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U.S. HOUSE OF REPRESENTATIVES
SEPTEMBER 2006

Analysis

Pharmaceutical Industry Profits Increase by Over \$8 Billion After Medicare Drug Plan Goes Into Effect

This analysis examines the profit reports of the ten largest pharmaceutical manufacturers for the six-month period following the start of the new Medicare drug program. It finds that in the six months after January 1, 2006, when the Medicare drug program went into effect, pharmaceutical industry profits increased by over \$8 billion. The Medicare drug program contributed to this surge in drug industry profits through a combination of increased utilization, higher prices, and switching “dual-eligible” beneficiaries from Medicaid to Medicare.

Background

The new Medicare drug plan was passed by the Republican Congress and signed into law by President Bush in December 2003. Since its inception, the program has been seen as a potential boon for the pharmaceutical industry. Analysts predicted that because of the privatized structure of the program and the ban on federal negotiations with drug manufacturers for price discounts, taxpayers and Medicare beneficiaries would be forced to pay high prices for prescription drugs.¹

Several investigations have confirmed these predictions. Reports released by Rep. Henry A. Waxman have showed (1) that the private Medicare drug plans have been unable to negotiate low prices for brand-name drugs,² and (2) that drug manufacturers have raised prices rapidly after the commencement of the new program.³ Some analysts have estimated the high prices paid by the Medicare drug plans would mean tens of billions of dollars in additional profits for drug manufacturers.⁴

The release of second quarter profit reports by large pharmaceutical companies represents one of the first opportunities to gauge the impact of the new Medicare drug program on drug industry

¹ See, e.g., Families USA, *Medicare Legislation Will Be A Deep Disappointment for America's Seniors* (Nov. 25, 2003).

² Democratic Staff, Special Investigations Division, House Committee on Government Reform, *New Medicare Drug Plans Fail to Provide Meaningful Price Discounts* (Nov. 22, 2005)

³ Democratic Staff, Special Investigations Division, House Committee on Government Reform, *New Medicare Drug Plan Prices Are Rising Rapidly* (Feb. 2005);

⁴ Center For Economic Policy Research, *The Savings From An Efficient Medicare Prescription Drug Benefit* (Jan. 2006).

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profits. At Rep. Waxman's request, this analysis examines these profit reports and provides a comparison of the profits of the ten largest drug manufacturers in the first six months of 2006, which coincides with the debut of the new drug program, to the manufacturers' profits over the same time period in 2005.

Findings

The ten largest pharmaceutical companies enjoyed substantial profit increases in the first six months of the new Medicare drug program. In the first half of 2006, profits for these companies increased by over \$8 billion, a 27% increase.

Overall, profits have increased for eight of the world's ten largest pharmaceutical companies. Pfizer, the largest pharmaceutical company, had the largest increase in profits. The company's profits over this six-month period increased by \$2.7 billion, a 73% increase. Merck's profits have increased by almost \$1 billion (44%); Sanofi-Aventis's profits have increased by more than \$1.3 billion (35%); and AstraZeneca's profits have increased by more than \$750 million (33%). See Table 1.

Table 1: Drug Manufacturer Profits Have Increased Substantially Since the Medicare Drug Benefit Went Into Effect			
Company	2006 Profits⁵ (Jan. – June)	2005 Profits (Jan. – June)	% Increase
Pfizer	\$6,526,000,000	\$3,763,000,000	73%
Merck	\$3,019,300,000	\$2,090,700,000	44%
Sanofi-Aventis	\$5,139,722,400	\$3,817,946,160	35%
AstraZeneca	\$3,026,000,000	\$2,267,000,000	33%
Hoffman-LaRoche	\$3,578,293,950	\$2,768,463,360	29%
Novartis	\$3,669,000,000	\$3,123,000,000	17%
J&J	\$6,125,000,000	\$5,427,000,000	13%
GSK	\$5,132,000,000	\$4,535,000,000	13%
Wyeth	\$2,184,373,000	\$2,054,745,000	6%
BMS	\$1,381,000,000	\$1,537,000,000	-10%
Total — Top Ten	\$39,780,689,350	\$31,383,854,520	27%

⁵ Profit data represents net total income in the first and second quarters of 2005 and the first and second quarters of 2006. Both Sanofi-Aventis (Euros) and Hoffman-LaRoche (Swiss Francs) stated income in currencies other than U.S. Dollars. In each case, the reported figure was converted into U.S. Dollars using the average conversion rate for the respective six month period.

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Role of the New Medicare Drug Program

The new Medicare drug program has contributed significantly to these increased industry profits. According to industry experts, three factors in particular explain why the new drug program has boosted industry profits.

First, “induced demand” is resulting in higher sales volumes of drugs. Many seniors who previously did not have drug coverage now do. As a result, they are using more drugs, and the industry is seeing sales increases in drugs that are heavily used by the Medicare population. Overall, experts have estimated that the Medicare drug benefit has increased drug sales volume by about 2%.⁶

Second, the new drug program has failed to limit drug price increases. When the drug benefit legislation was passed in 2003, Republican leaders in Congress justified the privatized structure of the program by claiming that it would result in lower prices for seniors. But there has been little evidence of declining prices. A recent Merrill Lynch analysis found that prices for popular brand-name drugs had increased by 8.6% over the last year, twice as fast as the overall inflation rate.⁷ Numerous pricing analyses, as well as several industry analysts, have indicated that there has been no significant price pressure on blockbuster drugs. To the contrary, as one industry analyst wrote, “for many brand name drugs, the start-up of Part D meant a significant net price increase.”⁸

Third, the industry is obtaining significant price increases for drugs used by one particular group of beneficiaries: the 6.1 million “dual-eligible” beneficiaries who used to receive drug coverage through Medicaid but now obtain their drugs through Medicare. Prior to January 1, 2006, when these beneficiaries were covered under Medicaid, pharmaceutical manufacturers were required to provide their drugs at prices that represented the “best prices” at which they sold their products.⁹ Once these 6.1 million dual-eligible beneficiaries were switched to the Medicare program, however, the drug manufacturers were no longer required to offer their drugs at their lowest prices. The result has been significant cost increases for the drugs used by the dual-eligible beneficiaries. Analysts have estimated that these price increases could result in pharmaceutical industry windfalls of over \$2 billion in 2006 alone and over \$30 billion over the next decade.¹⁰

⁶ The RPM Report, *Big Pharma’s Secret Weapon: Medicare Starts to Pay Off — Quickly* (July/Aug. 2006).

⁷ Merrill Lynch, *Monthly Rx Monitor — July* (July 2006).

⁸ The RPM Report, *supra* note 6, at 28.

⁹ Manufacturers are required to provide the federal government with the lower of either their “best price” or a discount of 15.1% off of the “Average Manufacturers Price” of the drug. See, e.g., Public Law 101-508 § 1927; CMS, *Medicaid Drug Rebate Program* (Jan. 2006) (online at <http://www.cms.hhs.gov/MedicaidDrugRebateProgram/>).

¹⁰ See, e.g., Letter from Rep. Henry A. Waxman to the Honorable David M. Walker (Jan. 27, 2005); The RPM Report, *Dueling for Duals: Why the Poorest Medicare Recipients Should be Pharma’s Top Priority in 2006* (Dec. 2005).

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Conclusion

Pharmaceutical industry profits have increased substantially since the new Medicare drug program went into effect in January 2006, increasing by over \$8 billion in the first six months of the year. Three factors account for the Medicare drug program's impact on profits: increased demand for popular drugs; the inability of the drug plans to obtain discounts from drug manufacturers; and the ability of the drug manufacturers to increase prices significantly for drugs used by over six million dual-eligible beneficiaries.