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TABLE OF CONTENTS

(In Alphabetical Order by Author)

Preface

Conference Program

- 1. Entry Time Effects and Follow on Drug Competition**
Luiz Flavio Andrade, N. Celant, S. Pichetti, C. Sermet & C. Sorasith
- 2. Analytic Approaches to Inform Research Funding Decisions - Evidence from a Systematic Literature Review**
Lazaros Andronis, Lucinda Billingham, Stirling Bryan & Pelham Barton
- 3. Price Elasticity of Demand of the Pharmaceuticals in Latvia**
Diana Arāja
- 4. Online Mental Health Resources – Support for People with Mental Illness**
Christina Athanasopoulou, Heli Hatonen, Maritta Valimäki & I. Apostolakis
- 5. Infrastructural Planning and Social Cost in Hospital Industry: An Empirical Application to Flemish Hospitals**
Jos Blank
- 6. Near Miss Reporting Systems in the German Hospital Sector - Current Status and Perspectives**
Sabine Bohnet-Joschko & Claus Zippel
- 7. Patient Involvement, Empowerment and Patients' Rights: Comparison of Health Policies, Systems and their Hospital Application in England and Greece**
Markella Boudioni
- 8. Economic Analysis of Health Technology: Issues for Developing Countries**
Liliana Chicaiza-Becerra
- 9. Are School Based Health Centers Sustainable in California? Analysis of a State Policy Issue**
Denishia Clark & Sondos Islam
- 10. The Dynamics of Depression in Adolescence and Early Adulthood**
Paul Contoyannis & Jinhu Li
- 11. Expanding Health Insurance to Increase Health Care Utilization: Will It Have Different Effects in Rural vs. Urban Areas?**
Kannika Damrongplasit, Erlyana Erlyana & Glenn Melnick
- 12. Equity Aspect of Health Care Delivery in India**
Lakshmi Narayan Dash
- 13. Health Care Corporations: Reconciling Profit Making Prerogatives with Moral Obligations in a Economically Disparate World**
Simeon Davies
- 14. The Excess Healthcare Costs Associated with Depression and Anxiety in Elderly Living in the Community**
Pierre Alexandre Dionne, Helen-Maria Vasiliadis, M. Preville, P-A Dion, L. Gentil, D. Berbiche & E. Latimer
- 15. Patterns of Gender Differences in Health Information Behaviour and Body Mass Index (BMI): Findings from a Finnish Population-Based Study**
Stefan Ek, Kristina Eriksson-Backa, Raimo Niemela & Maija-Leena Huotari
- 16. How Should the Market for Managed Care Be Organized?**
Alexander Ellert & Oliver Urmann

17. **Incidence of Abuse by Family and Caregivers in the Aging Male Population in Kermanshah, Iran (2010)**
Katayon Esmaeili, Farah Safei & Reza Pourmirza-Kalhory
18. **Tamoxifen vs. Aromatase Inhibitors for Breast Cancer in Risk Groups: Cost Effectiveness for Colombia**
Mario Garcia-Molina & Liliana Chicaiza-Becerra
19. **HIV / AIDS Education for Young People in Greece: Needs and Challenges**
Margarita Gerouki & Nikolaos Manesis
20. **Economic Evaluation of Recommended Immunization Policies: The Application to Pertussis and Measles**
Dorota Zdanowska Girard
21. **The Effects of Rebate Contracts on the Health Care System**
Julia Graf
22. **The Effect of Mandatory Seat Belt Laws on Socioeconomic Inequalities in Seat Belt Use**
Sam Harper, Erin Strumpf, Scott Burris, George Davey Smith & John Lynch
23. **Interactive E-health Tools on U.S. Hospital Web Sites**
Edgar Huang & Chiu-Chi Chang
24. **Long Term Care Services and Hospital Length of Stay in Norway: A Quantile Regression Analysis**
M. Kamrul Islam, Tor Helge Holmas & Egil Kjerstad
25. **Quality Of Life of Australian Chronically-Ill Adults: Smoking Has More Effect on Females than Males**
Upali Jayasinghe & Mark Harris
26. **Expenditure on Social Services for Urban Poor of Pimpri-Chinchwad Municipal Corporation, Pune, India**
Asha Khillare
27. **Health Justice, By the Numbers: Why the Choice of Measure Matters in Policies to Reduce Health Inequalities**
Nicholas King
28. **Inequality Decomposition by Population Subgroups for Ordered Response Data**
Martyna Kobus
29. **Sanitation Facilities and Health Economics: A Study on Spending Pattern and Quality of Life of Indian Rural Women**
B. Suresh Lal
30. **Promoting Valued and Integrated Healthcare: Defining and Implementing Program Budgeting Marginal Analysis in Italy**
Agnese Lazzari, Paola Galli, Emma De Feo, Ferruccio Pelone, Antonio Giulio de Belvis, Maria Lucia Specchia, Mariarosaria Gualano & Walter Ricciardi
31. **A Meta-Analytic Examination of Burnout Correlates in Nurses**
Raymond Lee, Bosu Seo & Brenda L. Lovell
32. **Building Research Capacity for Indigenous Health: An Australian Case Study of Research Funding Allocation in Policy & Practice**
Sophia Leon de la Barra, Sally Redman, Sandy Eades & Carey Lonsdale
33. **Living Positively Discourse and Thai Women Living with HIV/AIDS in Central Thailand**
Pranee Liamputtong, Niphattra Haritavorn & Niyada Kiatying-Angsulee
34. **Heterogeneous Impact Evaluation of the New Cooperative Medical Scheme in Rural China**
Dan Liu & Daniel Tsegai
35. **Disability Discrimination and Mental Health Litigation in Britain 2005-2011**
Graeme Lockwood

36. **A Cross National Meta-Analysis of the Relationships between Medical Practice and Health Outcome Variables with Physician Burnout**
Brenda Lovell, Raymond Lee, Steven Hladkyj, Bosu Seo & Laura Schwartzmann
37. **Productivity Change from 2008 to 2009 in the Provision of Care of Elderly when Effectiveness of Services is taken into Account**
Kalevi Luoma, Aki Kangasharju, Tero Tyni & Marja Valta
38. **Surrogate Motherhood in France: Does Denying Access to This Practice Contrary to the Right of Founding a Family?**
Allane Madanamootho
39. **Cost of Thalassaemia Treatment in Iran**
Simin Mashayekhi, Dorna Sheykhi, Alireza Nikanfar, Abasali Hoseinpur-Feizi & Mohammadreza Sattari
40. **Using Organisational Change Theory to Analyse Organisational Responses to Commissioning Policy in the NHS**
Sara McCafferty
41. **Frontier Research in Medical Sciences by Greeks: Regional Disparities in Greece and Australia**
George Messinis
42. **The Conflict between Efficiency and Equality in Health Outcomes: Determination of SWF Parameters**
Micaela Moreira Pinho, Anabela Botelho & Paula Veiga
43. **The Impact of Body Size on Urban Employment: Evidence from China**
Jay Pan, Xuezheng Qin & Gordon Liu
44. **Applying the Economic Instrument of Experimental Design to Investigate Nursing Decisions in Community and the Wider Implications**
Panos Papanikolaou
45. **Explaining Price Discrepancies between Me-Too Drugs in France**
Sylvain Pichetti
46. **Current Knowledge on the Benefits and Disbenefits of Clinical Genetic Services from a CBA Perspective: Are New Methodologies Needed?**
Christalla Pithara
47. **Measuring Financial Protection by National Health Insurance Programs: Evidence from the Philippines**
Stella A. Quimbo, Carlos R. Tan & Orville C. Solon
48. **Implementation of Remotely Monitored Medical Dialysis Units: Dealing with Multiple Criteria and Multiple Decision Makers**
Gerald-Reparate Retali, Patrick Meyer & Myriam Le Goff-Pronost
49. **Anticompetitive Impact of Pseudo-Generics**
Vasco Rodrigues, Ricardo Goncalves & Helder Vasconcelos
50. **The Medical Insurance Program for the Poor in a Health System in Transition, Georgia**
Ekaterine Ruadze
51. **Establishing the Connection between Livable Community Assets and Public Health**
Virginia Sisiopiku & Abdul M. Abro
52. **Does Health Insurance Affect Health? Evidence of Medicare's Impact on Cancer Outcomes**
Erin Strumpf & Srikanth Kadiyala
53. **Co-Payment Exemption and Competition in the Market for Pharmaceuticals: An Empirical Analysis for Germany 2007 to 2010**
Moritz Suppliet & Annika Herr

54. **Assessing the Effect of Antiretroviral Therapy on Intentional Reproductive Behaviour: A Case Study from Cameroon**
Miron Tequame
55. **African American Faculties' Career Decisions about a Predominantly Caucasian Institution in the United States**
Shirley M. Timmons
56. **SES in Emerging Adulthood: Implications for Health Behaviors**
Allison Tracy & Alice Frye
57. **Developing a Framework to Facilitate the Full Economic Evaluation of Disease Management Programs**
Apostolos Tsiachristas & Maureen Rutten-van Molken
58. **Serious Mental Health Problems and Patient Compliance in Mental Health Services: A Challenge for Policy Makers**
Maritta Valimaki, Heli Hatonen, K. Kauppi, M. Lahti & C. Adams
59. **Discerning the Impact of Vitamins and Natural Remedies (Plant Medicines) on Cardiovascular and Coronary Disease and Associated Prescription Costs**
Anastasia Ventouri
60. **Re-Balancing Cost Variations in Health Care Services: How to Leverage Top-Down Costing Approaches, Ensure Data Validity and Negotiate a Health Care System Reform**
Anna-Marie Vilamovksa, Jeni Nacheva, Ivan Markov, Maria Zareva, Petya Georgieva & Yosif Yosifov
61. **Identifying Sleep-Disruptive Noise Factors in Healthcare Environments**
Nadia Volchansky Nieves
62. **Fraud and Other-Regarding Preferences in a Health Care Market**
Christian Waibel
63. **Eliciting the Physicians' Preferences for Modern Long-Acting Insulin Therapy: A Discrete Choice Experiment**
Robert Weigelt
64. **An Introduction to Fārābī's thought**
Meryl Wheeler, Mark Lafave, Nicolas Mohtadi & Denise Chan
65. **Waiting in Hospital for Placement in a Nursing Home – Research for This Global Quandary**
Donna Wilson
66. **Evaluating the Impact of Healthcare Intelligence on Quality of Care**
Jennifer Yang-Meslet
67. **What is the Optimal Health Insurance Scheme for Aged Society? Primitive Analysis for Seeking Real Premium in Japanese New Social Health Insurance for the Aged**
Fumiaki Yasukawa
68. **The Influence of Activity Based Financing on Hospital Length of Stay for Elderly Patients Suffering from Heart Diseases**
Jun Yin, Hilde Luras, Terje P. Hagen & Fredrik A. Dahl

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Anticompetitive Impact of Pseudo-Generics

Competition between branded and generic products is an important dimension of the dynamics of modern pharmaceuticals markets. A puzzling feature of those markets is that sellers of branded pharmaceuticals will, sometimes, sell generic versions of their own branded products, either directly or through license agreements. Apparently, these pseudo-generics, as they are often called, cannibalize the sales of the, more profitable, branded products and so should reduce the firm's profit. Thus, it is often suggested that their introduction must have some type of anti-competitive effect that justifies their use. The extant theoretical literature, however, is limited and the mechanism through which that anti-competitive effect materializes has not been satisfactorily identified.

This paper proposes a new theoretical rationale for the fact that the introduction of pseudo-generics may have anti-competitive effects. Contrary to most existing models, we assume that firms compete in prices and do not presuppose first-mover advantages for the seller of the branded product. The main feature of our model is that it combines horizontal and vertical product differentiation: branded products are vertically differentiated towards generics, and generics are horizontally differentiated among themselves. In this context, we show that the producer of the branded product will not sell the pseudo-generic unless faced with competition and that, if he does so, in some circumstances, all prices raise to the benefit of all competitors and the detriment of consumers.

Although developed with the pharmaceuticals' market in mind, our model could be extended to other markets where vertical and horizontal differentiation coexist, particularly, markets in which branded and private label products compete.