**Economic Impact Analysis**
**Virginia Department of Planning and Budget**

**12 VAC 30-80 –Methods and Standards for Establishing Payment Rates-Other Types of Care: Pharmacy Services Reimbursement**
June 22, 2005

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 permanently implement the Maximum Allowable Cost methodology used to price generic drugs provided to Medicaid recipients. The proposed changes have been in effect under emergency regulations since December 2004.

## Estimated Economic Impact

The proposed regulations will permanently revise the Medicaid reimbursement methodology for generic drugs. Currently, pharmacies are reimbursed for the generic drugs the lowest of i) the Federal Upper Limit (FUL), ii) Virginia Maximum Allowable Cost (VMAC), iii) Average Wholesale Price (AWP) minus 10.25 percent, and iv) Pharmacy's usual and customary charge.

The VMAC reimbursement rates were developed and maintained by the Virginia Department of Health. However, the point of reference used in the VMAC methodology was not updated frequently. In a dynamic generic drug market, static prices established by the VMAC

methodology often produced higher rates. Because Medicaid payment is the lowest of (i) through (iv), few drugs were paid based on the VMAC price. For example, in FY 2004, there were 4.5 million claims that had a VMAC price. Of those claims, only seven percent of were paid the VMAC price. The remaining 93% of the claims were paid using one of the other pricing methodologies.

Pursuant to Item 326 WW (1) of the 2004 Appropriation Act, the proposed changes will permanently revise the VMAC pricing methodology. The proposed Maximum Allowable Cost (MAC) is determined based on the Wholesale Acquisition Cost (WAC). This methodology has been in effect since December 2004 under emergency regulatory authority. The rate is the higher of i) the lowest WAC plus 10 percent, or ii) the second lowest WAC plus 6 percent. For example, if the lowest WAC for Ibuprofen 800 mg tablet is $0.04312 and the second lowest WAC is $0.05210, the lowest WAC plus 10 percent would be $0.04743 and the second lowest WAC plus 6 percent would be $0.05523. Because the second lowest WAC plus 6 percent is greater than the lowest WAC plus 10 percent, the Medicaid program pays the pharmacy $0.05523 for this particular generic drug.

The proposed reimbursement methodology provides a 10 percent margin over the lowest WAC price. The intent of the 10 percent margin is to provide flexibility to pharmacies to purchase drugs from multiple wholesalers. For example, a pharmacy in Virginia may not have access to the wholesaler with the lowest price that may be located in another state. The ten percent margin enhances a pharmacy's ability to purchase drugs from multiple vendors.

The alternate MAC pricing, the second lowest WAC price plus 6 percent, is designed to address the cases where the lowest WAC is considerably lower than all other wholesale prices. For example, a wholesaler may be promoting a particular drug at a deep discount. In these cases, adding only 10 percent to the lowest WAC price may significantly hinder a pharmacy's ability to acquire the drug if the promoting wholesaler is not accessible. To prevent these cases, the proposed methodology checks to see if the second lowest WAC plus 6 percent is higher than the lowest WAC plus 10 percent, and pays the higher rate.

A generic drug must satisfy a number of criteria in order to have a MAC price established. One of the criteria is that drug must be included in national pricing compendia. In addition, there must be at least three different suppliers. This is intended to make sure that there

is some competition in the market where the WAC prices are determined. The drugs must also be therapeutically and pharmaceutically equivalent as determined by the Food & Drug Administration.

The administration of the MAC pricing is handled by a contractor. Additionally, once the MAC prices are established, a list of rates and the factors used in pricing are made available to pharmacies via the Department of Medical Services' website and the list is updated monthly.

The proposed regulations also provide an option for dispute resolution. In some cases, it may be impossible for a pharmacy to obtain a particular generic drug at the published MAC price for variety of reasons such as geographic location. In these instances, a pharmacy may dispute the rate.

The main economic benefits of the proposed changes include significant fiscal savings for the Virginia's Medicaid program. One half of the fiscal savings will be realized by the Commonwealth and the other half will be realized by the federal government. According to the data available from December 2004 through April 2005, fiscal savings annualized for a year is estimated to be approximately $26.5 million. This estimate represents approximately 23% savings out of the $115 million spent on generic drugs in FY 2003. On the other hand, these savings reduce profits of pharmacies that provide generic drugs to Medicaid recipients. The extent of the revenue impact on each individual pharmacy depends on many factors including the acquisition cost of the drug and the amount of drugs sold to the Medicaid recipients. There is no data to analyze the potential impact on each individual pharmacy. However, at the aggregate, a reduction in profits should be expected to reduce incentives of pharmacies to participate in the Medicaid program.

Also, there are some administrative costs associated with the proposed changes. The start up costs already spent by DMAS for computer system changes are approximately $83,000. Of this amount, approximately 90% is financed from the federal matching funds and the 10% from the state funds. In addition, DMAS will pay $277,000 biennially to a private contractor for the administration of the proposed MAC methodology including the costs associated with the dispute resolution process.

## Businesses and Entities Affected

The proposed regulations affect approximately 1635 pharmacy providers.

## Localities Particularly Affected

The proposed regulations apply throughout the Commonwealth.

## Projected Impact on Employment

At the aggregate, the proposed generic drug pricing methodology will reduce the profits of Medicaid pharmacy providers. To the extent reduced profits affect their ability to hire employees, a negative impact on employment in the pharmaceutical industry may be expected. On the other hand, implementation of the MAC program should have a balancing positive impact on employment as additional man hours are required to administer this program.

## Effects on the Use and Value of Private Property

The proposed regulations should not affect the value of real private property. However, a negative impact on the asset value of Medicaid pharmacy providers may result as their profitability is reduced. Conversely, the private contractor that will administer this program may realize a positive impact on its asset value.