

June 1994

## HOW HEALTH CARE REFORM AFFECTS PHARMACEUTICAL RESEARCH AND DEVELOPMENT

If the Congress were to enact it, the Administration's proposed health care legislation would not seriously affect the level of drug research and development (R&D) in the pharmaceutical industry.

In its study *How Health Care Reform Affects Pharmaceutical Research and Development*, the Congressional Budget Office (CBO) analyzes the economic impact of the Administration's proposed Health Security Act on the incentives for drug companies to develop pharmaceuticals. CBO concludes that the general effect of the proposal would be to increase the profitability of investments in drug R&D. But the change would be so small that manufacturers would be unlikely to spend much more on the development of new and better medicines. Although it focuses mainly on the Administration's proposal, the analysis can be extended to include other health care plans that contain similar provisions affecting drugs.

One of the knottiest problems of health care reform is how to contain costs while developing new and better medical technology. The Administration's proposal includes provisions that would expand drug coverage as well as hold down the cost of drugs. From the perspective of the drug companies, the two types of provisions balance out; the lost revenue from the cost containment provisions nearly washes out the sales added by the new benefits.

Within this average, however, the cost containment provisions of the Administration's proposal may reduce the incentives for pharmaceutical firms to develop new drugs for the elderly. The proposal would require drug companies to pay a rebate of 17 percent or more to the federal government on outpatient drugs purchased by Medicare beneficiaries. The rebate would reduce the profitability of investment in R&D for outpatient drugs aimed primarily at the 65-and-older population.

At the same time, the expansion of health care coverage would increase the profitability of developing drugs for people under 65. This could result in a small shift of R&D away from outpatient drugs aimed at the elderly and toward those developed for people under 65.

CBO estimates that the Administration's proposal would increase sales of prescription drugs by 4 percent to 6 percent. Most of this increase would result from providing benefits for drugs and physician's services to those who are currently uninsured. Adding outpatient prescription drug benefits to Medicare would increase drug consumption by 1 percent. CBO's estimates exclude those provisions that are surrounded with uncertainty and cannot be quantified, even imprecisely.

Questions regarding the study should be directed to Philip Webre or Anna Cook of CBO's Natural Resources and Commerce Division at 202-226-2940. The Office of Intergovernmental Relations is CBO's Congressional liaison office and can be reached at 226-2600. For additional copies of the report, please call CBO's Publications Office at 226-2809.



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Second and D Streets, S.W.

Washington, D.C. 20515