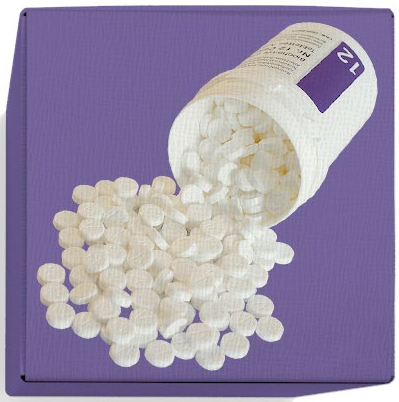
CEPA economics matters



TENSIONS IN THE UK PHARMACEUTICAL SECTOR ARE ROOTED IN ECONOMICS. THE WAY OUT REQUIRES CREATIVITY AND TRUST.

In 2025, the pharmaceutical sector's confidence in the UK has exhibited an unprecedented decline. AstraZeneca, Merck and Eli Lilly have paused or cancelled major investments, with other companies raising criticisms and concerns. The accelerated review of the voluntary scheme for branded medicines pricing, access and growth (VPAG) ended in acrimonious stalemate: Wes Streeting described the pharmaceutical sector's failure to agree a deal as "short-sighted", stating that he would not "allow big pharma to rip off our patients or taxpayers".[1] All this, despite the UK government identifying advanced manufacturing and the life sciences as two (of eight) UK sectors with the greatest potential to support economic growth over the next decade.[2]

The current tensions in the UK pharmaceutical sector are the culmination of constraints on pharmaceutical revenue and prices over many years, combined with recent 'turning point' moments during 2025. **The economist's toolkit can explain many drivers of recent events**. However, with the UK government having negligible fiscal headroom, there are few short-term economic levers available and creative solutions will be required. Moreover, investment decisions are not only the product of expected returns, but also of greater certainty. The government will need to restore trust, so that it can, in the words of Patrick Vallance, "*get [the pharmaceutical] companies back again*".[3]

Gradual squeezing of revenues and prices over time

The UK pharmaceutical sector is by no means broken, with annual turnover of around £50 billion.[4] Pfizer UK has highlighted the UK's "world-class community of life sciences people"[5] and Moderna has opened a state-of-the-art research centre in Oxford, which is forecast to leverage a cumulative £1 billion in UK R&D.[6]

However, there is evidence that the UK is losing its allure and competitiveness as an investment destination, in what is a competitive global landscape. Inward life sciences foreign direct investment (FDI) to the UK has declined relative to peer countries over the period 2017-2023.[7] Johnson & Johnson cites the UK's "decades-long underinvestment in medicines", while Novartis highlights that the UK "invests significantly less in medicines than our European peers".[8]

With the UK exhibiting signs of both strengths and weaknesses, it is important to recognise that international competitiveness is a function of various factors, such as capital grants, taxation rates, clawback payments, supply chain resilience and volatility.

In this context, there appear to be several longstanding economic factors that have gradually and persistently contributed towards the current impasse in the sector:

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[1] Wes Streeting criticises 'shortsighted' drug firms for rejecting pricing offer | The Guardian
[2] Sector Plans | GOV.UK
[3] UK wants to end pricing feud with drugs companies, says science minister | FT
[4] Facts, figures and industry data | ABPI
[5] UK tumbles down global rankings for pharma investment and research | ABPI
[6] Millions of vaccines to be made in Oxfordshire | GOV.UK
[7] Creating the conditions for investment and growth | ABPI
[8] UK tumbles down global rankings for pharma investment and research | ABPI

- **Asymmetry in cost control**. The VPAG scheme creates a firm financial envelope (or a 'hard cut-off') for pharmaceutical expenditure, via adjustments in the rebate percentage. However, historically, the control of other areas of NHS expenditure has been more flexible. For example, in 2020, the UK government wrote-off £13 billion of debt for NHS providers.[9] There may be reasons for this asymmetry, such as governments preferring to spend more on staffing volumes than drugs, and such preferences are shaped by a range of economic, policy and political factors. Nonetheless, it is important to observe that this asymmetry exists.

- **Asymmetry in treatment of inflation**. The cost effectiveness ('cost per quality adjusted life year (QALY)') thresholds for new medicines, as set by the National Institute for Clinical Effectiveness (NICE), have been constant in nominal terms for decades, at £20,000-£30,000.[10] As a result, pharmaceutical products must evidence an increase in effectiveness in order to receive an increase in price. In contrast, 'unit costs' of other areas of NHS expenditure, such as staffing, rise automatically following government pay awards, via the NHS payment cost uplift factor.[11] Any adjustments to the cost-per-QALY thresholds would require careful analysis, to reflect that a significant proportion of costs (R&D) were undertaken historically – both for a new medicine and its comparator.

- **Recognition of economic benefits**. A recent CEPA report, commissioned by ABPI, concluded that the process for appraising capital grant applications through the £520m Life Sciences Innovative Manufacturing Fund (LSIMF) does not fully capture the full range of benefits of innovative manufacturing in life sciences.[12] This work was based on an assessment of the application and design of the HM Treasury Green Book with respect to LSIMF appraisals.[13] Whilst project appraisals are inherently challenging, undervaluing economic and social benefits reduces the support available for investment, which in turn inhibits the UK government's ambition to boost UK life sciences.[14]

- **Sunk costs**. Research and development (R&D) costs for pharmaceutical products are long-term and substantial, with lower variable costs across manufacturing and sales.[15] With the UK constituting a relatively small proportion of global pharmaceutical sales – at roughly 2-3%[16] – firms may be willing to sell in the UK at prices which are close to variable costs, assuming sunk R&D costs can be recovered from sales in other countries. Indeed, US President Donald Trump claims that high US pharmaceutical prices cover the majority of R&D costs, which cross-subsidises lower prices in other countries, including the UK.[17]

- **Impact assessment from multiple schemes**. In England, there are several schemes impacting the financials of pharmaceutical companies and their products. For example, NICE's Health Technology Assessment (HTA) process determines *what* products are approved (based on value for money), VPAG sets out *how much* is affordable, and NHS England's Budget Impact Test phases *when* products are introduced, including through commercial negotiations. However, whilst these schemes have different objectives, the schemes' impacts on companies is often additive downward pressure on both revenue and pricing.

Concerns intensifying during 2025

In addition to the longstanding economic issues noted above, 2025 has constituted a 'tipping point' for the sector, including aborted re-negotiations around the VPAG scheme and announcements of paused or cancelled investment projects.

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[9] NHS to benefit from £13.4 billion debt write-off | GOV.UK
[10] Health technology evaluations | NICE
[11] 2025/26 NHS Payment Scheme | NHS England
[12] Assessing the value of innovative life sciences manufacturing | CEPA
[13] Green Book Analysis | ABPI
[14] The UK risks undervaluing life sciences manufacturing investment | ABPI
[15] Pharmaceutical policy in the UK | LSE, Health Foundation
[16] Pharmaceutical policy in the UK | LSE, Health Foundation
[17] US urged UK to offer better drug pricing deal to pharma companies | FT

Whilst the UK still offers significant investment potential and attraction – as evident in Moderna's new research centre in Oxford[18] – the overall mood in the pharmaceutical sector has been gloomy and critical, catalysed by the rising VPAG rebate percentage. Lord Patrick Vallance's admission, that "probably for medicines, we need to pay a bit more for some of them", reveals the government's concerns around the current state.[19]

There are several economic factors which help to explain the issues arising in 2025:

- **Forecasting issues**. Sales of 'newer' branded medicines in 2024 significantly outstripped forecasts. This led to medicines expenditure breaching the allowed sales growth by more than expected, and the 2025 headline payment percentage (rebate) has risen to 22.9%, compared to the initial forecast of 15.3%.[20] [21] This increase has undermined one of the major objectives of the current VPAG scheme, which was to avoid a repeat of the high rebate percentages experienced under the previous VPAS scheme.

- **High elasticity of supply**. Major categories of pharmaceutical investments – such as R&D and medicines manufacturing – can be undertaken internationally and are relatively responsive to financial incentives (such as tax rates or revenue clawbacks). For companies that perceive the UK to be a less competitive business environment – as is claimed by Merck and Eli Lilly – unfavourable financial stimuli can 'push' away investments to other countries.[22]

- **Game theory and strategic impacts**. US President Donald Trump has indicated that imported pharmaceuticals will face a tariff of 100%.[23] It is not yet fully clear how this will apply to large, global corporations which both manufacture in the US and export to the US. Nonetheless, with North America responsible for over 50% of global pharmaceutical revenues, companies will prioritise the US market.[24] Trump's recent demands for greater US investment[25] are likely to create a significant 'pull' factor, which attracts some investment away from the UK.

- **Benchmarking**. Typically, it is challenging for pharmaceutical companies to garner public support in negotiations with government, given the sector's high revenues relative to some other sectors. For example, in 2023, AstraZeneca's financial results show £36bn in revenue and over £5bn in profit before tax.[26] However, during 2025, the narrative appears to have shifted, from benchmarking *between sectors,* to benchmarking *across countries*. For the latter, there is evidence that UK competitiveness has deteriorated relative to other countries, which has emboldened pharmaceutical companies to raise their concerns.[27]

- **Tipping point**. In 2025, each time that a company has announced it will pause or cancel an investment, the position appears financially more rationale, which reduces the reputational cost of other companies following suit. Arguably, this tipping point has been reached: many of the major companies in the UK pharmaceutical sector have highlighted risks to investment from the current policy and regulatory landscape.[28] Moreover, the UK government convened a one-off (emergency) hearing of the Science, Innovation and Technology parliamentary committee in mid-September, to discuss Merck's decision to abandon a proposed £1bn investment project in London.[29]

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[18] Millions of vaccines to be made in Oxfordshire | GOV.UK
[19] UK wants to end pricing feud with drugs companies, says science minister | FT
[20] The 2024 voluntary scheme for branded medicines pricing, access and growth: 2025 | GOV.UK
[21] Annexes to the 2024 voluntary scheme for branded medicines pricing, access and growth
[22] Eli Lilly boss brands UK 'worst country in Europe' for cheap drug prices | FT
[23] Donald Trump announces 100% tariffs on branded pharmaceutical products | FT
[24] The pharmaceutical industry in figures 2024 | EFPIA
[25] Donald Trump announces 100% tariffs on branded pharmaceutical products | FT
[26] AstraZeneca boss's £17m pay package under fire | The Guardian
[27] UK tumbles down global rankings for pharma investment and research | ABPI
[28] UK tumbles down global rankings for pharma investment and research | ABPI
[29] 16 September 2025 - Life sciences investment - Oral evidence - Committees | UK Parliament

Potential solutions

With several economic factors driving the current predicament, it is reasonable to seek economic counter-solutions. However, whilst Lord Vallance has signalled the need to ease prices, the UK government faces tight fiscal constraints, which the pharmaceutical community itself appears to appreciate.[30] Therefore, creative solutions will be needed. These could include some of the following options:

- **Considering a streamlined and coherent regulatory framework**. As noted above, currently there are several policy and regulatory schemes that affect pharmaceutical revenues and prices. These have different intentions – such as value for money, affordability and timing – but often cause overlapping and/or additive pricing implications for companies, which adds complexity and uncertainty across the multiple stages of medicines sales.

- **Reviewing NICE's HTA cost-effectiveness thresholds**. First, the current cost-effectiveness thresholds should be reviewed, noting that there are a range of perspectives.[31] [32] [33] Second, consideration should be given to tariff indexation, given that the current thresholds have remained constant in nominal terms for decades, as noted above. However, technical quantitative analysis would be needed to consider historic investments. Forward-facing indexation would phase in gradually and therefore limit the short-run cost to the NHS.

- **Designing UK policies that support companies with their global strategies**. A review of UK medicine pricing offers opportunities to reduce pricing contagion risk for global companies. Intelligently designed UK pricing policies could generate positive global multiplier effects for companies, by lessening the risks that they face from international pricing contagion.

- **Seeking quid-pro-quo opportunities**. The NHS has various areas of need. For example, higher medicine prices could be 'exchanged' for assurances of investment by pharmaceutical companies, either in new facilities or to address the NHS capital backlog. A review of NICE's cost effectiveness thresholds could look for opportunities to ensure that HTAs fully reflect prevention impacts, as one the government's 'three shifts' within the 10 Year Health Plan.

Finally, and critically, the government should look for opportunities to improve trust and build long-term certainty for companies, given that investment is a product of expected returns and the volatility of those returns. The substantial rise in the headline VPAG rate for 2025 has tested this trust, given VPAG's objective to improve pricing stability.

The government will face challenging decisions and trade-offs in the coming months and years, balancing economic growth and strict fiscal rules with social welfare protection and strong public services. For pharmaceutical companies to commit to multi-million (and even billion) pound investments in the UK, companies will be seeking assurances that the government is genuinely committed to making the UK "a global leader in Life Sciences", as set out in the government's Life Sciences sector plan.[34]

[30] 16 September 2025 - Life sciences investment - Oral evidence - Committees | UK Parliament
[31] Population-health impact of new drugs recommended by the National Institute for Health and Care Excellence in England during 2000–20: a retrospective analysis | The Lancet
[32] Is investing in medicines harming the health of the UK population? | ABPI
[33] Should NICE's threshold range for cost per QALY be raised? | BMJ
[34] Life Sciences Sector Plan | GOV.UK

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