

Student Scenario Template

Given your understanding of market demand and supply models, elasticity, government intervention, and its impacts on the market answer the following question using **detailed explanation** and **sketches**.

Scenario

Pharmaceutical Price Gouging Chain (Drug: Acthar gel that cures Infantile spasms)

In 1950 two Mayo Clinic researchers were awarded the Nobel Prize in medicine for discovering ACTH, the active ingredient in Acthar. Half a century later, a company that did not contribute to the medicine's creation raised the price of a vial from \$40 to \$23,000. Adrenocorticotrophic hormone, or ACTH, is a drug that is secreted by the anterior pituitary gland in the human body. As a drug, it is branded as Acthar gel and has been used since 1952 to treat steroid-responsive conditions. Since then, it has expanded greatly to include diseases like infantile spasms, acute exacerbations of multiple sclerosis in adults and more. That is because Acthar was approved for use in 1952 before the Food and Drug Administration required clinical trials to show a drug is effective for a particular disease. Acthar was essentially grandfathered in. Don M. Bailey, Questcor's chief executive, told analysts in 2009. "And we only have about 800 patients a year. It's a very, very small — tiny — market." Infantile spasms are not common diseases, which is why prices have gone up by a huge margin to support the small amounts of users Acthar Gel has. Today, only about 10 percent of the drug's sales are for infantile spasms. Sales of Acthar, which accounts for essentially all of Questcor's sales, totalled nearly \$350 million in the first nine months this year, up 145% from the period a year earlier. Despite the drug's extremely high price, there is no support for the families who suffer from loved ones that bear these diseases. Insurance companies struggle to finance the expenses for individuals with these rare illnesses, and in some cases even go as far as disputing with families reluctant to pay hundreds of thousands for one person. In the case of a child named Trevor, at 7 months of age, he was diagnosed with infantile spasms, a rare type of epilepsy. Acthar acts as a miracle drug in Trevor's case to enable him to live a comfortable life. When his parents found out about the price required to keep Trevor safe, they realized they couldn't financially handle it and turned to their insurance company. The insurance company was extremely reluctant to pay \$125,000 for one individual, to begin with, until Trevor's parents took the case to court and got the treatment paid for.

Task

America is developing new economic policy in response to the price gouging of acthar gel. Using your understanding of elasticity and the different types of intervention, suggest **one** primary intervention (either price floor **or** price ceiling) suitable to this situation, **one** secondary intervention (excise taxes, subsidies, quotas, or demand NPFs), and outline the market impacts.

Mark Breakdown

In short, set out the theory of a price ceiling OR a price floor by explaining –

1. *describe the reason for the intervention (1 mark),*

2. *directly reference 2 specific details from the scenario itself that support your conclusions about elasticity and the original position of the market (4 marks),*
3. *what **it** is (i.e., define it) (1 mark),*
4. *how **it** occurs (i.e., in the market model) (1 mark),*
5. *how **it** impacts demand and supply in the market (i.e., describe the type of disequilibrium) (1 mark),*
6. *a secondary intervention necessary to correct the effect of the primary intervention and 1 specific detail from the scenario itself that supports your intervention (4 marks),*
7. *potential problems and/or criticisms of such an intervention (4 marks), and*
8. *a sketch to animate your intervention and illustrate your explanation (4 marks).*

* "**it**" being either a ceiling OR floor.

<https://hbr.org/2016/07/price-gouging-and-the-dangerous-new-breed-of-pharma-companies>
<https://www.cnn.com/2018/06/29/health/acthar-mallinckrodt-questcor-price-hike-trevor-foltz/index.html>
<https://www.nytimes.com/2012/12/30/business/questcor-finds-profit-for-acthar-drug-at-28000-a-vial.html>
<http://theconversation.com/why-cheaper-drugs-from-canada-likely-wont-cure-what-ails-us-121723>
<https://www.healio.com/ophthalmology/cornea-external-disease/news/print/ocular-surgery-news/%7B9f811acc-5d42-4325-b072-be1f58128416%7D/what-is-acthar>

Answer (in steps)

1.
 - The price of Acthar Gel is restrictive to most families, who then need to fight their insurance company to pay for it. The government should intervene so that neither the family nor the insurance company pay a ridiculous price.
 - The allocation of the Acthar Gel is not efficient, leading to a net social welfare loss while the Acthar Gel producers have complete market control. Here, the government would intervene to correct market failure.
2.
 - The evidence we have found leads us to believe the demand side of the market is extremely inelastic. Acthar Gel is the only drug that can consistently work to treat relapsing infantile spasms. It is the only option for most families who have members who suffer from this illness. As many people suffering from these illnesses require Acthar Gel to survive or live their lives without allowing their illness to constrict them, this is why demand is highly inelastic.
 - The evidence we have found leads us to believe that the supply side is highly elastic. There is the fact that the production of Acthar is very cheap, accounting for around only 1 cent of every dollar the company makes off of the drug. There is also the fact that infantile spasms account for only around 10 percent of the drug's market, meaning that if there were more cases of that disease, the company could easily compensate.
3. Price ceiling, a price ceiling is a mandatory maximum price.
4. A price ceiling is set below the equilibrium price.

5. The ceiling price creates a temporary shortage because demand is higher than supply at a lower price.
6. We have decided that a subsidy is the best secondary intervention.
 - A subsidy will support the producers of Acthar Gel to produce more with fewer costs fronted by the company. This is because the company will see that the government is interested in more of the drug being produced, ensuring that they don't stop producing it.
 - A subsidy will reduce the strain on families who can't live without it and insurance companies who pay for it, making the cost distribution more equal.
 - A subsidy will ensure companies won't exit the country's market, if they determine that the price ceiling is too restrictive for them, hence increased economic activity within the country.
 - This subsidy will prop up the inefficiency of the Acthar market by allowing companies to make their desired profits with the aid of the government.
7. Some problems and criticisms with this secondary intervention:
 - Encourages the continuation of unethical price gouging
 - Massive costs placed on the government for little gain (causes higher taxes).
 - Demonstrates weakness by the government, the price ceiling should be enough to limit the price gouging by the producers of Acthar.
 - Currently, the Canadian government will not subsidize drug prices that they determine to be excessively high (so there is precedent for this suggestion being rejected in some areas).

MOA = Acthar Gel Use For Infantile Spasms in US

