

Hidden Drug-Reimport Potential

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(by David R. Henderson and Charley Hooper)

Today, Illinois Gov. Rod Blagojevich and Minnesota Gov. Tim Pawlenty host a Washington forum on importing prescription drugs from Canada.

The Canadian government's price controls on wholesale drugs make some prescription drugs artificially cheaper in Canada than in the United States, and many Americans, understandably, want to import the cheaper drugs.

Messrs. Blagojevich and Pawlenty, in particular, want the U.S. Health and Human Services Department to allow their state employees and retirees to buy such drugs. They and many others in the United States see importation from Canada as the silver bullet that will dramatically reduce prescription drug prices in the United States.

The federal government should grant permission, but the effects of that permission may surprise them. Allowing importation from Canada will not be a huge boon to Americans, at least not in short run. But it might be a small boon, by causing the Canadian government to relent from its price-control policy. Here's why.

If many people in the United States are allowed to buy from Canada, drug companies will certainly notice. They don't want their U.S. pricing policies undercut because the U.S. market, relatively free of price controls, is the most lucrative drug market in the world. There is only one way not to have their prices seriously undercut: They will choose to limit supplies to Canada.

That's not the end of the story. Even with limited shipments, Americans will still find Canadian drugs a good deal, and so, unless the Canadian or U.S. governments step in to squash importation, a big chunk of drugs meant for the Canadian market will end up here.

Consider a hypothetical drug selling for \$100 here and \$70 in Canada. With free trade across the border, Canadian pharmacists will charge, say, \$85 to

Americans, making a nice profit for themselves and compensating Americans for the extra hassle.

If enough Americans want to save \$15, the price of all Canadian product will rise to \$85. Canadians will then have to pay \$85 or more at retail to compete with American consumers who outnumber them 9 to 1.

In fact, with enough interested Americans, the price will rise to \$100 minus the cost of the extra hassle, and Canadians will see this same price. The net result? Americans will get a lot of the drugs meant for Canada but will be no better off, Canadian mail-order pharmacies will get rich, and Canadian consumers will either pay higher prices or go without.

Because Canadian consumers would no longer benefit from their government's price controls, their political support for those price controls would diminish. The net effect: possibly some relaxation of those controls.

Just as Turkey's price controls on imported oil in 1980 lasted less than a month when the Turks saw those price controls lead to zero imports, so a vocal constituency would develop in Canada for getting rid of, or at least relaxing, the Canadian price controls.

And that's all to the good. Why? Because relaxing Canada's price controls would cause Canadians to start paying their pro-rated share of the research and development costs that drug companies need to recoup to develop drugs in the first place.

Ironically, then, allowing imports for Americans who want a deal will end up eliminating that deal but will create a better deal for all Americans; it will spread the cost of research and development, which is currently borne disproportionately by us.

Some have argued imports should not be allowed because the drugs are sold to wholesalers on condition they not be sold back to buyers in the United States. If this is the contractual arrangement with Canadian wholesalers, then they certainly are breaching their contract and shouldn't be allowed to.

But enforcing contracts is not the job of U.S. Customs or the Department of Health and Human Services. That's up to the companies working through the courts.

One bogus argument against imports is that we can't trust the quality of the imported drugs. But the drugs are a global item, often produced in Puerto Rico, Ireland or some other country and then shipped to Canada instead of the United States. What mysterious thing happens on the ship that makes those drugs safe for Canadians but suddenly unsafe for Americans?

There's a better way to make medicine cheaper for low-income seniors, a way that can be implemented now, well before the starting date of President Bush's \$536-billion socialized-medicine scheme. Pharmaceutical companies would love to sell at low prices to low-income Americans. But the federal government has unwittingly tied their hands.

The feds require drug companies to give the huge Medicaid program their "best prices." If a drug company sells to even one customer at \$25, it also has to sell at the same price to the 5 percent to 40 percent of its customers covered by Medicaid.

In effect, the government is saying, "You can either sell it for \$100 or you can give it away, but you can't sell it for \$25 to people who would be healthier and happier if you did." So the drug companies don't sell at these low prices. The feds should stop requiring drug companies to give their best prices to Medicaid, a provision that saves the government very little. Then low-income seniors would get affordable medicines and everyone would benefit.

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