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The Importance of Competition in Health Care

Good morning. I'd like to welcome the Ministers, Vice Ministers, and State Secretaries who have traveled to be with us today. I'm delighted to have the opportunity to talk to you today, because I know we share the goal of helping the people we serve improve their health, prosperity, and well-being.

Europe and the United States share many common problems. We both face aging populations and social welfare entitlement programs that will be funded by a smaller, younger population. Many of our people suffer from largely preventable chronic diseases, ranging from diabetes and obesity to alcoholism and cancer.

Today I'd like to talk a little about another challenge in particular: how to contain health care costs, while still fostering innovation? I'd like to begin by discussing the critical role that innovation plays in health care and in improving the human condition. My message is simple: Government actions affect prices, prices affect investment, investment affects innovation, and innovation affects health. The more free competition there is in the health insurance, health care, pharmaceutical, and medical device markets and the more barriers to innovation governments remove, the more innovation and health the world will enjoy.

Innovation and freedom of competition play a critical role in all of our health care economies, and misguided-albeit well-intentioned-government policies can greatly stunt its growth.

Let me offer a few examples of how free markets have transformed health over the past several decades in the United States.

Over the last 40 years, early infancy diseases have declined by 80% worldwide. New treatments have reduced ischemic heart disease by 68% and hypertensive heart disease by 67%.

Relatively inexpensive ulcer pills have replaced expensive major surgery and new medicines have led to shorter hospital stays, fewer complications, and better quality of life for the chronically ill.

Over the past 40 years the use of medicines has helped halve the number of hospital admissions for 12 major diseases, including mental illness, infectious diseases, and ulcers.

New medicines helped children with rheumatoid arthritis to walk and enabled them to go to school. They are an invaluable tool in the fight against cancer, heart disease and multiple sclerosis.

New vaccines have essentially eliminated a previously very common form of childhood meningitis in my country and many others around the world.

We're seeing the practical benefits of genomic inventions-engineered just a few years ago-in the form of new drugs and new diagnostic tests. Our understanding of the genome is creating many opportunities both to cure diseases and to prevent them.

Of course, the development of new drugs and new technologies is an expensive, complicated, time-consuming, and risky process. Fewer than one in a thousand new molecules created by researchers survive clinical trials and make it to the market. Today, by some estimates, it costs between \$800 million and \$1.3 billion American dollars of private investment on average-and between eight and twelve years-to develop a new drug, to demonstrate its safety and effectiveness, and to comply with regulations just to bring it to market in our country alone. The cost of developing new treatments has more than doubled over the past ten years, while success rates in developing new products remain as low as ever. And a great portion of these costs to develop a new drug are amortized costs of all the drug product failures that never make it to market and never turn a profit, but which must be incurred to get the drugs that work.

These high research and development costs naturally can lead to high prices for consumers. And the tension between meeting these costs while still investing in innovation is one of the most intractable questions political leaders face. Unfortunately, far too often, in trying to strike this balance, governments lean too much toward short-term savings and succumb to the temptation to control expenditures through direct price controls, cuts in reimbursement rates, delayed market access, and other subtle and not-so-subtle practices that either restrict the amounts paid for innovative products or reduce consumption of innovative medicines and devices.

Given the central importance that all of our societies attach to access to health care, there is a great temptation in every country to forget that health care goods are also economic goods and that all economic goods obey economic laws.

In a free market, companies allocate money to develop new products. If they invest wisely, their product will have advantages over older products, and many consumers will be willing to pay more to enjoy those advantages. In fact, that's how you know if a product's features have value: people buy them. When businesses gauge the market successfully, everyone wins: consumers, investors, and researchers. Competition also relieves suffering by allowing patients to enjoy the benefits of new drugs quickly. Their choices reward quality, value, and promptness.

Of course, for this process to work, consumers need to hear about the new product and its new features. Only informed consumers can make rational decisions. A free market automatically balances consumers' demand for immediate consumption-such as low-cost older drugs-against future consumption-such as access to innovative newer, better drugs or devices. Everyone wins.

As consumers become increasingly savvy, they expect more choices, more responsibility, and more control in every aspect of their lives. When it comes to their health care, engaged consumers demand and get higher quality health care at better prices. Informed consumers identify symptoms earlier, when treatment is easier and cheaper. Or they prevent disease

entirely through healthy practices. Ironically, in countries that restrict access to such information, it is easier for a tobacco company to reach a consumer with information about cigarettes than it is for a drug manufacturer to reach that same consumer with information about smoking cessation products. Health literacy creates engaged consumers, and health literacy depends on adequate access to information.

The free flow of information is critical to the whole process. If communication between producers and consumers is suppressed or distorted, consumers won't understand the value of new products, and won't make rational purchases. Consumers will suffer, today and tomorrow. Less money will be invested in innovation, and fewer new drugs will be developed. Everyone loses.

From trivial things such as what entertainment to purchase or where to travel for a vacation to important things such as what food to eat or what health care to consume, the value of any product depends on the consumer. When you go to the drugstore, or any store, you want to make the purchase you prefer, not the one other consumers prefer.

I might have an apple and prefer an orange. You might have an orange and prefer an apple. A trade would benefit both of us. Which is worth more? The only answer to that question is "worth more to whom?" Simply put, the value of any given product to any person depends on his situation.

But why should anyone make such a personal choice as the health care people consume for someone else? In health care, choices over items and services can involve very technically complex considerations. It is understandable, therefore, that physicians and health plans use their training, experience and information sources to assist these decisions. But the key is that individuals can make informed choices in a market setting.

Some governments want to make these decisions for the person. They set up monopsonistic systems where they make all the health care purchasing decisions. Yet bureaucrats cannot hope to and do not have proper incentives to internalize the needs of all the different individual consumers, and thus they cannot accurately determine what beneficiaries' health care preferences are. The impact of these policies is particularly disconcerting because there may be other ways to control costs while still providing for market rates of return for innovative products and services.

The first way that I would like to talk about today is how through our Medicare Part D prescription drug coverage and the Medicare Advantage program we are encouraging and fostering competitive market forces in order to provide better cost and quality outcomes for the health care economy than greater amounts of government involvement and regulation would.

In the United States, we have a health insurance program called Medicare. It services Americans 65 or older as well as Americans of all ages with certain disabilities or diseases. Over their lifetime, people contribute a portion of their income into the program, and, when they become eligible, are able to receive hospital insurance, medical insurance, and, starting just four months ago, prescription drug coverage.

The new Medicare prescription drug benefit, which we refer to as Part D, is provided through private health plans. The objective of the benefit was to provide high quality, affordable drug coverage to beneficiaries. The structure of the program encourages competition among health plans that administer key aspects of the benefit, rather than having it more centrally administered as are benefits under Part A-the hospital insurance-and Part B-the medical

insurance. In addition, Medicare beneficiaries can receive their Parts A and B benefit through a private health insurance plans if they want. These plans are called Medicare Advantage. With Medicare Advantage plans, the beneficiary chooses a private insurance plan to cover their health care expenditures. The federal government contributes a set amount of subsidy to purchase that insurance. If the beneficiary chooses a plan that costs more than the subsidy - for instance a plan that offers more generous benefits - the beneficiary pays the difference. The opposite is true also. If the beneficiary chooses a plan that costs less than the subsidy, then the plan can offer enhanced benefits or rebate some of the premium to the beneficiary. This concept of what we call "premium support" is an important option that other countries could consider as they seek to create more predictable government health expenditures, more consumer choice, greater access to care, more innovation, and better health care quality. Medicare's new drug benefit and the Medicare Advantage Program reflect a relatively new approach that we've adopted to address today's question of how best to balance the use of market competition with government support to improve the value obtained from our health care resources.

Essentially, the competitive market we have fostered through the Part D and Medicare Advantage programs allows insurance companies to internalize the preferences of consumers. For Part D, there are a number of advantages to this approach relative to an approach with more government administration. Private drug plans and pharmacy benefit managers can negotiate favorable prices with both manufacturers and pharmacies in a way that preserves incentives for investment in pharmaceutical research and development. They can also implement a variety of quality and utilization review programs that can provide savings to the program. Market competition will assure that there is a balance between cost management strategies, such as formulary restrictions, and beneficiary needs for particular drugs. Most important, beneficiaries will have a choice among plans, and should be able to select one that has the right combination of premium cost and quality of benefits to meet their needs. That is the ultimate check on the plans.

We're seeing a lot of success with our Part D and Medicare Advantage programs. Over the past year, Part D premiums have dropped from a projected \$37 to \$25 a month. Seniors are saving an average of 50% on the prescription drug purchases, and the cost to taxpayers is down 20% from last summer's estimates. And participants in Medicare Advantage programs are saving \$100 on average.

A second example of how you can control health care costs without stifling the market can be found in our recent rollout of what we call Health Savings Accounts, or HSAs. One of the major challenges all of our nations face in containing ever increasing health care costs is the negative incentive created by third party insurance of health care. When consumers do not bear the cost of their decisions, they overconsume. If you were told that you could go into a store and buy whatever you wanted for \$20, you would walk out with the entire inventory. The same is true with health care. All of our systems provide not only "insurance" in the classic sense, meaning insuring against non-recurring unpredictable losses, but also essentially pre-paid health care with low annual out-of-pocket payments by beneficiaries in the form of deductibles and cost sharing. The new HSAs work to fix these incentives, by placing the purchasing decision and impacts on the beneficiary. HSAs include a high-deductible, low-premium insurance plan combined with a savings account that can be used to pay the high deductible tax free. Employers can contribute money towards the premium and can put money into the

savings account. The key to HSAs, however, is that whatever the original source of the money in the savings account, the money becomes the beneficiary's. When she visits the doctor or hospital, she writes the check, not a distant insurance company, at least during the period of the deductible. HSAs cause beneficiaries to internalize the cost of their own health care decisions. HSAs give Americans more incentives to shop around carefully for services, to quiz their doctors as to whether certain tests or treatments are necessary, and to purchase lower-cost generic drugs instead of expensive brand name ones. We always take better care of what we own. HSAs simply build on the idea that you take better care of what you own to make people smarter consumers of health care. HSAs put the power to make health care decisions where it belongs: in the hands of the health care consumer.

And a third way that you can control health care costs without hurting your health care economy is through increasing competition between same molecule generic and brand-name drugs. Some countries actually use price control systems to prop up local manufacturers, retarding generic substitution, discouraging entry of multiple generics, and increasing health care costs. Some countries also do not offer strong patent protections to companies that invest in new products. It is hard to imagine that either price controls or disregard for intellectual property is sustainable in the long run as effective national or international health policy. Not surprisingly, generic prices are often lower in the United States-with its vigorous competition among generic drugs-than in Europe. Americans pay about half what many Europeans pay. Though 53% of prescriptions in the United States are filled with generics, they account for only 12% of drug spending. When there is full generic competition, the price plummets to about 20% of the branded price prior the expiration of the patent.

Here is the bottom line: It's possible to redirect billions of dollars in drug spending, through greater use of less expensive generic drugs, permitting greater financial rewards for developing and providing access to valuable new drugs quickly.

According to a report from the U.S. Department of Commerce, if OECD countries removed their price controls from generic drugs and increased generic utilization, they could save \$5-\$30 billion annually. This suggests that health systems could reimburse patented drugs at competitive market levels while at the same time significantly or fully offsetting the cost through a more competitive generic market.

In sum, a vigorous and profitable drug industry is not a problem to be solved, but a goal to be encouraged. The future need not be a binary choice between each government doing the best it can on its own to lower health care prices, choking off medical innovation in the process, or to raise health care costs still further to pay for medical innovation that our nations cannot easily afford when we act alone.

But I am confident that, given the great potential for worldwide improvements in medical care in the coming years, we can find ways to bring safe new cures to patients, while making medicines more affordable. Working together, we can set an example for a world that is getting smaller every day-and that should be getting healthier every day as well. Thank you.