



December 8, 2005

Honorable Charles Schumer
United States Senate
Washington, DC 20510

Dear Senator:

In response to your letter of October 28, 2005, I am pleased to provide the following additional information on CBO's estimate of the budgetary impact of the provision in the Senate's reconciliation bill that would increase the rebate that manufacturers of generic pharmaceuticals pay to the Medicaid program.

Section 6002 of S. 1932, the Deficit Reduction Omnibus Reconciliation Act of 2005, would increase the rebate that Medicaid receives from generic drug manufacturers from 11 percent of the average manufacturer price (AMP) to 17 percent. This change would take effect on January 1, 2006. Based on data from the Centers for Medicare & Medicaid Services on Medicaid spending on generic drugs and the AMPs that manufacturers report under the rebate program, we estimated that the additional rebates would reduce federal outlays by \$50 million in 2006 and \$330 million over five years.

As you pointed out in your letter, some manufacturers of generic drugs argue that the higher rebates would make it unprofitable for them to continue participating in Medicaid. If many generic manufacturers withdrew, Medicaid spending would increase because the program would only cover more expensive brand-name drugs.

Although some drug manufacturers might choose to withdraw from Medicaid, CBO concluded that most generic manufacturers would continue to participate in Medicaid for several reasons:

- Although the higher rebate might make the Medicaid market unprofitable for some generic drugs, manufacturers cannot pick

and choose which drugs they would like Medicaid to cover. The program either covers all of a manufacturer's products or none of them, and the program's size (currently about 15 percent of national sales, dropping to 5 to 10 percent with the Medicare drug benefit) would make it unlikely—in most cases—that a complete withdrawal would be in an individual manufacturer's interests.

- Withdrawing from the program would also hurt non-Medicaid sales to pharmacies. Pharmacies typically stock only one generic version of a drug and would likely prefer to stock a drug that Medicaid covers.
- Medicaid spending on generic drugs stands to increase substantially under S. 1932. The proposal to base payments for multiple-source drugs on the volume-weighted AMP would provide a very strong incentive for pharmacies to dispense generic drugs. Overall, we anticipate that Medicaid spending on generic drugs would rise by 10 to 15 percent under the legislation.
- Manufacturers would be able to offset some of the higher rebates by raising their prices for retail pharmacies and wholesalers. A small increase in prices—about 0.5 percent, on average—would be enough to offset the higher rebates. In effect, all purchasers would pay slightly more for generic drugs under the proposal. Our estimate accounts for that slight increase in the prices of generic drugs.

Your letter also noted that Missouri and New Jersey canceled increases in the rebates on generic drugs collected by their state-funded pharmacy assistance programs because manufacturers either withdrew or planned to withdraw from those programs. However, those state-funded programs are much smaller than Medicaid, and withdrawing from them did not prevent manufacturers from continuing to participate in Medicaid or pose the same risk of pharmacies switching to a competitor's drug. As such, we do not believe that the experiences in those states are indicative of what would happen in regard to the Medicaid program under the provision in S. 1932.

Honorable Charles Schumer
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I hope this information is helpful to you. The staff contacts for further information are Eric Rollins and Shinobu Suzuki, who can be reached at 226-9010.

Sincerely,

A handwritten signature in black ink that reads "Donald B. Manly for". The signature is written in a cursive style.

Douglas Holtz-Eakin
Director

Identical Letter sent to the Honorable John D. Rockefeller IV.

cc: Honorable Judd Gregg
Chairman
Committee on the Budget

Honorable Kent Conrad
Ranking Member

Honorable Charles E. Grassley
Chairman
Committee on Finance

Honorable Max Baucus
Ranking Democratic Member