



The Daily Dish

Is Arbitration the Magic Bullet for Drug Pricing?

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Eakinomics: Is Arbitration the Magic Bullet for Drug Pricing?

The Medicare policy world continues to be dominated by fantasy (Medicare for All) and frustration (what can be done about Medicare drug prices?). The administration remains focused on its [international price index proposal](#) for inpatient drugs and its [rebate rule](#) for outpatient drugs. Democrats remain committed to have the government “negotiate” on behalf of the Medicare system, despite the overwhelming [consensus](#) that it just won’t work.

In lieu of broad negotiation, some policymakers, academics, and researchers (including the Medicare Payment Advisory Committee, or MedPAC) have suggested third-party arbitration as an alternative. This tool has been suggested primarily for drugs with limited or no competition, such as sole-source, on-patent drugs, in instances in which the two parties cannot agree on an acceptable price. There are two common arbitration protocols: conventional and final-offer (also referred to as “baseball arbitration” because of its use in Major League Baseball). In conventional arbitration, the two parties submit bids and the arbiter decides any amount, typically by splitting the difference. Such a practice is thought to encourage the parties to make extreme offers. Final-offer arbitration, on the other hand, requires the arbiter to choose one of the two submitted bids. Thus, parties have an incentive in this instance to make a reasonable offer, lest they risk the arbiter choosing the other’s bid.

In evaluating any such proposal, there are numerous questions that must be addressed. What will the criteria be for determining which drugs will be subject to arbitration? At what point will arbitration be allowed to begin? Who will the arbiter be? Who will decide who the arbiter is? To what information will the arbiter have access in making a decision, and on what factors shall a decision be based? What information gets revealed once a price has been determined? To whom will the arbitrated price apply? Will all insurers negotiate collectively and have a single agreement for a given drug?

These are crucial questions in determining whether an arbitration system supports vigorous market competition. Certainly, any use of arbitration should be extremely limited with clearly defined criteria and limited authority for the arbiter because, in the end, it is a departure from reliance on market mechanisms.

Indeed, the potential for negative fallout is enormous. Imagine that every new, expensive sole-source drug ended up in arbitration, and political motives dominate the arbitrator’s decisions. Then the pricing of the most important new therapies will not be driven by market economics, but rather by a price-fixing arbitrator. The potential damage to innovation incentives is enormous.

Of course, there are more optimistic scenarios as well. But there is no reason to see arbitration as a panacea.