

# GOVERNANCE

BASEL INSTITUTE ON GOVERNANCE

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## Direct price negotiations instead of price fixing by the SFOPH

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The price fixing process used today in Switzerland by the Swiss Federal Office for Public Health (SFOPH) to set drug prices is damaging to the economy. On the one hand, the system of prices is too inflexible so modifications can only be made under specifically defined conditions. On the other, prices are arranged within a predefined administrative procedure which factually excludes demand-side factors. Therefore, suppliers and purchasers of drugs never meet together in the market place. For this reason the administratively determined drug prices do not correspond to those that would be formed under actual market conditions.

The aim of patent legislation is to protect and facilitate the exploitation of intellectual property. Without patent protection drug companies would most probably not be prepared to invest in developing new agents because every invention could be freely copied by the competition. The introduction of a patent can lead to the creation of an environment that encourages innovation. In Switzerland, patent protection for pharmaceutical agents is limited to 20 years. Weakening patent legislation is therefore reflected directly in less investment in research and development and therefore fewer novel drugs. In the patient's interest patent protection should not be undermined.

A patent on an agent guarantees that the manufacturer has exclusive commercial rights for ready to use drugs. Therefore the manufacturer has a temporary monopoly on a specific drug. This monopoly is coupled with a loss in welfare because the monopoly price set by the manufacturer does not reflect what the purchaser is effectively prepared to pay. To counter this negative effect of patent protection legislation, the SFOPH attempts to control drug prices in Switzerland by a system of price fixing. Thus, with this measure the SFOPH hopes to be able to lower the monopoly price.

Nevertheless, the question arises as to how the regulator is able to know where exactly the price should be fixed

so as to be able to achieve a specific reduction in the monopoly price. The SFOPH compares the prices in other countries and the prices of similar drugs in Switzerland but this does not help much because such prices do not reflect the parameter of demand and the further benefits of a drug. The regulator can easily err while fixing the price setting a price that is either too low or too high. As a result of exaggeratedly high drug prices or inadequate investment in research damage is done to the economy.

In comparison to the regulator, individual insurers or groups of insurers dispose of better information because they are able to process the data about the demand of their insured for specific drugs. Because the insurers bear the costs, individual insurers have an incentive to influence drug prices on a supply and demand basis. Differences in the willingness of those insured to pay for various drugs can therefore be much better reflected in direct negotiations with the manufacturers. Only under market conditions can there be an automatic guarantee that relevant information on the further benefits of a drug or information about the potential competition is reflected as correctly as possible in the drug prices at the time price negotiations are conducted.

If it is not possible to establish a price for a drug in this manner the SFOPH lays down the price for a three-year period. Both manufacturers and insurers are able to make an application to have the price stipulated in this manner. So that price determination by the regulator does not become the normal procedure both the suppliers and purchasers concerned have to inform the SFOPH of their minimum and maximum price. Where the offers intersect is where there is scope for the regulator to determine the price. In view of the prevailing uncertainty about the level of the price to be arrived at, suppliers and purchasers are forced to reveal the actual prices they would prefer. The SFOPH's decision can be appealed to the Federal Council, which in the end decides on the price to be set.



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A supply of drugs that is cost-efficient, available and safe can be established through market forces. State interference should be restricted to providing the legislative framework. Interference by the regulator should therefore be limited in the first place to areas where market forces classically fail, in this case to patent law, clinical safety and accreditation. Formation of prices in the drug sector does not count among the areas where market forces classically fail to function. Determination of prices by the State is therefore unnecessary for all those drugs for which there is a functioning market, which probably means the majority of the drugs on offer today. The Competition Commission should concern itself with

ensuring that there is competition on the drug market and to imposing sanctions on procedures which are damaging to the economy.

The Swiss public health system requires reform in the drug price sector. The price fixing practiced by the SFOPH therefore reinforces the negative market effects of patent protection legislation and is damaging to the economy. Through direct negotiation on prices between drug manufacturers and individual insurers or groups of insurers, formation of prices can take place under market conditions and thus function in an optimum manner.