans. People 75 years of age and older take an average of 7.9 drugs per person per day.[2]

The U.S. government could save roughly $20 billion a year by having Medicare negotiate for the same prices the Veteran's Administration already gets. Under pay-go budget rules, this represents an important source of savings that could be used to fund other programs. In fact, the potential savings from just two drugs alone (Lipitor and Zucor) could entirely fund the shortfalls faced by states' SCHIP programs (State Children's Health Insurance Program) and ensure that more American children have adequate health coverage.

Legislation to allow negotiation overwhelmingly passed the House in January and will soon be debated in the Senate. Groups like the AARP, Families USA, the Alliance for Retired Americans, the National Committee to Preserve Social Security and Medicare, US Action and Campaign for America's Future have mobilized to help pass this legislation. However, the pharmaceutical industry – with its annual lobbying budget of over $100 million - is also mobilizing to protect its excess profits by opposing any changes to Part D.

In addition to the tremendous savings offered by allowing Medicare to negotiate for lower prices, there is also an opportunity to save more than $5 billion a year in administrative costs by allowing seniors to get their benefits directly from Medicare. Both of these ideas are very popular with the American people, being favored by 85% and 76% of American adults, respectively. If both enacted, this could save American seniors and taxpayers more than $35 billion dollars annually.

Introduction:

The Part D prescription drug program that went into effect in 2006 was created by the 2003 Medicare Modernization Act. One of its most controversial aspects was a provision that expressly forbid Medicare from negotiating for lower prescription drug prices. Repealing this provision and allowing the government to negotiate for cheaper prices could save U.S. taxpayers and seniors more then $30 billion a year.

The provision forbidding price negotiation in the original bill is surprising. Every other industrialized nation achieves significant savings from price negotiation. This is largely why the U.S. consumers pays 52% more than British, 67% more than Canadian, and 92% more than French consumers for a market basket of 30 drugs.[3] Furthermore, the U.S. government has first hand experience with Medicaid, the Veterans Administration (VA) and Department of Defense (DOD) in obtaining significant savings by price negotiation. While the CMS generously suggests that private plans are able to negotiate to pay only 73% of the average wholesale price, Medicaid only pays only 51%, the VA only pays 42%, and the DOD pays only 41% of the average whole prices.[4]

This paper examines the savings from the Veterans Administration to show that roughly $30 billion could be saved each and every year if Medicare was allowed to negotiate for the same low prices that are obtained by the VA. This is an especially relevant as the Senate will soon decide whether to follow the House of Representatives' lead in repealing the law that forbids Medicare from negotiating for lower drug prices. A major element of the platform that helped Democrats take control of both chambers of Congress in the 2006 elections was proposing to save taxpayers and seniors money by negotiating for cheaper prescription drugs as a major part of their platform. The House Democrats made negotiating for lower prices part of their "100 hours agenda" and passed HR 4, the Medicare Prescription Drug Price Negotiation Act of 2007, to allow Medicare to negotiate for lower prices by a vote of 255 – 170.[5] Under this proposal the Secretary of the Department of Health and Human Services would be empowered to negotiate for lower prices and would have to report back to Congress on the program's success. The large margins by which the bill passed demonstrates the strong bipartisan support drug-price negotiation has in the House. Negotiating for lower prices is certainly as popular with the American people: polling has shown that 85% of American adults favor allowing the federal government to use its buying power to negotiate with drug companies to get lower prices for Medicare prescription drugs.[6]

The Savings From Negotiation

The main reason Americans favor having Medicare negotiate is the promise of cheaper prescription drug prices which would save both seniors and taxpayers money. That negotiating works is clearly evident when comparing drug prices under Part D to those of the Veterans Administration, which uses its bulk purchasing power to negotiate better deals. For the top 20 most-prescribed drugs, the lowest price offered by any Medicare prescription drug plan was at least 48.2% higher then the lowest price the VA was able to negotiate.[7] In the prices of the five largest Part D private insurers - who serve about 2 out of every three Part D beneficiaries – the top 10 drugs prescribed to seniors have a median difference that was 58% more expensive than prices for the VA.[8]

Clearly negotiating for lower prices has allowed the VA to obtain cheaper prescription drugs, but how much could this save Medicare? It is estimated that negotiating for lower prices would save a whopping $30 billion a year. Looking at the numbers below, it is easy to figure out how.

Under Part D, the CBO projects that the gross government spending for prescription drugs in 2008 under Part D will be about $52 billion. Assuming that the government is covering 2/3rds of all prescription drug spending, with individual seniors covering a third of costs, the total gross prescription drug spending for Medicare enrollees will be approximately $78 billion.[9] Approximately $5 billion of this pays for the excessive administrative costs, which still leaves $73 billion in prescription drug expenditures. If Medicare was able to negotiate similarly to the VA and get prices reduced by 40%, the effect would be savings of roughly $30 billion a year.

The potential annual savings from negotiating are also evident from looking at several particular drugs. Merck's Zucor and Pfizer's Lipitor are both top-selling prescriptions that, if sold at the VA's negotiated price would save U.S. taxpayers and seniors more then $2.8 billion annually, enough to fully fund the shortfall states face with the State Children's Health Insurance Program (SCHIP).[10] Table 1 below, compares the VA's negotiated prices to the lowest and highest prices under Part D. If Medicare was allowed to negotiate down to VA prices, the savings from just these two drugs alone account for over $2.8 billion a year.

Table 1: Potential savings for two prescription drugs: Lipitor and Zocor [11]

Manufacturer	Drug	Annual Prescriptions (millions)	Prices (in Dollars) VA	Part D (low)	Part D (high)	Excess Profits (in millions of dollars)
Pfizer	Lipitor (10 mg)	31.6	$520	$749	$927	$530
Pfizer	Lipitor (20 mg)	31.6	$782	$1,068	$1,302	$670
Merck	Zocor (20 mg)	11.2	$127	$1,275	$1,776	$856
Merck	Zocor (40 mg)	11.2	$191	$1,275	$1,711	$800
						$2.85 billion

This $30 billion a year is one of the easiest and largest sources of savings available to the Federal Government. By negotiating for all drugs, Congress could save enough money to not only fund current SCHIP obligations but would have enough savings to expand it to cover nearly all uninsured American Children.

Although ultimately a political decision, it is also worth examining who could benefit from these savings. Of the $30 billion in potential savings, approximately $10 billion a year would go to American seniors who would pay less under their Part D plans. As the very *raison d'etre* of Part D is to help these struggling seniors access necessary prescription drugs, it makes perfect sense to use the leverage of Medicare's bulk purchasing power in the market to help them.

Furthermore, negotiating for lower prices would save American taxpayers over $20 billion a year. This is especially significant under current pay-go budgeting rules that mandate additional spending be offset elsewhere in the budget. This $20 billion in savings could be used to help eliminate the doughnut hole coverage gap in Part D or to fund shortfalls and expansions of other vital programs like the SCHIP funding for Children's health care.

Administrative Savings

In addition to the savings that would be made possible by negotiating for lower prices, there are also administrative savings that could be gained by restructuring the benefit. The administrative expense of running the Medicare program accounts for only 3% of Medicare spending.[12] By contrast, the amount of every premium dollar retained by private insurance companies for marketing, administration and profit is 14%.[13] The Congressional Budget Office has projected that the marketing and the profits of the insurance industry would add $38 billion in costs in the first seven years of the program. Compare this to a benefit administered by Medicare and there is a possibility to save over $5 billion a year.[14]

If Medicare offered a benefit directly to seniors, much of these costs could be eliminated with the added benefit of making signing up for Part D would be much easier for many seniors and their families. Currently, seniors signing up for Part D average around eight hours to pick a plan.[15] A direct benefit from Medicare would simplify the process for millions of seniors and save significant time. If seniors', and their families', time was valued at the minimum paid wage of $5.15 per hour, the loss of their time in having to choose among the plethora of competing private companies would be worth over $395 million.[16]

Having a benefit administered directly by Medicare is also very popular with the American public. In fact, more than three out of every four American adults (76%) favor Allowing seniors the choice of obtaining their prescription drug plan directly from Medicare- instead of from a private insurance company.[17]

$34 Billion in Potential Savings

While the House bill (presumably the Senate bill will be similar) only goes after the savings of price negotiation, it could also seek the benefits of having a Part D plan run directly by Medicare, making the savings even more significant. It is estimated that the combined savings could be over $34 billion a year.

Conclusion

If the Senate follows the House in passing legislation that will allow Medicare to negotiate for cheaper prescription drugs, the result will be savings for seniors, for the Medicare Part D program, and for the health care system as a whole. These kinds of policy changes offer significant savings for the government that, in this era of pay-go budgeting, could be used to fund other vital programs or to help fill in the Part D coverage gap known as the doughnut hole. The Senate has spent a great deal of its times

focusing on reforming lobbying and ethics rules. The proposed changes in the Medicare Part D law would undo the legislative provisions that were only inserted into law only because of special interest lobbying combined with the K-Street influence peddling of the previous Congress. Allowing Medicare to negotiate for lower drug prices would bring around $30 billion in savings that can help American seniors and taxpayers.

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2 Medication Digest," by the American Pharmacists Association, 2003. Available at: http://www.pharmacist.com/pdf/MedDigest.pdf.
3 Testimony of Dr. Gerard Anderson before the House Oversight and Government Reform Committee. Feb, 2007. Available at: http://oversight.house.gov/Documents/20070209123654-09260.pdf
4 Ibid.
5 Roll Call vote 23, 1/12/07. Available at: http://clerk.house.gov/evs/2007/roll023.xml
6 "The Public's Health Care Agenda for the New Congress and Presidential Campaign," The Kaiser Family Foundation/Harvard School of Public Health, December, 2006. Available at: http://www.kff.org/kaiserpolls/upload/7598.pdf
7 "Falling Short: Medicare Prescription Drug Plans Offer Meager Savings". Families USA. 12/2005. Available at: http://www.familiesusa.org/assets/pdfs/PDP-vs-VA-prices-special-report.pdf
8 "No Bargain: Medicare Drug Plans Deliver High Prices." Families USA. 1/2007. Available at: http://www.familiesusa.org/assets/pdfs/no-bargain-medicare-drug.pdf
9 Note: this is only a rough estimate. The actual benefit is structured so that the in 2007 individual seniors pay the first $275 deductible, then 25% of their costs until they hit $2,471 in total costs. Then they enter the doughnut hole coverage gap where the individual senior pays 100% of the costs. Once they hit the $5,596 in total prescription drug spending, the individual senior pays only 5% of all remaining costs. The aggregate of all of these transactions means that the government roughly spends 2/3rds of the costs while the seniors pay the other 1/3rd.
10 Based on the $2.7 billion annual average in additional federal funding that the CBO has estimated is necessary over the next 5 years to shore up state shortfalls in providing current benefits under current eligibility rules. Robert Pear, 1/25/2007.
11 "The Origins of the Doughnut Hole: Excess Profits on Prescription Drugs," CEPR, 8/2006. Available at: http://www.cepr.net/publications/part_d_drug_profits_2006_08.pdf
12 CMS, Office of the Actuary, National Health Expenditures, Table 11. Calendar year 2005. Available at: http://www.cms.hhs.gov/NationalHealthExpendData/downloads/tables.pdf
13 Medicare For All: Quality, Affordable, Health Care for All Americans," by the Senate Committee on Health, Education, Labor, and Pensions. Available at: http://energycommerce.house.gov/medicare/M4A_factsheet.pdf
14 Congressional Budget Office, 2004a. "A Detailed Description of CBO's Cost Estimate for the Medicare Prescription Drug Benefit," Washington, D.C.: Congressional Budget Office, Table 3. Available at: http://www.cbo.gov/showdoc.cfm?index=5668&sequence=0
15 Post Pushes Drug Industry Line, Again," by Dean Baker, The American Prospect Online Edition. 1/13/07.
16 For this calculation we take only the 10,976,906 enrollees of private PDPs (those auto enrolled in the low income subsidy or in Medicare Advantage plans are not counted). We also assume a plan directly from Medicare would still take an hour to enroll into.
17 The Public's Health Care Agenda for the New Congress and Presidential Campaign," The Kaiser Family Foundation/Harvard School of Public Health, December, 2006. Available at: http://www.kff.org/kaiserpolls/upload/7598.pdf