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Summary: *The reimportation of prescription drugs is being pushed not only by big government regulators but also by misguided free market advocates. The result: the effective imposition of foreign price controls on U.S. drug markets and the further erosion of genuine competition. But the cost could be worse than money. Governments that control drug prices routinely sacrifice their people's health in order to save money.*

The Free Market Mirage of Reimportation

by Doug Bandow

People always want something for nothing. Nowhere has that been more true than in health care.

With approval of Medicare drug benefit legislation last fall, public attention has shifted to reimportation of pharmaceuticals from foreign nations, most of which sacrifice their citizens' health through use of price controls and formularies to save money. Although some reimportation advocates are attempting to sell the practice as a simple matter of free trade, most supporters have a different agenda: imposing foreign price controls on the U.S. market. Indeed, reimportation would be a first step towards turning the pharmaceutical market into a de facto public utility, behaving as if it were a community-owned, nonprofit entity.

Americans have come to view medicine as an entitlement. Yet drugs account for only about ten percent of health care costs, and total pharmaceutical expenditures includes the expense of generics and money paid to pharmacies.

Medicine in America is a messy mix of private and public, with nearly half of spending provided by the U.S. government, while most foreign systems are government-controlled, with state control over the provision of and payment for care. That almost invariably means restrictions on pharmaceuticals.

But comparisons of practices of U.S. and other countries most decidedly do not show that drug companies are cheating consumers. Complaints over pharmaceutical prices invariably ignore the benefits provided. How much is it worth to live instead of die from AIDS; to have an effective treatment for kidney cancer; to be able to ameliorate the effects of chemotherapy; or to deal with any number of irritating and bothersome, even if not life-threatening, conditions? Politicians looking for cheap applause and votes seem to have a particularly difficult time understanding that it costs money, a lot of money, to develop new medicines.

Typically only one of every 5000 to 10,000 substances investigated ends up as a marketable drug, and 70

percent of those lose money. Yet the existence of lower prices in foreign lands has spurred trans-border traffic, mail-order pharmacies, and internet sales. The result has been an ever-growing gray or parallel market. European Union rules have long encouraged the phenomenon in Europe: prices are set by individual governments even though sales are continent-wide, leading many consumers, particularly governments, to take advantage of the policies of governments which most penalize their entrepreneurial companies.

There is money to be made, but researchers from the London School of Economics found that most of the financial benefits from reimportation accrued to traders and pharmacists, not patients. Indeed, patient access to drugs reportedly suffered in some states due to resulting shortages. However, the combination of government rate regulation and reimportation has degraded European pharmaceutical R&D, accelerating the dramatic decline of the industry over the past two decades.

Despite this, U.S. support for reimportaion is growing. Minnesota Gov. Tim Pawlenty (R) has created a website to allow private citizens to buy drugs from Canada and Wisconsin intends to follow suit. A large majority of the House voted to allow drug imports from abroad, despite the safety concerns expressed by the Bush administration and Food and Drug Administration. Joining socialist Rep. Bernie Sanders (I-VT) and populist Sen. Byron Dorgan (D-ND) were free market congressmen Jeff Flake (R-AZ) and Ron Paul (R-TX).

On Reimportation and the Free Market

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"Complaints over pharmaceutical prices invariably ignore the benefits provided."

"Foreign governments have created artificial markets to take advantage of U.S. patients by free-riding on American R&D."

"No profits, no products. No products, and we die earlier and suffer more."

"Governments with nationalized systems routinely sacrifice their peoples' health in order to save money."

"Congress wants to place domestic markets under the influence of foreign price controls."

"Americans would enjoy lower prices today but fewer medicines tomorrow."

Health and Safety

Most of the ongoing debate over reimportation has focused on concerns over public health and safety. As a result, the Food and Drug Administration and individual states have been attempting to tighten controls over the distribution of pharmaceuticals. The challenge to ensure the quality of medications prescribed and consumed would grow with reimportation.

But FDA Administrator Mark McClellan allows that advanced technologies and expanded regulatory authority might cause his agency to rethink its opposition to reimportation. The more fundamental objection to the practice is an economic one. Complains Rep. Gil Gutknecht (R-MN), one of the leading GOP proponents of reimportation: "American consumers are held captive in a market that forces them to pay four, five, six... even ten times as much for the same prescription drugs as our friends in Canada and Europe." Rep. Paul, one of the most reliable defenders of liberty in Congress, declared: "Reimportation allows American consumers, particularly seniors, to benefit from worldwide price competition.... The pharmaceutical companies should not be allowed to profit by this government-enforced price fixing."

If only this were true. Actually, the fault lies abroad, not at home.

Reimportation is Not Competition

Foreign governments have created artificial markets to take advantage of U.S. patients by free-riding on American R&D. As Stephen Pollard writes of Europe, "parallel traders contribute nothing to innovation or the wider economy; they make their profits entirely on the back of government price controls." Although price differentials reflect economic as well as legal factors, the irreducible difference is foreign government policy. Companies cannot charge the same amount even if they desire to ignore differences in local conditions. Genuine competition presumes the freedom to set and adjust prices.

Moreover, the "competition" advanced by reimportation is competition against oneself. Llewellyn H. Rockwell of the Ludwig von Mises Institute contends that "the arguments used in favor of cracking down on drug re-importation are identical to all the arguments used for all forms of protectionism." This is an almost willful misunderstanding of the issue, however. Federal law does not ban foreign drug makers from selling their products in

America. It does not prohibit American firms from offering alternative medicines. Nor does it bar foreign goods because, broadly speaking, another market is unfair. Rather, the ban on reimportation prevents third parties from reselling in the U.S. American company's medicines, or what they claim to be American company's medicines, originally sold overseas at an artificially low price fixed by foreign governments. The "government-enforced price fixing" is occurring on the other side of the border. And while these nationalized systems differ in their details, their outcomes are the same. In general, governments tax their citizens, decide on the medical products and services to be provided, and set prices to be paid. There is neither arm's length bargaining between buyers and sellers, nor meaningful private markets (servicing people of moderate means) outside of government systems. Whether termed "reimbursement rates" or something else, government prices are in effect price controls. Thus, attempts at price arbitrage based on lower prices abroad effectively means applying foreign price controls at home.

American Companies Possess Little Negotiating Clout

But what of the free market argument that reimportation will force American companies to negotiate hard from prices increases abroad? The argument goes, "Liberalize your markets, or we will leave." The problem is that governments with nationalized systems *routinely* sacrifice their people's health in order to save money.

For instance, pharmaceutical regulations have sharply reduced Canadian access to needed drugs. Of 400 drugs considered for reimbursement by the Canadian province of Ontario between 1994 and 1998, only 24 were added. Provinces waited months or years before adding medicines to their formularies.

In the province of British Columbia more than a quarter of doctors report that they have had to treat or even hospitalize patients because of government substitutions of medicine; six of ten have seen their patients' condition deteriorate.

Similar is Europe's experience. Europeans also have far less access to prescription drugs, particularly newer, more effective products. Use of cancer drugs, as well as medications for a variety of less serious conditions, has been artificially limited.

Incredibly, the more useful the medicine and the more people it would help, the smaller the likelihood that European governments will quickly approve it. Explains Europe Economics: countries "facing tight budget constraints will be more resistant to a given price demanded by a company the higher they expect the demand for the product to be."

Foreign Governments Can (and Will) Steal U.S. Medicines

Over the long-term, a united boycott by American companies would have a dramatic impact on health care in other nations. At some point, that might spur a patient—and political—revolt. Unfortunately, however, U.S. manufacturers would find it difficult to maintain a hard line negotiating position when other nations desire access to important new medicines. By law, most governments have the legal power to procure drugs at basement prices. Countries may seize patents from unwilling companies and allow in-country generic production. For instance, Canada has provided for compulsory licensing since 1923. Ottawa lifted Bayer's Cipro patent (though the government later rescinded that action) in the midst of America's anthrax scare. And there would be little to prevent a medicine produced under compulsory license from being exported to America.

Despite the presumption that compulsory licensure should be used only in public health emergencies (Brazil has been especially active here), in practice countries have been willing to break patents to cut prices, and sometimes for nonessential drugs. In October 2002 Egypt lifted the patent for Viagra to allow generic production. Some political activists freely admit that they want to break patents in developed states for routine conditions. Explains James Love, director of the misnamed Consumer Project on Technology: "This goes beyond AIDS, malaria and tuberculosis. Any health care item could be included. We want to use this in the United States, in Germany and in Switzerland."

Governments Have Ways of Making American Companies Cooperate

If Congress approves reimportation, it will do so in the expectation that the practice will lower prices. Only a few members—such as Congressmen Flake and Paul—advocate the policy as a means to make the market work, to whatever end. Everyone else sees this as a politically popular way to deliver benefits to their constituents. (Market-friendly advocates allow that "many supporters" might advocate this result, but "overwhelming majority" would be a more accurate characterization.) The number one purpose of S. 1781, introduced by Sen. Conrad Dorgan, who has incongruously been joined by free market

advocates to push reimportation, is "to give all Americans immediate relief from the outrageously high cost of pharmaceuticals." Drug maker restrictions on supplies to Canada are "a real risk factor to our plans," complains Minnesota Gov. Tim Pawlenty. Thus, if companies attempt to thwart the politicians' goal of imposing foreign price controls, the Dorgans, Gutknechts, and Sanders will likely return to the political warpath in search of more votes. For them, reimportation is merely the first step of more regulation.

There are other problems to consider:

- Whatever the merits of reimportation in theory, neither foreign nor American governments are likely to fight fair: when it comes to saving money, they will, routinely and inevitably, violate property rights, ignore contractual responsibilities, politicize health care decisions, sacrifice the health of their citizens, choose short-term political gains over long-term medical benefits, and enshrine good politics over good policy.
- Demagoguery would flourish even more. Says Rep. Dan Burton: Reimportation "is about money, the money that the pharmaceutical companies are making on the backs of the American people." Come again? Drug makers make money only by developing and producing medicines that Americans value and are willing to pay for. Companies make money only by benefiting people. For a politician, who rarely produces anything of value, to complain about an industry that saves and enriches lives demonstrates the sad character of political debate in Washington today.
- Indeed, by most measures profits cannot be considered excessive. In any case, writes Uwe Reinhardt, "they are not large enough to offer much relief for any cost containment effort, as they constitute only a minute fraction of total national health care spending." More important, those profits are the incentive for drug makers to develop and market medicines that improve and save lives. No profits, no products. No products, and we die earlier and suffer more painfully.
- The U.S. needs to reduce regulations over the development and approval of pharmaceuticals, reducing the cost and time necessary to produce drugs. Washington also should abandon its policy of requiring that drug makers provide pharmaceuticals for Medicaid and the Department of Veterans Affairs at the lowest price given to any private purchasers, since doing so discourages companies from accommodating needy private buyers with special discounts. More broadly, the U.S. needs to address the many perverse incentives, most as a result of government budget and tax policy, that have created a cost-plus medical system, inflating costs throughout the system.

Conclusion

Well-intended friends of freedom mistakenly view reimportation as a question of free trade. But friends of regulation have more accurately diagnosed the impact of reimportation: government control of drug prices at home. When forced to choose between innovative medical research and arbitrary cost controls, foreign governments routinely pick the latter. So, unfortunately, would many American politicians. If they succeed in doing so by legalizing reimportation, all Americans will be the losers.

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