CITIZENS RESEARCH COUNCIL OF MICHIGAN

"***The right to criticize government is also an obligation to know what you're talking about.***"
Lent Upson, First Director of the Citizens Research Council

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Fighting the Rise of Prescription Drug Costs

In a Nutshell

- Prescription drugs are a significant public and private expenditure in the United States and costs are rising.
- No single policy solution exists to reverse the high and rising costs of prescription drugs, but a variety of proposals are being piloted around the country.
- Establishing a state-level agency to gather data and review costs; state-sponsored prescription drug manufacturing; overseas importation; and bulk purchasing are all options Michigan should seriously consider as it works to reduce costs.

Prescription drugs are a major component of health care for people in every developed country. Over 60 percent of adults in the United States report using prescription drugs, with nearly half of those adults taking four or more drugs. Given the importance of prescription drugs to the overall health of the population, the cost of delivering those drugs is a vital matter of economic, physical, and mental well-being.

The United States spends more on prescription drugs per capita than its peer nations, and the gap is widening. Costly prescription drugs have negative economic consequences and lead people to not take their medications as prescribed, which can lead to a range of negative health outcomes.

The cost drivers of prescription drugs are complicated and interdependent, but the federal government and states have a variety of policy options to pursue to combat rising costs, including price regulation, increasing supply, and greater transparency. No single policy is going to solve the prescription drug cost problem in Michigan, but several options call for careful consideration.

Prescription Drugs are Increasingly Expensive

Prescription drugs are a significant public and private expenditure in the United States, totaling approximately $603 billion in 2021. Costs are on the rise, as inflation-adjusted spending on prescription drugs rose 16 percent between 2016 and 2021.

While prescription drugs are a part of the cost puzzle in every country, expenditures are particularly high in |the United States relative to other developed countries. Between 2004 and 2013, per capita prescription drug expenditures in the United States were about 1.7 times greater than the average of comparable counties, but this gap grew by another 20 percent by 2019. While this discrepancy is not new, it is important to note that the United States was in line with many of its peers as recently as the mid-1990s.

While the high cost of prescription drugs is a problem across the country, spending on prescription drugs is higher in Michigan than the national average (on a total and per capita basis), in part because Michigan residents use prescription drugs at higher rates than people in 36 other states.

Reining in Prescription Drug Costs

Reducing the total and out-of-pocket costs of prescription drugs is an important policy issue. About 30 percent of people in the United States have reported not taking their prescriptions as directed due to high costs, which

is greater than the percentage in comparable countries. Failing to take medication as prescribed has numerous downstream health complications that can lead to worse health outcomes and higher spending on more intensive treatments later. One survey found that patients who experience prescription drug price increases are more likely to delay visits to the doctor and other medical tests than those who did not experience price increases.

The factors that shape the cost of prescription drugs are complex and interdependent. The size of the population, overall prescription drug utilization, the type of prescription drugs being consumed (e.g., name-brand vs generic), retail drug prices, and the nature of health care financing all play a role in how much a country spends on prescription drugs. As a result of these complexities, there is no single policy solution to the high and rising costs of prescription drugs.

There are, however, interventions to rein in the costs and make lifesaving and life-improving drugs more affordable.

Prescription drug policy is ripe for federal action given the interstate nature of the pharmaceutical market and the fact that the problem exists in every state. A variety of proposals seek to drive down costs at the national level. For example, the federal Inflation Reduction Act has several provisions aimed at reducing the cost of prescription drugs, mostly related to those covered by Medicare. Broader ideas have been proposed and debated, including expanded price negotiation provisions, caps on annual price increases, allowing purchases from abroad, patent reform, and regulatory changes, among others.

While federal action makes sense because the problem touches every part of the country, states have policy tools at their disposal to address issues within their borders as well. Given the scale of the problem and the uncertainty around the federal appetite for greater reform, states have been looking at a variety of different options for combatting the high cost of prescription drugs.

State Options for Addressing Prescription Drug Costs

In recent years, several state-level policies have been put forward to address rising prescription drug costs. These policies aim to address the direct cost burden on individuals, as well as health care system costs generally. Proposals fall broadly into three related categories: price regulations; efforts to increase supply; and transparency and information. Policies in each of these categories have been introduced in multiple state legislatures, including Michigan, and many have been enacted into law in at least a few states.

Direct Price Regulation

Public conversations about prescription drug costs often focus on the prices paid by consumers, and many policies are aimed at regulating out-of-pocket costs and/or the prices of specific drugs. Twenty-eight states have enacted laws establishing some sort of limit on consumer cost sharing for one or more prescription drugs, such as out-of-pocket caps on the price of insulin. In essence, these laws are designed to reduce out-of-pocket expenses for individuals covered by public and private health plans. While these policies benefit individuals who use various prescription drugs, the policies generally do not drive down system-level costs because the policies do not limit how much pharmaceutical companies can charge insurers. When insurers are required to pay a higher share of the cost of specific drugs, they typically offset the costs by raising premiums, meaning that out-of-pocket caps redistribute overall costs rather than reduce them.

Other proposals that directly regulate costs include limits on annual price increases, limits on price gouging, requiring the use of reference rates to set prices (i.e., tying prices to the prices paid by some entity, such as Medicare), and mandating justifications for some price increases. These policies are designed to lower out-of-pocket costs of individuals, but also address broader health care system costs because the limits apply to the amounts paid by insurers. The logic of these proposals is clear, as they would limit the ability of pharmaceutical companies to raise prices. But, this level of regulation may generate undesired economic impacts, such as pharmaceutical companies choosing not to sell their products in the state or shifting costs to other parts of their business.

Every state has enacted laws related to pharmacy benefits managers, or organizations that manage prescription benefits on behalf of insurers, but the stringency of oversight and the nature of regulations varies. Concerns exist that pharmacy benefits managers have historically established agreements with insurers and providers that are complicated and sometimes confidential, making it difficult to understand the difference between the amount they charge insurers for prescription drugs and the amount they pay to pharmacies. The overall goal of these policies is to ensure prescription drug costs are not inflated by pharmacy benefits managers earning excessive profits by limiting what regulatory agencies and the public know about these agreements. A federal review of state pharmacy benefits manager laws identified the authority of the state regulatory body as a key variable in program success.

Finally, nine states have enacted laws creating affordability review boards that are tasked with identifying high-cost prescription drugs, evaluating the appropriate costs of those drugs, and setting or recommending an upper limit on the price of the drugs. The boards are generally independent bodies appointed by the governor consisting of experts in health policy, health economics, and clinical practice. The specific provisions vary across states, but the general focus of these entities is to leverage the state's role in purchasing medication (e.g., through Medicaid) as a means to drive down costs. This approach may stop short of price regulation, as limits would only be imposed based on a thorough review of the costs. States are relatively early on in the process of implementing these boards, so their impact on drug costs is not yet known. Legislation to establish a board in Michigan passed the Senate this session and is under consideration in the House.

Increasing Supply

States have designed policies to address "supply-side" factors in efforts to bring down costs. Federal debate about importing drugs from overseas has been happening for years, but states have just begun to take direct action. Eight states have enacted laws establishing some form of a drug importation program. Federal law has technically permitted state importation programs since the early 2000s, but necessary regulations were not in place to allow state programs to operate until 2020, so the first programs are just coming into effect. The real-world savings are not yet known, but there is a potential to reduce costs through importation, as Florida and Colorado estimated an annual savings of $183 million and $51 million, respectively.

The arguments in favor of importation are relatively straightforward. Prescription drugs are cheaper in other countries and a program that facilitates bulk purchases of those drugs would help lower costs in the United States. One argument against importation is safety, but the federal standards on which drugs can be imported are quite strict, so the larger question will be whether the costs of administering the importation program and the costs of delivery from overseas outweigh the savings. It also remains to be seen what quantities of prescription drugs will be available in these programs, so the effects could be limited until more countries beyond Canada get involved, which would require federal action.

Additionally, states have started to consider the possibility of state-sponsored manufacturing of prescription drugs. California has a program in place to manufacture insulin with a private sector partner, something that Governor Whitmer has proposed doing in Michigan. While these ideas are relatively novel, the potential savings to the state could be significant, especially for drugs that have been on the market for years and have a large, consistent demand in the state. California is also considering expanding the program to other drugs, such as naloxone.

The argument in favor of state-sponsored manufacturing is that states do not need to produce a return on investment for shareholders the way private pharmaceutical companies do, so the drugs could be sold at cost. This lowers the direct price to the consumers and incentivizes private companies to reduce their prices in order to compete. State governments are not necessarily well-situated to conduct research and development of new life-saving drugs, but manufacturing and distributing established medications is something states are considering. These efforts are not without risks, as there would need to be significant upfront investment and a build-out of expertise to make it happen.

Finally, volume purchasing and pooling approaches are options for states. Three states have enacted laws related to volume purchasing within their own borders, while entities in every state participate in one or more

multi-state bulk drug purchasing programs. The goal of these programs is to capitalize on scale economies to lower costs. These types of programs generally lead to savings, but the structures vary so it is not clear what costs would be associated with establishing an in-state volume purchasing program that would benefit the private market and exactly how much could be saved.

Transparency and Information

Another set of policy options aimed at reducing the cost of prescription drugs center on shining more light on those costs. Nine states have enacted laws that establish some sort of study related to one or more aspects of prescription drug costs in their states, while 23 states, including Michigan, have enacted transparency legislation of some kind. Similarly, one aspect of affordability review boards (referenced above) is to study the appropriateness of prices for certain prescription drugs, which generates public information about the costs of the drugs.

One argument for greater transparency and information around prescription drug costs is that health care financing in the United States is opaque. End users rarely know or pay the true cost of their prescriptions and have limited ability to make decisions among drugs based on price before they begin taking it, so more public information about costs could lead to better decision-making. Perhaps more importantly, bringing information to light gives policymakers the ability to identify whether reform could have the most impact. While measuring direct outcomes is difficult in such a complicated policy space, Oregon's transparency program appears to be working. Affordability review boards are typically structured to target high-cost drugs, but lowering the price of a drug that is widely used but not particularly expensive could generate large savings systemwide.

On the other hand, transparency may only go so far in reducing costs. It may be possible to identify certain drugs for which companies are charging more than is reasonable, but the economic and regulatory forces driving costs will not change simply because the public is better informed. Additionally, the scope of transparency laws may also be challenged if they attempt to go beyond costs paid by government insurance programs and seek information purely on the private market.

Possible Paths Forward for Michigan

Michigan is by no means a national leader on prescription drug costs, but it has enacted legislation on the topic over the last few years, including some transparency legislation and laws on many of the aspects of pharmacy benefits managers. There have also been proposals on many of the other topics, including insulin manufacturing and affordability review boards, among many others.

The available policy options are wide-ranging, but there are several that make sense as areas of focus due to the different risks associated with each strategy. First, the state should strongly consider building on its recent work on prescription drug cost transparency and establish an agency tasked with studying and reporting on the costs of prescription drugs in Michigan. The state has a lot of information through its management of Medicaid, but gaining information about the Michigan-specific costs will be helpful in any future policymaking.

Relatedly, the affordability review board concept makes sense as part of this effort as a way to focus policy on determining whether the costs of particular drugs are appropriate. Creating an affordability review board does not require empowering appointees and bureaucrats to set price limits, as the law could easily leave it to the legislature to decide if it wants to act in the event that the affordability board determines a prescription drug price is inappropriate and worthy of limitation. The risk associated with investing in state capacity to study these issues in great detail is relatively low and would help policymakers better understand the nature of prescription drug costs in Michigan, including the potential costs and benefits of various price regulation strategies. As noted above, there are many different ways to directly regulate the price of prescription drugs if the state decides to pursue price regulation in the future based on expanded data collection. If the state does eventually consider price regulation more directly, a policy that requires pharmaceutical companies to justify price increases is likely the most balanced approach, as it gives them the opportunity to explain why costs should be higher, akin to the way many states regulate utilities, while opening the door to cost savings.

Driving down costs by increasing supply is an area where the state has better footing. State-sponsored manufacturing has major upside potential for established drugs, such as insulin. Similarly, while importation is largely untested, putting a program in place to allow the state to capitalize on overseas markets is another high upside, low downside proposition. If the market never materializes, the cost of setting up the program is relatively minor. But if the market does materialize, there could be tens of millions of dollars in savings.

Finally, thinking about the ways the state government could coordinate bulk in-state purchases of drugs is another potential source of savings. Finding ways for smaller purchasers in the state to obtain drugs at the same price as some of the larger buyers would likely yield significant savings.

Conclusion

Prescription drugs are a costly, but vital aspect of the health care system in Michigan. Aside from the direct costs, expensive prescription drugs lead people to not take their medication as prescribed, which has downstream costs for the economic, physical, and mental well-being of Michigan's residents.

With costs rising in Michigan and around the country, states have begun to explore policies that can limit costs absent broader federal action. Policies fall into various categories, such as price regulation, increasing supply, and greater transparency. There is no guaranteed formula to drive down the cost of prescription drugs in the state, but the state-level steps that make the most sense are establishing state-level agencies to gather data and review costs; pilot programs for state-sponsored manufacturing; overseas importation; and bulk purchasing. There may be a point at which it makes sense for the state to take a heavier-handed approach with price regulation, but those policies have greater potential for negative economic consequences.

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