By Paul Belleflamme, 1 October 2010

'Pay for delay' deals in the pharmaceutical industry

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'Pay for delay' deals are commonplace in the pharmaceutical industry; they involve branded drug makers paying generic groups to delay the launch of lower-cost versions of their drugs. Last July, the US House of Representatives passed a legislation banning such deals. These deals are also at the center of European Commission scrutiny.

It does not take too much thinking to understand why big pharmaceutical firms propose such deals. What is more intriguing, at first glance, is that generic producers accept these deals. One can indeed wonder whether it wouldn't be more profitable for them to reap the profits of an earlier launch of their generic drugs rather than accepting the money that is offered to them if they delay. The explanation for this puzzle has been given in 1982 by Richard Gilbert and David Newbery in their article '*Preemptive Patenting and the Persistence of Monopoly*' (published in the *American Economic Review*). Douglas Clement (in his article 'Creative Disruption'), summarizes very nicely the main argument of this influential paper:

> *"The Gilbert-Newbery model, then, says that a monopolist must choose between adopting an innovation and allowing a rival to adopt it. The monopoly firm must calculate not only the value of the innovation to its own operation, but the repercussions of allowing a rival to have it. In this situation, the economists showed, monopolists often have a strong incentive to innovate, if only to preempt their rivals."*

Of course, what really matters for society, are the welfare effects of such deals. Are the US and European legislators right in trying to prohibit them? As usual with the economics of innovation, the answer is not simple; reasonable arguments can indeed be found for and against such ban (see for instance this Forbes article: 'Pay-For-Delay Or Pay-For-Innovation?'; see also the related post by Alain Strowel on this blog). On the one hand, delaying the entry of cheaper drugs certainly has a negative impact on the well-being of consumers in the short run. Yet, on the other hand, shortening the exclusivity period during which pharmaceutical firms enjoy monopoly profits is likely to reduce their incentives to produce new drugs, which may harm the consumers' well-being in the long run.

Since this post was written (October 2010), the issue of 'pay for delay' has been largely debated.

Your job is thus to update this post while articulating your opinion about this issue. You can start by looking at the presentation that Matthew Bennet (from Charles River Associates) made in May 2013 about the economics of pay for delay cases. You can also have a look at past comments to this post. Otherwise, just google ‘pay for delay’ and you’ll find a large list of recent articles on this topic.