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To the Subcommittee on the Administrative State, Regulatory Reform, and Antitrust of the Committee on the Judiciary, US House of Representatives
On "The Role of Pharmacy Benefit Managers"
September 11, 2024

Chairman Massie, Representative Correa, and members of the Committee, I thank you for the privilege of appearing before you today. I believe that today's topic is an incredibly timely and salient one, given the legislative and regulatory efforts presently under consideration. With every passing day, the decisions made regarding the regulation of PBMs will directly affect the cost and availability of medications for millions of Americans.

The Essential Role Intermediation and PBMs

Throughout history, intermediaries in economic transactions have been viewed with suspicion. From the ancient Greek philosopher Plato to modern-day critiques, middlemen have often been seen as unnecessary actors who add costs without adding value. This perspective, while understandable, is deeply flawed when applied to the role of PBMs in the pharmaceutical supply chain. In reality, PBMs are indispensable in managing the complexities of the drug market, negotiating lower prices, and ensuring that patients have access to the medications they need at affordable prices. Policies that eliminate, weaken, or overly constrain PBMs would ultimately lead to higher drug prices and reduced access to essential medications, playing directly into the hands of pharmaceutical manufacturers. Far from being a source of higher drug prices, PBMs represent one of the few mechanisms to inject true price competition into the market for drugs with the direct aim of lowering drug prices.

The Misunderstood Role of PBMs

The narrative that PBMs are unnecessary middlemen has gained traction in recent years, fueled by concerns over rising drug prices and the perception that PBMs contribute to these increases. Critics argue that PBMs raise costs and create barriers to life-saving treatments. This perspective is not only misguided but also dangerous, as it threatens to undermine one of the few entities with both the goal and the ability to actively work to contain drug costs.

PBMs negotiate with drug manufacturers on behalf of health insurers, Medicare Part D plans, large employers, and other payers. Through these negotiations, PBMs secure

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significant discounts and rebates that directly reduce the cost of prescription medications. These savings are passed on to insurers and, ultimately, to consumers in the form of lower premiums and out-of-pocket expenses. This role is crucial, especially in a market where pharmaceutical companies can exercise significant pricing power due to patent protections. It is important to note that the pharmaceutical industry is known for high profit margins in the range of 15% to 30%[2], while PBMs operate in a low-margin industry with margins in the range of 2% to 5%.[3]

PBMs and Cost Containment

One of the most important functions of PBMs is cost containment. By leveraging their purchasing power, PBMs are able to negotiate substantial discounts with drug manufacturers. These discounts come in the form of rebates, which are often misunderstood as merely a way for PBMs to increase their profits. In reality, rebates are price reductions that benefit consumers by lowering the overall cost of drugs.

For example, a comparative analysis of the Medicaid programs in Michigan and Illinois illustrates the value of PBMs in cost containment.[4] Michigan chose to centralize its purchasing of specialty pharmacy products, while Illinois relied on PBMs to manage these purchases. The results were stark: Illinois, through its use of PBMs, was able to switch rapidly to cheaper generic alternatives as they became available, saving taxpayers as much as $50 million per year. In contrast, Michigan's centralized approach led to higher costs, as the state continued to pay for more expensive brand-name drugs even when cheaper generics were available. This stark contrast highlights the crucial role PBMs play in ensuring that states, and by extension taxpayers, do not overpay for necessary medications.

This example underscores the agility of PBMs in responding to market changes and their ability to secure lower prices for high-cost medications. The ability to respond to changing dynamics in the marketplace is an often-overlooked aspect of the value PBMs provide to payers. Without the negotiating power of PBMs, states and other large purchasers would likely pay much higher prices, which would ultimately be passed on to taxpayers and patients.

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[2] https://csimarket.com/Industry/industry_Profitability_Ratios.php?ind=803

[3] Carlton, D. PBMs and Prescription Drug Distribution: An Economic Analysis of Criticisms Levied Against Pharmacy Benefit Managers. Compass Lexicon Working Paper July 2024.

[4] Brannon, Ike and Anthony T. Lo Sasso, “The Myth that the State can do Better: Medicaid Drug Prices and Managed Care Organizations,” May 26, 2021. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3852446.

Addressing Short-Sighted Policy Proposals: The Reality of PBM Operations

Despite the clear benefits of PBMs, they are not without their critics. One of the most common criticisms is related to the use of spread pricing and rebates. Spread pricing refers to the difference between what a PBM pays for a drug and what it charges the insurer. Critics argue that this practice is a way for PBMs to generate profit at the expense of patients. However, spread pricing is a standard practice in many industries and serves as an incentive for PBMs to negotiate the lowest possible prices for drugs. Moreover, payers typically have the option of spread pricing or administrative fee-based payment and most choose spread pricing. The reason for the choice is clear: it generates the greatest incentives to reduce prices paid to pharmaceutical manufacturers, which is in turn shared between the payer and the PBM. Eliminating spread pricing leads to one winner: the pharmaceutical industry.

Similarly, rebates are often portrayed as a mechanism that drives up drug prices. However, rebates function as price reductions that benefit consumers by lowering their out-of-pocket costs and reducing insurance premiums. The use of the rebate mechanism represents an awkward work-around to the Robinson-Patman Act of 1936 which prohibits "price discrimination" where a seller charges different prices to different buyers. Allowances are, however, made for volume discounts.[5] Arguments that a PBM would prefer a high-cost drug because the manufacturer offers a larger rebate make no sense because what matters is the net price the PBM must pay. It will always make sense to pay a lower net price for a drug because the PBM will be able to offer lower premiums and lower cost-sharing to payers. Indeed, a recent GAO study found that more than 99 percent of rebates were passed on to plan sponsors.[6]

Additionally, proposals to mandate the pass-through of rebates directly to consumers may seem beneficial on the surface, but they risk undermining the negotiating power of PBMs, ultimately leading to higher drug prices for everyone. Specifically, when PBMs, payers, and consumers have their incentives aligned they are in the best position to negotiate with pharmaceutical companies; requiring full pass-through of the rebated amount removes the incentive for the PBM to fight for price concessions from pharmaceutical manufacturers. Again, efforts to de-link PBMs from incentives to negotiate lower prices benefit the pharmaceutical industry first and foremost.

A related lament is the lack of "transparency", which is typically meant to imply that PBMs craft nefarious secretive deals with pharmaceutical companies to solely benefit PBMs. This

[5] See https://www.ftc.gov/advice-guidance/competition-guidance/guide-antitrust-laws/price-discrimination-robinson-patman-violations.
[6] https://www.gao.gov/assets/gao-19-498.pdf.

ignores the reality that PBMs must compete for business by offering lower premiums, lower cost to patients, and higher quality service because these are the factors that ultimately matter to payers and patients. As an analogy, if a grocery store obtains excellent prices for high quality apples, the consumer is the beneficiary despite being none the wiser about the "shadowy" deals between orchards, wholesalers, and distributors. Moreover, transparency is not a panacea; the experience of the Danish cement market shows that in some cases, transparency can lead to tacit collusion and higher prices rather than competitive outcomes.[7] Obviously, the supply chain for drugs is complicated by third-party payment and other factors, but the end consumer still has a voice and, in a market economy, can vote with their feet.

Mail-Order Pharmacies: A Success Story

Mail-order pharmacy services, supported by PBMs, provide a compelling example of how these intermediaries improve both convenience and patient adherence. By negotiating bulk purchasing agreements and leveraging their extensive networks, PBMs can offer lower prices for medications through mail-order programs. These services are particularly beneficial for patients with chronic conditions, who require a steady supply of medications.

Studies have shown that mail-order pharmacies improve medication adherence,[8] [9] which is crucial for managing chronic diseases such as diabetes and hypertension. Higher adherence rates lead to better health outcomes and lower overall healthcare costs, as patients are less likely to require emergency care or hospitalization.

Efforts to limit mail-order pharmacy services, whether through regulation or legislation, would have the unintended consequence of increasing costs for patients and reducing their access to necessary medications. Additionally, limiting mail-order pharmacy services could force patients, particularly those with chronic conditions, to pay more and potentially experience disruptions in their medication regimens, leading to worse health outcomes. It is essential that policymakers recognize the value of these services and support the continued role of PBMs in facilitating access to affordable medications. Efforts to curtail the direct delivery of drugs do not benefit patients.

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[7] Albæk, S., Møllgaard, P., & Overgaard, P. B. (1997). Government-Assisted Oligopoly Coordination? A Concrete Case. *The Journal of Industrial Economics*, *45*(4), 429–443. http://www.jstor.org/stable/2950610.

[8] Do D, Geldsetzer P. Trends in Mail-Order Pharmacy Use in the U.S. From 1996 to 2018: An Analysis of the Medical Expenditure Panel Survey. Am J Prev Med. 2021 Aug;61(2):e63-e72. doi: 10.1016/j.amepre.2021.02.017. Epub 2021 May 3. PMID: 33958237; PMCID: PMC8319048.

[9] Lloyd JT, Maresh S, Powers CA, Shrank WH, Alley DE. How Much Does Medication Nonadherence Cost the Medicare Fee-for-Service Program? Med Care. 2019 Mar;57(3):218-224. doi: 10.1097/MLR.0000000000001067. PMID: 30676355.

Enhancing Market Efficiency

Beyond cost containment, PBMs play a critical role in enhancing market efficiency. The pharmaceutical supply chain is complex, involving manufacturers, wholesalers, pharmacies, and payers. PBMs streamline this process by managing formularies, conducting drug utilization reviews, and processing prescription claims. This centralization reduces redundancies and errors, ensuring that medications are delivered promptly and accurately to patients.

Preferred pharmacy networks are another tool used by PBMs to enhance efficiency and reduce costs. By negotiating selective contracts with pharmacies, PBMs are able to secure better pricing for medications. Research has shown that the use of preferred pharmacy networks can reduce drug prices by 2.3 percent in Medicare Part D, which translates into significant savings for both patients and the healthcare system.[10] This reduction could save the healthcare system millions of dollars annually, translating to lower costs for both taxpayers and patients.

Moreover, PBMs provide valuable market information and analytics to insurers and healthcare providers, aiding in better decision-making and resource allocation. This data-driven approach allows for more effective management of drug benefits, leading to improved patient outcomes and more efficient use of healthcare resources.

The Future of PBMs in Healthcare

PBMs have been a vital part of the healthcare system for decades, balancing the dual objectives of cost containment and high-quality patient care. They reduce drug prices, improve market efficiency, foster innovation, and ensure that patients have access to the medications they need. The current legislative efforts to constrain the role of PBMs are misguided and could have serious adverse consequences for consumers.

It is essential that we recognize the value of PBMs and support their continued role in the healthcare system. Rather than dismantling the mechanisms that serve to counter-balance high drug costs, we should focus on enhancing wherever possible market mechanisms in the pharmaceutical supply chain. Improving market competition through preserving PBMs' ability to negotiate lower prices remains the best way to both lower cost and improve patient access to care.

I urge this committee to carefully consider the broader implications of any legislation that would weaken the role of PBMs. The stakes are high, not just for the healthcare system, but

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[10] Starc, Amanda, and Ashley Swanson. 2021. "Preferred Pharmacy Networks and Drug Costs." *American Economic Journal: Economic Policy*, 13 (3): 406-46.

for every American who depends on affordable access to medications. The decisions made here will determine whether we continue to have a healthcare system that prioritizes patients or one that places undue burdens on them.

Thank you for your attention, and I look forward to your questions.