Weekly Checkup

Of Prices and Costs

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Love it or hate it, the Inflation Reduction Act (IRA) is now the law of the land. **In the coming months and years, the Centers for Medicare and Medicaid Services (CMS) will begin the process of "negotiating" (read: setting) drug prices.** The results of these negotiations don't kick in until 2026, however, and the inflation penalty for existing drugs—which is intended to keep prices from rising faster than inflation—is tied to higher-than-usual inflation rates. In the meantime, **how will pharmaceutical companies prepare for these future price controls? Very likely, they will do what any other for-profit business would do under similar circumstances: raise prices in the short term, and shift investments away from drugs that have closer dates of negotiation eligibility.**

46Brooklyn, a drug pricing research firm, reported that 870 drugs have seen a list price increase so far in January 2023, averaging about 6.5 percent, while only two drugs decreased in price. This is not out of line with the expectations of drug purchasers (hospitals, pharmacy benefit managers, health maintenance organizations, and the like) that reported in a survey that they expect prices to rise by about 8 percent annually. That 6.5 percent increase is also just slightly above the benchmark 2021 inflation rate of 6.2 percent that triggers a penalty on existing high-spend drugs in Medicare Parts B and D – so there's plenty of room to raise prices. There's some nuance to all of this, naturally: Brand name drug prices have actually gone down over the past five years. Purchasers in this survey also only expect about 25 percent of that 8 percent increase to be related to the IRA – list prices overall have been trending up for some time. Additionally, list prices aren't usually what people pay (but do impact co-insurance for patients) so net cost increases are still unknown. Still, **between the inflation rebate rule and price negotiations, one would be hard pressed not to see the incentive for companies to launch drugs with high list prices to maximize profits.** The Medicare Payment Advisory Commission has pointed this out, noting that Medicare should expect increased costs on protected classes of drugs due to insurers' inability to limit use of these drugs as well as the cap on seniors' annual out-of-pocket drug costs created by the IRA that will encourage higher utilization.

Higher prices aren't the only issue. The IRA makes small molecule drugs (pills and capsules) negotiation-eligible after nine years, while biologics (infusions and injections) would become negotiation-eligible after 13 years. **Companies are responding by shifting their long-term investment focus away from small molecule drugs and towards biologics, citing the IRA specifically.** In a survey by the trade group Pharmaceutical Research and Manufacturers of America, 63 percent of companies said they expect to shift research and development resources away from small molecule drugs. Eli Lilly has already pulled the plug on a small molecule blood cancer drug because it "just couldn't get the math to work," according to its CEO. Expect more of this shift in the coming years. **The price controls in the IRA also decrease the value of generics, which will no longer be the big savers they once were, reducing incentive for companies to invest in them.**

These consequences of the IRA drug pricing provisions were not unforeseen. Previous Weekly Checkups and American Action Forum analyses, joined by countless others, have highlighted the potential consequences of the IRA's passage. **There is a cost to forcing artificially low drug prices, and ultimately patients will pay it.** Let's hope the federal government learns that lesson soon.