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PRESCRIPTION DRUGS

Companies Typically Charge More in the United States Than in Canada

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SUMMARY

Drug manufacturers typically charge wholesalers more in the United States than in Canada, according to GAO's study of manufacturers' prices for 121 widely dispensed drugs sold in both countries. This group of drugs would cost 32 percent more in the United States than in Canada if a common prescription of each drug was purchased at its factory price. This calculation reflects May 1, 1991, prices and does not pertain to the prices paid by institutional purchasers of drugs who negotiate discounts from manufacturers.

For the drug products in GAO's study, U.S.-Canadian price differentials vary widely. The U.S. price to wholesalers ranged from 44 percent below to 967 percent above the Canadian price. Of the 121 drugs studied, over 80 percent were more expensive in the United States and almost half cost wholesalers over 50 percent more in the United States than in Canada.

Differences between U.S. and Canadian drug prices can be explained largely by two factors that manufacturers encounter in Canada but not in the United States: (1) federal regulations that are designed to restrain prices on patented drugs and (2) provincial drug benefit plans that pay for drugs for a large segment of the population. Differences in costs, whether of research, production, or distribution, are not a major factor in explaining differences in drug manufacturers' prices.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the results of our recent report comparing U.S. and Canadian prescription drug prices,[1] which we prepared at your request.

There is widespread concern in the United States about rising prescription drug prices and drug spending. From 1980 to 1990, both consumer prices and prices charged by producers for prescription drugs rose far more rapidly than the rate of inflation and total spending on prescription drugs and other medical nondurables, adjusted for inflation, increased by almost two-thirds.

Some concern has been raised that drug manufacturers are charging more in the United States than in other industrialized countries for the same drugs. While there is evidence that prescription drug prices are higher in the United States than in other countries, there has been little systematic study of the variations in manufacturers' prices from one country to another. To shed some light on this issue, we have been comparing the prices that manufacturers charge for drugs in the United States to prices they charge for identical drugs in other industrialized countries. Our discussion today focuses on differentials in the prices that drug manufacturers charge in the United States and Canada and on the factors linked to these differentials.

METHODOLOGY

Consistent with the Congress' interest in drug manufacturers' contributions to high drug prices in the United States, we compared factory prices of drugs bought in retail pharmacies in the United States to the factory prices of similarly purchased drugs in Canada. For our analysis, we gathered information on the 200 drugs most frequently dispensed by U.S. drugstores, which represent 54 percent of all prescriptions dispensed in U.S. drugstores during 1990.[2] For each of these drugs, we selected a single, commonly used U.S. dosage form, dosage strength, and package size, and tried to identify the identical product in Canada.[3]

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[1]Prescription Drugs: Companies Typically Charge More in the United States than in Canada (GAO/HRD-92-110, Sept. 30, 1992).

[2]The top 200 drugs are listed in American Druggist, February 1991.

[3]We determined the common prescription for each drug and manufacturer by consulting each product's labeling along with the following references: Facts and Comparison, American Hospital Formulary Service, and USP Dispensing Information. Generally, a 100-unit package size was used unless there was a frequently used patient package, such as 60 units for a drug used twice a day.

Of the 200 drugs in our study, we were able to match 121 according to these criteria. We then obtained U.S. and Canadian factory prices for each specific product. These prices represent the factory component of the price paid in retail pharmacies on May 1, 1991, by typical consumers in the United States and Canada. Our analysis does not pertain to a smaller, though substantial, part of the market that obtains discounts from manufacturers. This part of the market includes Medicaid, many managed care programs, and mail-order pharmacies.

DIFFERENCES IN U.S. AND CANADIAN DRUG PRICES

When we compared U.S. and Canadian prices, we found that manufacturers typically charge more to wholesalers in the United States than in Canada for identical drugs. As is shown in figure 1, the vast majority of the 121 drugs we studied were more expensive in the United States, and almost half the drugs cost over 50 percent more in the United States than in Canada. As a way of summarizing the magnitude of these price differences, we calculated the cost of purchasing a common U.S. prescription of each of the 121 drugs in both the United States and Canada. We found that such a basket of drugs would cost wholesalers 32 percent more in the United States.

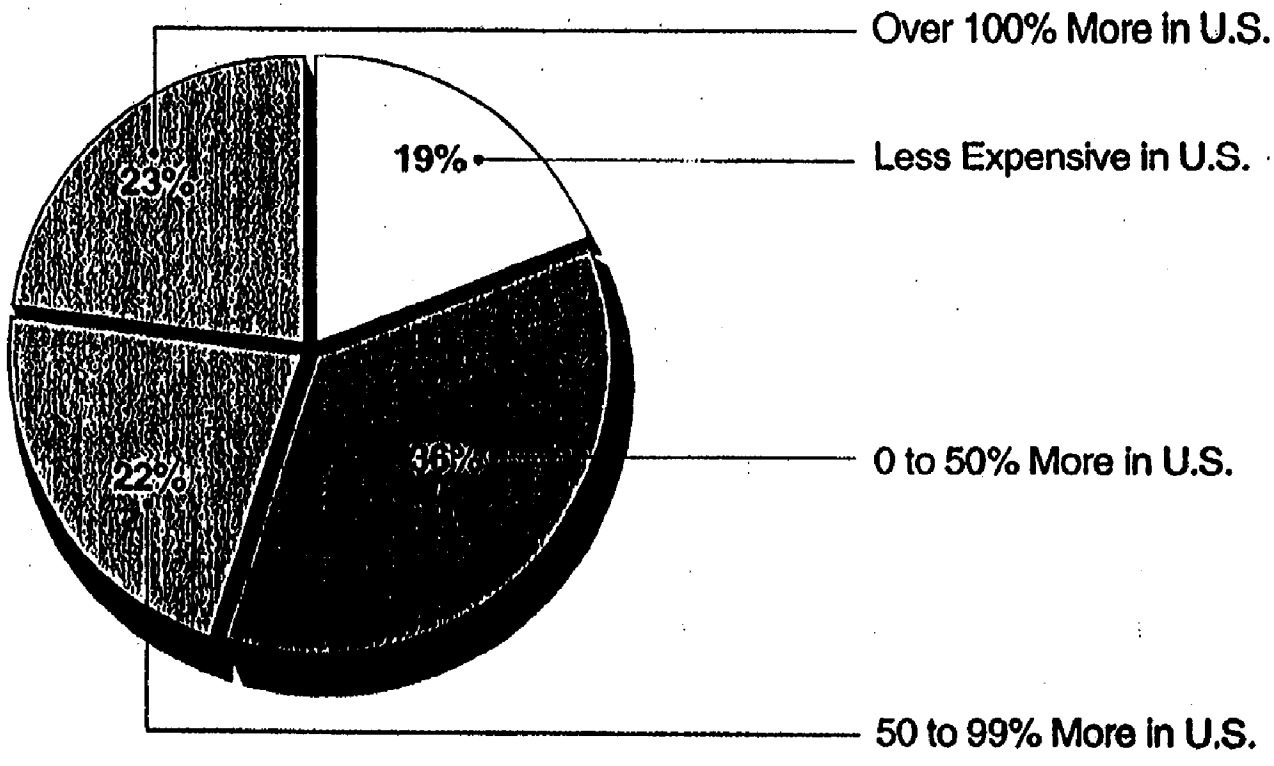
We also found that U.S.-Canadian drug price differentials for specific products vary widely. On a per-package basis,[4] the U.S. price to wholesalers ranged from being 44 percent lower to 967 percent higher than the Canadian price. The five most commonly dispensed products exemplify the variation in U.S.-Canadian price differentials. Amoxil, the most commonly dispensed product in the United States in 1990, cost only 5 percent more per package in the United States than in Canada. Lanoxin, Zantac, Premarin, and Xanax--the second, third, fourth, and fifth most commonly dispensed products in the United States--cost 16, 30, 162, and 183 percent more per package in the United States than in Canada, respectively.

FEDERAL AND PROVINCIAL POLICIES APPEAR TO RESTRAIN PRESCRIPTION DRUG PRICES

What factors explain this variation in drug price differentials? Not differences in research, production, or distribution costs, according to industry experts and some drug company officials with whom we spoke. A substantial portion of drug manufacturers' costs--the cost of research and development (R&D)--does not contribute to price differences because R&D costs are not allocated

[4]Package refers to the container from which a pharmacist dispenses drugs.

GAO Many Drugs Cost More in the United States Than in Canada



to specific products in specific countries. Furthermore, those costs allocated to specific products--such as the costs of marketing, production, and distribution--either do not vary substantially between the United States and Canada or vary to such a small extent that they do not substantially affect the total cost of a drug or its price.

Rather than differences in manufacturing costs, we found that U.S.-Canadian drug price differences can be explained by two factors that manufacturers encounter in Canada that do not exist in the United States: (1) federal regulations that are designed to restrain prices on patented drugs; and (2) provincial drug benefit plans that pay for drugs for a large segment of the population. I would like to briefly discuss both of these factors in turn.

Federal efforts to restrain drug prices in Canada rely largely on the actions of a regulatory body known as the Patented Medicine Prices Review Board. Since its inception in 1987, the Board has been charged with ensuring that prices on patented drugs are not excessive. The Board ties the maximum allowable price on a new drug either to costs of therapeutically comparable medicines or--for certain products--to the median price charged for the same product in seven other industrialized countries. The Board also limits drug price increases, tying allowable increases--broadly speaking--to the rate of inflation. The Board's enforcement powers have been based in Canada's patent laws: if a drug's price was found to be excessive, the Board had the power to revoke the product's market exclusivity, thereby allowing entry of generic competitors. (Recent changes in Canadian patent laws have altered these enforcement powers.)

Along with this price review board, provincial governments, by virtue of their role as large third-party payers of prescription drug bills, can exert pressure on manufacturers to lower prices. Each of the 12 Canadian provinces or territories has its own drug benefit program. Most of these programs cover drugs used by the elderly and low-income persons, but, in some provinces, they cover drugs used by all residents.

Strictly speaking, the provinces do not regulate drug prices. Rather, they use concentrated buying power to negotiate drug prices with manufacturers in a way similar to how hospitals or health maintenance organizations in the United States might try to reduce the prices they pay for drugs. The provincial plans, however, cover a greater share of the population than does any single payer in the United States.

For example, in Ontario, Canada's most populous province, provincial officials negotiate with manufacturers to determine the prices that the province will pay. This price need apply only to that share of the prescription drug sales covered by the provincial plan--about 40 percent. If a manufacturer and the province cannot

come to agreement on a price, then the manufacturer loses access to the share of the market covered by Ontario's drug benefit plan. By contrast, if a manufacturer lists its drugs on the formulary, it still can, in theory, charge a higher price to the private market. In practice, however, the Ontario price tends to be the basis for setting prices throughout Canada, possibly because the prices are published in a formulary that is accessible to all payers.

IMPLICATIONS OF CANADIAN REGULATION FOR U.S. MARKET ARE UNCLEAR

That drug prices are lower in Canada than in the United States has led some to propose restricting U.S. prices through regulation. These advocates note that to the extent that regulations would lower average U.S. drug prices to the Canadian level, the burden of prescription drug costs on public payers, private insurers, and individuals would be lessened.

Opponents of U.S. drug price regulation assert, however, that high drug prices--and high drug industry profits--are required to engage in the research and development activities that are necessary to bring a new drug product to market. They contend that lowering U.S. drug prices to the Canadian price level would reduce research and development, thereby limiting the availability of innovative, new drugs in the future and denying significant medical benefits to patients.

An alternative possibility is that price regulation may have little effect on the development of innovative products, but would instead simply reduce drug company profits and marketing outlays.

The debate over the linkage of drug prices to innovation in the United States cannot be resolved solely by referring to the Canadian experience with drug price regulation. First, because Canada represents a relatively small share of the world market--less than one-tenth the size of the U.S. market--regulations that reduced drug prices in the United States would have a more adverse effect on manufacturers' revenues than would similar regulation in Canada. Whatever the effect of regulation on R&D in Canada, the effect of drug price regulation on R&D in the United States could well be far different. Second, although Canada's R&D levels, proportionate to sales, are low relative to the United States, this may be due to factors other than price regulation. Most notable among these factors are Canada's patent laws which, until recently, were relatively weak and had allowed generic competitors to enter the market far more quickly than in the United States. Many Canadian industry experts have suggested that these weak patent laws have made pharmaceutical firms reluctant to engage in R&D in Canada.

We hope to gain further insights into the linkage of drug prices and R&D by comparing drug prices in the United States to those in

other countries--Germany, France, and the United Kingdom--that, unlike Canada, have a strong innovative drug industry. While such a comparison will not reveal whether the United States should regulate drug prices, it will give us a better idea of how other countries balance the concern of constraining pharmaceutical drug spending with the desire to maintain a strong research-based pharmaceutical industry. We plan to report on the results of this study later this year.

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This concludes my remarks. I will be happy to answer any questions you may have.

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