

Drug Companies winning the drug war

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Patented drug prices are regulated in Canada under the Patent Act by the Patented Medicine Prices Review Board (PMPRB), created in 1987. The PMPRB is supposed to keep drug prices reasonable.

Now that the PMPRB is ten years old, maybe it's a good time to ask, is the Board working?

It's a timely question. The PMPRB recently held hearings on itself across Canada, following up on a somewhat vague recommendation by the Standing Committee on Industry in the Bill C-91 Review in 1997 that its mandate be "strengthened". The hearings will culminate in a report by the Board on its own effectiveness and future direction. The report's due out in next few weeks

In effect, the PMPRB will be grading its own performance. Expect it to give itself high marks.

In fact, total spending on patented drugs is growing incredibly fast in Canada, despite the PMPRB. It's increased 131% since 1990, reaching \$3.7 billion in 1997, according to the PMPRB's latest annual report. The rate of growth is increasing faster lately. Spending increased 23% in 1997 alone.

To some extent, this reflects the aging of the population. The oldest baby boomers are now in their fifties, old enough to have begun needing more ulcer, heart and other drugs (not to mention Viagra, the infamous Pfizer Riser, about to be approved in Canada). But it also reflects the fact that newer drugs cost more, and drug companies are good at getting your doctor to prescribe new, expensive drugs.

Drug spending is going to explode soon because the baby boomers will reach an age when drug consumption per capita will really climb steeply. Then drug pricing will heat up as a political issue.

The reason the PMPRB doesn't seem to have much effect is that it merely checks to make sure that the prices of individual drugs don't increase at more than the consumer price index. Spending goes up anyway because drug companies devote much time and money to convincing doctors to prescribe costly newer drug A instead of older, less-expensive drug B. There may be little or no evidence that A is better.

Take hypertension drugs. As reported in the April 13 issue of Business Week, a panel of cardiologists at the influential National Institute of Health (NIH) in the US has twice recommended to the medical profession that older, cheaper drugs, beta-blockers and diuretics, are safer and most effective for most patients than more expensive calcium channel blockers and ACE inhibitors. Two recent studies show doctors nevertheless write more prescriptions for the more expensive drugs. This is because drug companies vigorously promote them, and of course don't promote the older, cheaper ones. Yet there is some evidence the new drugs may in fact have greater health risks.

A unique feature of the prescription drug business is that consumers don't compare prices. Doctors, rather than consumers, select the product, i.e. prescribe a drug, without much attention to cost. Consumers are usually on drug plans, either public or private, making price comparisons even harder.

As a result, innovator drug companies have phenomenal pricing power. In any comparison of returns on equity earned by different industry sectors, the brand name drug industry always comes out on top. For example, according to the "Corporate Scorecard" in the August 17 issue of Business Week, the return on common equity for the 12 months ending June 30, 1998 for the "Drugs and Research" industry was 33.2%, the highest of any industry. Some innovator drug companies had truly eye-popping returns on equity. Schering-Plough's was 50.8%. Bristol Myers' was 47.6%. Eli Lilly's was 40.3%. It's the world's most profitable business.

The big pharma drug companies claim that they must earn these vast returns in order to make the large investment in R&D needed for drug research. But many other industries invest heavily in R&D, without earning the phenomenal returns on equity that are routine in the drug business. Indeed, these huge returns are earned net of R&D expenditure. As long as returns on investment in the pharmaceutical remain at the average levels earned by North American industry, R&D will go on, spurred by normal competitive pressures.

After numerous mergers, there are now only a few, very large, major pharmaceutical companies. There have been no new entrants to this exclusive club in decades, despite numerous biotechnology start-ups.

Governments around the world may have to deal with these problems somehow, particularly those, like Canada, committed to funding public drug plans for their seniors. A federal task force recently recommended a "National Pharmacare" program covering all Canadians.

The question that policy makers in all the G7 countries will be asking themselves in future years will be, do our complex prescription drug laws in fact unduly discourage new entrants, thus inhibiting competition and business and scientific innovation? Do we need to do more to introduce competitive forces, or in some other way do more to control drug prices?

It's a complex question. We'll be hearing more about it.