



Yale SCHOOL OF MANAGEMENT

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Should Pharmaceutical Manufacturers Pay Insured Patients to Consume their Drugs?

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Insurance basics

Why do people want insurance?

- To smooth health costs over time: if illness arrives at a point in time and is expensive, a person might not have savings
- To smooth health costs over people: if illness hits some people more than others, that sick person might not be able to earn enough to pay

Ideal financial setup is constant premium, no out of pocket payments. But...

Imperfections

- People might over-consume because they are insured
 - Don't value the medication, but take it because it's free
 - Therefore add (small) co-pays
- Insurer responsible for negotiating prices
 - Extracts discounts by threatening to walk away
 - Move consumers to another brand in response to price
- How to move them? HMO v “traditional insurance”
 - Trad insurance has no tool to shift physician prescribing
 - Trad insurance uses financial tool with patient – co-pays

Result?

- We need copayments to reduce moral hazard (over consumption) and allow the insurer to “shift share” (be elastic and extract discounts)
- However, ideally want to be as close to full insurance as possible, so co-pays should be set as low as will achieve these goals.
- Current problems driven by high healthcare costs
 - High deductible? Designed to reduce the value of the benefit (lower costs for employers -- and maybe therefore higher wages for employees)
 - Specialty tier 30%? Designed to reduce the value of the benefit for a few expensive patients

Result when consumers face high co-pays

- Now the manufacturer has a strategy: Give the patient money to help with the co-pay in return for the profit margin earned by consumption of the drug!
 - Two problems...
 - The patient is insured! So there is an externality – others ultimately pay for the drug.
 - The patient payments prevent the insurer from shifting share so the manufacturer doesn't have to bargain
- ⇒ Equilibrium prices are higher

Intuition by analogy

- The head of a Transportation Department also chooses to consume items (roads rather than drugs) that others pay for (citizens rather than enrollees)
- Do we allow the head of the Transportation Department to personally accept payment from a construction firm when he chooses its product?
NO. Kickback.
- Patient coupons and financial aid to insured patients are kickbacks to people *choosing* the product but who are not *paying* for the product
- And, they are designed to reduce elasticity of demand.
- Not good public policy to allow manufacturers to help patients – clear conflict of interest

Ultimate harm

- PBM/insurer cannot shift share away from a brand with a high co-pay if the brand undoes the incentive with a coupon or financial aid
- Insurer moves drug A to a preferred tier with \$15 co-pay and competing expensive brand B to tier with \$70 co-pay. Consumer normally would pick A.
- Coupon for \$55 means she gains nothing financial from switching and instead stays with B.
- Then the insurer can't move its patients. Has no bargaining power with B. "Give me a lower price or I will move my business" is empty threat.
- Prices – paid by all enrollees – are therefore higher. Patient has shifted high costs to others

Suggested Policy Pair

Need co-pay to enable insurer to bargain for low prices, but if coupons limited, employer or insurer could design significant financial burdens that make needed medication out of reach. So need a *pair* of policies:

- 1) Cap patient co-payments at some dollar amount (perhaps \$150) per month/course of treatment
- 2) Forbid coupons or any type of kickback from manufacturers

Would result in **LOWER** cost of drugs for consumers