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Fact Sheet for the Chairman,  
Subcommittee on Regulation, Business  
Opportunities, and Technology,  
Committee on Small Business, House of  
Representatives

August 1994

# MEDICAID

## Changes in Best Price for Outpatient Drugs Purchased by HMOs and Hospitals



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United States  
General Accounting Office  
Washington, D.C. 20548

Health, Education, and  
Human Services Division

B-252845

August 5, 1994

The Honorable Ron Wyden  
Chairman, Subcommittee on Regulation,  
Business Opportunities, and Technology  
Committee on Small Business  
House of Representatives

Dear Mr. Chairman:

In the Omnibus Budget Reconciliation Act of 1990 (OBRA), enacted November 5, 1990, the Congress tried to reduce Medicaid's prescription drug costs by requiring that drug manufacturers give state Medicaid programs rebates for outpatient drugs.<sup>1</sup> The rebates were based on the lowest or "best" prices that drug manufacturers charged other purchasers, such as health maintenance organizations (HMO) and hospitals. You were concerned that, after OBRA, drug manufacturers might try to minimize the rebates to state Medicaid programs by increasing best prices and reducing best price discounts for drugs purchased by HMOs and others.

This fact sheet responds to your request that we (1) determine the changes in the best prices for the drugs purchased by the HMOs and group purchasing organizations (GPO)<sup>2</sup> we studied; (2) determine the changes in the difference between the drugs' best prices and their average prices, known as the "best price discount;" and (3) compare the changes in the best prices with the changes in the prices paid by the HMOs and GPOs.

## Background

Although Medicaid is the largest single payer for prescription drugs, state Medicaid programs did not receive significant discounts on drug prices before OBRA. Medicaid had been paying near retail prices for outpatient drugs, while other purchasers, such as HMOs and hospitals, paid significantly lower prices. State Medicaid programs' ability to control drug costs was generally limited to restricting coverage, increasing the beneficiary's share of costs, and reducing pharmacy reimbursements.

To help reduce Medicaid's drug costs, OBRA required that drug manufacturers pay rebates on outpatient prescription drugs to state

<sup>1</sup>These are drugs that can be dispensed on an outpatient basis to ambulatory patients, typically as capsules or tablets. In contrast, inpatient drugs are typically injectable drugs administered by intramuscular or intravenous injections.

<sup>2</sup>To study prices charged hospitals, we obtained prices from GPOs, which typically represent many hospitals in negotiating prices with drug manufacturers.

Medicaid programs. In general, the rebate amount equals the greater of (1) a fixed percentage (12.5 percent in 1991 and 1992, 15 percent after 1992) of the average manufacturer price (AMP)<sup>3</sup> or (2) the difference between the AMP and the lowest price any purchaser paid for that drug, called the drug's best price. The percentage by which a drug's best price is below its AMP is called the best price discount.<sup>4</sup> The Department of Health and Human Services (HHS) computes the rebate amounts based on the best price and AMP data that manufacturers provide each quarter, and drug utilization information that states provide.

The Congress was concerned that after OBRA drug manufacturers might increase prices to purchasers other than Medicaid. Therefore, OBRA required the Comptroller General to report on changes in prescription drug prices that manufacturers charged these other purchasers. In January 1993, we reported that, although changes in the drug prices paid by the HMOs and GPOs we studied varied considerably the year after OBRA, price increases tended to be more common and more significant for outpatient drugs than for inpatient drugs.<sup>5</sup> Although our 1993 report covered only changes in the drug prices paid by the HMOs and GPOs, this fact sheet focuses on changes in best prices and best price discounts for the outpatient drugs purchased by the HMOs and GPOs.

## Summary

In the 2 years since OBRA became law, the average best price for the outpatient drugs purchased by the HMOs and GPOs increased. For both years, the best price increased, on average, at a slightly faster rate than the drugs' AMP or the producer price index (PPI) for prescription drugs.<sup>6</sup>

Because the drugs' average best price increased faster than their AMP, the gap between average best price and AMP narrowed, resulting in a decrease in the average best price discount. By the first quarter of 1993, the drugs' average best price discount—the average percentage that the best price was below the AMP—had fallen to about the minimum rebate amount required by OBRA of 15 percent of the AMP. (See sections I and II for additional information on changes in best prices and best price discounts.)

<sup>3</sup>The AMP is the average price paid to a manufacturer by retail pharmacies or wholesalers for drugs distributed to the retail pharmacy class of trade.

<sup>4</sup>For example, a drug with an AMP of \$10 minus its best price of \$6 results in a best price discount of \$4 or 40 percent below its AMP.

<sup>5</sup>Medicaid: Changes in Drug Prices Paid by HMOs and Hospitals Since Enactment of Rebate Provisions (GAO/HRD-93-43, Jan. 15, 1993).

<sup>6</sup>The PPI for prescription drugs tracks changes in manufacturers' prices for a market basket of prescription drugs over time.

**Figure 1: Changes in Median Best Price Discounts for HMO and GPO Drugs, 1991 to 1993**

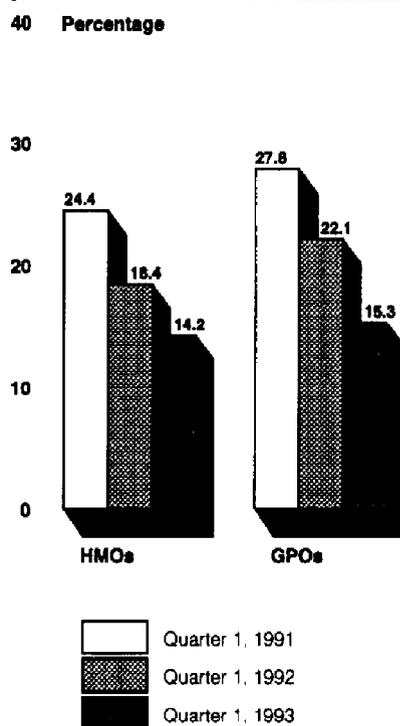


Figure 1 shows that, by the first quarter of 1993, the average best price discount for the drugs purchased by the HMOs and GPOs had fallen to about 14 and 15 percent, respectively. The median best price discount for the drugs purchased by the HMOs and GPOs decreased about 6 percentage points from the first quarter of 1991 through the first quarter of 1992. For this period, the Congressional Budget Office (CBO)<sup>7</sup> found the same decrease in the median best price discount for the 100 outpatient drugs on which Medicaid spent the most in fiscal year 1991.<sup>8</sup> The fall in the average best price discount for the HMO and GPO drugs continued from the first quarter of 1992 through the first quarter of 1993 as the median best price discounts fell by about 4 and 7 percentage points, respectively. By the first quarter of 1993, the median best price discount for the drugs purchased by the HMOs and GPOs approximated the minimum rebate amount owed the Medicaid program.

<sup>7</sup>"Questions and Answers: Medicaid Prescription Drug Options," CBO letter to the Chairman, House Committee on Energy and Commerce, June 22, 1992.

<sup>8</sup>Of the drugs included in our study, 80 were on the Medicaid list of 100 used by CBO.

Because data on the drug prices paid by the HMOs and GPOs were limited, we could not determine the extent to which the prices they paid also changed during the entire 2-year period. However, during the last 6 months of 1991—the period for which we had both best prices and purchase prices to compare—the average best price and average purchase price for the drugs purchased by the HMOs and GPOs changed little. (See section III for additional information comparing changes in best price and purchase price.)

## Scope and Methodology

To determine how best prices and best price discounts have changed for the drugs purchased by HMOs and hospitals, we used a list of outpatient drugs purchased by the four HMOs and eight GPOs included in our January 1993 report.<sup>9</sup> From this data, we determined the number of HMO and GPO outpatient drugs that matched the drugs in HHS' database of outpatient drugs covered under the rebate program. This gave us a list of 408 different drug products purchased by at least one HMO or GPO.<sup>10</sup> For each product, HHS provided us the best price and AMP for each quarter from the first quarter of 1991 through the first quarter of 1993.<sup>11</sup> For the HMOs and GPOs, we analyzed outpatient drug price changes to determine the

- differences in the rates of change between best price and AMP,
- changes in the percentage difference between best price and AMP to calculate changes in best price discounts, and
- differences in the rates of change between best prices and prices paid by the HMOs and GPOs.

To help put the drug price changes in perspective, we compared them with changes in the AMP for the drugs we studied and the PPI for prescription drugs. The AMP represents the average selling price to HMOs, GPOs, and other large purchasers. The PPI represents changes in drug prices for another market basket of drugs.

<sup>9</sup>The HMOs cover about 22 percent of the approximate 38.6 million U.S. enrollees in HMOs; the GPOs cover about 55 percent of the approximate 6,500 nonfederal U.S. hospitals.

<sup>10</sup>Drugs are purchased in different dosage amounts and package sizes, which are considered individual drug products. For example, some drugs, such as Zantac, can be purchased in different dosage amounts and package sizes; each drug form is considered a different product.

<sup>11</sup>Because more than one HMO or GPO may have purchased the same drug product, each drug product purchased by an HMO or GPO was a unique drug observation. For the 408 products, we received about 800 observations.

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We reported changes in best price, AMP, best price discounts, and prices paid by the HMOs and GPOs as median changes<sup>12</sup> because the mean price changes were sensitive to a few drugs with relatively large decreases and increases. In addition, because of OBRA's confidentiality provisions, this report contains no specific drug prices—only percentage changes in prices—and price changes appear in aggregate form rather than by individual drug.

We did not try to determine the relationship between OBRA and changes in prices paid by HMOs and GPOs, best prices, and best price discounts. Changes in market conditions, including the relative strength of the purchasers' negotiating positions with drug manufacturers and the pricing strategies of the manufacturers, may have changed the prices paid by individual HMOs and GPOs as well as best prices and best price discounts. However, determining the influence of such factors on market conditions is beyond the study's scope.

We did our work between July 1993 and January 1994 in accordance with generally accepted government auditing standards.

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We are sending copies of this fact sheet to the Health Care Financing Administration and other interested parties. Copies also will be made available to others upon request.

Should you or your staff have any questions on this fact sheet, please contact John Hansen, Assistant Director, at (202) 512-7105 or Joel Hamilton, Senior Evaluator, at (202) 512-7142. Other contributors to this fact sheet include Kevin Dooley and James Cosgrove.

Sincerely yours,



Leslie G. Aronovitz  
Associate Director, Health  
Financing Issues

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<sup>12</sup>Because only six of the HMOs and GPOs gave us drug utilization data, the average price changes reported are unweighted.

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**Abbreviations**

AMP	average manufacturer price
CBO	Congressional Budget Office
GPO	group purchasing organization
HHS	Department of Health and Human Services
HMO	health maintenance organization
OBRA	Omnibus Budget Reconciliation Act
PPI	producer price index

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# Changes in Best Price, AMP, and the PPI

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In the 2 years since OBRA became law, the increase in best prices for the drugs purchased by the HMOs and GPOs slightly exceeded the rates of change in the drugs' AMP and the PPI for prescription drugs.<sup>13</sup> The change in the median AMP for the drugs purchased by the HMOs and GPOs was slightly less than the change in the median best price for both years and about the same as the change in the PPI for the period. Figure 1.1 shows the median changes in best price, AMP, and the PPI for (1) the first quarter of calendar year 1991 through the first quarter of calendar year 1992 and (2) the first quarter of calendar 1992 through the first quarter of calendar year 1993.

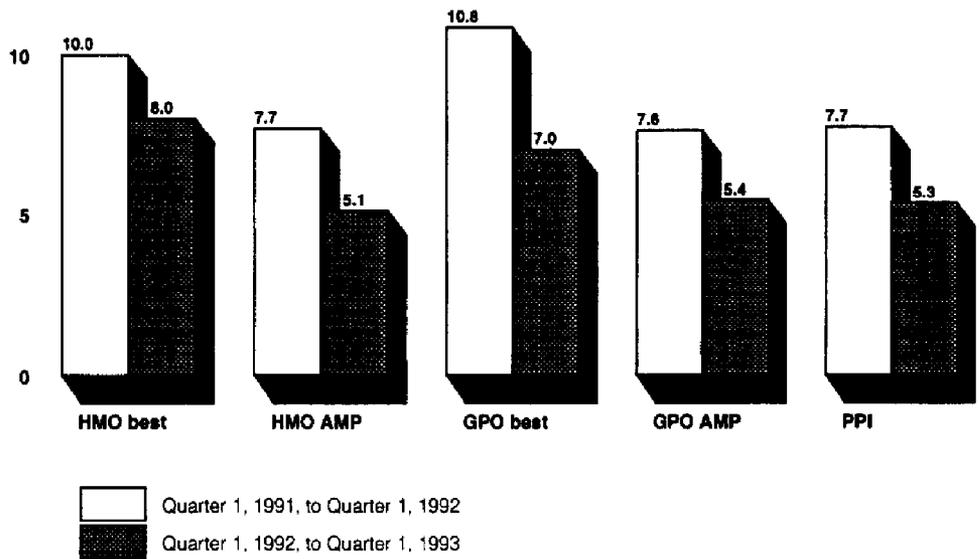
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<sup>13</sup>We determined changes in the PPI from data prepared by the Bureau of Labor Statistics under commodity code 0635.

Section 1  
Changes in Best Price, AMP, and the PPI

Figure 1.1: Changes in Median Best Price, Median AMP, and the PPI for Prescription Drugs

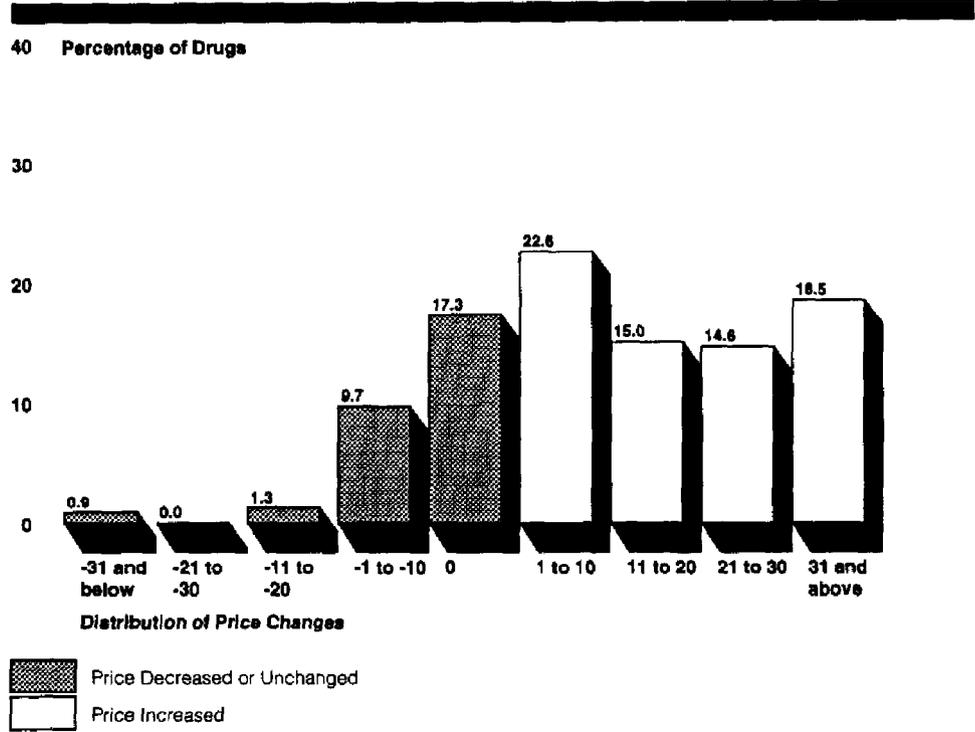
15 Percentage Price Change



The range of best price changes for the drugs purchased by the HMOs and GPOs varied considerably in both years. Figures 1.2 through 1.5 show the distributions of the best price changes. The shaded bars represent the drugs that decreased in price or remained the same and the white bars, the drugs that increased in price. For example, figure 1.2 shows that from 1991 to 1992, 17.3 percent of the HMO drugs' best prices did not change, although 22.6 percent of drugs' best prices increased up to 10 percent.

**Section 1**  
**Changes in Best Price, AMP, and the PPI**

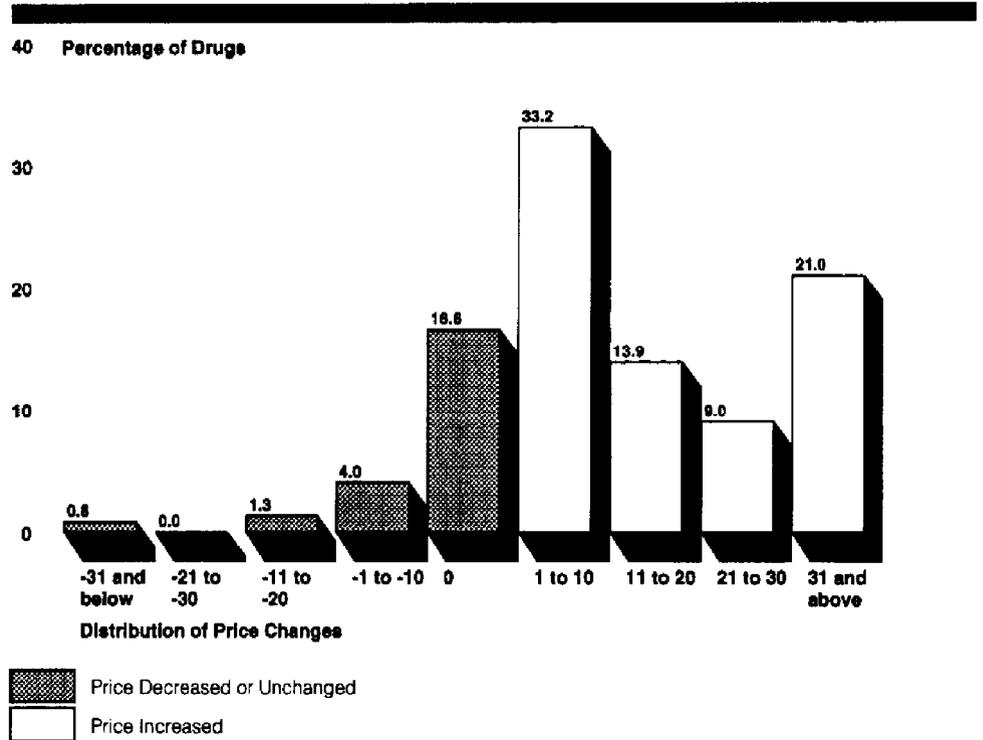
**Figure 1.2: Distribution of HMO Drugs' Best Price Changes, First Quarter 1991 to First Quarter 1992**



Range: 42 percent decrease to 210 percent increase

Section 1  
Changes in Best Price, AMP, and the PPI

Figure 1.3: Distribution of HMO Drugs' Best Price Changes, First Quarter 1992 to First Quarter 1993



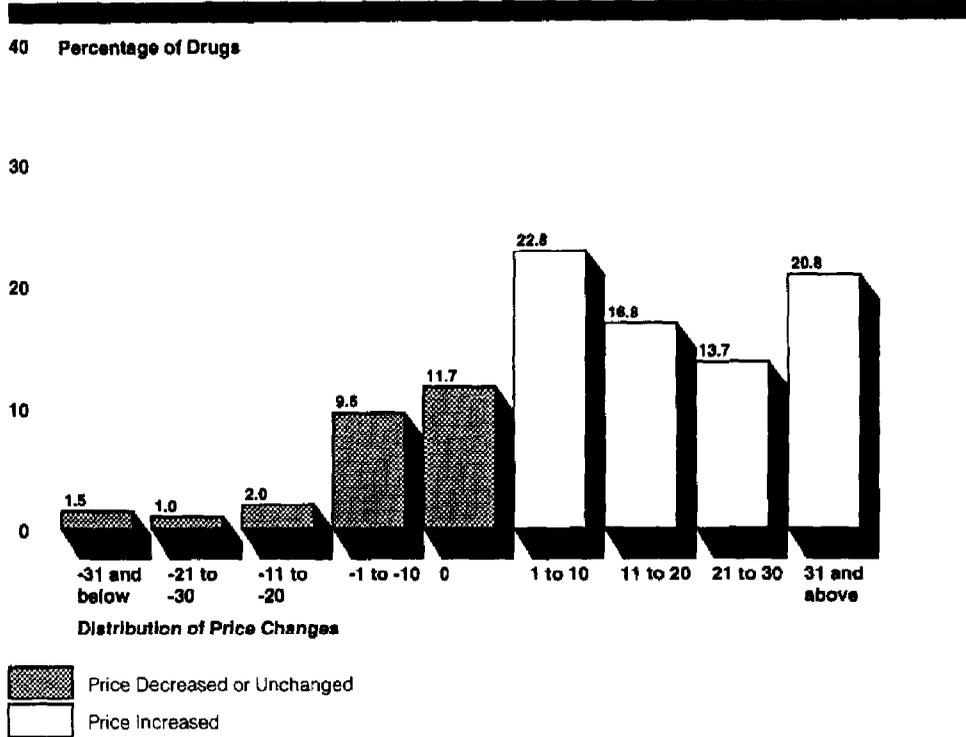
Range: 43 percent decrease to 648 percent increase

A comparison of figures 1.2 and 1.3 shows that about the same number of HMO drugs experienced increases in best price in both years. From 1991 to 1992, about 71 percent of the HMO drugs increased compared to about 77 percent from 1992 to 1993. The number of drugs with large price changes was about the same both years as well, with about 33 percent of the HMOs' drugs increasing more than 20 percent the first year compared to about 30 percent the second year.<sup>14</sup> The only notable differences in best price changes from one year to the next were the higher number of drugs that increased and decreased 1 to 10 percent the second year.

<sup>14</sup>We defined a large price increase as one over 20 percent.

Section 1  
Changes in Best Price, AMP, and the PPI

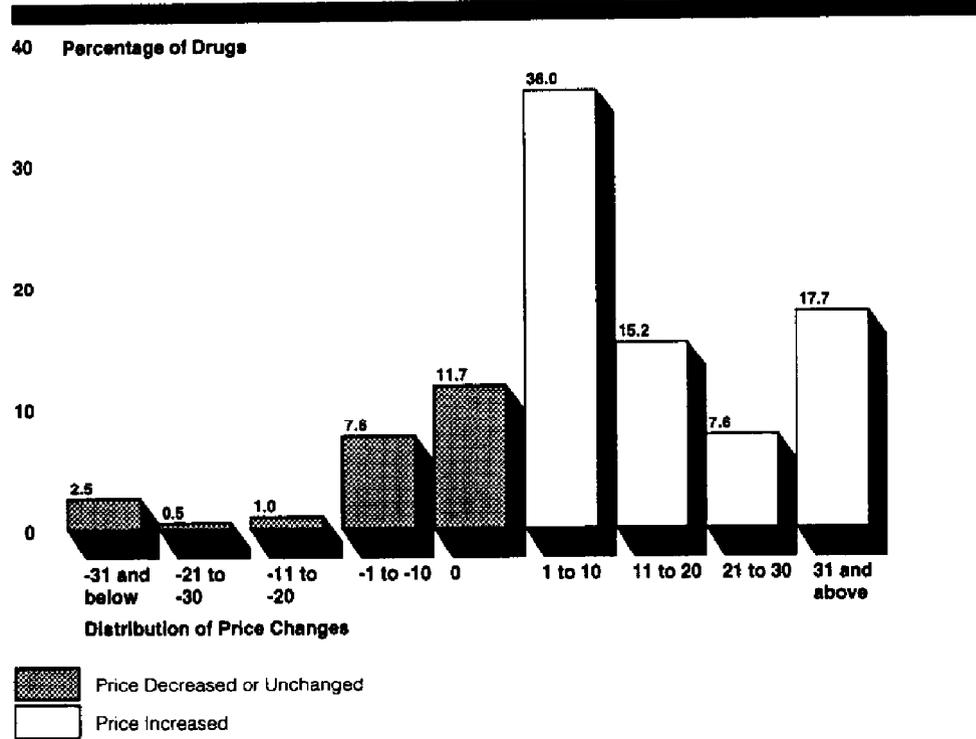
Figure 1.4: Distribution of GPO Drugs' Best Price Changes, First Quarter 1991 to First Quarter 1992



Range: 95 percent decrease to 198 percent increase

Section 1  
Changes in Best Price, AMP, and the PPI

Figure 1.5: Distribution of GPO Drugs' Best Price Changes, First Quarter 1992 to First Quarter 1993



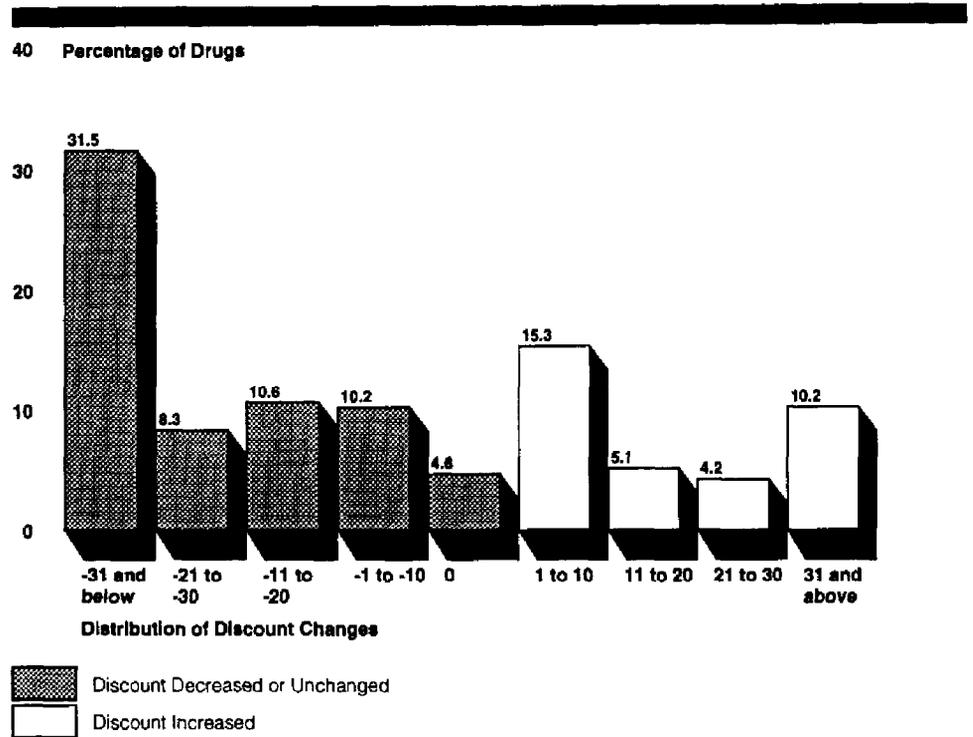
Range: 45 percent decrease to 656 percent increase

Figures 1.4 and 1.5 show that the GPOs had about the same percentage of drugs with best price increases both years as did the HMOs. From 1991 to 1992, about 74 percent of the GPOs' drugs increased in price compared to about 77 percent from 1992 to 1993. However, the number of the GPOs' drugs that had large price increases the first year was greater than the number the second year. From 1991 to 1992, about 35 percent of the GPOs' drugs increased by more than 20 percent compared to about 25 percent of the drugs from 1992 to 1993. The GPOs had, however, a greater percentage of drugs with increases from 1 to 10 percent in the second year.

# Changes in Best Price Discounts

In the 2 years since OBRA became law, changes in the best price discounts for individual drugs varied widely. The following figures show the distributions of percentage changes in best price discounts for the HMO and GPO outpatient drugs during both years.

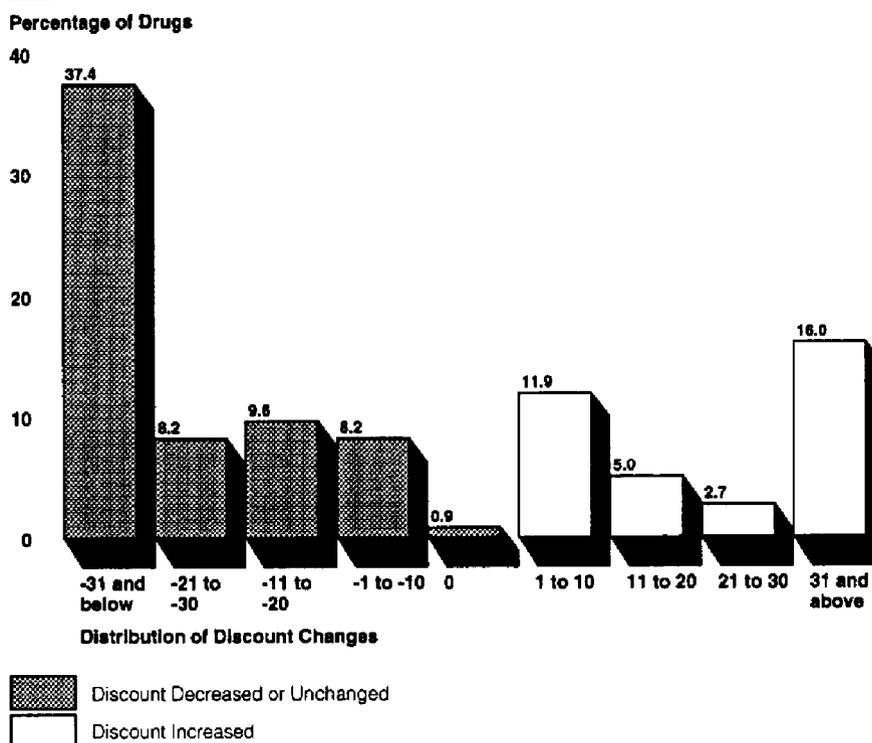
**Figure 2.1: Distribution of HMO Drugs' Best Price Discount Changes, First Quarter 1991 to First Quarter 1992**



Range: 104 percent decrease to 714 percent increase

Section 2  
Changes in Best Price Discounts

Figure 2.2: Distribution of HMO Drugs' Best Price Discount Changes, First Quarter 1992 to First Quarter 1993

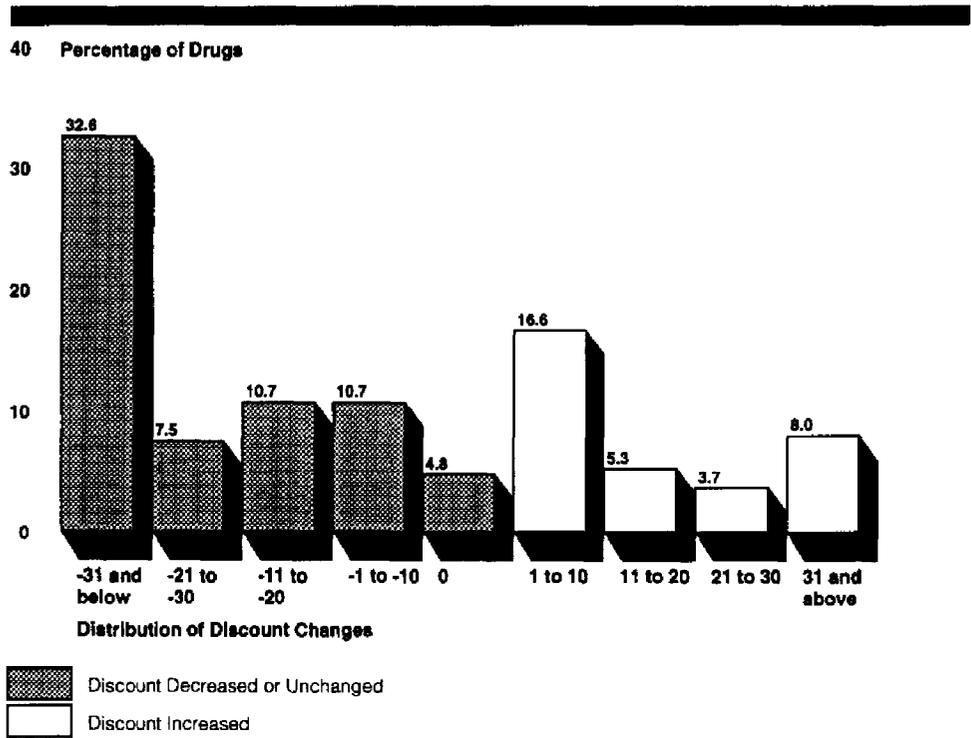


Range: 100 percent decrease to 623 percent increase

Figures 2.1 and 2.2 show the wide variance in changes in best price discounts for the HMOs' drugs during both years. From 1991 to 1992, best price discounts decreased for about 61 percent of the drugs compared with about 63 percent from 1992 to 1993. Best price discounts increased for about 35 percent of the drugs the first year to about 36 percent the second year. The number of drugs whose best price discounts remained the same decreased from about 5 percent the first year to about 1 percent the second.

Section 2  
Changes in Best Price Discounts

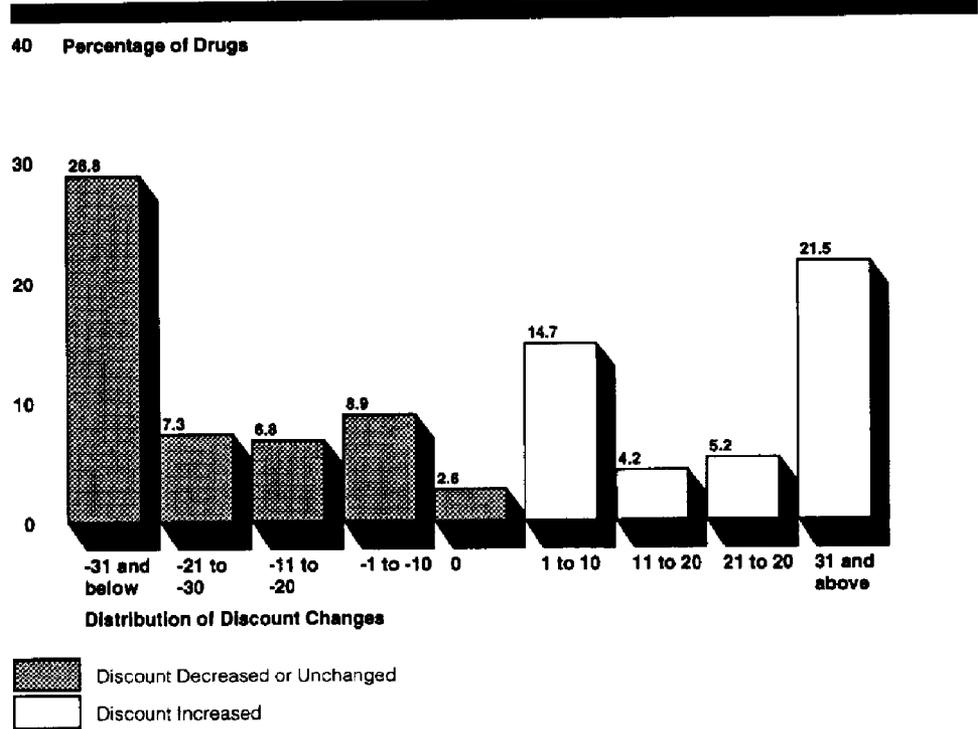
Figure 2.3: Distribution of GPO Drugs' Best Price Discount Changes, First Quarter 1991 to First Quarter 1992



Range: 454 percent decrease to 494 percent increase

Section 2  
Changes in Best Price Discounts

Figure 2.4: Distribution of GPO Drugs' Best Price Discount Changes, First Quarter 1992 to First Quarter 1993



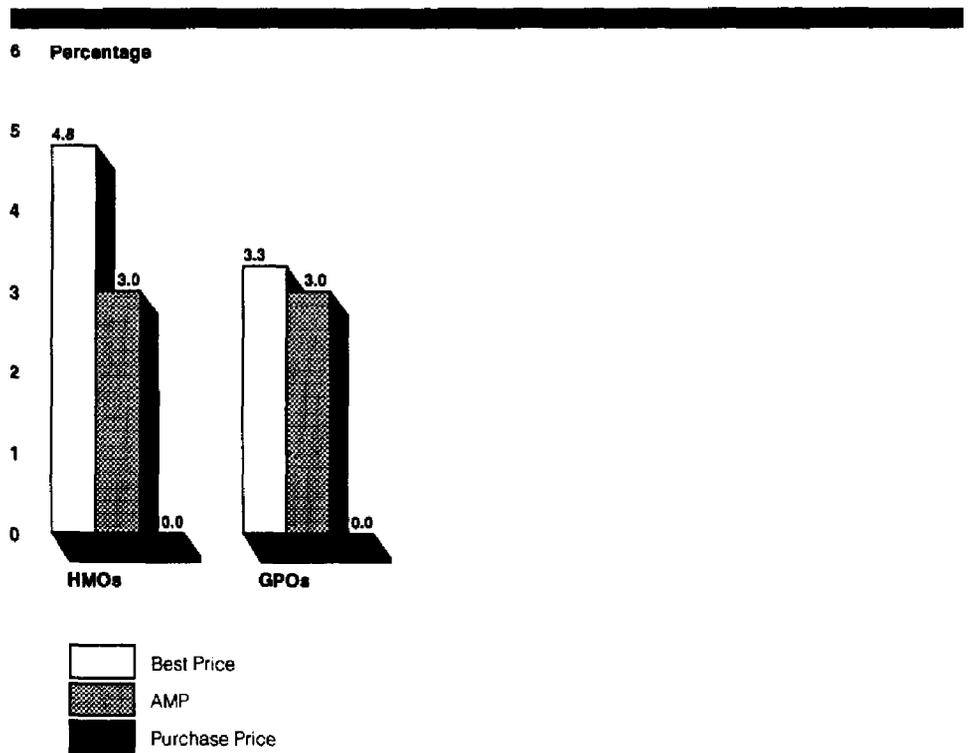
Range: 271 percent decrease to 623 percent increase

Figures 2.3 and 2.4 show that differences in best price discounts for drugs purchased by the GPOs also varied widely. From 1991 to 1992, best price discounts decreased for about 62 percent of the GPOs' drugs compared with about 52 percent from 1992 to 1993. Best price discounts increased for about 34 percent of the drugs the first year to about 46 percent the second year. The number of drugs whose best price discount remained about the same decreased from about 5 percent the first year to about 3 percent the second year.

# Comparison of Changes in Best Prices and Prices Paid by HMOs and GPOs

In the last 6 months of 1991, the median best price for the outpatient drugs purchased by the HMOs and GPOs increased slightly, while the median purchase price remained constant for both groups. This period was the only one for which we had both purchase price and best price data to compare. Figure 3.1 shows the extent to which the median best price for the HMOs and GPOs rose. Figure 3.1 also shows the relatively small change in the drugs' median AMP for the HMOs and GPOs. During the same 6-month period, the PPI for prescription drugs increased 2.7 percent, a rate greater than the median change in purchase price for both the HMOs and GPOs, but less than the median change in best price and AMP for the two groups.

**Figure 3.1: Change in Median Best Price, Median AMP, and Median Purchase Price for HMO and GPO Drugs, July 1, 1991, to January 1, 1992**

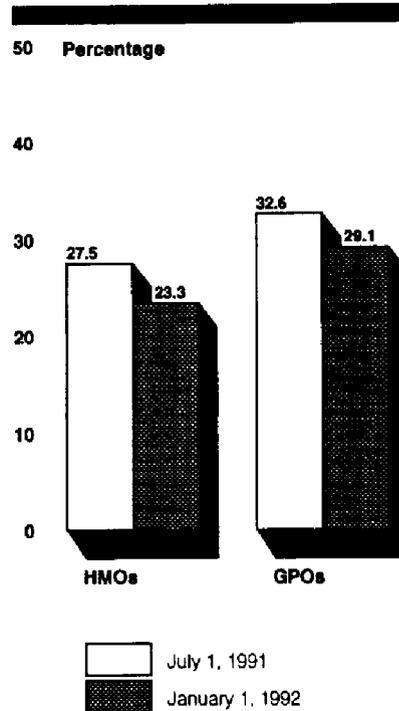


In addition, during the last 6 months of 1991, the percentage difference between purchase price and best price decreased, on average, for the

**Section 3**  
**Comparison of Changes in Best Prices and**  
**Prices Paid by HMOs and GPOs**

drugs purchased by the HMOs and GPOs.<sup>16</sup> Figure 3.2 shows the change in the median percentage difference between purchase price and best price.

**Figure 3.2: Median Percentage Difference Between Purchase Price and Best Price for HMO and GPO Drugs, July 1, 1991, to January 1, 1992**

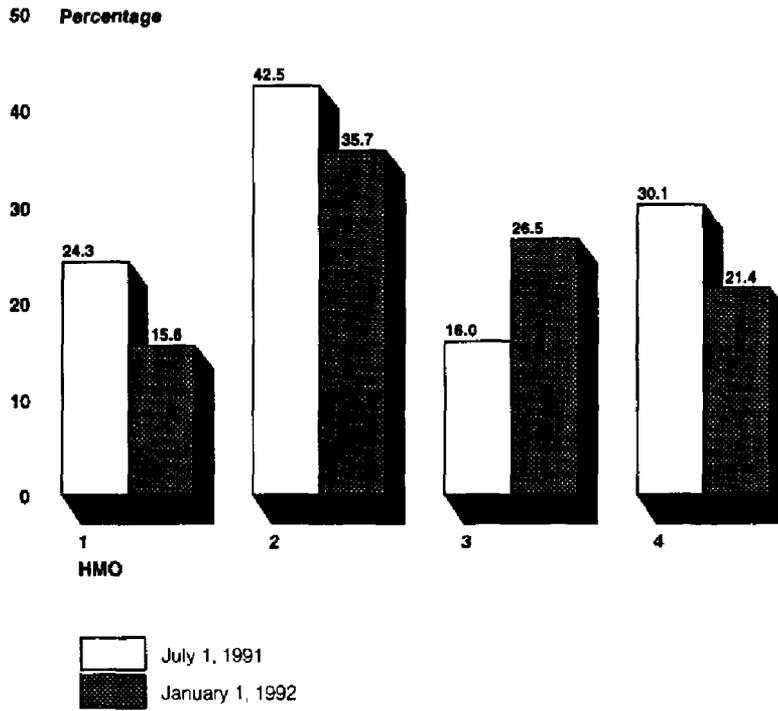


The difference between drug purchase price and best price decreased, on average, about 4 percentage points for the drugs purchased by the HMOs. The drugs purchased by the GPOs had a similar change as the median difference between purchase and best price decreased about 3.5 percentage points. Figures 3.3 and 3.4 show the distribution of the changes.

<sup>16</sup>Change in the median percentage difference between purchase price and best price was the result of change in both variables.

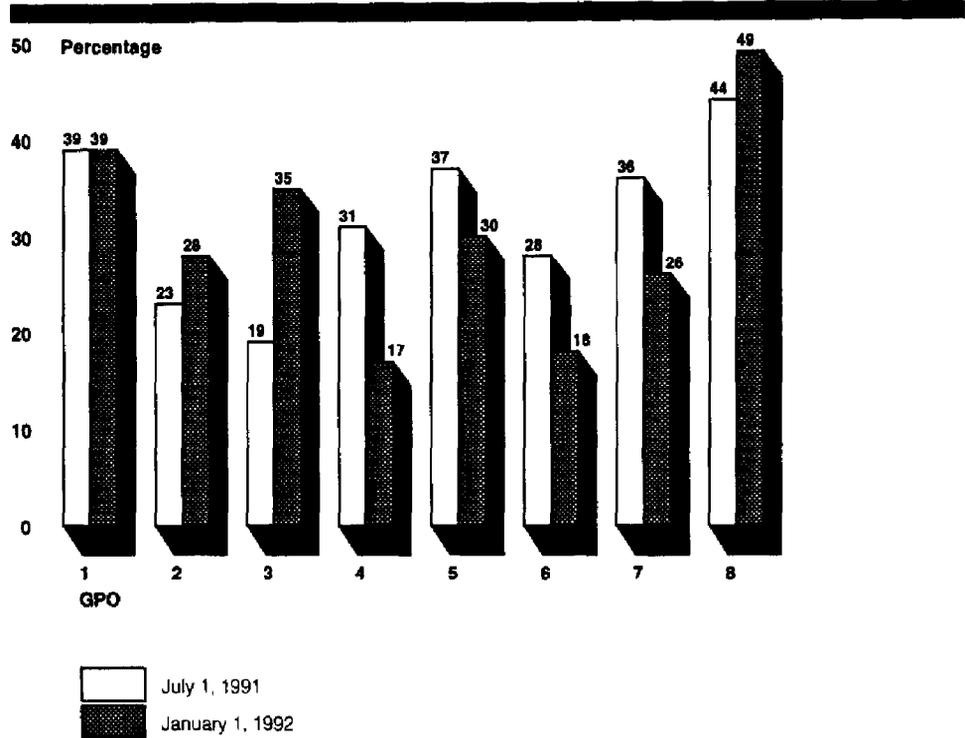
**Section 3**  
**Comparison of Changes in Best Prices and**  
**Prices Paid by HMOs and GPOs**

**Figure 3.3: Median Percentage**  
**Difference Between Purchase Price**  
**and Best Price for Individual HMOs'**  
**Drugs, July 1, 1991, to January 1, 1992**

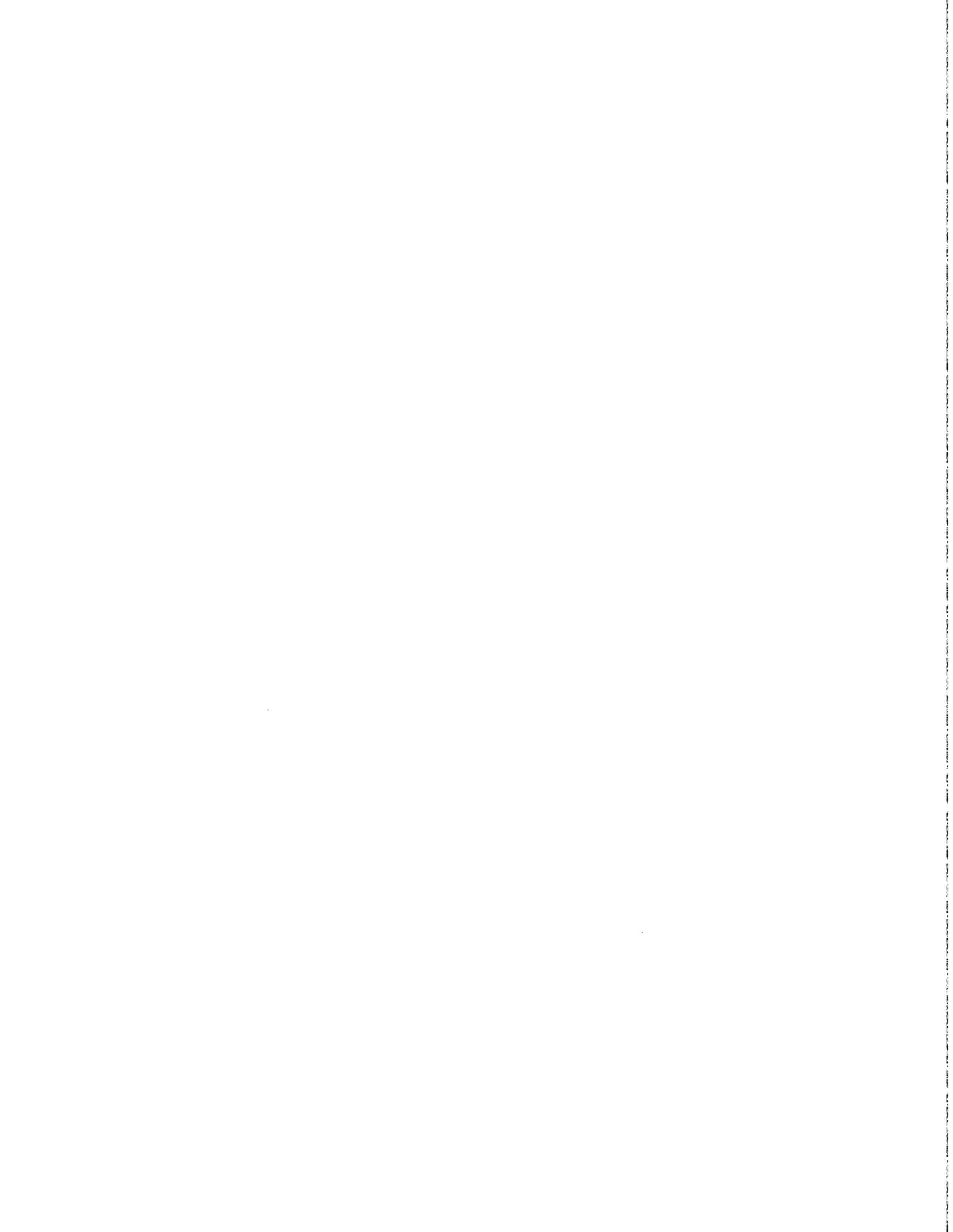


Section 3  
 Comparison of Changes in Best Prices and  
 Prices Paid by HMOs and GPOs

Figure 3.4: Median Percentage  
 Difference Between Purchase Price  
 and Best Price for Individual GPOs'  
 Drugs, July 1, 1991, to January 1, 1992



Figures 3.3 and 3.4 show that most of the HMOs and GPOs had drug purchase prices that, on average, were closer to best price by 1992. The decrease in the difference between purchase price and best price ranged from about 7 to 9 percentage points for the HMOs' drugs and about 7 to 14 percentage points for the drugs purchased by the GPOs. However, for one HMO and three GPOs, the difference between their purchase prices and best prices increased. Of these four purchasers, figures 3.3 and 3.4 show that one HMO and two GPOs had paid outpatient drug prices that, on average, were some of the lowest prices paid by all the purchasers in the study.



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