

House Democrats delivered on a campaign promise yesterday, passing a bill that would require the government to negotiate the price of pharmaceuticals covered by the new Medicare drug benefit. The idea is that government negotiators could force prices down, generating savings that could be used to make the benefit more generous. But the measure is misguided.

The Democrats point to the Department of Veterans Affairs, which manages to negotiate discounts for the drugs covered in the veterans' health program. But the department can do this because it is free to deny coverage for drugs whose makers refuse to provide discounts: Fully 3,000 of the 4,300 medicines covered by Medicare are unavailable under the veterans' program. Restricting the list of covered drugs saves money, but it also reduces the quality of the benefit -- 1.5 million veterans are sufficiently unhappy with the result that they opt to buy the more inclusive Medicare coverage. Recognizing that narrow formularies are unpopular, the Democratic plan does not permit Medicare to establish one. But if drugmakers know that Medicare must buy their pills, why would they grant a discount? The Congressional Budget Office estimated this week that savings from direct negotiation would be "negligible."

Not only are the Democrats too optimistic about government negotiation; they are also too pessimistic about the current system in which private insurers administering Medicare drug benefits do the price bargaining. These private insurers stand to profit if they can secure discounts and cut premiums and thus attract more customers: Witness the fact that the average monthly premium has fallen since the program began a year ago. Private insurers can do this precisely because they are free to establish formularies, but market discipline ensures that these lists are not unappealingly narrow. The insurers need to keep customers.

The Democrats' stance is troubling because it suggests an excessively government-led view of health-care reform. One of the key challenges in health

policy is to understand which drugs, tests and therapies are most cost-effective; although it will take government pressure on doctors and hospitals to disclose the information necessary to figure out what works, solutions are most likely to be found by competing private entities. In drugs, for example, there needs to be a culture of paying handsomely for new ones that really do add value -- and refusing to pay for pseudo-new drugs that merely mimic cheap generics. Striking the right balance is not easy, and it won't be accomplished by government fiat. The better approach is to let each insurer offer its own version of the right balance, see whether it attracts customers -- and then adapt flexibly.

