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Big Pharma Fights Back

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The Democrats have proposed paying for part of President Biden's Build Back Better plan with $500 billion in savings on what the government will pay prescription drug companies through Medicare and other public programs over the next decade. The country currently pays the pharmaceutical industry over $500 billion annually for its products. If we look at spending over the next decade, and like the news media, ignore that it's over ten years, we would say that we will give the pharmaceutical industry $7 trillion, double the projected cost of Biden's agenda.

Naturally, no one expects to be able to get $50 billion a year out of the hide of a huge industry without a serious fight. The pharmaceutical companies surely have all their lobbyists working overtime courting members of Congress (primarily Democratic members) whose votes are needed to pass legislation allowing for Medicare to negotiate the prices it pays. They are also flooding the airwaves with ads telling us the horrors that would face us if the industry got lower profits.

Megan McCardle gave us the essence of their message in her Washington Post column today. McCardle cited a report from the Congressional Budget Office (CBO) that projected that negotiated drug prices in Medicare could save $500 billion over the course of the decade. (The idea is to get our drug prices in line with what Germany, Canada, and everyone else pays.)

CBO also projected that these savings would mean that the industry would have less money to invest in developing new drugs. It projected a decline in new drugs of roughly 10 percent. The industry has been hyping this projection as posing a threat to medical progress. McCardle raises the threat that if the industry was developing 10 percent fewer drugs, then we might not have the vaccines that saved tens of millions of lives in the pandemic.

Contain Your Fear

I know everyone is shivering in their boots now, but let's get a little perspective here. First, the vast majority of new drugs are not qualitative approvals over existing drugs. Typically, when there is an important new drug that presents a major breakthrough, competitors rush in with their own drug to gain a portion of the patent rents earned by the first drug. The Food and Drug Administration rates drugs' expected benefits when they go through the approval process. Almost 80 percent of drugs get standard reviews, as opposed to priority reviews, meaning that they are not qualitative improvements over existing drugs.

These duplicative drugs are not of zero value, patients may react poorly to one drug, but be fine with another. And sometimes, the follow-up drugs will actually be qualitative improvements. However, as a general rule, we would probably like to see the industry develop drugs for conditions where no treatment exists than for a condition where five or ten good drugs have already been approved.[1]

But what if one of the drugs that isn't developed due to our budget savings is in the 20 percent that does merit priority reviews? What if we're talking about the Covid vaccines?

Well, the choice of the Covid vaccines is an interesting one for this argument, because we actually have several vaccines. We have the two mRNA vaccines, which have proven most effective in reducing the risk of infection, serious illness, and death. However, we also have the Oxford/AstraZeneca (AZ) vaccine, which has been widely distributed in Europe and elsewhere, as well as the Johnson and Johnson vaccine. There are several other US and European vaccines that are at various stages of development. In addition, there are two WHO-approved Chinese vaccines, with a markedly lower level of effectiveness, and a Russian vaccine that was reported to be highly effective in a published journal article.

Suppose the dimwitted cost-cutters had prevented us from having one of these vaccines, maybe even one of the highly effective mRNA vaccines? Well, that would be unfortunate if we lost one of the most effective vaccines, but it hardly seems like a catastrophe. After all, if we didn't have the Pfizer vaccine, then we could just look to produce more of the Moderna vaccine. And both the AZ vaccine and the Johnson and Johnson vaccine have been shown to be safe and highly effective. So, even in this supposedly disastrous case, it is likely that we would be pretty much exactly where we are in controlling the pandemic.

It is also important to note that these vaccines were developed with a huge amount of public funding. The mRNA technology was developed almost entirely on funding from the National Institutes of Health. In the case of Moderna, the funding for the actual development and testing of the vaccine came entirely from the federal government through Operation Warp Speed.

Pfizer, Moderna, and the other companies did put up money for research and development, but the point here is that public and private funding are substitutes. If the federal government puts up more money for research and development, we can get the same results with less private money. In fact, President Biden has proposed substantial increases in public funding for biomedical research to make us better prepared for future pandemics. In my view, we should be relying primarily on public funding (see *Rigged*, Chapter 5 [it's free]) instead of patent monopoly financing. But even if we stick with the current model, it is important to recognize that we can substitute increased public funding for patent financed research.

For perspective, the Bureau of Economic Analysis reports that the pharmaceutical industry spent $105.7 billion on research and development last year. If we have to replace ten percent of this with public funding, it would mean less than $11 billion a year, far less than the projected $50 billion in annual savings.

There is a final point about our current system of patent monopoly financed research that we should keep in mind. Being able to sell drugs at prices that are far above the free market price doesn't just give companies incentive to do research, it also gives them the incentive to push their drugs as widely as possible. This could mean not being honest about the safety and effectiveness of their drugs.

If that sounds like a strong charge, then people have not been paying attention to the opioid crisis. Three major drug manufacturers have paid multi-billion dollar settlements based on the accusation that they deliberately misled doctors and patients about the addictiveness of the new generation of opioids. To be clear, the allegation is not that they didn't recognize how addictive they were. The accusation is that they knew and were not honest about it.

If these opioids were selling as cheap generics in a free market, it is highly unlikely that drug companies would have lied for the modest boost to profits that they might get. But, even if we don't go all the way to full public funding, it is pretty straight economic theory that if the drug companies get lower prices, they have less incentive to mislead the public about the safety and effectiveness of their drugs.

In the case of opioids, this might have produced an enormous payoff. After all, the impact on peoples' lives and health from the opioid crisis runs into the hundreds of billions of dollars, if not trillions. While most efforts by drug companies to push their drugs by being less than honest are much less consequential, we should recognize this very important side benefit of lower drug prices. Lower drug prices mean less incentive to lie.

The long and short is that we should expect some impact from lower drug prices on innovation. It is hard to make the case that the likely impact is especially ominous. It is also the case that lower drug prices will reduce the perverse incentives that patent monopolies give them. This is a very good thing.

Notes.

[1] If we think the prospect of having ten percent fewer drugs approved would be disastrous, then we could ask what is the magic is of the status quo? Perhaps we should increase our spending by $500 billion to get 10 percent more drugs.

This first appeared on Dean Baker's Beat the Press blog.

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