

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

This paper seeks to explain the empirical importance of price dispersion due to customers searching cost by examining retail prices for prescription drugs. The central proposition of the study is that increasing intensity of consumers searching cost will lead to lower prices and less dispersion in the market. This is because the easier consumers can search about price for prescription drugs, the easier consumers can compare products price with rival firms which cause equilibrium price to be lower. In this paper, the author uses cross-sectional and regression to analyse the data.

$$\text{RANGE}_{ij} = \beta_0 + \beta_1 \text{PFREQ}_i + \beta_2 \text{AWP}_i + \beta_3 \text{BR1}_i + \beta_4 \text{BR2}_i \\ + \beta_5 \text{NEWB}_i + \sum_{k=6}^{25} \beta_k D_{ik} + \epsilon_{ij}.$$

From the regression model has shown, the authors expect absolute dispersion of prescription prices to decrease with purchase frequency.

The dependent variable

- the price range (across pharmacies in town j)

Variables

- PFREQ is the purchase frequency
- AWP is the drug's acquisition cost
- BR1 and BR2 are dummies for two kind of brand name drugs
- NEWB is a dummy variable for Newburgh
- D are the indicators for 20 categories of drug therapy

The results of regression show us that:

- the estimated coefficient on the purchase frequency variable is negative and statistically significant.
- estimates using the coefficient of variation suggest that drugs purchased monthly exhibit 20 percent less relative dispersion than one-time purchases
- the brand dummies suggest that prices are more dispersed for generics than for branded drugs, although the estimates are not statistically significant
- The estimates also indicate that prices are less dispersed in Newburgh than in Middletown, in spite of the fact that the two cities are ostensibly quite similar

- The estimated drug class effects which are included primarily as controls, give some evidence that dispersion depends on the drug's intended use

Overall from the finding, the evidence suggests that even if pharmacy differences explain one-third of price variation, the price patterns are still not consistent. The implication of price dispersion has an important effect on policies related to acquiring information cost. This means the price dispersion generated by imperfect price information, programs or policies that centralize price information, it may results in decreasing overall price for consumers