# Surge in prices boosts drug industry profits

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An investigation by Bloomberg News, published earlier this year, has found that in recent years the increases in the prices of competing prescription drugs rose in lockstep by about the same amount at the same time. “Contrary to the consumer’s ideal in which bare-knuckled rivals cut prices to grab market share,” the report notes, “competitors in branded pharmaceuticals often drive each other’s prices higher.”

The news outlet surveyed drug brands with at least $350 million in U.S. sales in the past year. Drug companies evade anti-trust laws by independently following each other’s drug price increases, as opposed to active collusion. This practice is known as “shadow pricing.”

For example, Bloomberg found that the prices of the long-lasting injectable insulin drugs Lantus (marketed by Sanofi) and Lemivir (sold by Novo Nordisk) have increased in tandem 13 times since 2009. Similar price increases were found for the shorter-acting insulin drugs, Humalog (Eli Lilly) and Novolog (Novo Nordisk).

The news outlet found that at least 30 brand-name pharmaceuticals sold in the U.S. have more than doubled their price tags in the past 5 years. They include: Xyrem, a treatment for narcolepsy symptoms marketed by Jazz Pharmaceuticals (350 percent price increase); Epipen, sold by Mylan to address allergic reactions (223 percent); Premarin Vagina Cream, sold by Pfizer to treat menopausal symptoms (218 percent); Synthoid, a thyroid hormone marketed by AbbVie (149 percent); and Welchol, a treatment for high cholesterol sold by Daiichi Sankyo (139 percent).

Drug companies contacted by the news outlet responded with a litany of excuses, arguing that discounts and assistance programs, or simply the “significant value” the drugs provide their customers, justified the enormous price hikes.

The Bloomberg report follows a number of studies highlighting the skyrocketing costs of prescription drugs.

A recent article published in the journal *Neurology* found that treatments for multiple sclerosis now cost seven times more than they did in 1995, far above the rate of inflation. The lowest-priced treatment currently stands at $50,000 a year. According to the researchers, “the simplest explanation is that pharmaceutical companies raise prices of new and old MS DMTs [multiple sclerosis disease modifying therapies] in the United States to increase profits and our health care system puts no limits on these increases.”

Likewise, a study published in March by pharmacy benefits manager Express Scripts found that 2014 witnessed the highest annual increase in drug spending in the U.S. since 2003. Spending by commercially insured patients rose by 13 percent. Driving much of the increase was spending on Hepatitis C medications, which grew by 742.6 percent in 2014 compared to the previous year. For example, the hepatitis C treatment Harvoni (marketed by Gilead), with an estimated patient population of 3 million, is priced at $33,000 for a 30-day prescription.

Generic drugs, which are supposed to provide a lower-cost alternative to branded drugs, have seen similar price hikes. The *Chicago Tribune* reports that the price of the 50 most popular generic drugs rose from $13.14 per prescription in 2010 to $62.10 in 2014—an increase of 473 percent.

The pharmaceutical industry argues that these exorbitant drug prices are necessary for it to recoup the costs of research and development, including the costs incurred during the three phases of clinical trials necessary for FDA approval.

Calculating the costs of producing a new drug requires taking into account a number of complex variables. To ensure that an industry-friendly figure was arrived at, drug makers helped finance the

formation of the Tufts University Center for the Study of Drug Development in the mid-1980s. Starting in 1991, a group of economists at the center led by Joseph A. DiMasi have regularly issued estimates of the cost of producing a new drug that inevitably inflate the figures. Thus, according to the Center, the cost of producing a new drug was $114 million in 1991, $802 million in 2001 (or $1 billion in 2013 dollars), and $2.6 billion in 2014.

However, the Tufts estimates make a number of unwarranted assumptions, resulting in an inflated figure that is then promoted by the pharmaceutical industry and its trade association, PhRMA.

The 2014 figure was derived from data provided by 10 pharmaceutical companies based on 106 randomly selected drugs that entered human testing between 1995 and 2007. Information on the study's methodology is limited to a PowerPoint presentation released by the authors.

The $2.6 billion figure includes both the estimated cost of drug failures and opportunity costs of capital.

"Because the R&D process is marked by substantial technical risks," says DiMasi, the principal investigator of the study, "the expenditures incurred for many development projects that fail to result in a marketed product, our estimate links the costs of unsuccessful projects to those that are successful in obtaining marketing approval from regulatory authorities."

The Tufts study arrived at a figure of $1.4 billion for average out-of-pocket costs (including failures). It then doubled the price tag by including $1.2 billion in "time costs," or returns that investors forgo while the drug is under development. That is, the figure eliminates all financial risk from the equation.

The figure, moreover, ignores the role that public research institutions and universities play in subsidizing much of the basic research that undergirds drug discovery and development. Additionally, the study fails to consider the tax credits and other incentives offered to drug makers working on "orphan diseases."

Depending on how the companies do their bookkeeping, marketing expenses may also be included in the estimate. Even areas that could be viewed as legitimate R&D expenses, such as clinical trials, are often themselves simply marketing ploys. So-called "seeding trials," for instance, are clinical trials conducted not to establish the safety or efficacy of a drug, but simply to get physicians used to prescribing it. A particularly egregious example of this practice by the pharmaceutical company Parke-Davis (now a subsidiary Pfizer) was highlighted in a 2011 article in the journal *Archives of Internal Medicine,* which reassessed the company's "study" of the seizure drug Neurontin.

While the Tufts figure continues to be touted as a justification for high drug prices, the pharmaceutical industry maintains the highest profit margins of any industrial sector (including banking), with an average of 20 percent in 2013, according to the BBC. That year, drug maker Pfizer reported a 42 percent profit margin, while Hoffman-La Roche, AbbVie, GlaxoSmithKline (GSK) and Eli Lilly all saw profit margins of 20 percent or more.

An analysis of the corporate filings of the 11 largest drug makers between 2003 and 2012 by the lobbying group Health Care for America Now (HCAN) found that these drug companies pulled in $711.4 billion in profits over the course of 10 years. In 2012, the companies made $83.9 billion in profits, a 62 percent increase over the 2003 figure.