

Why do prescription drug prices vary among different pharmacies?

Like so many Americans, you probably wonder why we not only pay the highest retail prices in the world for prescription medications, but why prescription drug costs vary from state to state, city to city, and even pharmacy to pharmacy. A number of common factors contribute to what consumers pay for prescription drugs. Some of these factors are quite straightforward while others are more complicated. This chapter focuses on some of the reasons for variability in retail costs of prescription medications.

What factors contribute to pharmacy retail medication prices?

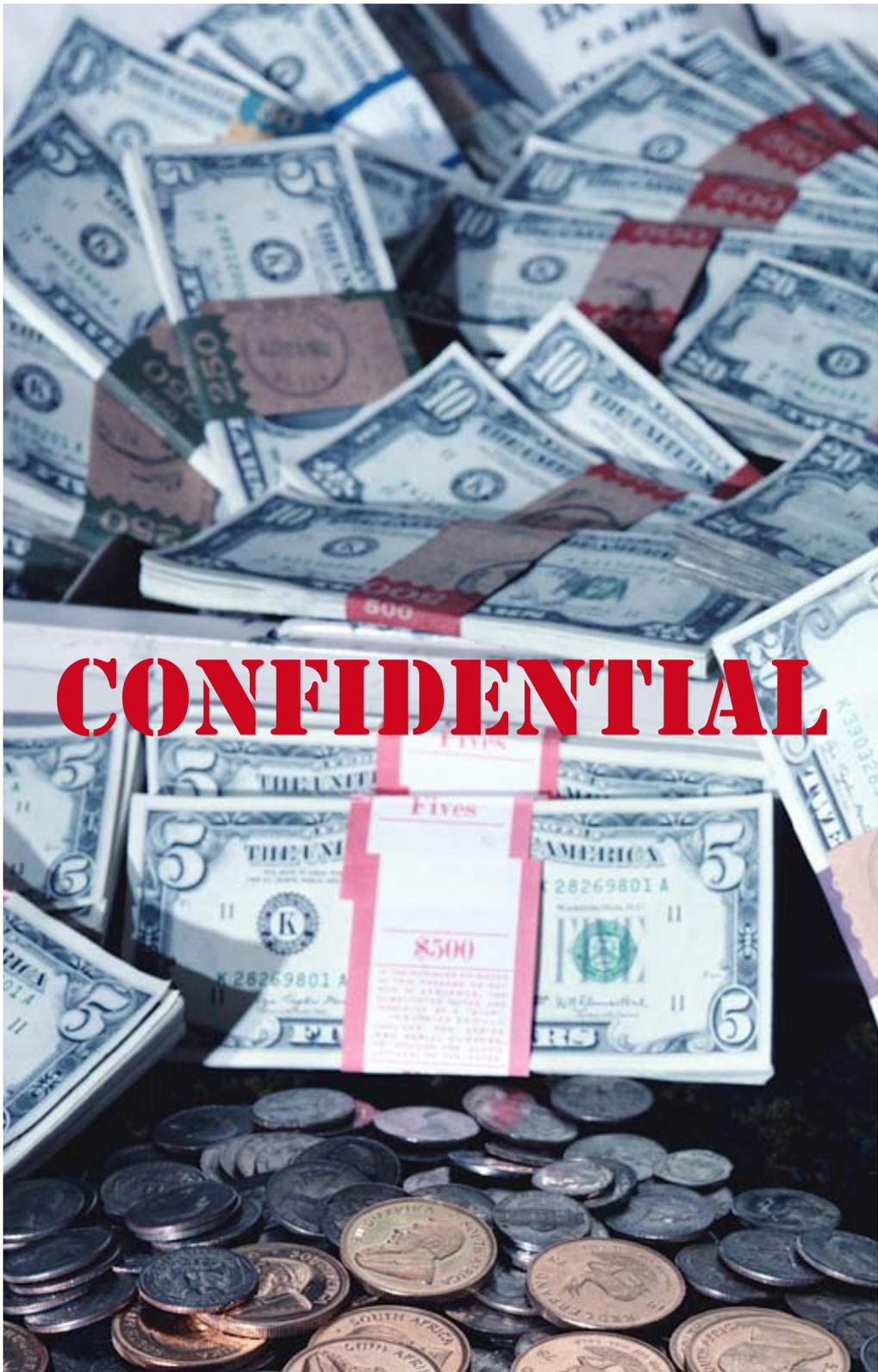
Key factors contributing to the retail price of prescription medications include pharmacies' business (overhead) costs, profit margins, and costs to obtain prescription drugs from manufacturers or wholesalers.

A pharmacy's costs of doing business are not much different from other businesses. These relate to employee wages and benefits, facility costs (rent/mortgage, property insurance, and taxes), and prescription department operating costs (license fees, liability insurance). Because these expenses are influenced by geographical location and current local market conditions, this provides one explanation regarding medication cost variability.

Beyond the costs of doing business, pharmacies' profit margins are based on what they actually pay for the prescription drugs that they sell. This actual acquisition cost is considered proprietary information, which is unfortunate because it strongly influences prescription drug costs to individual consumers, as well as Medicare and private insurer reimbursement rates for prescription drugs. Since pharmacy retail prices are very much related to government and private insurer reimbursement for pharmacy costs, we will address this more complicated topic below.

What is the true cost of a medication to the pharmacy?

The actual acquisition cost for a drug can be difficult to pin down, since it may depend on discounts granted on a quarterly basis only after the drug purchase agreement takes place. The actual acquisition cost remains a closely guarded secret. Only the person signing the purchasing contract for the pharmacy and the seller of the medication are informed.



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How are Medicare and private insurer prescription drug reimbursements determined?

For years, prescription medication reimbursements to pharmacies by government drug programs and private sector insurance companies were based on the Average Wholesale Price (AWP). The AWP also was used to establish pharmacy retail prices for prescription medications. The irony of using the AWP as the basis for cost reimbursements and retail pricing is that it is artificial. The AWP was set by pharmaceutical manufacturers and large database publishing companies, but no pharmacy has actually paid the AWP. According to the U.S. Government Accountability Office (GAO), the AWP may be neither “average” nor “wholesale.”

Because of this “disconnect” between actual acquisition costs and the AWP, the government and other insurers began to reimburse pharmacies on the basis of AWP, minus a given percentage. This was done after it became clear that medication reimbursements were higher than what pharmacies actually paid for drugs. Pharmacies were able to increase their profit margins by billing or charging based on the AWP, while paying a much lower price for a drug than the AWP. Legislation was proposed to change the reimbursement for outpatient prescription drugs under Medicare from AWP to the average acquisition price. While the AWP is self-reported by manufacturers and leads to unchecked overpayments, the average acquisition price is based on the actual price of drugs paid by domestic purchasers. This price is determined by taking into consideration all available discounts, including rebates, volume discounts, and other price concessions provided by manufacturers.

The new Medicare Modernization Act, which provides a prescription drug benefit for seniors, uses a base for reimbursement called the Average Sales Price (ASP). The ASP is similar to the average acquisition cost described above in proposed legislation. The hope is that ASP will more accurately reflect the true cost of medications in the marketplace.

How ASP might influence future retail costs for prescription drugs remains to be seen. One thing is certain: Payers will only want to reimburse based on the best wholesale prices in the marketplace, which is good news for American consumers and the American health care delivery system.

The complicated cost reimbursement system applies mainly to generic medications, where price competition is greater than for brand-name drugs, which effectively hold a monopoly in the market until a manufacturer’s patent expires. The technical language (actual acquisition cost, average acquisition price) and abbreviations (AWP, ASP) related to drug reimbursement reflect the complexity of the wholesale cost of medications. The fact that this process differs for retail, hospital, and government drug pricing markets only adds to this confusion.

A sustainable drug benefit program, whether it is a private insurance policy or a public program such as Medicare, can only survive if a fair price is paid for the safest and most effective drugs. Current government efforts to better control pharmacies' reimbursement costs are laudable. But as noted in Chapter 17, much more could be done to deal with the unregulated prescription drug prices pharmaceutical manufacturers are allowed to charge, and to establish fair and reasonable reimbursement costs for new medications.

Key messages

- ✓ The determination of a medication's retail price is complex and not transparent to the public.
- ✓ Prescription drug prices can vary substantially from pharmacy to pharmacy.

