Quality Regulation and Competition Evidence from Pharmaceutical Markets

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Quality regulation attempts to ensure quality and foster competition by reducing vertical differentiation, but it may also have adverse effects on market structure. We study this trade-off in the context of pharmaceutical bioequivalence, which is the primary quality standard for generic drugs. Exploiting the introduction of bioequivalence in Chile, we find that stronger regulation decreased the number of drugs in the market by 21% and increased average paid prices by 13%. We estimate a model of drug entry, certification, and demand to study the role of drug quality, aversion against generics, and certification costs in shaping the equilibrium effects of quality regulation. We find that quality regulation increased demand for generic drugs by resolving asymmetric information and reducing aversion against unbranded generics, which induced entry of high-quality drugs in place of low-quality drugs. Consumer welfare increased despite higher prices and a lower number of firms. We compare minimum quality standards to quality disclosure and other designs of quality regulation.