Economic Impact Analysis
Virginia Department of Planning and Budget

12 VAC 30-80 – Department of Medical Assistance Services
Methods and Standards for Establishing Payment Rates-Other Types of Care
December 27, 2002

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

Summary of the Proposed Regulation

The proposed regulations will increase the discount rate applied to average wholesale price of pharmaceutical products purchased by Medicaid from 9% to 10.25% and expand the definition of Virginia Maximum Allowable Cost methodology to include all pharmaceutical products with a rebate program. The proposed changes have been in effect under emergency regulations since July 2002.

Estimated Economic Impact

These regulations contain the Medicaid reimbursement methodology for pharmaceutical products provided to fee-for-service recipients, which comprises approximately 70% of about 230,000 total Medicaid population. Medicaid acquisition rate for multi-source (generic) drugs prior to emergency regulations is the lowest of i) Average Wholesale Price (AWP) price minus 9% discount, ii) usual and customary costs, iii) federal upper payment limits, and iv) Virginia maximum allowable cost. When specified by the prescriber as "medically necessary," the acquisition rate for single-source (brand name) drugs is the lesser of (i) or (ii). Except for usual

and customary costs, a $4.25 dispensing fee is added to the lowest ingredient cost for each prescription to cover the dispensing expenses incurred by the pharmacy. This $4.25 dispensing fee is only paid once in 30 days per patient per prescription regardless of the number of times the pharmacist fills the prescription. The Virginia Medicaid program also receives a rebate from the manufacturers on each product unit.

AWP is the manufacturer's "sticker" price. The pharmacists can usually obtain lower prices. As a result, state Medicaid programs, managed care organizations, and state health programs apply a percent discount to the AWP. Virginia Medicaid program currently applies 9% discount to the AWP. Usual and customary price is the retail price to the cash-paying customer. Federal upper limit payment is generally 150% of the lowest price available nationwide. Virginia maximum allowable cost is calculated from the price of drugs listed in the Virginia drug formulary. Virginia Medicaid requires the use of generic drugs unless the physician prescribes the brand name drug. Under this method, approximately $388.7 million is reimbursed to 1,500 pharmacy providers annually.

The growth in the Commonwealth's Medicaid pharmacy expenditures has been in double digits during most of the last decade. The main reasons for rapid growth include the increase in drug prices simultaneously with the increase in utilization, growth in elderly population, innovation of new drugs, and changes in federal drug advertising guidelines.[1] The effects of these factors on pharmacy expenditures are observed nationally. However, Joint Legislative Audit and Review Commission found that Virginia Medicaid acquisition costs were high relative to the national average and several neighboring states.[2] The national standard was average wholesale price minus 10% plus a $4.32 dispensing fee and the acquisition costs for Kentucky, Maryland, North Carolina, South Carolina, and West Virginia varied from average wholesale price minus 10% to 12% plus a $3.90 to $5.75 dispensing fee. After these findings, pursuant to 2002 Appropriations Act,[3] the Department of Medical Services (the department) promulgated emergency regulations effective July 2002 and reduced the maximum acquisition cost to average

[1] Pharmaceutical Expenditures in the Commonwealth of Virginia, A report to the Governor and the Chairmen of the Senate Finance and House Appropriations Committees, October 20, 2000.
[2] Joint Legislative Audit and Review Commission, "A Review of Selected Programs in the Department of Medical Assistance Services," 2000.
[3] Chapter 899, item 325 FF.

wholesale price minus 10.25%. These proposed regulations are the permanent replacement regulations for the emergency rules.

The department estimates that the proposed change in the reimbursement rate will amount to $7.7 million ($3,806,250 GF, $3,923,746 NGF) reduction in FY 2003 for pharmacy reimbursements, $8.4 million ($4,181,250 GF, $4,270,841 NGF) reduction in FY 2004, and approximately the same amount with inflation adjustment thereafter.

The main cost of this change will be on pharmacy providers. Their revenues are likely to decrease proportionally. It is also likely that some of the revenue losses will spill over to drug distribution businesses and pharmaceutical manufacturers. Overall, the revenues to manufacturers, distribution businesses, and pharmacies will decline by about $7.7 million or 2% of the current total Medicaid reimbursements annually. This may reduce by a small degree the profit margins of drug manufacturers/distribution businesses/pharmacies, and therefore may reduce the number of these businesses participating in the Virginia Medicaid program and reduce accessibility of drugs. On the other hand, the proposed changes will produce about $3.8 million in FY 2003 and $4.2 million in FY 2004 in general fund savings, which may be used for many other purposes. It should be noted that about $3.9 million reduction in federal matching funds represents an additional loss for the Commonwealth's economy while saving $3.8 million in general fund expenditures.

Pursuant to 2002 Appropriations Act,[4] the department also proposes to expand the definition of Virginia Maximum Allowable Cost (VMAC) to include generic drugs as long as the drugs are included in the Center for Medicare and Medicaid Services' state drug rebate program, have been approved by the Federal Food and Drug Administration, are included in the Approved Products with Therapeutic Equivalence Evaluations as generically equivalent, and are sold or marketed in Virginia. Currently, the VMAC is based on the cost of drugs in the Virginia Voluntary Formulary (VVF) only. Virginia drug formulary is a list of covered drugs by the Virginia Medicaid program. Pharmacies are allowed to automatically fill the prescriptions with interchangeable generic drugs listed on the formulary without having to get approval from the prescriber.

[4] Chapter 899, item 325 JJ (2).

For a drug to be listed on VVF, the manufacturers incur significant costs associated with getting an approval, which involves submission of data for evaluation. These costs create disincentives for manufacturers to be included in VVF. As a result, the number of products for current VMAC pricing is small and often more expensive than similar products available in the marketplace.

With this change, VMAC reimbursement methodology will be applicable to all generic drugs that participate in the manufacturers' rebate program. This may allow the department to negotiate with the manufacturers of drugs in the expanded definition. In most cases, the current best option available to the department is the federal upper limit payment method. Thus, this proposed change will allow the department to obtain lower prices on many drugs such as hemophilic factor and growth hormones.

The department estimates that this change will reduce Medicaid pharmacy reimbursements by about $3.8 million ($1,800,000 GF, $1,977,340 NGF) annually. Since this change will reduce the Medicaid pharmacy expenditures, pharmacies are likely to see a reduction in their revenues of which some will likely spill over to the distribution businesses and pharmaceutical manufacturers. However, it is unlikely that this change will introduce significant financial stress to pharmaceutical businesses to the extent to force them out of business. Similarly, this change is not expected to significantly affect the accessibility of the generic drugs because the department has the option of acquiring drugs under the federal upper limit payment methodology. The main expected benefit of this change is providing about $1.8 million savings in general funds to the Commonwealth. Additionally, this change may make some generic drugs available to recipients more quickly by reducing pharmacists' confusion about the VVF and increasing their awareness of their ability to select from a wider variety of drugs available in the marketplace when filling Medicaid prescriptions. Eliminating the reference to the VVF in the department's regulations is expected to result in a more consistent procedure with the federal drug rebate process without the confounding factor of the VVF.

The administrative costs of these changes are expected to be insignificant as the department anticipates implementing them easily through the already existing computerized claims processing system.

Businesses and Entities Affected

The proposed changes will directly affect approximately 1,500 pharmacies currently providing services to approximately 230,000 Virginia Medicaid recipients. It is also likely that approximately 450 major drug manufacturers participating in the Medicaid program and less than 12 drug wholesalers will be affected indirectly.

Localities Particularly Affected

The proposed changes to the regulations apply throughout the Commonwealth.

Projected Impact on Employment

A higher discount rate applied to the AWP will reduce pharmaceutical reimbursements. There may be a small decrease in demand for labor in the pharmaceutical industry in Virginia.

Effects on the Use and Value of Private Property

The value of pharmaceutical businesses may decrease as the reimbursements decrease. The total likely reduction in reimbursements is expected to be about $11.5 million or about 2.9% of the total pharmacy reimbursements. Lower reimbursements will likely reduce the profitability of pharmacies, manufacturers, and distribution businesses, their future profit streams, and consequently their values. This reimbursement reduction applies only to pharmacies' prescription drug services and not to any of the other products, such as over-the-counter drug sales, cosmetics, food, gifts, paper products, etc. Although the value of pharmacy-related businesses may decrease to some small degree, the total reduction of 2.9% in Medicaid reimbursements may not be sufficient to significantly affect pharmaceutical businesses when revenues from other sources are taken into account.