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Ronald HALSTEAD

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The BEECHAM GROUP

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10 DOWNING STREET

From the Private Secretary

17 January 1985

I enclose a copy of a letter to the Prime Minister from the Chairman of the Beecham Group plc, about the return on capital in the pharmaceutical industry, and the limited list proposals.

I should be grateful if you would arrange for a draft reply to be prepared for the Prime Minister's signature, to reach this office by Wednesday 30 January. You will note that Mr Halstead has marked his letter "Private and Confidential" - could you please ensure that it is handled accordingly.

(David Barclay)

Steve Godber Esq
Department of Health and Social Security

SH

GR

10 DOWNING STREET

THE PRIME MINISTER

Dear Mr. Halstead,

Many thanks for your letter of 15 January. It was good to see you on Sunday.

I have read with great care your letter and memorandum, and have taken careful note of what you say about the pharmaceutical industry, and the proposals of the DHSS. You will understand that I cannot say any more than that!

Yours sincerely

Margaret Thatcher

Ronald Halstead, Esq., C.B.E.

Ack'd on 16/1

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RONALD HALSTEAD, C.B.E.
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PRIVATE & CONFIDENTIAL

RH/PVW

15th January 1985

The Rt. Hon. Mrs. Margaret Thatcher, M.P.,
Prime Minister,
10 Downing Street,
London SW1.

Dear Mrs Thatcher,

Thank you very much for inviting me to lunch on Sunday. It was a most enjoyable occasion and I was delighted to have the opportunity of visiting Chequers.

I should like to confirm to you the points I made concerning the profitability of industry in general and the pharmaceutical industry in particular. As we have discussed on a number of occasions, one of the major problems of British industry in competing internationally has been the low return on capital stemming from the years of price control regimes in the 1960's and 1970's. This affected cash flow, innovation, investment and productivity and has been a major cause of our loss of share in world trade of manufactures and the change from a surplus to a significant deficit in our manufacturing trade balance.

One of the few areas where we have succeeded in maintaining a strong international market position has been the pharmaceutical industry. This was not subject to the full rigours of the Price Commission since it was dealt with separately in the 1970's under its agreements with the DHSS. As a consequence, the profitability of the industry was not seriously undermined and it was able to maintain its competitive position in the world. Indeed, its record has been a very good one and is a case study example of how British science and technology can be exploited by British companies in world markets. In 1984 its exports were £1200 million and it had a balance of payments surplus of £600 million. It also carried out 10% of the world's research and development in pharmaceuticals even though the U.K. has only 4% of the world market.

cont...

I was, therefore, greatly concerned after reading the House of Commons Public Accounts Committee Reports on the "Dispensing of Drugs in the National Health Service" (1982/83 and 1983/84). The general view appeared to be that because the pharmaceutical industry's return on capital had risen from 21% (historic cost basis) in 1978 (5% above the industry average) to 23% (historic cost basis) by 1980 whilst the profitability of industry elsewhere had declined, the return on capital of the pharmaceutical industry should be reduced. The fact that the return on capital of British industry had been depressed by price control and was generally far too low was not even mentioned. Indeed, as a result of compulsory price reductions the rate for the pharmaceutical industry as a whole was reduced from 25% to 21% in 1984 with the target rate for individual companies somewhat below the 21% figure. The 21% return on capital which is the new average for the whole industry included an allowance for the so-called "grey area". This is the procedure whereby for a limited period of time a successful company can enjoy an individual return on capital greater than its target, resulting from successful new product introductions and improved productivity programmes. I understand that proposals are now in hand to reduce the average for the industry as a whole to approaching 17%. I find this hard to believe for two reasons:-

a) As I said at our CPS dinner in Downing Street, the much welcomed removal of price controls, etc., in 1979 has enabled British industry generally to progressively improve its profitability and investment. Although it still has some way to go in its return on capital, this should improve steadily leading to more investment and better international competitiveness.

b) In the international markets in which we operate, successful companies have a return on capital at the rate of 25-35%. The more successful ones are at the top end of this range. This not only applies to pharmaceuticals, but also to our competitors in the consumer goods industry. Also, in the USA the return on capital of a number of American pharmaceutical companies with whom we compete is substantially higher than the rest of American industry.

In view of all this, I feel it is important to review the 1984 return on capital targets with a view to increasing them back to the 25% level, and I am horrified that we are even considering reducing them below the 21% level!

I have not dealt with the present proposals for a restricted drug list since I feel that the return on capital is the critical issue facing the British pharmaceutical industry in its ability to compete internationally. However, there are potential pitfalls in the restricted list proposals and I think it is important for the industry and the DHSS to work closely together to prevent any unnecessary backlash if the proposals are implemented on 1st April 1985. I asked my pharmaceutical colleagues in Beecham to give me a memorandum on the industry case and also indicate how they would save the £100 million that Norman is looking for. I enclose a copy of this memorandum and I hope that the notes will be of help to you.

With very best wishes.

Yours Sincerely,

Ron

NOTES ON D.H.S.S. PROPOSALS OF NOVEMBER, 1984

HISTORICAL

Two years ago, because of the country's recession, Industry asked to cut prices by 2½% and then freeze prices. This was contrary to PPRS but Industry reluctantly agreed - effective August 1983. Immediately followed by further restrictions including fall of R.O.C. for Industry from 25% to 21% - estimated to reduce drug bill by £100m p.a.

ASSURANCES

8th December 1983. Mr. Clarke gave assurance that the Government rejected generic substitution. Also stated that Government accepted all other recommendations of the Greenfield Report including rejection of limited lists.

Mr. Jenkins gave Industry his categoric assurance that Government policy excluded concept of limited list in his speech at the ABPI Dinner on April 2nd 1981.

P.R.

Industry has over the last decade operated on the basis of maintaining a low profile as being consistent with an industry in the health care field and preferred to negotiate with its main customer without the misleading pressures of public debate. Further, the Industry considered such PR as an unnecessary expense.

However the DHSS in its cavalier handling of the Industry forced the Industry to defend itself to the public, to the medical profession and to politicians.

NEW D.H.S.S. PROPOSALS

In two parts

1) limited lists

2) reduce profitability by cut in ROC.

1) Statements by Mr. Fowler and Mr. Clarke flawed on many counts - must have been badly advised.

a) Statement in House by Mr. Fowler on 8th November that 17,000 medicines are available for prescribing by UK general practitioners. Claimed that this was excessive when compared to medicine available in other countries. Mr. Fowler's advisers failed to tell him that this 17,000 includes 6,000 homeopathic medicines and, because of the UK licensing system, each separate presentation of a medicine requires a separate licence. Thus Mr. Fowler was quoting the number of licences - not the number of medicines. In fact, MIMS (the doctors' handbook on prescribing) contains less than 3,000 medicines and there are only 1,300 drug substances used in the UK - a very similar number to that available in most other countries.

b) Statement by Mr. Fowler that in the last 25 years the number of prescriptions has increased by 100 million per annum. In the last 25 years

(i) contraceptives have been added by Government to the prescription list - this has resulted in over 10 million scripts.

(ii) There has been a change in procedure for dispensing doctors (10% of G.P.s) whereby their dispensing is now included in the script count - accounts for 10 million scripts.

(iii) Over the last four years, hospital policy has moved outpatient scripts from Hospitals to Family Practitioners. No accurate

assessment of effect but believed to be about 30 million scripts.

(iv) The number of people over 65 in 1982 was 8.3 million compared with 6.0 million in 1958. On the basis of the difference in prescription rate for retired people to younger people, this has resulted in an increase in prescriptions of 24 million.

(v) The population has increased by 4.2 million since 1958, equivalent to increased script level of 28.5 million on basis of 6.8 script per head in 1982.

In addition in the last 25 years there has been increase in the standard of health care, the quality of life and life expectancy.

c) Value for money -
View appears to be that - whatever the magnitude of the drug bill - it is too high. Compared to most developed countries the cost of medicine in the UK on a per head basis is very moderate reflecting reasonable drug prices and responsible prescribing by doctors.

In France, often quoted as the cheap drug country, the cost of medicine per head of the population is 60% higher than UK. Germany is 80%, Japan 100%.

d) "Limited lists universal throughout Europe" -
Limited lists used in other European countries vary and are different from that proposed for the UK. Recent report on the use of a negative list introduced in Germany indicates that at best it had a neutral effect, but it probably had the effect of increasing the total cost of medicine in Germany.

e) Proposed limited lists are generic substitution, although at this time in a limited area of medicine. Where applied not only is it generic substitution, the lists actually further limit the generics which may be substituted. Complete violation of undertaking of 1983.

Likely effects if proposed limited lists introduced -

a. Estimated that over 10 million people will note the change - half of them will be significantly affected - estimated that some 80 - 90 million current scripts at risk (total scripts in UK per annum - about 400 million).

People most affected will be elderly.

b. Because of the procedures and restrictions which apply to Dispensing Doctors (10% of all G.P.s), will not be practical for Dispensing Doctors to issue private scripts. If they do, they cannot fill the script themselves and the patient will require to travel a significant distance (could be several miles) to find a chemist to dispense the script. Will tend to occur in rural areas - Conservative constituencies.

c. Private scripts will cost the patients up to 50% more than the current cost to the N.H.S.

Average script costs NHS £4.4 including dispensing fee. Cost of a comparable private script £5.20 to the patient. Cost of medicine dispensed O.T.C. - minimum of £6 to the patient.

d. Effect on chemists

- in poor areas - marked reduction in income
- in rich areas - substantial increase in income.

e. Quality of medication will suffer.

Comparable medicine offered on restricted lists is NOT comparable and will certainly not be accepted either by patients or doctors as comparable. The two laxatives initially offered on the restricted list (as selected by the DHSS advisers) are totally unacceptable in modern medicine in this country. Methyl cellulose granules are unpalatable and in any case are more expensive than some branded laxatives which are excluded. Glycerol suppositories may be good French medicine, but are generally unacceptable to the British public. Similar

situations arise in every classification of medicine when limited lists are proposed.

f. There is a confusion between so-called peripheral medicine (e.g. cough and cold remedies etc.) and serious medicine (e.g. mild analgesics and tranquilisers). The attack on the latter is based on medical prejudice in certain DHSS circles but the view of the Medicines Commission was not sought. Most of this listed serious medicine is P.O.M. - prescription only medicine - (although not exclusively so). This serious medicine must be removed from restrictive lists.

2) REDUCED PROFITABILITY

a) Introduction of limited lists will significantly reduce the profitability of the Industry.

b) The British Research-based Companies in the Industry have presented two papers, one in September 1983, the other one year later, to the DHSS. Both papers presented substantive arguments that the Industry's profitability should be between 25% - 35% return on historic capital.

c) The DHSS and the Public Accounts Committee quote the results of the Review Board for Government Contracts as a basis for assessing the fair level of profitability for pharmaceuticals. Study of the Review Board's report certainly shows that it is inappropriate for the pharmaceutical industry as the comparison is by devious means, related to the average return for all industry (excluding North Sea oil). We argue that the Pharmaceutical Industry should be compared with successful industry. The Review Board data indicate a R.O.C. of 16.9% for so-called Risk Defence Contracts (Risk is defined as Contracts which are not cost plus) and this is the figure quoted by DHSS for pharmaceuticals.

The British Companies are presenting data to show that updating the Review Boards data would raise this 16.9% to over 20% and there is no case for the DHSS to reduce the present figure of 21% used in the current A.F.R. (Annual Financial Return under PPRS).

d) The DHSS have implied that not only do they wish to reduce the R.O.C. to close to 16.9%, they wish to impose immediate price reductions - these reductions would be on a scale such that the successful companies have the largest price cuts. An average of 2½% has been quoted (i.e. £40m in a full year) but it could range up to 5% or even 10% in some cases.

ALTERNATIVES

The Industry have made a number of suggestions on alternative ways to save money on medicine.

A. Reduce distribution cost by £35 million. The Industry would collect this money for the DHSS and actually pay it monthly or quarterly to the DHSS.

B. If contraceptives were excluded from NHS medicines, the Medicine Bill would be reduced by £40 million. An alternative or half-way position would be to impose prescription charges on contraceptives - this would raise £20 million p.a.

C. Reduce Sales Promotion to 8% in 1986 - would save £15m p.a.

D. Reduce prescription exemption level (including season tickets) from 80% to 70% i.e. level in 1980 - save £70 million p.a.

E. Limit on Scrip size to a maximum of one month's supply.

LIKELY EFFECTS

1. Substantial adverse public reaction after 1 April. In the surgery the doctor will blame the DHSS and the Government for his inability to prescribe patients established medicine.

2. DHSS activities over the last two years have introduced lack of stability within the pharmaceutical industry. This environment cannot be conducive to expansion of a successful British industry.

3. Investment in R & D must be curtailed, simply because of lack of resource. Research in certain areas of medicine, e.g. analgesia, will virtually cease.

4. An R.O.C. below 21% will inhibit capital investment as return inadequate to fund investment.

5. Export markets will be adversely affected

   - if UK prices are reduced - many overseas prices for products sourced from UK will be reduced.
   - market restrictions introduced in UK likely to be emulated overseas.
   - exports of £1 billion at risk.

6. UK market represents 4% of World Pharmaceutical Market
   UK supplies 8% of World Pharmaceutical Market
   UK carries out ca. 10% of World Pharmaceutical R & D.

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