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PHARMAC CONSULTATION TO REINVEST A PORTION OF SAVINGS BACK INTO PHARMACY SECTOR

SUBMISSION BY RESEARCH MEDICINES INDUSTRY ASSOCIATION OF NEW ZEALAND (RMI)

The RMI is strongly opposed to this proposal which is considered to be fundamentally flawed in principle and insufficiently consulted on. The proposal represents a significant policy shift that is based on a direct cross-subsidisation of individual brands, benefiting only a select group of stakeholders while penalising others. This proposal breaches expected and acceptable standards of commercial practice.

The specific concerns of RMI are outlined as follows:

1. This proposal is not covered by PHARMAC's Statutory responsibility and no apparent decision criteria have been applied

While PHARMAC's commercial activities may have precipitated a sudden fall in revenue for pharmacists, pharmacy contracting and remuneration are excluded from PHARMAC's jurisdiction and budget. The situation should, therefore, not be dealt with by, or via, PHARMAC.

Not only does this proposal involve PHARMAC in something for which it has neither a statutory responsibility nor a defined role, but in addition has the potential to undermine PHARMAC's core objectives and strategies.

PHARMAC is required to take into account a set of nine criteria when making decisions about Community Pharmaceuticals.

The proposal is not justifiable under any of the eight specific criteria and the ninth criterion states:

"Such other criteria as PHARMAC thinks fit. PHARMAC will carry out appropriate consultation when it intends to take any 'other criteria' into account."

While PHARMAC is consulting on this proposal, no other criteria under which the proposal might be justifiable have been specified as required under PHARMAC's operating policies and procedures. Therefore RMI asks "What are the decision criteria on which this proposal is based?"

2. The direct cross subsidisation of individual brands through a wholesaler's uplifting fee is unfair, improper and creates distortions

It seems that the issue for wholesalers is that the actual cost of distribution of certain low-cost generic items exceeds the percentage mark-up currently received through retail pharmacy contracts. The reality is that with falling prices driven by low cost generics the percentage mark-up is inadequate to fund the distribution infrastructure needed in New Zealand under current arrangements. However, PHARMAC propose to "deal" with the issue by paying a short term incentive to distribute the low cost items. However, as soon as the incentive is removed the wholesalers are back in the situation of distributing items at a loss. PHARMAC's answer appears to be that they will artificially maintain total income for wholesalers at a certain agreed level with a short term incentive until new investments kick in. Presumably this is premised on PHARMAC's view that wholesalers should be cross-subsidising distribution of non-profitable lines with income from profitable lines. In other words income from higher priced, innovative pharmaceuticals should be used to cross subsidise unprofitable generic lines. With this cross subsidisation approach more and more monies for "new" investment will simply be diverted to cross subsidise distribution of generics rather than purchasing improved health outcomes.

A rational approach would be to ensure that distribution of every line is profitable without cross subsidising to maintain sector incomes at an agreed level.

If more than $3,000,000 of direct subsidies is to be removed from the pharmacy sector with the change of the rebate structure, then surely this could be more easily and properly addressed by adjusting the wholesaler margin contribution of the total reimbursement across all products via the DHBs contract with community pharmacy. The $3 million not being paid to community pharmacy in mark-ups represents a $3 million saving to the DHBs, not to the community pharmaceutical budget. Therefore, the $3 million "reinvestment proposal" being put forward should logically be funded directly by the DHBs.

Further, the consultation document states "at the end of the 2009 calendar year, community pharmacy mark-ups are expected to reach $29.8 million dollars. This is

$3 million dollars less than what community pharmacists and wholesalers would have expected given historical growth of approximately 2.5% per annum…".

The RMI does not believe that is PHARMAC's role to ensure that privately owned businesses maintain positive year-on-year growth in income, especially when that income is provided from the community pharmaceutical budget. It is a harsh reality that many businesses will be unable to achieve year-on-year growth under the prevailing economic conditions.

It is widely appreciated that PHARMAC's savings strategies are based on brand switching – often from innovative pharmaceutical products to cheaper generic substitutes. This proposal provides compensation to one group within the supply chain for the adverse impact created by the brand switch. Surely if compensation is to be paid for the obvious impact of brand switches then as a matter of principle any such payment should be paid in a neutral manner to all parties who suffer adverse impacts from brand switches. PHARMAC has provided no rationale or explanation for why it considers that pharmacists are deserving of compensation in this case, nor why other parties should not receive any compensation.

The PHARMAC proposal also creates a bizarre situation wherein the subsidy paid will be greater than the ex-manufacturer cost of the product.

The consultation paper indicates that other products, additional to the two covered by this proposal, will be treated in a similar manner in the future. It therefore appears likely that this mechanism could become a permanent or regular feature of the Pharmaceutical Schedule where brand switching is required. This would diminish PHARMAC's ability to utilise savings to fund new innovative pharmaceuticals and can only lead to a confused web of cross-subsidisation that will greatly compound the distortions created by the initial proposal.

This also reinforces the commonsense alternative approach of adjusting the wholesaler margin contribution of the total reimbursement across all products.

3. The proposal undermines the Tender process

Under this proposal PHARMAC is directing additional subsidies to support the use of individual products

The timing of the proposed subsidy increases relating to omeprazole and paracetamol, some three months before the other currently funded brands are due to be delisted, would appear to undermine the transition periods defined in the rules of the Tender/RFP. The effect is to disadvantage those companies which were unsuccessful in the Tender/RFP in terms of their ability to sell remaining stocks of their brand because, even if they remain fully funded in the Second Transitional Period, pharmacists would forgo the "bonus" conferred by the wholesaler uplift fee if they purchased the outgoing brand. We acknowledge that both Losec and Panadol would have been associated with a manufacturer's surcharge in any case. However, the proposal is still, in principle unfair with PHARMAC providing pharmacy with a cash incentive from the community

pharmaceutical budget to dispense a specified brand. This must be addressed given that PHARMAC has signalled that it intends to utilise the same mechanism on other products in the future.

CONCLUSION

There appears to be no rational justification, especially within PHARMAC's Decision Criteria, for the proposal outlined in the consultation paper and the issue addressed is not a matter for PHARMAC. A much simpler and less distorting remedy is available. It is noted however that the proposal as outlined will increase PHARMAC's commercial leverage and capacity to manipulate supply contracts.

The RMI urges PHARMAC to not proceed with this fundamentally flawed proposal that is not based on any acceptable principle.

This is a short term, stop-gap measure designed to placate and appease the immediate concerns of pharmaceutical wholesalers and retail pharmacy, but fails to address the basic problem.

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