August 29, 2018

The Honorable Michael Burgess, M.D.
Chairman
House Energy and Commerce Subcommittee on Health
2125 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Burgess,

The Council for Citizens Against Government Waste and the National Taxpayers Union oppose H.R. 6642, which would amend the Social Security Act and sunset the limit on the maximum inflation rebate of 100 percent of the Average Manufacturer Price (AMP) for outpatient Medicaid drugs. The AMP is the average price paid to the manufacturer for the drug by wholesalers for drugs distributed to retail community pharmacies and retail community pharmacies that purchase drugs directly from the manufacturer. The legislation purports to lower drug prices, but it would instead raise drug prices.

The Medicaid rebate was created in 1990 and led to additional price-controlled markets with the Veterans Affairs drug benefit and 340B drug discount program. Under the Patient Protection and Affordable Care Act (ACA), or Obamacare, the basic Medicaid rebate was increased for most outpatient drugs from 15.1 to 23.1 percent of the AMP for brand drugs and from 11 to 13 percent for generic drugs. Medicaid expansion and the exponential growth of the 340B program under ACA has further distorted pricing in the pharmaceutical market.

Just as squeezing down on one side of a balloon causes the other side to grow larger, any rebate based on the AMP will encourage list prices to be increased, causing costs to be shifted to the private-sector market to make up for the losses. This cause-and-effect phenomenon is suggested throughout the Department of Health and Human Services' (HHS) May 2018 report, "American Patients First," also known as President Trump's blueprint to lower drug costs.

Brand-name pharmaceutical companies and generic companies pay an inflation rebate if a drug's price increase is more than the inflation rate. Under ACA, a Medicaid rebate cap was put in place, so rebates would not exceed 100 percent of the drug's AMP. This cap for covered drugs prevents manufacturers from paying more in rebates than a drug's AMP.

The inflationary rebates can be quite substantial. According to the December 2016 Congressional Budget Office report, "Options for Reducing the Deficit 2017-2026," in 2013 the average statutory rebate for branded drugs, weighted by the dollar amount of drug purchases, was 63 percent of the AMP. About half of that amount was the inflationary-based rebate.

Not only do inflationary rebates in the brand industry cause distortions, they can also be very destructive to generic drug firms due to the commoditized and unpredictable nature of that industry. The Association for Accessible Medicines, which represents generic manufacturers, stated in its response to HHS's request for information to the blueprint to lower drug costs that generic firms, "are now paying additional, inflation-penalty rebates for products *for which they did not take a price increase*. In many instances, changes in customer mix from one quarter to another have triggered penalties solely due to purchasers getting lower discounts on smaller volume orders – a normal occurrence in a competitive market. These changes do not necessarily reflect any new price being set by the manufacturer but, may merely reflect new purchasing patterns." If caps are lifted on what is already an objectional policy, fewer generic firms will market drugs with low margins.

Removing the rebate cap will further aggravate Medicaid's price control structure, cause more price shifting, and hurt competition, resulting in higher drug costs. Instead of jerry-rigging the drug rebate program, Congress should re-evaluate Medicaid's pricing structure and implement free-market reforms.

Sincerely

President
Council for Citizens Against Government Waste

President
National Taxpayers Union