China’s Initiative to Cut Generic Drug Prices

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A patent on a drug allows a drug company to maintain a, sometimes very, wide profit margin on a drug by force of the monopoly granted by the patent. The patent’s expiry allows competitors to enter the market with generic substitutes while the price for the drug drops to less than 10% of the original drug’s price.

This principle, surprisingly, does not apply to China’s drug market, where generic drugs are anomalously sold at 74% or even 90% in gross profits (compared to the global average of about 55% according to Bloomberg).

The reason lies in, among others, the difficulty China-based companies have in manufacturing drugs that meet the drug industry’s strict safety and quality assurance standards and thus the preference of hospitals and physicians to purchase and prescribe patients drugs produced by foreign companies.

Generally speaking, the lack of strict regulations and adequate enforcement of existing regulation leads to a relatively compromised market and therefore, for instance, antibiotics can be purchased at pharmacies in China without a prescription (the prohibition against doing so is not enforced). The result is that despite the presence of China’s traditional medicine, antibiotic consumption per capita in the country is 10 times higher than in the United States. This high antibiotic consumption has even led to the flourishing of antibiotic-resistant bacteria.

Only recently was the Chinese vaccine producer Changchun Changshen Life Sciences Ltd. fined 1.3 billion USD by Chinese authorities. The fine was exacted for filing falsified records, using expired materials and making ineffective rabies vaccines.

The Chinese government has launched a new initiative to confront the phenomenon by mobilizing the masses and initiating a concerted procurement of medicine for hospitals. According to the project, currently in its pilot phase, 11 major Chinese cities, including Beijing, Shanghai and Guangzhou (which together number over 70 million people) are coming together to issue a joint tender for supplying medicine to hospitals. Under this program, the drug manufacturer offering the lowest price will be able to supply the drug exclusively to hospitals in the 11 cities participating in the pilot, which includes 31 generic drugs for a variety of indications such as allergy, hypertension and cancer (there are four million new cancer patients every year in China).

As one would expect, the initiative, which was met with opposition from generic companies both internationally and domestically, led to dramatic cuts in drug prices, with an average decline of 52% and in some cases 90% in the price of the drug.

International companies can find comfort in another reform in China that allows foreign drugs to be approved at record speed, sometimes only taking a few weeks. The reform has already shifted precedent, where, for the first time, approval of a foreign company's drug in China preceded that of all other countries, namely, the new drug for anemia called Roxadustat developed by AstraZeneca and Fibrogen.

This shows that China continues to invest efforts in accelerating access to China's market for foreign drug companies. Be that as it may, China-based companies sustained by generics and lacking research and development divisions are those apparently expected to be more adversely affected by the move.

It remains to be seen what impact the new initiative will have on the generic industry in China and whether there will be implications for the development of new drugs.

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