

RIDING ON THE COATTAILS OF U.S. PATIENTS

Other Countries Are Shirking Their Share of Drug R&D Costs

By Merrill Matthews, Ph.D.

When Dr. Mark McClellan was still commissioner of the U.S. Food and Drug Administration (FDA), he addressed the First International Colloquium on Generic Medicine by saying, "The heart of this problem [i.e., funding new drug research and development] is that we are not all paying our fair share of the costs of bringing new treatments to the world. And this problem is getting worse."

A look at the available data indicates that Dr. McClellan was right.

The U.S. Pays Higher Prices. In general, people in other countries pay less for brand name prescription drugs than Americans pay—though they usually pay more for generics than do Americans. As a result, a relatively small number of Americans travel to Canada or Mexico to get their prescriptions. But increasingly they are using the Internet to buy drugs from other countries.

In response to the price variations, some argue that drug companies should charge those in other countries the same as U.S. consumers are charged. Others, by contrast, argue that the U.S. government should ensure that Americans have access to the lower prices charged by foreign countries—either by controlling U.S. prices or helping Americans buy their drugs from outside the U.S.

Those proposals overlook one important economic fact: the U.S. has the highest per-person income (save for Luxembourg and Norway). In a rational economic world, you would expect Americans to pay more.

The Role of Differential Pricing. Everyone knows that there are some places in the U.S. where the cost of living is low, while in other places it's high. It just doesn't cost as much to live in Abilene, Texas, as it does in San Fran-

cisco or New York City. Salaries are lower because costs are lower, and costs are lower because salaries are lower.

Similarly, people in other countries have, on average, lower incomes than Americans. For example, in 2001 the per-capita GDP in the U.S. was \$35,045, while in Canada it was \$22,343. And in Mexico it was only \$6,227. Mexicans simply cannot afford to pay the same prices for goods and services that most Americans pay.

Companies and industries often compensate for the lower incomes in other countries by charging lower prices for their products or services, a practice known as "differential pricing."

ARE COUNTRIES PAYING THEIR SHARE OF R&D COSTS?

Purchasing Power Parity and Average Patented Drug Prices (2001)

	PPP %	Patented Drugs %
U.S.	100.0	100.0
Italy	74.7	49.6
France	74.7	50.8
Germany	75.1	59.7
Canada	82.5	59.2
U.K.	74.8	63.4
Switzerland	85.4	64.3
Sweden	74.1	58.0

Source: U.S. Census Bureau, Statistical Abstract of the United States: 2003, Table No. 1334, and Patented Medicines Prices Review Board 2002 Annual Report.

Note: The PMPRB says "Effective January 2000, and following public consultation, the PMPRB implemented the policy of including prices listed in the U.S. Federal Supply Schedule (FSS), which is publicly available, in calculating the average U.S. price of patented drugs." The purpose was to reflect the fact that most U.S. consumers don't pay the "retail" prescription drug price, but get a discounted price.

Differential pricing is well accepted by economists and widely practiced by businesses, because it is the most efficient way to ensure that people with varying incomes have access to a wide range of products and services at prices they can afford.

Put another way, if you force people in Abilene to pay the same price for a house as people pay in San Francisco, very few people in Abilene could afford to be homeowners. Conversely, if you force San Francisco homebuilders to charge the lower price of a new home in Abilene, there will be no new homes built in San Francisco.

So the question isn't whether people in other countries get prescription drugs at lower prices than Americans pay; they do and they should. The real question is whether those discounts reflect an equivalent level of purchasing power. And, as Dr. McClellan suggested, they don't.

Purchasing Power Parity. The Organization for Economic Co-operation and Development (OECD), which compares international economic data, produces a "purchasing power parity" (PPP) index for the major, industrialized countries. According to the U.S. Census Bureau, which publishes some of the OECD data, "PPPs show how many units of currency are needed in one country to buy the same amount of goods and services which one unit of currency will buy in the other country." Although the comparisons aren't perfect, purchasing power parity is the best way we have to compensate for the variations in income, currency exchange and other factors in international comparisons.

In 2001, the purchasing power parity of Canada was about 82.5 percent of what U.S. consumers spent for the same basket of goods and services, reflecting the fact that Canadians on average have lower incomes than Americans. Consumers in the U.K. spent about 74.8 percent of the U.S., and those in France about 74.7 percent.

Thus, if brand name (i.e., patented) prescription drugs in Canada were to cost roughly 80 percent of what U.S. consumers paid, there would be cost parity—and Canadians would be covering an equal share of the R&D costs.

Are Countries Paying Their Share of R&D? In fact, according to the Canadian Patented Medicines Prices Review Board (2002 report), a government-created entity, Canada pays, on average, about 59.2 percent of what the U.S. pays for prescription drugs (in 2001). As the table on the opposite page shows:

- Italy, with a purchasing power parity of 74.7 percent of the U.S., pays about 49.6 percent of what the U.S. pays for brand name drugs.

- Switzerland, with a PPP of 85.4 percent of the U.S., pays about 64.3 percent of what the U.S. does for patented drugs.
- The U.K. has the smallest shortfall, with a PPP of 74.8 percent of the U.S., and pays 63.4 percent of what the U.S. pays for the average patented drug.

The Need for Change. The comparisons show that the U.S. is paying the lion's share of R&D—just as Dr. McClellan suggested—while other countries' government-run health care systems are pushing the price of drugs down toward their marginal cost (i.e., the cost to produce one more unit). That has to change. The U.S. cannot be expected to bear the cost burden of all of the new pharmaceutical innovation. Of course, if Congress passes legislation allowing U.S. consumers to buy price-controlled prescription drugs from other countries, *no one will be paying for the R&D.*

There may be other reasons for the cost variations. Most countries have fewer regulatory barriers that tend to drive up the cost of products. More importantly, prices in other countries need not reflect the costs imposed from the badly broken U.S. tort system.

Conclusion. If other countries want to reinvigorate their R&D sectors, which have been pulling up stakes and moving to the friendlier U.S. economic climate, they have to be willing to relax their price controls and let the prices rise. The result is they will be paying a greater share of the R&D, but they will likely also find that innovation-driven companies are willing to settle—or resettle—in those countries, pumping up the economies and creating good jobs.

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