



CCPA
CANADIAN CENTRE
for POLICY ALTERNATIVES
CENTRE CANADIEN
de POLITIQUES ALTERNATIVES



Institut de recherche
et d'informations
socio-économiques

The complete report is available free of charge from the CCPA website at www.policyalternatives.ca.

The Economic Case for Universal Pharmacare

Costs and Benefits of Publicly Funded Drug Coverage for all Canadians

Executive Summary

A public drug insurance plan should form an integral part of a country's pharmaceutical policies. The plan must tie together social programs designed to provide a minimum of well-being for all citizens, health policies designed to optimize public health, industrial policies aimed at attracting foreign investment, intellectual property policies, and tax policies designed to ensure greater fairness in redistributing wealth.

A drug insurance plan that includes a drug assessment process can also help distinguish between drug products in order to ensure the quality, safety, and cost-effectiveness of prescription drugs. A drug insurance plan is not only a way to compensate for or reimburse drug expenses, but also a way to control costs through efficient pharmaco-economic assessment of new drugs and by developing bargaining power when dealing with powerful transnational drug companies.

The complexity of these various aspects of Pharmacare must be considered in order to determine the best drug insurance plan to meet the common goals of a community.

As far back as 1964, the Royal Commission on Health Services recommended that a universal drug insurance plan be established for all Canadians. The National Health Forum, under Jean Chrétien in 1997, recommended universal drug coverage. The Romanow Commission in 2002 recommended catastrophic drug coverage as a first step towards universal Pharmacare. But the National Pharmaceuticals Strategy, implemented since 2004, has failed to achieve even catastrophic drug coverage for all Canadians.

The lack of political enthusiasm for Pharmacare can mainly be explained by fears of the escalating costs such a plan is expected to entail. But this argument, which also predominates in the media, is completely lacking in substance.

The sound economic analysis included in this report shows that the rational implementation of universal Pharmacare, with first-dollar coverage for all prescription drugs, would not only make access to medicines more equitable in Canada and improve health outcomes, but also generate savings for all Canadians of up to \$10.7 billion in prescription drugs. Canadians cannot afford not to have universal Pharmacare.

Understanding the failures of current Canadian pharmaceutical policies

Inequitable access to drug treatments

Canada spent \$25.1 billion on prescription drugs in 2008. The cost of drugs has risen at more than 10% per year since 1985, and represents a major element in the increase of total health expenditures. To reduce the burden on public finances, access to private insurance (though more costly to individuals) has also risen. So have deductibles and co-payments in government plans, coupled with a constant increase in the share of out-of-pocket expenditures for prescription drugs.

Only 45% of total drug expenditures come from public spending, which is very low compared to other OECD countries. Canada is second among OECD countries, behind the United States, in the participation of private insurers in drug expenditures.

According to a survey by Statistics Canada, 24% of Canadians have no drug coverage, and 8% of Canadians admit they did not fill a prescription in the last 12 months due to the costs of drugs. Citizens with inadequate drug coverage are mostly unemployed or self-employed workers. This lack of coverage for drugs prevents many Canadians from receiving the quality of health care they need. For example, after myocardial infarction, free medications would increase a patient's life by one year, on average.

The current system has become a jumbled assortment of public and private plans in which individual coverage is no longer based on pa-

tients' needs, but subject to where people live and work, as well as on each person's and family's financial means.

Private Insurance inefficient

Private insurance is an expensive solution, given the inefficiency of private drug insurance plans compared to public plans. The vast majority of private drug plans are provided by employers, covering about 16 million Canadians, about half the population. The premiums for such plans soared by 15% annually between 2003 and 2005, while drug costs rose 8% a year.

The reason for the steep rise in premiums is simple: most of the private drug plans are managed by insurance companies which are usually compensated in the form of a percentage of expenditures. As a result, their financial incentive is not to try to stem the growing costs, but to increase them. Also, private drug plans' formularies welcome all new expensive drugs even if they are no more beneficial to patients than cheaper existing drugs.

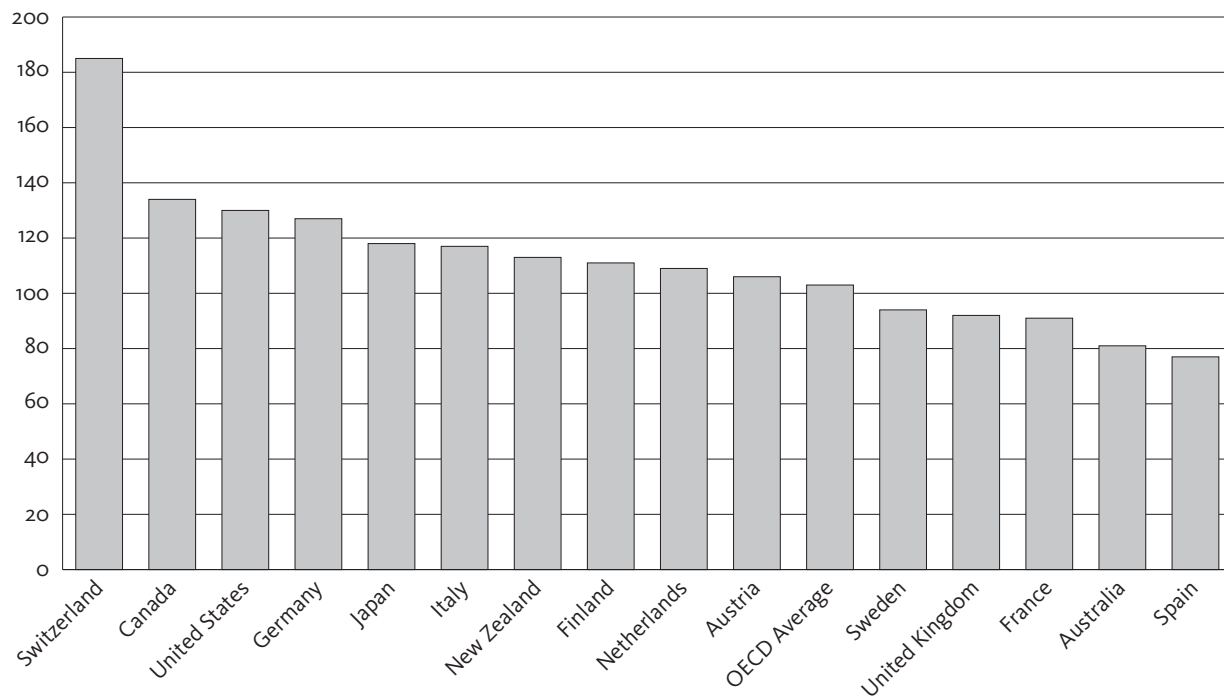
Private insurance is clearly less efficient in terms of administrative costs. The administrative fees for public plans in Ontario and Quebec were estimated at 2%, whereas they were 8% for private plans. In total health spending, Canada's public program had administrative costs of 1.3% compared to costs of 13.2% for private plans. We can conservatively infer that at least 6% of costs for drug insurance coverage could be saved if this coverage were provided by a universal Pharmacare program, which would have resulted in savings of \$560 million per year.

Private insurance plans receive tax subsidies on the order of 10% of their expenditures. Every year, about \$933 million in tax subsidies could be recovered through a universal Pharmacare program.

Private drug insurance plans also pay more for drugs than public plans, especially in the case of generics, because of the public plans' superior bargaining power. The private plans usually pay

FIGURE A Detail prices for the same volume of medicines in OECD countries, 2005 (US\$, Market exchange rate, including branded and generics)

Detail Prices = Ex-manufacturer price + wholesaler markup + pharmacy markup + Prescription fees + tax



SOURCE OECD 2008 - Eurostat OECD PPP Program, 2007

7% more for generic drugs and 10% more for non-patented brand-name drugs. Private drug plans normally reimburse for any type of drug without making any pharmaco-economic assessment of cost-efficiency.

Expensive drugs and rising costs

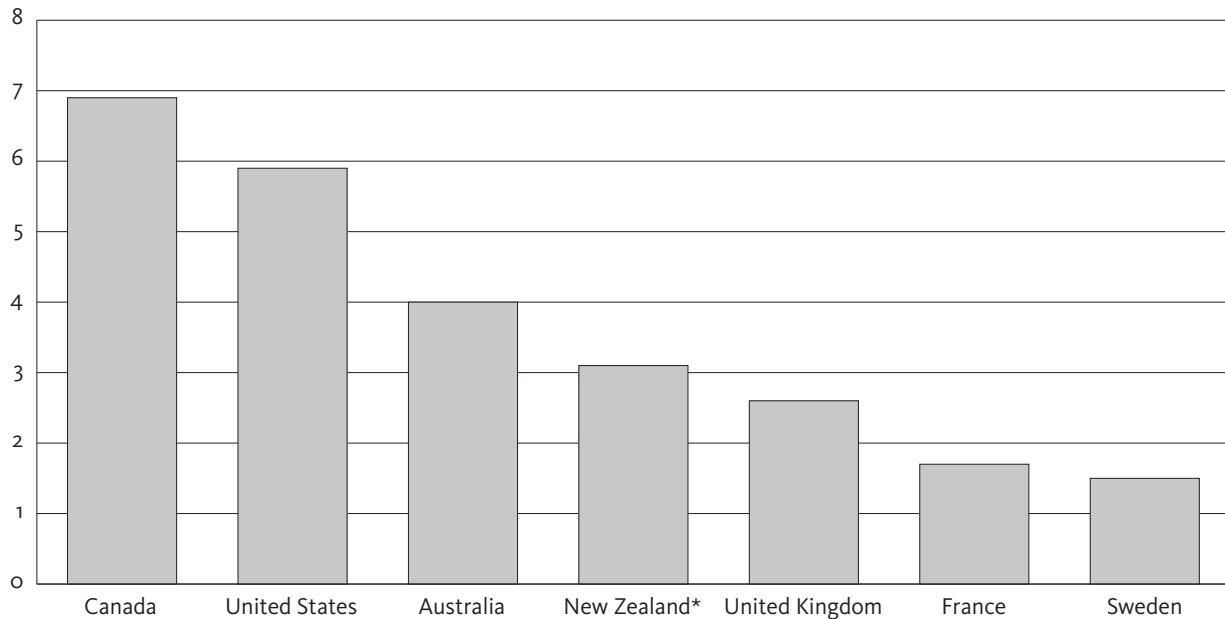
The result is that Canada has among the highest detail prices for prescription drugs among OECD countries, and Canadians pay 30% more than the OECD average.

Switzerland, like Canada, pays high prices to support its national pharmaceutical industry. The burden is not problematic for Swiss citizens since 94% of drug costs are paid by public spending as compared to 45% in Canada. Switzerland benefits from huge spin-offs from the industry: the ratio of pharmaceutical R&D on sales is 113%,

but only 7.5% in Canada, according to the 2009 annual report of the Patented Medicine Prices Review Board (PMPRB).

Not only detail prices are excessively high in Canada. The rate of growth in prescription drug costs is also far higher in Canada than elsewhere. Note that Australia, New Zealand, United Kingdom, France, and Sweden have lower costs and lower growth of these costs, and all have some form of universal public drug coverage. These countries show not only the feasibility, but also the sustainability and much greater effectiveness of a universal Pharmacare program. Economic comparisons show how the universal Pharmacare programs in other countries are by far more advantageous in terms of costs than is the current hodgepodge of private/public drug insurance plans in Canada.

FIGURE B Real annual growth in prescription drug costs, from 2001 to 2007 (%)



* Average based on available data, 2004 to 2007.

SOURCE OECD Health Data 2009; OECD Main Economic Indicators; NHS Information Centre 2009

Canada's pharmaceutical policies are a total failure. Many Canadians do not have equitable access to medicines, and the lack of coverage makes some treatments inefficient due to lack of compliance. The whole system is unsustainable because we cannot control the growth of drug costs.

Rigorous drug assessment needed

In order to improve the quality of medical practice and curb undue costs from the promotion of costly drugs with limited or no therapeutic benefits, a universal Pharmacare plan will have to adopt a strong and pro-active pharmacoeconomic drug assessment program. This will be needed not only to determine which drug will be put on the formularies, but also to adapt clinical guidelines in order to further instill a culture of evidence-based medicine among physicians.

This will not be readily achievable. In the United States, drug companies spend an estimated \$61,000 per physician on promotion, and

we can assume that the Canadian firms spend a proportional amount.

A rigorous drug assessment process would provide a strong financial incentive for the pharmaceutical industry to produce more truly innovative drugs. Currently, the incentive is to develop imitations of existing medicines that generate more sales because of the effectiveness of promotional campaigns rather than the effectiveness of the drugs themselves.

Such a drug assessment process, in conjunction with a universal Pharmacare plan, would be at least as efficient as the system that already exists in British Columbia, and would thus save Canadians at least 8% of total prescription drug costs — a saving of \$2 billion a year.

Rethinking pricing policies for prescription drugs

In Canada, the prices of brand-name drugs are normally capped at the median price of seven comparator countries. The problem is that these

seven comparator countries include the four countries with the most expensive brand-name prices (United States, Switzerland, Sweden, and Germany). Every year, Canada is thus automatically the fourth or third most expensive country in terms of brand-name drugs. By taking a more rational approach to choosing the comparator countries used by the Patented Medicine Prices Review Board (PMPRB) for determining the price of patented drugs, by sliding from the fourth to the seventh most expensive country in the world, Canadians could save another \$1.43 billion.

A universal Pharmacare program would also help coordinate public programs to address the unethical rebate system for pharmacists. By setting up a supply system such as the hospitals have, a universal Pharmacare program could save at least \$1.31 billion per year on the cost of generic drugs — and without reducing the profits of generic manufacturers. Ontario has moved to eliminate the system of kickbacks, but, without national coordination, it is not clear if the savings in Ontario will translate into overall savings throughout Canada.

If Canada chooses to get rid of industrial policies that artificially inflates drug costs in order to implement competitive purchasing (in the same way that New Zealand does, for example), Canadians could save more than \$10 billion on the cost of their prescription drugs.

A universal public plan would make it possible to realize these substantial savings in an efficient, fair, and transparent manner.

Summary of the economic analysis

Methods of the Economic Analysis

To analyze possible costs and benefits, our report used IMS data provided by the Rx Atlas to identify the main cost drivers for per capita expenditures in prescription drugs. The report then analyzed the differentials between provinces after controlling for age disparity, in order to use

the best data available to analyze discrepancies and identify best practices.

We analyzed the volume effects determined by the number of prescription and their size; the therapeutic choice effects; and the price effects by comparing the prices of the same product and comparing the proportion of prescriptions dispensed as generics.

While most costs and savings were calculated this way, other savings were calculated by comparing private and public drug plans, and finally by comparing prices between Canada and other countries.

Future scenarios for Canada

We take it for granted that the objectives of access to medicines and their safety are non-negotiable. But for cost control, we look at four scenarios for implementing a universal Pharmacare program in Canada. They vary in their compromise between the objectives of cost reduction and industrial policy. All scenarios estimated that universal Pharmacare with first-dollar coverage would increase consumption by 10%, which is a generous estimate based on existing available data.

Scenario 1

Universal Pharmacare with the same industrial policies linked to drug costs

If a universal Pharmacare plan had to be established with the current industrial policies which are favourable to the pharmaceutical industry, the new plan would still lead to substantial savings. Such a plan would result in savings of \$1,454 million in prescription drug costs alone, a reduction of 6%. Additional savings of \$1,493 million would come from eliminating the extra administrative costs of private drug insurance plans and by eliminating the tax subsidies these plans receive.

***Net cost reductions: \$2.95 billion
(11.7% of total costs).***

Scenario 2

Universal Pharmacare with industrial policies linked to drug costs which have been revised to be in line with those of other OECD countries

This scenario would lead to more significant savings, since Canada would slide from the third or fourth most expensive country in the world for brand-name drugs to sixth. Around 12%, or \$3 billion, could be saved on the cost of prescription drugs, and the savings of \$1,493 million in Scenario 1 would be maintained.

**Net cost reductions: \$4.47 billion
(17.8% of total costs).**

Scenario 3

Universal Pharmacare with stronger industrial policies artificially inflating drug costs

This scenario would be to strengthen industrial policies linked to the costs of patented drugs in order to more effectively promote the pharmaceutical industry based in Canada. In this regard, we consider the possibility of the PMPRB setting patented drug prices, not by way of the median in the several comparator countries now used, but by the median in the three countries with the highest patented drug prices in the world: the United States, Germany, and Switzerland. The median of the ratio of foreign prices to Canadian prices for these three countries is 102%.

By strengthening its industrial policy in this way, Canada could ensure that it consistently aims for second place internationally in terms of ex-manufacturer prices of patented drugs, rather than fourth place, which is now the case. The PMPRB would then raise the prices of brand-name drugs by 2%. Since sales of brand-name drugs at ex-manufacturer prices were \$13 billion in 2008, this would mean an additional cost of \$260 million.

**Net cost reductions: \$2.67 billion
(10.6% of total costs).**

Scenario 4

Universal Pharmacare with cancellation of the industrial policies artificially inflating drug costs

The fourth scenario is based on drug purchasing policies that maximize cost reductions for prescription drugs, the way it is done, for example, in New Zealand. Using systematic tendering and reference-pricing, Canada could save \$10.2 billion on drug prices for brand-name medicines and generics. Maintaining other savings and considering the increase of consumption, additional savings of \$540 million could be obtained.

**Net cost reductions: \$10.7 billion
(42.8% of total costs).**

Should we maintain industrial policies that artificially increase drug costs?

Our report shows that increasing the revenues of bio-pharmaceutical companies through policies geared toward facilitating higher prices are completely ineffective, for two main reasons.

First, such policies are inequitable on a provincial scale, since 94% of venture capital in this sector is concentrated in Ontario, Quebec, and British Columbia. The other provinces receive virtually no spin-off benefits from the pharmaceutical sector, even though their citizens pay the same high drug prices.

Secondly, although Canada deliberately sets its drug prices high to encourage research and development on Canadian soil, total R&D spending by the industry is \$1.31 billion, 59% of which consists of tax subsidies. The PMPRB's policy has therefore been a complete failure, since it leads Canadians to spend \$1,530 million more than the average prices of brand-name drugs in OECD countries in order to generate \$537 million in R&D spending. Canada would benefit greatly from using this money instead to encourage pharmaceutical R&D by funding new types of incentives — for example through public spending in pharmaceutical research or the implementation of a prize-system for innovation. It may

be reasonable to maintain alternative industrial policies for this sector, but artificially increasing drug costs is extremely costly and fails to foster pharmaceutical innovation in Canada.

Conclusion

A universal drug plan providing first-dollar coverage, established alongside a rigorous drug assessment process, would not only ensure greater fairness in accessing medication and improve drug safety, but would also help contain the inflationary costs of drugs, regardless of the industrial policy Canada may choose.

Even though our report clearly shows that industrial policies aiming to artificially increase drug costs are totally ineffective in generating proportionate pharmaceutical spinoffs, our purpose is simply to demonstrate the economic inefficiency of the current drug insurance program.

A comparison of Canada with other OECD countries reveals that Canada can be considered an inefficient model in terms of drug policy: 1) we spend more per capita on drugs, the costs of which are growing faster than elsewhere; 2) our public plans are inequitable because they do not provide adequate or suitable coverage to a large number of Canadians; and 3) the meager industrial benefits in the pharmaceutical sector are totally out of proportion with the money given

by Canadians in various privileges and subsidies to the industry.

By comparing the various provincial drug plans, we identified the problems with the status quo and were able to calculate the savings that could be achieved through a publicly-funded universal drug plan providing first-dollar coverage. Canadians could save between 10% and 42% of total drug expenditures, depending on the choice of industrial policies related to drug costs.

The main argument that is typically made against the establishment of universal Pharmacare is economic in nature. This report shows that the economic argument in favour of such a program is loud and clear, *regardless of which industrial policy is subsequently considered*.

Admittedly, establishing a national, universal drug plan providing first-dollar coverage is not a simple matter. Government funding, even when lower than comparable private spending, is often very difficult to justify publicly. A national Pharmacare program will have to find a balanced approach to ensure coherence across the country while respecting provincial health jurisdictions. But these are not insurmountable obstacles. Quite the contrary. A clear policy backed by real political will would give all Canadians equal access to the best drug treatments available, while generating substantial savings over the existing plans.

The analysis in this report shows that the only hindrance to establishing a fair, effective drug insurance program is political apathy, not economic cost restraints.