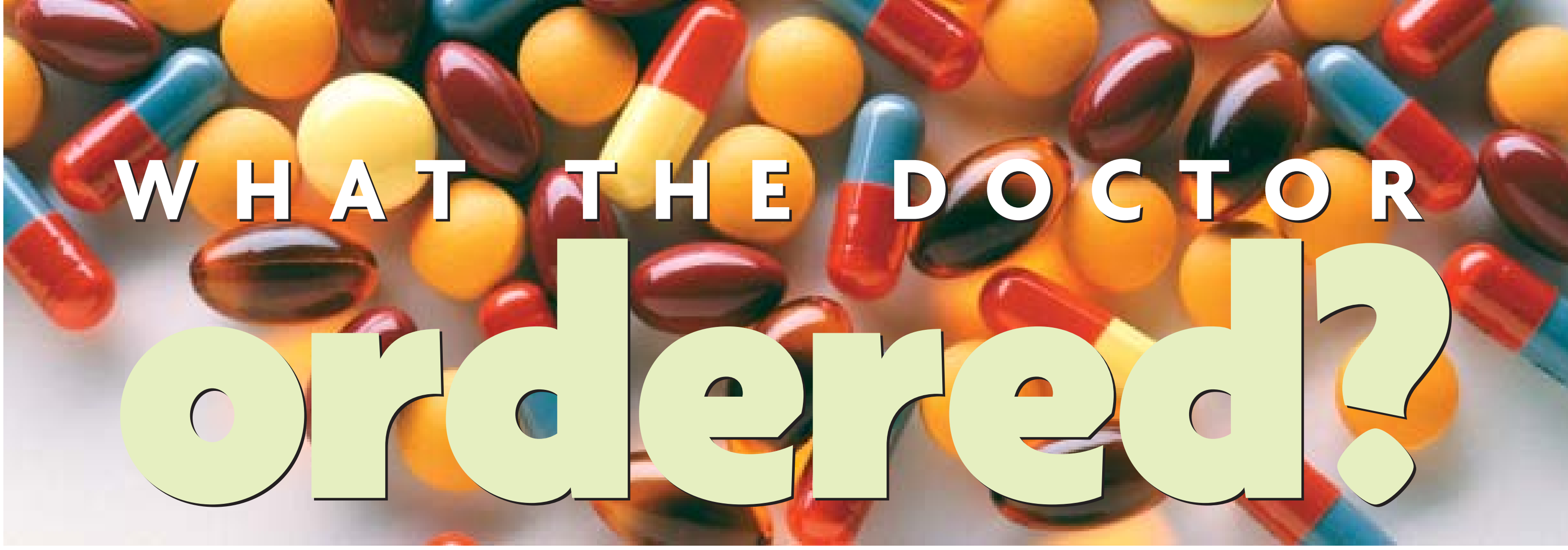

WHAT THE DOCTOR ordered?

The economics of drug reimportation

BY AARON STEELMAN

If there is a concept that enjoys almost universal support among economists, free trade is it. According to a survey published in the *American Economic Review*, 95 percent of U.S. economists agreed with the proposition that "tariffs and import quotas reduce general economic welfare." So the case of drug reimportation should be clear-cut, right? Not exactly.

American drug companies routinely sell their goods abroad at prices lower than those found in the United States. For instance, many American consumers could probably order their prescriptions more cheaply from a pharmacy in Toronto than one in Baltimore. Why not allow those drugs to be sent back to the United States for sale at Canadian prices, a practice that is currently prohibited by law?

That's a good question, says Rep. Gil Gutknecht (R-Minn.). He says that people who regularly take prescription drugs should be able to buy their medicines from pharmacies abroad — and has introduced a bill that would legalize the practice. Gutknecht, who represents a largely agricultural district, argues that if free trade in farm products is a good thing, then free trade in prescription drugs should be as well. "The more I studied the differences between what Americans pay for prescription drugs and what the rest of the industrialized world pays for those same drugs, the more I came to the conclusion that if markets work with pork bellies, they will work with Prilosec," he has said.

This analogy may seem apt, but many economists argue that the case is more complicated. Drugs are unlike other goods because they are often extremely expensive to develop. For instance, industry estimates put the average cost of developing a new drug at $800 million. That cost has to be recouped in some way. Canadian law, though, puts strict limits on drug prices, setting the maximum price just above the marginal cost of production. That may seem fair. But it does not take into account the high research expenses that drug companies face, which drive up the *average* cost of pharmaceuticals. If drug companies relied on the Canadian market alone, they probably could not turn a profit on many of their goods. So why do they enter the market at all?

Here it might be useful to draw an analogy with the airline industry. The cost of putting a plane in the air is roughly the same whether that plane is empty or full. So once the airline has sold enough tickets to make the flight profitable, it has a strong incentive to fill the rest of the seats, even if that means charging less for the 50th ticket sold than the first.

The case of prescription drugs is similar. In order to make a profit, the pharmaceutical company needs a relatively large market that is willing to purchase its drugs at relatively high prices. In most cases, that market is the United States. This allows consumers in other countries with pharmaceutical price controls, such as Canada, to effectively act as free riders. Having already recouped their research expenses, pharmaceutical companies are willing to sell their goods abroad at lower prices, because the cost of making and distributing, say, the one millionth Prilosec pill is quite small.

So what would happen under a regime of drug reimportation? It's hard to say for sure, of course. But economists have offered some informed speculation. American drug companies might sharply cut their shipments of drugs abroad, knowing that those goods would wind up back in the United States. Or they might try to renegotiate the prices they can charge in foreign markets, raising the average global price, and thus reducing the potential economic damage they face from reimportation. Neither scenario would do much to help American consumers and could potentially harm foreign consumers a good deal.

A better solution, instead, may be to encourage other industrialized countries to relax their price control regimes. The vast majority of pharmaceuticals are developed in the United States. Part of that is because American companies employ researchers — many of whom are foreign born — with the knowledge required to produce groundbreaking drugs. But part of it is also due to the structure of the U.S. health-care system. American companies are rewarded in the marketplace for developing drugs that make our lives better and longer. If other countries were to liberalize their systems, they, too, might become home to innovative pharmaceutical firms — companies that could compete with American incumbents and drive down prices for everyone. **RF**