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Government negotiations in drug prices are dangerous

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On Tuesday, House Democrats released the Affordable Health Choices Act of 2009, their comprehensive health reform package. As expected, the proposal to create a brand new government insurance program designed to directly compete with private plans is getting a great deal of attention.

An important power of this "public option" has yet to receive much scrutiny, though. The secretary of Health and Human Services will be given the authority to "negotiate" prescription drug prices for the public option.

This is a big deal. Government "negotiations" with private vendors almost always mean public officials simply dictating below-market prices. If that holds true in the public option, drug companies that want to participate in the program will be forced to deeply discount their meds.

These negotiations might translate into cost-savings for patients up front. But the long term effect would be a stifling of pharmaceutical innovation, leading to fewer new breakthrough medicines and compromised patient care.

How so? Developing a new pharmaceutical drug is incredibly expensive. The whole process –including the initial research stages, the countless in-lab experiments required to turn a promising chemical into a usable drug, and the slow, grinding navigation through the FDA's notoriously difficult safety approval pathway — costs over a billion dollars and takes over a decade for the average drug.

Forcing pharmaceutical makers to sell at artificially low prices for a substantial slice of their customer base would drastically reduce their revenues, and leave an increasingly small amount for financing the discovery of new drugs.

It's also likely that many drug producers simply won't be able to afford to sell at government-demanded rates. They won't participate in the public option, and beneficiaries will be stuck with fewer drugs choices.

As Stanford economists Alain Enthoven and Kyna Fong have explained, when discussing Medicare Part D, "Government price negotiation could leave people without drugs that manufacturers decide aren't sufficiently profitable under the plan."

That's exactly what has happened under the health insurance program run by the Department of Veterans Affairs, which is already empowered to directly negotiate prices with drug producers.

Of the 300 most prescribed drugs among Americans 65 and older, the VA only covers 65 percent of them, according to a study from the Lewin Group. By contrast, the two most popular plans in the Medicare Part D drug benefit — where private insurers compete for customers — each cover 94 percent of those medicines.

In fact, over a third of retired veterans supplement their VA coverage by enrolling in Part D

The Part D model hasn't sacrificed cost-savings for choice, either. The competitive pressures among participating insurers have lead to a 17 percent drop in out-of-pocket spending for seniors who enrolled in the program in 2006 — that's equivalent to 14 extra days of medicine a year.

Moreover, Part D's total expenses over the next decade are expected to be nearly $120 billion less than originally estimated when the program was created.

Senate Democrats could unveil their healthcare bill by as soon as the end of the week. Legislators from both chambers will then have to hammer out compromise legislation. Hopefully, when it comes time to vote, the final bill will eschew the government-heavy approach typified by direct negotiating powers. Instead, officials should take a cue from Part D and enable market competition to bring down health costs while expanding patient access to vital pharmaceutical treatments