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OPINION | COMMENTARY

# *Drug Rebates Aren't 'Kickbacks'*

A rule designed to save patients money would end up having the opposite effect.

By Joseph Antos and James C. Capretta

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The Trump administration is close to issuing a new rule that could effectively ban rebate payments from drug manufacturers to pharmaceutical benefit managers, or PBMs. The plan is misguided. A full ban would backfire and increase costs to consumers.

The regulation, now under review at the Office of Management and Budget, could remove the safe-harbor protection for rebate payments under an anti-kickback law. But rebates are price discounts, not kickbacks. They reduce prices based on sales volume: Drug companies charge less when more of their drugs are sold to patients.

PBMs are at the center of the debate. Private employers and insurers, faced with rising drug costs, have turned to PBMs to manage their drug benefit programs. PBMs develop lists of covered drugs, or formularies, negotiate discounts and rebates with drug makers, and pay claims. PBMs lower the cost of the benefit by steering patients toward preferred drugs.

PBMs have more leverage than employers or insurers because they negotiate on behalf of numerous clients. When more than one patented drug is available for an illness, manufacturers offer rebates for preferred placement.

An automatic capsule package production line. PHOTO: ISTOCK/GETTY IMAGES

The Trump administration says that because consumer payments are based on prices before rebates, patients don't benefit from the savings. That's only part of the story. PBMs typically require lower out-of-pocket payments from patients who use preferred drugs, and they save consumers money by steering them toward generic drugs.

Consumers also benefit directly from rebates paid to PBMs. The Altarum Institute estimates that in 2016 PBMs earned $11 billion in profits and passed on $89 billion in rebates to employers and insurers. Health plans in turn have strong incentives to pass on rebate revenue to their enrollees in the form of lower premiums and better coverage. A ban on rebates would make coverage more expensive and less generous.

Yet while a complete ban on rebates would backfire, Medicare's drug benefit needs to be fixed, because it favors rebates rather than lower prices. Above a modest level of drug spending, private Medicare drug plans (mostly insurance plans tied to PBMs) are responsible only for a small portion of a patient's drug costs—15% once a beneficiary's expenses exceed the annual catastrophic threshold, $5,000 in 2018. The Medicare program pays for 80% of the costs above this threshold, and beneficiaries pay the remaining 5%.

Because insurers and PBMs pay such a small portion of the costs above the catastrophic threshold, they are less sensitive to high drug prices than they should be. High prices at the pharmacy push beneficiaries above the catastrophic threshold quickly, so the government begins picking up most of the bill. Medicare drug plans prefer rebates over lower prices because they can use rebate payments to lower their premiums, leading to higher enrollment and greater leverage with drug makers.

Not surprisingly, spending for the drug benefit has become distorted. The government spent $37 billion in 2017 covering expenses for beneficiaries above the catastrophic threshold, up from $9 billion in 2008.

This problem can be fixed not with a ban on rebates, but by requiring insurers and PBMs to pay more of the costs for drugs above the catastrophic threshold. If Medicare plans were responsible for 80% of the cost instead of 15%, they would have an incentive to press for lower prices for their high-cost patients. That would produce a better balance between lower list prices and rebate payments.

Administration officials claim they want to lower drug prices with market incentives, but a broad-based attack on drug rebates is the opposite of a market solution. Streamlining regulations to bring new products more quickly to the market, reforming Medicare's drug benefit design, and removing unnecessary interference that impedes competition would do far more to promote affordable and effective medicines for Americans.

*Mr. Antos is a resident scholar in retirement and health policy at the American Enterprise Institute. Mr. Capretta is a resident fellow at AEI.*