



Rebates and Generic Drugs – A Lesson in Misguided Pharmaceutical Economics

The high cost of prescription drug coverage has resulted in nearly every state looking at ways to lower healthcare costs. Several states have focused on increasing rebates for generic drugs, a misguided health policy that has led to failure. These states have been forced to stop implementation of plans that increase the generic rebate from 11 percent, or take action to rollback these increases and return to the previous system.

Some generic manufacturers report a loss on up to 40 percent on the products sold through a Medicaid program with rebates. Because pharmacists typically carry only one generic version – not one for Medicaid and one for other patients – generic manufacturers usually will accept a loss in order to be the generic product of choice. However, when the loss becomes too large (such as in the case in states with high rebates), generic manufacturers often pull out of the market – as was the case in Pennsylvania and New Jersey.

Mandated rebates will put at risk access to, and savings from, lower cost generic drugs for all taxpayers and patients. Increasing rebates on generic drugs dramatically alters the competitive landscape, and can leave consumers without a more affordable choice at a time when choice creates real savings, particularly to those under-insured or uninsured.

What are Rebates?

The Medicaid Drug Rebate Program was created under the Omnibus Budget Reconciliation Act (OBRA) of 1990. It required brand and generic drug manufacturers to enter into and have in effect a national rebate agreement with the Secretary of the Department of Health and Human Services (HHS) in order for states to receive federal funding for outpatient drugs dispensed to Medicaid patients.

Generic pharmaceutical manufacturers must pay an 11 percent rebate, while brand manufacturers must pay a 15.1 percent rebate. OBRA '90 was amended by the Veterans Health Care Act of 1992, requiring brand drug manufacturers to enter into discount pricing agreements with the Department of Veterans Affairs. This measure did not apply to generic drugs.

In 1993, OBRA '90 was amended to allow state Medicaid programs to control the use of certain formulary drugs. Those drugs that lacked “significant clinically meaningful therapeutic advantage” over comparable drugs would have to be considered through a state’s Medicaid program prior authorization process for approval and use by Medicaid program enrollees. With the exception of Arizona, all states and the District of Columbia cover drugs under the Medicaid program. Approximately 500 pharmaceutical companies participate in the rebate program.

Supplemental rebates are additional rebates to a state’s Medicaid program that are above and beyond those required by federal law. A number of states have enacted legislation or created policies that establish Medicaid supplemental drug rebate programs. In addition to supplemental rebate programs, states have also considered or enacted drug rebate and discount programs, bulk purchasing and price control programs to reduce the cost of pharmaceuticals. The larger the rebate negotiated by the state, the greater the savings the state will have for the drug it covers. It is important to note that the federal matching share of all rebates must be paid, so increasing a state rebate also increases the federal matching share.

Increasing Generic Rebates Harmful to Cost Savings

The generic pharmaceutical industry, particularly in highly competitive products with multiple manufacturers, operates on razor-thin profit margins. The industry average profitability for generic manufacturers is less than 16 percent, compared with brand industry average profits of 20-24 percent. The 11 percent rebate on generic products already reduces this profit margin to less than 5 percent, and increasing the rebate could make many generic products unprofitable for the manufacturer.

Increasing rebates on generic pharmaceuticals represents a misguided healthcare policy that could dramatically derail state efforts to control pharmaceutical costs for a number of reasons.

- Increasing generic rebates would provide only a minimal financial benefit for a minority of consumers.
- Increasing generic rebates unfairly penalizes the segment of the pharmaceutical industry that creates savings in excess of 80 percent every day for all consumers.
- Increasing generic rebates could result in a complex and costly administrative nightmare that effectively erases any minimal savings resulting from a rebate increase.
- Increasing generic rebates could result in removal of more affordable generics from the marketplace at the expense of all consumers.
- Increasing generic rebates does nothing to lower the cost basis of the largest factor in the prescription drug dollar – namely, the exorbitant price of brand name drugs.
- Increasing generic rebates distracts from implementation of public policy initiatives, including consumer education to increase generic utilization and other efforts to increase generic substitution that could create significant additional savings.

If increased rebates force a generic manufacturer to exit the market, consumers could be left without any lower cost, money saving generic options for their prescription while pharmacies scramble for a replacement supplier willing to pay the additional rebate to place their product in the state. Driving the only money saving alternative to a high priced brand product from the market – even temporarily – could be particularly devastating to patients who cannot afford expensive brand products. And this will place a significant burden on the local pharmacist, who will have to deal with irate consumers and the challenge of finding a new supplier.

Thus, reduced competition for low-cost drugs is the likely end result if the rebate is raised on a number of generic products, resulting in significant harm to the competitive environment, and potential increases in costs, rather than increased savings. It is significant to note that the question of generic rebates addresses only one out of every three consumers. The greatest savings to all taxpayers would come from a focusing on ways to increase the overall usage of generic products.

Case Study in Failed Generic Rebates

On July 1, 2002, Missouri initiated a new prescription drug program that was designed to offer prescription discounts to the state's more than 26,000 limited-income senior citizens by requiring the use of generics when they are available. The program, SenioRx, covers 60 percent of seniors' prescription expenses after an annual deductible is met and consists of 1,400 pharmacies across the state and nearly 100 drug manufacturers nationwide. But the program initially required both brand and generic drug manufacturers to pay Missouri a 15 percent rebate, making it economically impossible for several of the largest generic drug manufacturers to offer their products to consumers.

According to the Associated Press, the State Health Department projections demonstrated that the increase in rebates would, in effect, result in higher costs, not savings. Through the cooperation of independent generic drug companies, the Generic Pharmaceutical Association (GPhA), and Missouri officials, some generic companies agreed to join the program on a temporary basis, with the understanding that the legislature would revisit this decision. The Missouri SenioRx program pledged to work with the Missouri governor's office in an attempt to reduce the rebate for generic companies to 11 percent by May 30, 2003. On May 15, 2003, a bill to rescind the rebate increase received final legislative approval, and was subsequently signed by the Governor. In fact, Governor Bob Holden sent a letter to Texas Governor Rick Perry in May 2003 encouraging Texas not to increase its rebates. Governor Holden wrote, "I encourage you to consider our experience as you work to improve access to affordable medicine for seniors in Texas."

What began as a plan to substantially lower prescription drug costs nearly ended in disaster because Missouri failed to recognize the economic and market issues facing generic pharmaceutical companies. Fortunately, the legislature, the Governor, and senior and other groups recognized the damage and reversed this failed initiative.

Summary

Generic pharmaceuticals are commodity-priced products that provide high quality healthcare at affordable prices as a direct result of aggressive competition. Increases in generic rebates could make it impossible for generic manufacturers to provide their more affordable products to states. As a result, prescription drug prices could rise as a result of this mis-guided public health initiative.