



# In the Literature

## DOUGHNUT HOLES AND PRICE CONTROLS

Gerard F. Anderson, Ph.D.  
Dennis G. Shea, Ph.D.  
Peter S. Hussey  
Salomeh Keyhani, M.D.  
Laurie Zephyrin, M.D.

**Health Affairs Web Exclusive**  
July 21, 2004  
W4-396-W4-404

For more information about  
this analysis, contact:

Gerard F. Anderson, Ph.D.  
Johns Hopkins University  
Center for Hospital Finance  
and Management  
TEL 410-955-3241  
E-MAIL ganderso@jhsp.edu

or

Mary Mahon  
Public Information Officer  
The Commonwealth Fund  
TEL 212-606-3853  
E-MAIL mm@cmwf.org

Commonwealth Fund Pub. #769  
July 2004

*In the Literature* presents brief summaries of Commonwealth Fund-supported research recently published in professional journals. To read or learn more about new publications as soon as they become available, visit [www.cmwf.org](http://www.cmwf.org) and register to receive Commonwealth Fund e-mail alerts.

**THE COMMONWEALTH FUND**  
ONE EAST 75TH STREET  
NEW YORK, NY 10021-2692  
TEL 212.606.3800  
FAX 212.606.3500  
E-MAIL [cmwf@cmwf.org](mailto:cmwf@cmwf.org)  
<http://www.cmwf.org>

Could senior citizens in the United States receive full prescription drug coverage under Medicare, without causing any increase in Medicare spending? According to a new study, they could: if prescription drug prices in the United States were typical of the prices in Canada, United Kingdom, and France.

This is the conclusion of “[Doughnut Holes and Price Controls](#)” (*Health Affairs Web Exclusive*, July 21, 2004), a report of an economic simulation conducted by researchers at Johns Hopkins University and Pennsylvania State University with support from The Commonwealth Fund and the Robert Wood Johnson Foundation.

The simulation examines a controversial provision of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003—the interruption in coverage that’s been nicknamed the “doughnut hole.” To cap Medicare spending, the Act excludes from coverage seniors’ prescription drug expenses that fall, for the year 2006, between \$2,250 and \$5,100 (the upper figure rising in the “out years” 2007 to 2013). This gap will mean a serious level of cost sharing—more than \$3,400 during 2006 for many Medicare beneficiaries (and rising with each out year)—despite the Act’s 75 percent coverage below \$2,250 and 95 percent catastrophic coverage above the upper limit.

The authors wondered, however, if there might be any way of expanding the prescription drug benefit to fill in the gap without adding to the costs of the Medicare program. They zeroed in on the high

cost in the United States, relative to other countries, of the medicines most frequently used by seniors (for the treatment of Alzheimer’s, arthritis, cancer, diabetes, heart conditions, hypertension, mental disorders, osteoporosis, pulmonary conditions, and stroke). They also took aim at the provision in the 2003 legislation that actually forbids Medicare from directly negotiating with pharmaceutical firms to lower drug prices.

Using pharmaceutical pricing data obtained from IMS Health, the authors created and priced, for Canada, U.K., France, and the United States, a “market basket” of 30 widely prescribed medicines. The medicine Lipitor, they discovered, costs from 45 to 63 percent less in Canada, U.K., and France than in the U.S., even assuming that listed wholesale prices are 20 percent higher than the prices Medicare actually pays. The bigger picture—the costs of the market basket—is similar. Depending on the particular calculation, prices are from 34 to 59 percent lower abroad than in the U.S.

Higher U.S. prices, the authors say, could be brought into the range typical of the other countries studied. “Most other industrialized countries,” they note, “have instituted a variety of mechanisms to limit pharmaceutical spending.... If the Medicare prescription drug bill did not preclude Medicare from directly negotiating with pharmaceutical companies, it is likely the Medicare program could feasibly obtain prices that are similar to those in other industrialized countries.”

Such price decreases would not only ease the pressure on Medicare but would also

dramatically reduce what Americans spend on prescription drugs, the researchers argue. A simulation using data from the 1999 Medicare Current Beneficiary Survey demonstrates that if the doughnut hole remains, then in 2006 \$101.9 billion will be spent on prescription drugs for Medicare beneficiaries—\$31 billion coming from the pockets of those beneficiaries and \$44.5 billion from Medicare (third-party payers account for the rest). If prices are reduced as the authors believe to be possible and the savings are used to eliminate the doughnut hole, total spending would drop to \$73.6 billion. Medicare would continue to spend \$44.5 billion, but beneficiaries would owe far less out-of-pocket.

Such price reductions, furthermore, mean that the benefit would be experienced most by the most ill senior citizens: the 15 percent of Medicare beneficiaries with five or more chronic conditions, the ones most likely to be affected by the coverage gap. Lower prices would save persons with four or more illnesses \$1,034 in 2006, the authors find.

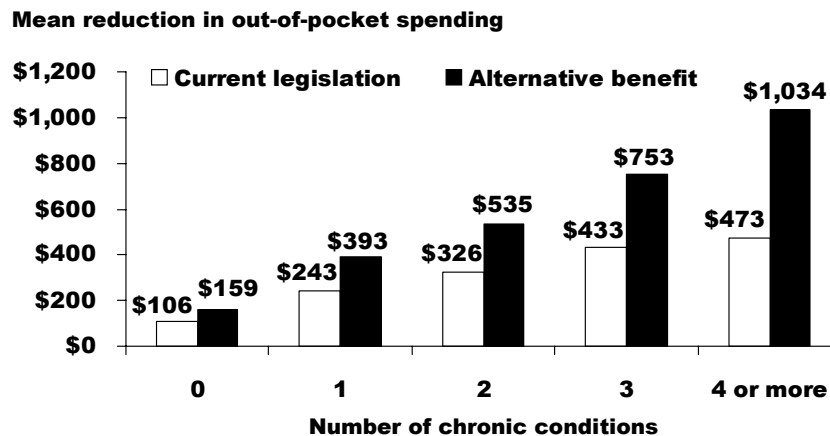
The authors also suggest that out-year spending for the years 2006 to 2013 will be reduced under the alternative scenario. For these years, under the terms of the 2003 Act, the Medicare program will spend as much as \$667 billion on prescriptions. With the lower drug costs the authors consider possible, their calculations show that spending could be held to \$537 billion.

Less spending on prescriptions implies less revenue for pharmaceutical companies. That, the authors note, could translate into less spending on drug research and development, into which the industry pumped \$33.9 billion in 1999 (60 percent of R&D spending overall), according to a 2002 Kaiser Family Foundation report. The authors, however, cite widely varying estimates and opinions about the effectiveness of industry R&D spending as well as the cost of bringing a new medicine to market.

### Facts and Figures

- During 2003, prices of pharmaceuticals in Canada, the U.K., and France were 34% to 59% of prices in the United States.
- Medicare beneficiaries with prescription drug expenses of \$5,100 during 2006 will have to pay more than \$3,400 out of their own pockets—not including premiums.
- Fifteen percent of Medicare beneficiaries have five or more chronic conditions; during 1999, they filled an average of 50 prescriptions.
- The United States accounts for 41% of the world pharmaceutical market. Europe buys 23.5%, and Japan 15.9%.

### Reduction in Out-of-Pocket Costs Under Current and Alternative Medicare Drug Benefits, by Number of Chronic Conditions



Source: G. F. Anderson et al., "Doughnut Holes and Price Controls," *Health Affairs* Web Exclusive (July 21, 2004): W4-396–W4-404.