

Why are brand-name medications more expensive than generic medications?

Cost differences can be substantial between brand-name medications and generic medications with the same active ingredients in identical amounts. When the first generic medication is introduced following the patent expiration of a brand-name medication, typically its cost is reduced only slightly. The first generic product has a six-month marketing exclusivity. Thus, significant cost reductions are often not seen until six months after the patent expires. The introduction of a second generic equivalent, on average, reduces the cost to approximately half the brand-name cost. If a large number of generic manufacturers are attracted to market and introduce competing generic medications, the average cost may fall to 20 percent of the branded cost, and sometimes lower. These substantial drops in price make patients rightfully wonder whether generic medications are as effective as brand-name products (see Chapter 8).

Why are patent-protected medications so expensive?

First, the estimated cost of taking a medication to market is \$1 billion (Chapter 51). This figure is self-reported by the pharmaceutical industry and may be exaggerated. The approval process (the time from identification of a promising chemical to FDA approval) ranges from 8 to 12 years. This means that half of the 20-year patent period has passed by the time the medication reaches the market, and the time to recoup developmental costs and make a profit is short. Second, the pharmaceutical companies spend very large amounts on marketing their patent-protected medications. Advertising expenditures typically exceed those invested in research and development. Only about 15 percent of a company's budget is set aside for pursuit of new and hopefully better products. Third, a main objective of any pharmaceutical company is to generate profit for its shareholders. Over the past decade, this industry has been among the most profitable of all industries. High medication costs are required to produce high profits and to keep stock prices from falling. Fourth, pharmaceutical manufacturers set a high price for their new drugs because they can; a patent-protected brand-name drug is a monopoly.

How does competition influence medication costs?

Competition is healthy and keeps the cost of medications down. This is



illustrated by the low cost of generic medications marketed by multiple manufacturers. The cost of brand-name drugs is often lowered when there is competition from another brand-name drug with similar benefits and safety considerations. More importantly, when the first few medications of a particular class lose their patent protection, these products become available as low-cost generics. This may put pressure on the manufacturers of the remaining brand-name medications in that class to reduce cost in order to hold on to their market shares in some segments of the market. In other market segments, brand-name manufacturers react by increasing the cost of the drug to maintain revenues.

Are there societal efforts to contain the cost of prescription medications?

Medications, especially brand-name medications, are more expensive in the U.S. than in any other country in the world. There are many explanations for this. The U.S. is the only country that has so-called “open pricing,” which means pharmaceutical companies can set any price for their new drugs. Other countries establish a reimbursement price for every new medication, based on its health effects, the availability of treatment alternatives, and other factors. In the U.S., companies can increase the price of their products at any time without

any justification, which is why costs increase more on an annual basis than the inflation rate.

Many countries restrict price increases and may actually reduce reimbursement prices, which more or less forces the companies to lower their prices. Unlike other governments, the U.S. government does not engage in cost negotiations with pharmaceutical manufacturers, except for medications provided through programs such as the Department of Defence and the Veterans Administration systems. With this policy, it is not surprising that our medication costs are high and continue to escalate.

Why are the costs for generic medications so low?

Is it true that the quality of a generic medication is equivalent to the quality of its more expensive brand-name product, even though the latter may cost 10 times more? The answer is yes. Generics undergo the same rigorous standards of production and control as their brand-name equivalents. In fact, some brand-name manufacturers sell generic drugs through their subsidiaries.

The main explanation for this large cost differential is that manufacturers of generic medications have low developmental costs. Rather than starting with a large number of promising chemicals, they select medications with a proven record and with large market penetration. The production costs for a brand-name medication are often less than 5 percent of its retail price. In addition, generic manufacturers spend much less on marketing and accept much lower profit margins.



Key messages

- ✓ Major factors driving the high cost of brand-name medications include developmental costs, marketing, and profit.
- ✓ The cost of production is often less than 5 percent of the medication's price.
- ✓ Generic companies have no developmental costs, limited marketing, and much smaller profit margins.
- ✓ Another major contributor to the high cost of brand-name medications in the U.S. is the lack of governmental policies to keep cost down.