

### Prescription Drug Trends

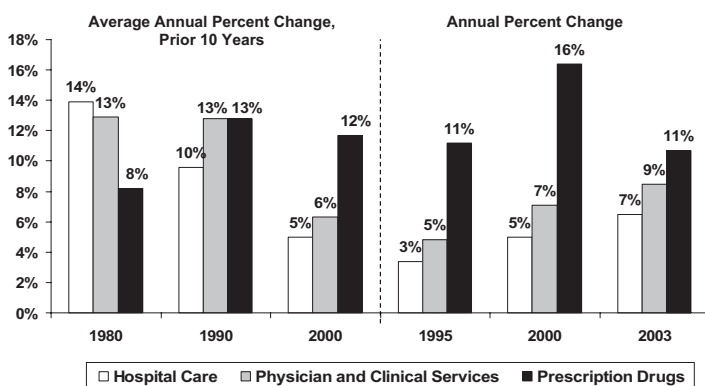
#### Overview

Prescription drugs are a vital component of health care in preventing and treating illness and helping to avoid more costly medical problems. However, rising costs and implementation of the new Medicare drug benefit have raised concerns about the affordability and availability of prescription drugs, prompting the need for a better understanding of the pharmaceutical market and for new approaches to rising costs.

#### Rising Expenditures for Prescription Drugs

Spending in the US for prescription drugs was \$179.2 billion in 2003, almost 4½ times larger than the \$40.3 billion spent in 1990. Although 2003 prescription drug spending was a relatively small proportion (11%) of national health care spending compared to spending for hospital care (31%) and physician services (22%), it was one of the fastest growing components, increasing at double digit rates from 1995 to 2003. From 2002 to 2003, national prescription spending increased 11%, compared to 7% for hospital care and 9% for physician services. However, the rate of increase in prescription spending has declined from a high of 20% in 1999, to 15% in 2002, and 11% in 2003 (Figure 1).<sup>1</sup>

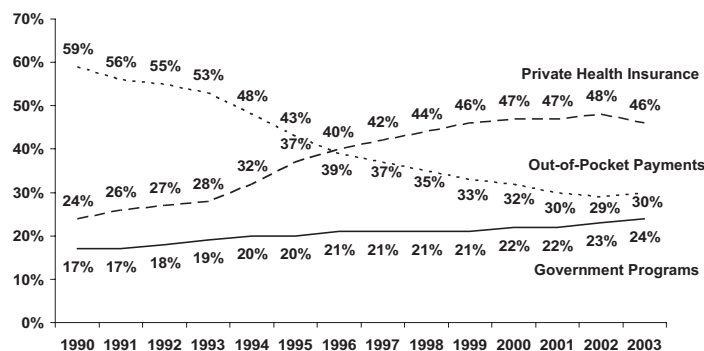
Figure 1: Annual Percentage Change in Selected National Health Expenditures, 1980-2003



Source: KFF analysis of National Health Expenditures data from Centers for Medicare & Medicaid Services at <http://www.cms.hhs.gov/statistics/nhe/default.asp>

The share of prescription drug expenses paid by private health insurance increased substantially over the past decade (from 24% in 1990 to 46% in 2003), contributing to a decline in the share that people pay themselves (from 59% in 1990 to 30% in 2003) (Figure 2). Private insurance spending for prescription drugs rose by 7% in 2003, much slower than the 16% increase in 2002.<sup>2</sup>

Figure 2: Percent of Total National Prescription Drug Expenditures by Type of Payer, 1990-2003



Note: Out-of-Pocket Payments includes direct spending by consumers for health care goods and services not covered by a health plan and cost-sharing amounts (coinsurance, copayments, deductibles) required by public and private health plans. It does not include consumer premium payments and cost sharing paid by supplementary Medicare policies, which are included in the Private Health Insurance category.

Source: KFF analysis of National Health Expenditures data from Centers for Medicare & Medicaid Services at <http://www.cms.hhs.gov/statistics/nhe/default.asp>.

#### Factors Driving Increases in Prescription Spending

Three main factors drive increases in prescription drug spending: the increasing number of prescriptions (utilization), price increases, and changes in the types of drugs used.

- Utilization.** From 1994 to 2004, the number of prescriptions purchased increased 68% (from 2.1 billion to 3.5 billion), compared to a US population growth of 12%. The average number of retail prescriptions per capita increased from 7.9 in 1994 to 12.0 in 2004.<sup>3</sup> The percent of the population with a prescription drug expense in 2002 was 61% (for those under age 65) and 91% (for those 65 and older).<sup>4</sup>
- Price.** Retail prescription prices<sup>5</sup> (which reflect both manufacturer price changes for existing drugs and changes in use to newer, higher-priced drugs) increased an average of 8.3% a year from 1994 to 2004 (from an average of \$28.67 to \$63.59),<sup>6</sup> more than triple the average annual inflation rate of 2.5%.<sup>7</sup>
- Changes in Types of Drugs Used.** Increases in prescription spending generally result from newer, higher-priced brand name drugs whose availability is affected by the research and development (R&D) activities of pharmaceutical manufacturers and government-supported research. Manufacturer R&D spending increased from \$13.4 billion (17.3% of sales) in 1994 to an estimated \$38.8 billion

(15.9% of sales) in 2004.<sup>8</sup> New drug use is also affected by the number of new drugs (new molecular entities) approved by the US Food and Drug Administration, which has fluctuated over the past decade, with 21 approvals in 1994 and 36 approvals in 2004.<sup>9</sup>

Both prescription use and shifts to higher-priced drugs are affected by advertising. Manufacturers spent \$11.9 billion for advertising in 2004 (excluding the \$15.9 billion in retail value of drug samples), with \$7.8 billion (66%) directed toward physicians and \$4.0 billion (34%) directed toward consumers. Spending for direct-to-consumer advertising -- typically to advertise newer, higher-priced drugs -- was 15 times greater in 2004 than in 1994.<sup>10</sup>

From 1995-2002, pharmaceutical manufacturers were the nation's most profitable industry. In 2004, they ranked third, with profits (return on revenues) of 16%, compared to 5% for all Fortune 500 firms.<sup>11</sup>

### **Insurance Coverage for Prescription Drugs**

Employers are the principal source of health insurance in the United States, providing coverage for 174 million (nearly 60%) of Americans in 2004.<sup>12</sup> About 60% of employers offered health insurance to their employees in 2005, and 66% of those employees took their employers' coverage. Others may have obtained coverage through a spouse. Nearly all (98%) of covered workers in employer-sponsored plans had a prescription drug benefit in 2005.<sup>13</sup>

The traditional Medicare program (the federal health program for the elderly and disabled) has not provided coverage for outpatient prescription drugs. About one-quarter (27%) of seniors age 65 and above, and one-third of poor (34%) and near-poor (33%) seniors, had no drug coverage in 2003.<sup>14</sup> That will change January 1, 2006 when, as authorized by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Medicare will begin a voluntary prescription drug benefit. To provide some assistance in the years prior to 2006, the law created a Medicare-endorsed discount card program to give beneficiaries greater access to negotiated discounts on their prescription drug purchases. The discount card program also included a temporary transitional assistance program that provided \$600 per year in subsidies to low-income beneficiaries without drug coverage from other sources in 2004 and 2005.

Lack of drug insurance can have adverse effects. A 2005 survey found that uninsured adults (51%) are twice as likely as insured adults (25%) to say that they or a family member cut pills, did not fill a prescription, or skipped medical treatment in the past year because of the cost.<sup>15</sup> For seniors age 65+, the survey found that those with no drug coverage were more likely than those with drug coverage to not fill a prescription or to skip or take a smaller dose due to costs in 2003 (37% vs. 22%).

### **Private and Public Responses**

Employer-sponsored health plans have responded to increasing prescription drug costs by establishing tiered cost-sharing formulas and increasing drug copayments. In 2005, about three-quarters (74%) of workers with employer-sponsored coverage had a cost-sharing arrangement with 3 or 4 tiers, over 2½ times the proportion in 2000 (27%). Copayments for nonpreferred drugs (those not included on a formulary or preferred drug list) have doubled from an average of \$17 in 2000 to \$35 in 2005. Copayments for preferred drugs (those included on a formulary or preferred drug list, such as a brand name drug without a generic substitute) increased by 69%, from \$13 in 2000 to \$22 in 2005.<sup>16</sup>

Medicaid is the joint federal-state program that pays for medical assistance to low income individuals and families. Outpatient prescription drug spending has steadily increased as a share of overall Medicaid spending from 5.6% in FY1992 to 13.4% in FY2003.<sup>17</sup> In a 2005 survey of 36 states + DC, all (100%) attempted to control drug costs by requiring prior authorization, 95% imposed limits on quantities dispensed per prescription, 92% required the use of generics, 81% charged limited copayments for prescription drugs, and 68% used preferred drug lists.<sup>18</sup> On January 1, 2006, drug coverage for those eligible for both Medicare and Medicaid will be shifted from Medicaid to Medicare as a result of the Medicare Modernization Act, although states will be required to provide payments to the federal government to finance this coverage.

Consumers are turning to a variety of methods to reduce their prescription costs, including requesting cheaper drugs or generic drugs from their physicians, using the Internet and other sources to make price comparisons, using over-the-counter instead of prescribed drugs, buying drugs in bulk and pill-splitting, using mail-order pharmacies, using pharmaceutical company or state drug assistance programs, and using Medicare discount drug cards.<sup>19</sup>

Drug importation has received attention as a way to address expensive drug prices in the US. Importation of pharmaceutical products from Canada using Internet orders and cross-border visits totaled \$760 million in sales, or 0.3% of the total US market, in 2004.<sup>20</sup> An equivalent amount of prescription drugs is estimated to enter the US from the rest of the world, mostly through the mail and courier services.<sup>21</sup>

Proponents of permitting Americans to import drugs from Canada or other countries argue that prescription expenses have become a significant burden on families and third-party payers and that it is unfair to deny them access to the lower prices available abroad. Permitting importation also is seen as a way of reducing domestic prices, because manufacturers would be forced to lower their prices to compete with the lower costs of imported drugs. Opponents argue that it is difficult and costly to assure the safety of imported drugs. Opponents also argue that importation is likely to increase prices or reduce supply in countries exporting drugs to the US, so that manufacturers and foreign governments would likely take steps to limit exports to the US.

## Outlook for the Future

Annual increases in US spending for prescription drugs are projected to rise from 10.7% in 2003 to 11.9% in 2004, and then decline to 9.7% in 2014. Increased spending due to increased prescription use by Medicare beneficiaries under the new Medicare Part D coverage is expected to be offset by increased availability and use of lower-cost generic drugs, more people covered under tiered copayment drug plans, fewer blockbuster drugs, and more drugs shifting to over-the-counter status.<sup>22</sup>

## REFERENCES

- <sup>1</sup> Centers for Medicare & Medicaid Services, National Health Accounts, at <http://www.cms.hhs.gov/statistics/nhe/default.asp>.
- <sup>2</sup> Ibid.
- <sup>3</sup> KFF calculations using data from IMS Health at [www.imshealth.com](http://www.imshealth.com) and Census Bureau at <http://www.census.gov>. The number of prescriptions per capita (12.0 in 2004) differs from that at <http://www.statehealthfacts.kff.org> (10.7 in 2003) because the data come from different sources (IMS Health vs. Verispan).
- <sup>4</sup> Agency for Healthcare Research and Quality, Medical Expenditure Panel Survey, *2002 Compendium of Tables – Household Medical Expenditures*, at [http://www.meps.ahrq.gov/MEPSNet/TC/TC15.asp?File=HCFY2002&Table=HCFY2002\\_PLEXP](http://www.meps.ahrq.gov/MEPSNet/TC/TC15.asp?File=HCFY2002&Table=HCFY2002_PLEXP).
- <sup>5</sup> Retail prescription prices reflect the prices paid by insured and uninsured patients, and do not reflect rebates, discounts, and other payments that in effect lower the cost of prescriptions.
- <sup>6</sup> KFF calculations using data from National Association of Chain Drug Stores, "Industry Facts-at-a-Glance," at <http://www.nacds.org>, based on data from IMS Health.
- <sup>7</sup> Consumer Price Index, US City Average, All items, from the Bureau of Labor Statistics at <http://www.bls.gov>.
- <sup>8</sup> Pharmaceutical Research and Manufacturers of America, *Pharmaceutical Industry Profile*, various years, at <http://www.phrma.org/publications>; reflects data from PhRMA members only (approx. 80% of total R&D in 2004).
- <sup>9</sup> US Food and Drug Administration at <http://www.fda.gov/cder/rdmt/NMEapps93-04.htm>; the 2004 figure includes new BLAs for therapeutic biologic products transferred from FDA's Center for Biologics Evaluation and Research to the Center for Drug Evaluation and Research.
- <sup>10</sup> *Medical Marketing & Media*, "The IMS Health Report – Pressure Zone," May 2005, Fig. 7 and Fig. 9, at <http://offlinehbpl.hbpl.co.uk/Misc/MMM/Features/MAY05%2036-50%20IMS.pdf>; Kaiser Family Foundation, *Prescription Drug Trends*, a chartbook, July 2000, Ex. 3.13, at <http://www.kff.org/rxdrugs/3019-index.cfm>.
- <sup>11</sup> *Fortune*, April 18, 2005, and earlier April issues.
- <sup>12</sup> US Census Bureau, *Income, Poverty, and Health Insurance Coverage in the United States: 2004*, August 2005, pp. 16 and 60, at <http://www.census.gov/prod/2005pubs/p60-229.pdf>.
- <sup>13</sup> Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits 2005 Annual Survey*, September 2005, Section 9, at <http://www.kff.org/insurance/7315/index.cfm>.
- <sup>14</sup> DG Safran et al., "Prescription Drug Coverage And Seniors: Findings From A 2003 National Survey," *Health Affairs*, April 19, 2005, p. W5-160, at <http://www.kff.org/medicare/med041905pkg.cfm>.
- <sup>15</sup> Kaiser Family Foundation/Commonwealth Fund/Tufts-New England Medical Center 2003 National Survey of Seniors and Prescription Drugs, Additional Charts and Tables, April 2005, Figure 3, at <http://www.kff.org/medicare/med041905pkg.cfm>.
- <sup>16</sup> Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits 2005 Annual Survey*, September 2005, Exhibits 9.1 and 9.2, at <http://www.kff.org/insurance/7315/exhibits/index.cfm>.

<sup>17</sup> Kaiser Commission on Medicaid and the Uninsured, *Medicaid Prescription Drug Spending and Use*, June 2004, at <http://www.kff.org/medicaid/7111a.cfm>, with FY2003 data from *Medicaid and Outpatient Prescription Drugs*, March 2005, at <http://www.kff.org/medicaid/1609-03.cfm>; percentages include estimates of Medicaid managed care spending for prescription drugs.

<sup>18</sup> Kaiser Commission on Medicaid and the Uninsured, *State Medicaid Outpatient Prescription Drug Policies: Findings from a National Survey, 2005 Update*, October 2005, Fig. 3, at <http://www.kff.org/medicaid/7381.cfm>.

<sup>19</sup> D Herrick, National Center for Policy Analysis, *Shopping for Drugs: 2004*, NCPA Policy Report No. 270, October 2004, at <http://www.ncpa.org/pub/st/st270>.

<sup>20</sup> *Medical Marketing & Media*, "The IMS Health Report – Pressure Zone," May 2005, p. 45, at <http://offlinehbpl.hbpl.co.uk/Misc/MMM/Features/MAY05%2036-50%20IMS.pdf>.

<sup>21</sup> U.S. Department of Health and Human Services Task Force on Drug Importation, *Report on Prescription Drug Importation*, December 2004, p. ix, at <http://www.hhs.gov/importtaskforce/Report1220.pdf>.

<sup>22</sup> S Heffler et al., "U.S. Health Spending Projections For 2004-2014," *Health Affairs*, Web Exclusive, February 23, 2005, pp.W5-74 to W5-85; see <http://www.cms.hhs.gov/statistics/nhe/projections-2004/proj2004.pdf>.

### For More Information:

In addition to the Kaiser Family Foundation reports in the Endnotes above, this Fact Sheet (#3057-04) and the following reports are available on the Foundation's website at <http://www.kff.org>: *Trends and Indicators in the Changing Health Care Marketplace* (#7031), *Prescription Drug Trends—A Chartbook Update* (#3112), *Medicare Prescription Drug Benefit Fact Sheet* (7044-2), *Resources on the Medicare Prescription Drug Benefit*, *Federal Policies Affecting the Cost and Availability of New Pharmaceuticals* (#3254), and *Current Trends and Future Outlook: Findings from the Kaiser/Hewitt 2004 Survey on Retiree Health Benefits* (#7194). See also <http://www.statehealthfacts.org> for state-specific prescription drug utilization, sales, and average prices (under Health Costs & Budgets), and <http://www.kaiserEDU.org> (Prescription Drugs) for Issue Modules and a Tutorial on prescription drugs.