GoodRx Health

How Does Drug Pricing Work in the US?

Written by Alex Evans, PharmD, MBA

Published on March 21, 2022

Key takeaways:

- The U.S. has the highest drug prices in the world, leading to the highest drug spending globally despite average drug utilization.
- Prescription drugs move from manufacturer to distributor and finally to the pharmacy before ending up in the hands of patients. Each party plays a role in the final price of the medication.
- Prescription drug claims move from the pharmacy to the payer, which is usually a prescription benefits manager (PBM). PBMs also play a role in the final drug price.

afishman64/iStock via Getty Images Plus

Despite the U.S. having drug utilization similar to other developed nations, its high drug prices have resulted in the highest prescription drug spending in the world. In fact, a widely cited report from the Rand Corporation found that our prices averaged 256% of those seen in 32 other countries included in the study. For branded medications, that cost difference jumped to 344%.

To the public and also to much of the healthcare community, drug pricing is shrouded in mystery. The complexity of the U.S. system, combined with the fact that major players in the system negotiate contracts behind closed doors, makes unraveling that mystery challenging.

Below, we'll look at the major components of drug pricing in the U.S. to better understand both the sources of the prices paid at the pharmacy as well as the reasons for so much variability. We'll follow the path of a prescription drug from the manufacturer to the patient. But first, let's start with a simplified overview.

The basics

The manufacturer has the freedom to set the price of its drug, termed wholesale acquisition cost (WAC), without regulation. After negotiations, rebates, and other incentives, manufacturers almost always get less than the WAC when the distributor buys the drug, and the average manufacturer price (AMP) reflects more closely what they actually get.

The pharmacy buys from the distributor, usually using the average wholesale price (AWP) as a starting point for negotiations, and then decides the drug's cash price. The patient pays that price, using a discount card or insurance. Insurers often hire prescription benefits managers (PBMs) to handle their pharmacy claims.

While this overall path of the supply chain is oversimplified, it is easy to imagine how widely drug prices can vary, given the negotiations happening every step of the way. Let's now dive a bit deeper into each of those steps.

From the manufacturer to the distributor

The U.S. does not regulate the price manufacturers set for their drugs, or WAC, as many other countries do. While the WAC is the so-called "sticker price," manufacturers do not typically receive that amount for the medication. This is because of rebates paid to insurance companies and PBMs as well as negotiations between manufacturers, pharmacies, and distributors.

An estimate of the actual price the manufacturer receives from a distributor or pharmacy, after rebates and discounts, is termed the average manufacturer price (AMP). Finally, the manufacturer is required to sell its drug to Medicaid and a few other federal programs at prices lower than the AMP.

From the distributor to the pharmacy

The distributor then sells to the pharmacy based on individually negotiated prices. Average wholesale prices, or the AWPs (not to be confused with AMPs), are ostensibly an estimate of that price, although most pharmacies never pay the AWP for drugs they purchase. In many cases, the difference between the AWP and what a pharmacy pays can be substantial, and naturally there is a range of prices that pharmacies ultimately end up paying.

While some chain pharmacies negotiate on their own, most independent pharmacies and small chains join group purchasing organizations (GPOs) to negotiate on their behalf and secure the best pricing possible. GPOs also negotiate directly with manufacturers in some cases, bypassing the distributor altogether.

The reason that the price the pharmacy pays varies so much is because of the competition among drug distributors and the existence of numerous GPOs.

From the pharmacy to the patient

Pharmacies set their prices based on a formula, commonly a multiplier of AWP plus a dispensing fee (such as the AWP plus 20% plus $5). They sell the drug at that price or, if the patient has insurance, they submit that price to the payer. The payer reimburses based on their contract with the pharmacy, with rates that vary considerably.

Once again, pharmacies band together to form pharmacy services administrative organizations (PSAOs) in an effort to get the best rates possible from the insurance companies, typically through a PBM.

Reimbursement is usually based on the lowest of the following:

1. **Usual and customary:** This is the pharmacy's cash price.
2. **Contracted rate:** This is typically used for brands and calculated using a formula (such as the AWP minus 20% plus a $1 dispensing fee). Because of large differences between the AWP and the price pharmacies actually pay, some payers have moved away from using the AWP to calculate reimbursement.
3. **Maximum allowable cost (MAC):** Usually used for generics, this is the maximum reimbursement for any manufacturer of the same drug, strength, and dosage form.

Because of this, pharmacies will set usual and customary, or cash, prices relatively high to ensure their price is never lower than their contracted rate or the MAC price. That's one reason prices at pharmacies can be so high.

PBMs have become a central part of the U.S. drug pricing system and contract on behalf of the patient's insurance company to handle their pharmacy claims. Most of the time, when a pharmacy submits a claim to the payer, they are actually submitting it to a PBM, not directly to the insurance company.

Other than paying cash or using insurance and, depending on the drug or pharmacy, patients have the option of using copay cards, free trial offers, discount cards, and reduced-cost drug lists to reduce their out-of-pocket cost.

Key factors in the variability of drug pricing

Lack of price regulation, price negotiations at every stage, complex reimbursement systems, and numerous methods of payment, like cash, insurance, discount cards, and reduced-cost drug lists — all of these factors play major roles in drug pricing variability.

For patients, as long as a medication and the pharmacy they choose are covered under their insurance, the price they pay will likely be the same at different pharmacies. If they are paying with cash, using a discount card, or shopping a pharmacy's reduced-cost drug list, though, shopping around can reveal surprising price variations.

The bottom line

Prescription drug pricing in the U.S. is convoluted and understandably confusing, even for seasoned healthcare professionals. Having a grasp of the players and complexities involved in moving both drugs and claims through the system can help professionals better understand the variability of drug pricing.

Was this page helpful?

Prices & Discounts

Tools & Info

Health

Support

Company

Download the GoodRx app now

Download on the App Store

GET IT ON Google Play

Don’t miss out on savings!

Enter your email address

Subscribe

By providing your email address, you agree to receive emails containing coupons, refill reminders and promotional messages from GoodRx. You can unsubscribe at any time.

GoodRx

Cookie Preferences Privacy Policy Privacy Center Your Privacy Choices Disclaimer Terms of Use

This information is for informational purposes only and is not meant to be a substitute for professional medical advice, diagnosis or treatment. GoodRx is not offering advice, recommending or endorsing any specific prescription drug, pharmacy or other information on the site. GoodRx provides no warranty for any information. Please seek medical advice before starting, changing or terminating any medical treatment.

GoodRx works to make its website accessible to all, including those with disabilities. If you are having difficulty accessing this website, please call or email us at (855) 268-2822 or ada@goodrx.com so that we can provide you with the services you require through alternative means.