Premise #1

If prices aren’t linked to quality or quantity; or subjected to other constraints (e.g. caps, closely-matched substitutes), they do just what they want to: run free*

*Assumes profit-maximizing producers who are free to nominate prices, i.e. to set ‘list’ prices

Premise #2

Far more often than not, individuals in industry and the capital markets are moral actors; however as a group, the capital markets are morally agnostic

Stated differently: The capital markets function primarily as a means of allocating capital to its most economically efficient uses, largely independent of whether these allocations are the most socially efficient uses

I.e. all else equal, two stocks with comparable earnings power will also have comparable share prices, largely independent* of the social impacts of their activities

*Assumes the companies’ activities are legal, and are not likely to soon be illegal
In US healthcare price: quality and in particular price: quantity links are weak at best;

price caps generally do not even exist; and,

the relevance of substitutes is diminished by our insistence on best available technologies, somewhat independent of new technologies’ marginal advantage

Therefore prices for new innovations grow rapidly for a very simple reason: because they want to (incentive is to maximize economic gain), and nothing is stopping them (weak links to quality/quantity; no caps)

Essential Context: Affordability

A fifth of US drug spending goes to households whose out-of-pocket costs are on par with their housing costs

70 percent of US drug spending goes to households whose out-of-pocket costs are on par with what they spend on food
Brand Rx Inflation (new product pricing)

It is reasonably clear that elasticity effects (shown here as intensity of need) and the availability of substitutes have at least a modest influence on relative specialty drug prices (lower table);
However there is no evidence of any elasticity effect on the inflationary march toward higher absolute prices (chart at right).

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<thead>
<tr>
<th>Exh 3: Specialty regimen costs (US) as a function of disease severity and presence or absence of alternatives</th>
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<tbody>
<tr>
<td>Acute, life threatening</td>
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<td>$</td>
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<tr>
<td>Single option</td>
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<td>Multiple options</td>
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<td>Sources: Company disclosures; FDA; product inserts; Wolters Kluwer Price Rx; SSR Health analysis &amp; estimates</td>
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Brand Rx Inflation
(existing product pricing, aka ‘same basket’ inflation)

List (WAC) price inflation is running at a +/- 10% pace; however ...
Net price inflation is running MUCH more slowly, because average discounts are growing. In 2Q15, net prices grew at an average 0.7% annual rate.
Brand Rx Inflation (existing product pricing, aka ‘same basket’ inflation)

There is a recent trend (1Q14) toward excluding major brands from coverage; which has dramatically intensified price competition within affected categories.

The four largest contributors to 2Q15 net pricing losses overwhelmingly account for net price deceleration; and, all are driven by decisions to exclude major brands – something that before 1Q14 rarely if ever occurred.

Generic Rx inflation

The fact that generic prices have grown is in and of itself highly remarkable – the usual pattern is for generic prices to steadily fall.

Generic inflation is almost entirely explained by median-reversion of products whose prices were very low to begin with.
Generic Rx inflation

US wholesalers gain from generic price inflation; and, as the result of recent alliances with pharmacy chains, wholesalers now account for most (+/- 75%) US generic purchases

The spread between AMP (the price at which mfg’s sell) and NADAC (the price at which pharmacies purchase) is a proxy for wholesale gross margins

This spread has expanded, particularly on generic products whose prices have inflated