

Sorensen (2000): Equilibrium Price Dispersion in Retail Markets for Prescription Drugs

This paper study about the empirical importance of price dispersion that arises from imperfect information by examining the retail market for prescription drugs. The “law of one price” is never empirically valid. Homogeneous goods are sold at different prices by rival firms. This study wants to find the equilibrium price distribution which is based on consumer search cost. The data was collected from individual pharmacies in upstate New York. The central finding of this study is that observed price distributions are consistent with the predictions of models based on consumer search. Consumers increased propensities to price-shop for frequently purchased prescriptions should lead to less absolute dispersion and lower markups for such prescriptions. This prediction is found to be true in the data which is measures of both dispersion and markups are significantly lower for drugs that are purchased repeatedly. The outcome still be the same which is negative relationship between price dispersion and purchase frequently whether they included or did not included the different pharmacies effect. Therefore, if there have more frequently purchase consumer will be more incline to price-shop for the drug and then when search intensity increase this will lead to lower prices and less dispersion.

For the regression, the dependent variable is price range. The estimates are obtained using GLS shown that is statistically significant and has a negative coefficient. While other variables are not statistically significant but it suggests that prices are more dispersed for generic than for branded drugs and prices are less dispersed in Newburgh than in Middletown. The importance of search models is that measures of margins and absolute dispersion should move together in response to changes in the search environment. The result of dispersion and margin regression indicating that both margins and dispersion decline with a prescription’s frequency of purchase.