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Time to Free a Controlled Marketplace for Generic Drugs

Group Purchasing Organizations buy drugs and supplies for hospitals, supposedly to save money. But they have constricted supply and raised prices paid by patients and insurers.

By PHILLIP L. ZWEIG
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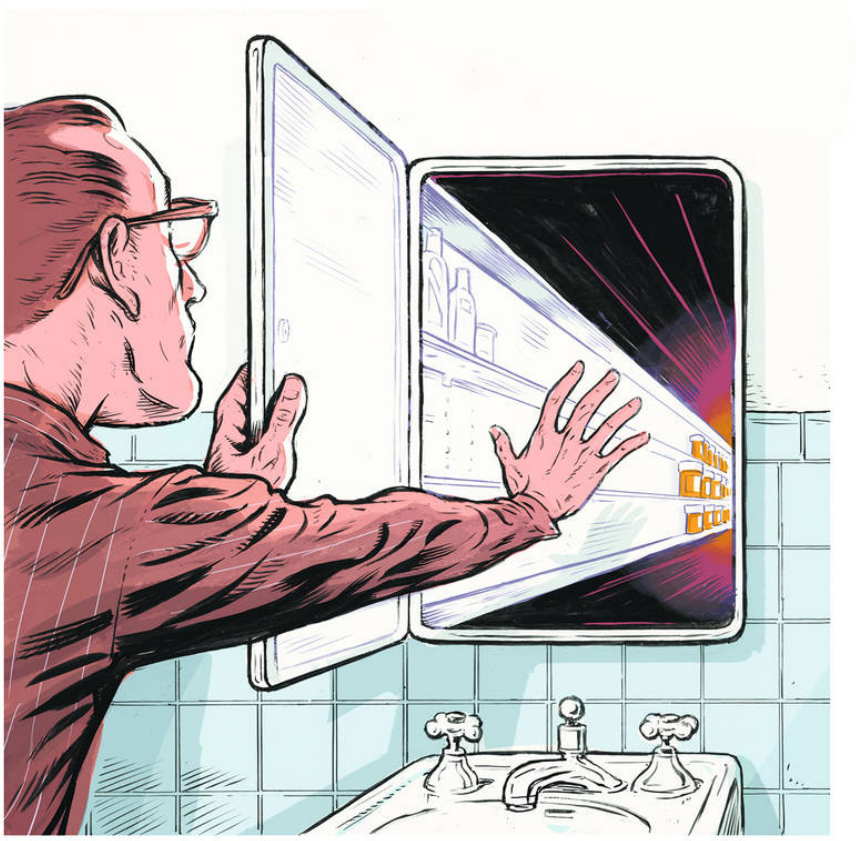

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After Martin Shkreli, the Peck's Bad Boy of the generic pharmaceutical industry, took the Fifth at a February hearing of the House Committee on Oversight and Government Reform, he recklessly tweeted that the members were "imbeciles." They had hauled him to Washington, D.C., to lambast him and his company, Turing Pharmaceuticals, for acquiring exclusive rights to market Daraprim, an antiparasitic agent, and then jacking

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up the price more than 50-fold to $750 per pill.

He was wrong: Most members knew exactly what they were doing—kicking the can down the road and competing to deliver catchy sound bites that would land them on the evening news.

Turing and Valeant Pharmaceuticals International, another "rebrander" whose interim CEO testified at the hearing, are predators. But they didn't cause the shortages and skyrocketing prices of generic prescription drugs, which are merely symptoms of a broken marketplace. The controlled market has denied millions of patients and their providers access to hundreds of affordable, lifesaving chemotherapeutic agents, anesthetics, antibiotics, and even mainstay nutritional intravenous solutions like sterile saline. Some patients are dying and others are suffering from avoidable side effects and excessive recovery times.

Congress created this fiasco, and it's up to Congress and the White House to fix it. Instead, for more than five years, in more than a dozen hearings, members have addressed this public health crisis as if it were one of the great unsolved mysteries of the universe. But this is just a failed market in which the fundamental law of supply and demand no longer functions.

Congress has embraced the false idea that the causes are complex, with many factors, and that there is no single remedy. Putative causes have included: price-gouging by so-called gray-market drug distributors; government price controls; raw-materials shortages; manufacturing and quality-control problems and overzealous Food and Drug Administration inspections.

A Government Accountability Office report in February 2014 discredited some of these factors and dismissed the rest as consequences, not causes. Later allegations that an FDA applications backlog is to blame have been debunked.

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The GAO and former senior Obama administration officials have strongly implicated anticompetitive contracting and pricing practices of giant hospital group purchasing organizations as the real underlying cause.

These buying cartels control purchasing of an estimated $300 billion in drugs, devices, and supplies annually for 5,000 hospitals. Four of them—Vizient, Premier, HealthTrust, and Intalere—account for an estimated 80%-plus of the total business. Most of the scarce drugs are sterile injectables; virtually all are sold to health-care facilities through group purchasing contracts. The organizations award exclusive contracts, on a drug-by-drug basis, to favored suppliers, in return for exorbitant fees. For some drugs, those "fees" have exceeded half of the suppliers' annual sales revenue for each drug, according to court documents. This is a pay-to-play scheme that has destroyed competition by reducing the number of domestic drug suppliers and undermining their ability to maintain quality.

GROUP PURCHASING ORGANIZATIONS, or GPOs, have been around since 1910, when several New York hospitals banded together to save money by purchasing supplies in bulk. Member hospitals paid dues to cover administrative expenses. This co-op model worked well for more than 80 years.

But in 1987, at the urging of hospital lobbyists, Congress fixed what wasn't broken. It enacted a safe harbor provision that exempted group purchasing organizations from criminal penalties for taking kickbacks from vendors, thereby enabling vendors, instead of member hospitals, to pay GPOs.

After the safe-harbor rules took effect in 1991, GPOs became the market makers and gatekeepers. They set prices and decide which vendors can sell to member hospitals.

Instead of saving hospitals money, the organizations have inflated the annual cost of supplies by at least $30 billion, according to a 2011 study in the Journal of

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Contemporary Health Law and Policy. Because their fees are based on a percentage of total volume, higher prices mean more revenue for GPOs.

The group purchasers claim that they get the lowest prices for hospital supplies, including drugs. But these are artificial contract prices, not market prices. No one outside this secretive system seems to know what happens to the billions in kickbacks, because there is virtually no industry disclosure, oversight, or regulation. A lobby supported by the Healthcare Supply Chain Association and the American Hospital Association makes sure of that. The AHA opposes reform because many members gladly accept a portion of the kickbacks for maintaining compliance with GPO contracts.

Media exposés on GPO abuses prompted the Senate Antitrust Subcommittee to hold four hearings from 2002 through 2006. More investigations followed.

In 2005, Sen. Chuck Schumer (D., N.Y.), the industry's leading congressional apologist, derailed bipartisan legislation that would have restored market competition, and arguably prevented the shortages by repealing the safe harbor. Other attempts to pass legislation have also come to naught.

But early this year, at the urging of Physicians Against Drug Shortages, Sen. Richard Blumenthal (D., Conn.), who investigated GPOs as Connecticut attorney general, placed the issue on the antitrust panel's agenda. Chairman Mike Lee (R., Utah) currently holds the key to whether competition and integrity are restored to the hospital supply chain. They, or their successors, must finally demonstrate their duty of care to the American people by repealing the safe harbor.

PHILLIP L. ZWEIG is executive director of Physicians Against Drug Shortages, a nonprofit, pro bono patient-advocacy group. It is self-funding and has no budget.

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