

ABSTRACT

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Impact of competition on the drug market

Price competition in the Finnish drug market has traditionally been very modest. Consumers mainly purchased those drugs prescribed by their doctor. On the other hand, the price of the drug to the consumer did not have any major effect on the doctor's choice of the drug. The competitive situation changed dramatically on 1 April 2003, when generic substitution was introduced in Finland as one way of controlling the growth of drug costs. According to generic substitution, the pharmacy will replace a prescription drug by a less expensive generic equivalent if there is one, unless either the physician or the consumer specifically prohibits substitution. With regard to competitiveness, the introduction of generic substitution meant that original drugs not protected by patent lost their special position in the market by being submitted to competition from parallel products.

This study investigates the impact of the change in the competitive environment on the prices of individual drugs. The focus is on the prices of substitutable drugs with the particular aim of finding out what factors have affected the observed variation in the price reductions of original drugs. The study also examines price formation of substitutable drugs within and around the price pipeline of a given drug group.

The most noticeable result of the study is that a higher number of competitors in the substitution group lowers prices. This result in itself is not unexpected, but what is surprising is that the entry of additional new competitors causes a clear decrease in prices within a group even when the group already comprises several competitors. Furthermore, the impact of competitors on prices varies among substitution groups. Competition has lowered prices considerably less in groups that had a lower average price level originally than in those with a higher original price level. This is because the price pipeline set for the lower price groups, 2 EUR, is quite sizeable in percentage terms. In a group in which the lowest price is, say, 4 EUR, even drugs priced 50% higher are still within the pipeline. The point is not that "too expensive" drugs are within the pipeline but that a pipeline which is too wide gives no incentive to reduce prices: if nearly all the drugs in the group fit in the pipeline, what reason is there for anyone to decrease prices? To remove this problem, the price pipeline should be much narrower than 2 EUR in the case of low-priced substitute groups.

Another important finding of the study is that there is a marked difference in the way the prices of original drugs have developed in small substitution groups and in large ones. The second problem in generic substitution today is that the prices of the original drug in substitution groups with many competitors have decreased hardly at all. Because a part of consumers want to buy these expensive original products in any case, their high prices raise the costs of drugs both to consumers and to the Social Insurance Institution KELA.

Keywords:

Drugs, medical policy, competition, markets, prices, price control