

PRIME MINISTER

18 June 1986

RENEWAL OF THE PHARMACEUTICAL PRICE REGULATION SCHEME

Prime Minister!

*Agree to write as
proposed? DLS 18/6.*

Yes not

The NHS spends about £1.9bn a year on drugs. It is a monopoly buyer, and a company with a patented drug may well be a monopoly seller. In the absence of normal market forces the PPRS establishes a framework for pricing and buying drugs. We set target levels of profit for companies (within a broad range) based upon a return on capital employed.

The 25% average target rate of return set by Labour in 1978 was much too generous, especially as the profitability of most of British industry fell during 1979-81. So we have been steadily toughening up the PPRS - bringing the average profit rate down to 18% and reducing the allowance for sales promotion costs. But meanwhile British industry has bounced back from the recession, and the inevitable protests from the drug companies have begun to seem more sincere.

The new deal negotiated with the Association of the British Pharmaceutical Industry (it must now be put to their members) is the best we could hope for in these circumstances. The drug companies get an increase in the average profit rate of 1.5% in October, and a further 2% in October 1987.

Thereafter, changes in the profitability of the rest of British industry will be taken into account - though no rule is specified. In return, we get better financial information, particularly from multinationals on their transfer prices so it will be more difficult to fiddle their profitability figures. We can also hope for a period of stability in our relations with the drug companies.

The Opposition may argue that it shows we help out rich drug companies whilst clobbering nurses. The reply to this is that the increased profit rate will still be lower than the 25% inherited from Labour; allowable sales promotion costs have been reduced since 1979; and the régime for transfer prices will be tougher. Moreover, the British drugs industry is a success story - we do not want to kill the goose that lays the golden eggs.

At the other extreme, some companies will moan. American firms may object that the transfer price régime discriminates against them. We can reply that the transfer price arrangements are in line with the OECD code of practice.

The Treasury accept that the deal is the best we could hope for in the circumstances. I therefore recommend you agree to it.

The only point which you might want to add is that our drugs bill is high because GPs - who prescribe 3/4 of NHS drugs - have no reason to care about the cost. The consultation document on primary care contains an anodyne statement that 'Once better information on individual doctors' prescribing patterns is fully available, the possibility of using this information to increase the incentives for cost-effective prescribing will be explored.' The DHSS are hoping this will bury issues like drug budgets. This is an opportunity to remind them that the issue should be pursued as part of the consultations on primary care.

David Willetts

DAVID WILLETTS

late LPO
ccBG



10 DOWNING STREET

19 June 1986

From the Private Secretary

Dear Tony,

RENEWAL OF THE PHARMACEUTICAL PRICE REGULATION SCHEME

The Prime Minister has seen a copy of your Secretary of State's letter to the Secretary of State for Wales of 15 June about the proposed agreement with the pharmaceutical industry.

The Prime Minister accepts that the agreement represents a reasonable deal for the Government.

The Prime Minister believes it will continue to be most important that DHSS should pursue vigorously proposals for more cost effective prescribing of drugs by GPs. The consultation document on primary care referred to the possibility of increasing the incentives for cost effective prescribing and this issue will need to be pursued during the consultations.

I am copying this letter to the Private Secretaries to the Lord President, Foreign and Commonwealth Secretary, the Secretaries of State for Northern Ireland, Scotland, Trade and Industry, the Chief Secretary and Sir Robert Armstrong.

Yan,

David.

DAVID NORGROVE

Tony Laurance, Esq.,
Department of Health and Social Security.

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From the Secretary of State for Social Services

The Rt Hon Nicholas Edwards MP
Secretary of State for Wales
Welsh Office
Gwydyr House
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LONDON
SW1A 2ER

Any PV comments by
Wednesday please.
B/A then.

15 June 1986

Dear Nick.

RENEWAL OF THE NHS PHARMACEUTICAL PRICE REGULATION SCHEME

*WILL REQUEST
IF REQUIRED*

The negotiations with officers of the Association of the British Pharmaceutical Industry (ABPI) for a renewal for the Pharmaceutical Price Regulation Scheme (PPRS) foreshadowed in Kenneth Clarke's letter of 23 July last year to the Chief Secretary and other interested Ministers are now complete. The proposals envisage a 6 year agreement starting in October of this year, with a provision for review after three years.

As intended, we have offered a new procedure, based mainly on published index movements, for keeping the industry's allowable profits on NHS drugs in line with changes from 1988-89 in the average profitability of British industry. In the meantime we have offered some belated interim increases, within expenditure limits agreed by the Chief Secretary. In return, we have secured more explicit powers to constrain the growth in the industry's costs and a renewed and more emphatic commitment on the industry's part to cost improvement.

The proposals also include somewhat improved powers of last resort in cases of serious dispute over foreign companies' transfer prices. The industry's sales promotion allowance will remain at the level (9 per cent of NHS sales revenue) to which we reduced it last year, but we have agreed that for limited periods companies marketing major pharmaceutical innovations should be able to spend limited amounts of their own profits on extra promotion. We have also improved the incentives to innovation and competitiveness by somewhat increasing the share of profits allowed to companies demonstrating special

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efficiency gains or research successes, and by insisting that the level of support for research and development in NHS prices may be influenced by the industry's success in containing its general costs as well as by the overall financial position of the NHS.


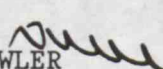
The ABPI cannot commit its member companies to these proposals without consulting them in full. The agreement on offer is less generous than they had hoped for, and considerably less advantageous to them than the scheme introduced by the Labour Government in 1978. Our expectation is that the British and European companies will acquiesce, though there may be some difficulty with the United States sector which is more aggressive and most at risk on transfer prices. My Department will liaise closely with the Department of Trade and Industry and the Foreign and Commonwealth Office over the position of the US companies and any reaction from the US Government.

When the ABPI's consultation with its members begins towards the end of this week the proposals are likely to become public. I therefore intend to inform Parliament of the position reached by means of a written answer, probably on Thursday 19 June.

The proposals are satisfactory for us. If accepted they will stabilise our relations with the industry after two years of hostility, and should improve - if only modestly - the investment climate for both British and foreign companies. We should be able to secure medium and long term expenditure gains from the new emphasis on the containment of cost growth. However, the pharmaceutical industry's terms of business with the NHS are always sensitive, so I do not intend a high profile political presentation and particularly during the forthcoming period of debate on the proposals within the industry will aim for the minimum of public and political comment. Assuming that the industry's response is in due course favourable, my Department will discuss with the Department of Trade and Industry the best means of exploiting the industrial policy and inward investment potential that a final and formal agreement should offer.

Copies of the detailed proposals have been circulated by my officials.

I am sending copies of this letter to the Prime Minister, Willie Whitelaw, Geoffrey Howe, Tom King, Malcolm Rifkind, Paul Channon and John MacGregor, and to Sir Robert Armstrong.

Yours etc. 
NORMAN FOWLER 

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Norman Fowler MP
Secretary of State for Social Services
Department of Health and Social Security
Alexander Fleming House
Elephant and Castle
London
SE1 6BY

NBM

18 June 1986

Dear Norman,

RENEWAL OF THE PHARMACEUTICAL PRICE REGULATION SCHEME

Thank you for sending me a copy of your letter of 15 June to Nick Edwards. WITH ON

As you say, the agreement your officials have provisionally reached with the ABPI is in line with the terms we had previously discussed. We agreed that you would do your utmost to avoid a claim on the Reserve on account of the increased profit rate in 1986-87, though I would be prepared to accept one as a last resort. For 1987-88 and 1988-89, you have agreed that you will try to meet the extra costs by means of a review of the role of the GPFC (including the possible sale of part of its portfolio) or some other measure. Thereafter, you are intending to make economies on the costs side of the scheme.

On the details of the proposals, I welcome the decision to restrict the application of the new scheme to branded drugs alone, leaving generic prices to be set by the market. I also welcome your plans to tighten up on allowable costs. The objective of securing savings here seems to depend on the manner in which your officials administer the scheme: I trust that they will continue to adopt the tough approach which has been characteristic of recent years. I also continue to see the allowance for sales promotion as a particular area where we might look for more economies; I regret that the new proposals do not achieve this directly, and I look to you to keep pressing on this.

In the longer term, of course, we are hoping to see changes in prescribing practices which would enable market forces to play a greater role in determining prices for branded as well

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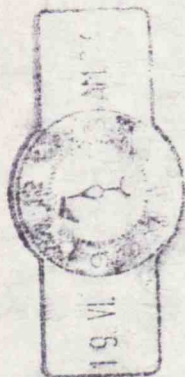
as for generic drugs. Notwithstanding the completion of the present negotiations, therefore, I would urge you to continue to examine the practicalities of possible alternatives, as we agreed when we discussed the primary care consultative document.

I am content to await the Survey discussion before tackling the issue of expenditure on the Family Practitioner Services over the next three years. But I should say now that I will be looking for much greater efforts from you to deliver on your previous commitments, including finding a workable way of covering the extra expenditure under the PPRS.

I am copying this letter to the Prime Minister, Willie Whitelaw, Geoffrey Howe, Tom King, Malcolm Rifkind, Paul Channon, Nick Edwards and to Sir Robert Armstrong.

Yours,
JH

JOHN MacGREGOR



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