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FACTS & OPINIONS

On Public Interest Issues

Quotes

To restore. . .harmony,. . .to render us again one people acting as one nation should be the object of every man really a patriot.
—Thomas Jefferson

One of the reasons that a Noam Chomsky or Edward Said wears so thin is precisely that his own radical politics are so at odds with the compensation he receives, the house he lives in, and the places he jets to — all greater than those enjoyed by most of the middle-class Americans whom the professoriate so smugly dismisses.
—Victor Davis Hanson

There are basically only two ways of reducing a deficit — cut spending or collect more taxes. When you see liberals in politics and in the media going ballistic about the deficit, you know that they are not thinking about cutting spending.
—Thomas Sowell

Budget Deficits Threaten Tax Agenda

Brian M. Riedl

The Congressional Budget Office's (CBO) latest budget projections should serve as a wake-up call to fiscal conservatives in Congress and the White House. Unless they restrain spending, they'll see budget deficits jeopardize the tax-relief agenda and imperil much of the hard-fought progress achieved over the past three years.

The CBO projects deficits of $401 billion in 2003, $480 billion in 2004, and $1.5 trillion over the decade. Even those estimates exclude the costs of offering a Medicare drug benefit, extending expiring tax provisions, and reforming the alternative minimum tax.

Furthermore, they assume that discretionary spending, including defense, will grow no faster than inflation, rather than the typical 7.7% annual increase over the past five years.

Factoring in those costs raises the projected annual deficits to between $600 billion and $700 billion through most of the decade.

Where did this expanding deficit come from? A sluggish economy, tax relief, and necessary defense spending played a part. But one cannot overlook the largest domestic spending spree since the Great Society. Mandatory spending will reach 11.1% of GDP this year, its highest level ever. New pressures on Social Security, Medicare, and Medicaid will combine with recent legislation, such as last year's farm bill, to push those costs even higher in coming years.

Non-defense discretionary spending in 2003 will hit 3.9% of GDP for the first time since 1985. Yet rather than balance new homeland security spending with cuts elsewhere, lawmakers ramped up funding for education, health research, and dozens of small, low-priority programs. The corporate welfare budget hasn't been touched, and the number

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President
Dr. Don Racheter

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What's New at PII?

Amy K. Frantz

In September, Public Interest Institute released a Policy Study, *WorldCom's Fraud and Bankruptcy: Promoting the Public Interest While Staving Off the Telecom Vultures*, by Dr. Richard E. Wagner, Senior Fellow and Academic Advisory Board Chairman at Public Interest Institute, and Harris Professor of Economics at George Mason University.

Bankruptcy hearings have begun to determine whether MCI-WorldCom will be allowed to reorganize under chapter eleven or whether the court will force the dissolution of the company under chapter seven, a decision MCI-WorldCom rivals would prefer. Dr. Wagner's study explores the misperceptions that surround the bankruptcy of WorldCom and determines that "the public interest requires that WorldCom be allowed to proceed through bankruptcy so that it can resume its position as a vigorous competitor in the telecom marketplace."

Research Analyst David Hogberg has authored a new Policy Study titled *Social Security Reform and Union Households in Iowa*. If no changes are made in the Social Security system, the coming financial crisis will force benefit reductions or increased payroll taxes. This study examines one potential reform, allowing workers to put a portion of their payroll tax into a personal retirement account, and shows the impact of such a reform on union households in Iowa. Results show that personal retirement accounts would yield better returns for union households than the current Social Security system.

Both of these Policy Studies are available on Public Interest Institute's website at www.limitedgovernment.org.

Check out our feature — **Question of the Quarter** — on page 7. We want to know your thoughts about the issues!

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Budget Deficit Threatens Tax Agenda

Brian M. Riedl

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of pork projects doubled since 2000.

Such spending may be acceptable to President Bush, who recently has been described as a "big government conservative" who couples tax relief with high government spending. But these goals are contradictory. All government spending eventually must be funded with taxes (with interest). This year's $401 billion budget deficit will add $3,774 to the average household's future tax burden. If a budget deficit reaches $600 billion to $700 billion, the annual tax increase will top $6,000 per household. Unless they balance tax relief with spending cuts, President Bush and Congress will leave a legacy of temporary tax relief followed by permanently higher taxes.

Some insist that economic growth alone will solve the deficit problem. It's true that the recent rate cuts will add economic growth and tax revenues by providing new incentives to work, save, and invest. But the CBO's dire projections already assume revenue growth of 13% in 2005, 10% in 2006, and approximately 6% thereafter. The economy won't grow the budget into balance any time soon.

Thus far, the public has accepted mild budget deficits as the predictable result of the 9/11 attacks and the 2001 recession. As we move further from these events, though, the expanding deficits will become more difficult for people to swallow. White House officials and Congressional leaders can't escape blame, and heading into an election year, their opponents surely won't let them off easy.

Lawmakers will now find it difficult, if not impossible, to further reduce the tax burden on American families. Increasing deficit projections led the normally tax-averse President Reagan to raise taxes in 1982. President Bush may now have to expend more energy protecting previous tax cuts than proposing new ones. A broad-based tax increase may remain a political "third rail," but class-warfare calls to raise taxes on "the rich" may find an increasingly receptive audience.

The only alternative to tax hikes is spending restraint. An obvious first step: Scrap the proposed budget-busting Medicare drug benefit and start over. Now is not the time for the largest expansion of government since the Great Society. Targeted help to poor seniors, combined with real Medicare reforms, makes more sense than creating a new $7 trillion liability that funds many seniors who don't need the benefits.

There are other ways to save money: The $90 billion corporate welfare budget can go, along with another $50 billion in waste, fraud, and abuse identified by the Heritage Foundation. Create an independent commission to identify outdated and ineffective programs ripe for elimination.

Yes, cutting spending can be difficult. But it sure beats raising taxes.

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For ideas on how to cut the budget deficit, see Institute Brief 8-24 "The 2002 Federal Budget: Let's Do Some Cuttin'!" August 2001.

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Prescription Drug Advertising: Problem or Solution?

Dr. Merrill Matthews Jr.

Critics of direct-to-consumer (DTC) advertising by pharmaceutical companies claim the ads increase health care costs, encourage drug overconsumption, strain doctor-patient relationships, misinform consumers, and undermine the quality of patient care.

However, these concerns largely are misdirected. They focus on the evolving pharmaceutical marketplace when in fact the whole health care system is in transition. And direct-to-consumer pharmaceutical ads are not the cause of that transitional process; they're a response to it.

Sunday newspapers are filled with advertising flyers for department stores, office products, computers, cars, food, and clothing. Yet no one says they can't afford food because all the grocery stores advertise. General Motors is the number one advertiser in the country, yet no one — and especially GM — claims its cars would be less expensive if the company quit advertising.

In virtually every sector of the economy, those with products or services to sell must get information to those who will buy. Advertising is the vehicle for getting that information to the intended customers. It tells prospective customers about product availability, quality, and price — the information consumers need in order to make comparisons. Without advertising, consumers would spend lots of their own time trying to find out the same information ads bring to us every day.

Criticism # 1: DTC Advertising Increases the Cost of Drugs. Drug companies are increasingly advertising directly to consumers. In just 10 years, DTC advertising increased from $55 million (1990) to an estimated $1.8 billion in 2000. However, most of that growth came after 1997, when the Food and Drug Administration (FDA) loosened restrictions on DTC ads. Are those advertising costs driving up the cost of drugs?

The fact is there is little or no relationship between the cost of a product and the money spent on advertising. Over-the-counter drugs are heavily advertised, yet they remain inexpensive. And some of the prescription drugs that are virtually never advertised to consumers such as Gleevec, a new leukemia drug by Novartis, are much more expensive than the widely advertised drugs.

Criticism #2: Direct-to-Consumer Advertising Leads to Increased Drug Utilization. Does DTC advertising increase drug utilization? Probably. Surveys do indicate that patients ask their doctors about drugs they have seen advertised. But how can that be bad if people concerned they may have a medical condition are encouraged to see a doctor and possibly receive medical treatment?

It is also true that implementing a 911 emergency system increases fire and police department utilization thus driving up a city's public spending on these services. But few people would criticize such efforts because they get help to the people who need it. That's what DTC advertising does.

Criticism # 3: Giving Away Samples Lures Patients Into Using Prescription Drugs. Brand-name drug companies give away about $10 billion worth of free samples every year. Indeed, free samples comprise about half of the industry's total marketing budget. Time was — before the media and critics decided to portray every drug company action as driven by greed — that free samples were considered a good thing. Patients like it when doctors provide samples because it means they don't have to pay for those drugs themselves.

Samples also allow patients to try a drug to see if it is effective before they actually buy it. Most important, doctors sometimes use samples as a way to get needed drugs to low-income patients who might not have the funds to pay for them. If drug companies are forced — either through legislation or public pressure — to cut back or end

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free samples, it will be patients and low-income people who are hurt most.

Criticism # 4: DTC Ads Encourage Patients to Demand That Doctors Give Them an Advertised Drug. The medical profession is legendary for producing doctors with big egos. The notion that patients are somehow bullying doctors into prescribing something the doctor doesn't think the patient should have is almost ludicrous. That is not the average doctor, nor is it the average patient.

For example, according to a 1999 FDA survey of patients who asked their doctor about an advertised drug:

- 81% of the respondents thought their doctor welcomed the questions;
- 79% discussed the advertised drug with their doctor;
- 71% of the respondents said their physician acted like asking such questions was a normal part of the process;
- And only 4% said their physician appeared angry or upset by the question.

And according to *Prevention Magazine*, while 72% of patients who talked to their doctor about an advertised drug asked the doctor for more information, only 26% actually asked for the drug.

No doubt some patients demand their doctor give them an advertised drug, but eliminating DTC advertising won't cure human arrogance and bad manners. Health care information is widely available on the internet and in published materials — as it should be! Killing the ads won't kill the quest for information. Indeed, TV, radio, and print ads are subject to more regulations and controls than what goes up on the internet. It would be a huge irony if DTC critics, in hopes of saving both patients and doctors from drugs ads, drove people from the more regulated outlets for advertising to the internet where misinformation abounds.

Criticism #5: Prescription Drug Ads Are Deceptive, Misleading, and Irresponsible. It is the nature of advertising to promote a product, and there are truth-in-advertising laws that prohibit false and misleading information. The fact is that prescription drugs are among the most benign — and ethical — on television. They promote their product rather than criticize their competitors' products. And almost all of them end by stating something akin to, "See your doctor to see if our product is right for you." The doctor still plays the key role. Now compare the drug companies' approach with some of the other ads on television. Automakers do their best to get us to spend $ 20,000 or $30,000 or more to buy a new car or truck — whether we need one or not! Yet no one questions the integrity of automobile advertising.

If implementing freebies to lure in consumers is questionable behavior, what can we say about manufacturers who promised zero interest and $2,500 cash back? And none of these ads end by saying: "Check with your financial planner to see if a Chevy Tahoe is right for you." Yet economists applaud if the automakers are successful in inducing us to spend that money on some thing we don't really need.

Conclusion. Prescription drug ads aren't the problem; they're the solution. They inform consumers and patients about products that may help a medical condition, and most do so ethically. They get patients in to see doctors who may discover an even more serious underlying cause of the medical condition. We don't need less DTC advertising; we need more.

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The World Is Dining Out on America's Prescription Drug Tab

Aengus Barry

Recent debate concerning prescription drugs has focused on the fact that drug prices in Europe and Canada generally are a lot lower than in the United States. This difference has led states to consider price controls. While price controls might bring Ohio's drug prices more in line with Canada's, in the long run Ohioans will be hurt as incentives to create new drugs are destroyed.

Governor Taft, for example, recently expressed interest in a multi-state compact that would negotiate with pharmaceutical companies for reduced prices using its bulk Medicaid purchasing power as leverage. This "negotiated" price will act as a cap on prescription drug prices and is a poor solution to the perceived unfairness between drug prices in Ohio compared to other countries.

Critics are quite right that the current situation is unfair, but they miss the point as to why. Americans pay the market price for prescription drugs while Canada, Japan, and many European nations force drug companies to charge them less. They do this by enacting legislation that strictly limits drug prices to a level closer to their cost of production.

For the most part, the market price of prescription drugs is high because of the lack of competition created by patents. Few complaints are made about drugs that have generic equivalents. Patents exist, however, to encourage the production of new drugs by allowing manufacturers to recover the cost of researching and developing new drugs.

By forcing pharmaceutical companies to sell closer to marginal cost, "negotiated price reductions" effectively negate the incentives created by patents. Since the United States is such a large portion of the worldwide drug market, the effect of price caps in Canada and Europe have not had a very significant effect on drug research and development.

Essentially, the United States is subsidizing research and development for the rest of the world. If Ohio and other states follow the lead of Canada, soon no one will be left to pass the buck to.

If negotiated price reductions come to fruition, the short-term effects will be readily apparent. Ohioans will have cheaper prescription drugs and "revenge" against drug companies.

After the initial reductions, however, the lower return on the drugs that make it to market will mean that drug companies can only afford to produce those drugs they are certain will cover their research and development costs. This means less research, less innovation, and fewer drugs down the road. Ohio's biotech industry, one of the state's few growing economic sectors, would be harmed.

It will be hard to know what will have been lost, as a drug that can help humankind in 20 years is hard to envision today. The benefits of drugs researched many years ago, however, are possible to quantify today. Columbia University economist Frank Lichtenberg found that an expenditure of $11,000 on general medical care extends a person's life by an average of one year. Spending $1,345 on pharmaceutical research and development, however, achieves the same result.

Furthermore, increased drug research has a proven link with reducing the need for hospital stays. Savings in drug costs may be forfeited several times over in terms of increased hospital costs and lost pharmaceutical innovations.

The introduction of price controls on prescription drugs, either directly or through "negotiated price reductions," is a bad idea. Ohio would be limiting innovation and stifling research in an industry that can have a tremendous positive influence on the quality of life. A price-cap bill is the wrong medicine for Ohio's long-term health.

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Rusty Thinking on Steel Tariffs

Sara Fitzgerald and Aaron Schavey

There's no such thing as a do-over in politics, but President Bush is about to get a rare second chance to make the right decision.

In March 2002, the Bush administration imposed a tariff of up to 30% on several imported steel products. The President has the option of eliminating those tariffs. Doing so would undo some of the damage the tariffs have done to our economy, smooth over relations with our trading partners, and strengthen the administration's free-trade credentials. In retrospect, Bush's decision seems more political than economic. After all, the tariffs offered little hope to revitalize the faltering steel industry. But politically, the tariffs seemed to offer Republicans some potentially important votes in the 2004 elections in steel-producing swing states like Pennsylvania, West Virginia, and Ohio.

Bush's gamble appears to have backfired. In August, the United Steelworkers Union threw its support behind Democratic presidential candidate Richard Gephardt, an early endorsement that signals the union will work hard to defeat Bush next year.

Domestically, the steel tariffs have hurt more workers than they have helped. That's because industries that use steel to manufacture other products such as auto parts, appliances, and buildings produce more products and employ more people than the steel industry does. In fact, according to the Consumer Industries Trade Action Coalition, for every employee in the steel-producing industry, 59 work in the steel-using industry. The tariffs increased prices in these industries, lowering demand. That's why the Institute for International Economics estimates that as many as 52,000 jobs have been lost in the steel-using industry since the tariffs were enacted. Eliminating the tariffs would help strengthen the manufacturing sector by restoring some of these lost jobs.

Although they harmed our economy, the tariffs offered little hope of boosting the steel industry. Even if foreign imports were completely prohibited, the steel industry would remain inefficient. One reason is that steel makers have high fixed costs, including overhead costs that don't change no matter how much — or how little — steel a company is rolling out. To be competitive, industries with high fixed costs should have only a few large firms. That's why there are three American automakers, not 33. But steel tariffs prop up inefficient firms, allowing them to remain in business even though they're actually losing money. In effect, they're being kept alive by corporate welfare.

Internationally, the steel tariff succeeded only in angering our trading partners and injuring our credibility in the global market. The administration was blindsided by the reaction it received both at home and abroad. Our international trading partners were livid, while domestic companies that use imported steel demanded exemptions.

Almost immediately, the administration started doling those exemptions out. Countries that held trade agreements with the United States were completely exempt. Australia received an 85

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Facts & Opinions
Question of the Quarter:

What government programs should Congress and the President eliminate in order to reduce the deficit?

Send your thoughts on this issue to us at public.interest.institute@limitedgovernment.org.

We will publish some of your ideas in the next issue of *Facts & Opinions* in February 2004 and on our Website at www.limitedgovernment.org.

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Rusty Thinking on Steel Tariffs

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percent exemption (without it, Australian exporters could have lost up to $450 million per year). Several other countries were granted exemptions, and several American companies, such as Caterpillar, were given exemptions for the imported products they use.

Despite the administration's attempts to mitigate the damage of the steel tariffs it had approved, a number of countries brought a case against the United States before the World Trade Organization (WTO) claiming that the steel tariffs violated WTO rules. Predictably, the WTO ruled against the United States in July. That decision paved the way for the European Union to impose $2.2 billion in tariffs on American products.

If these retaliatory tariffs were implemented, they would harm American companies in politically important states. That's bad news for President Bush's re-election bid, and even worse news for the employees in these companies. Undoubtedly, these tariffs would force firms to reduce production. That means less work for existing employees, or job losses in the manufacturing sector. Thus one bad idea could hurt the economy twice.

Last year, Bush put politics above economics. For the sake of the American worker and our credibility with U.S. trading partners, Bush now should put economics above politics by repealing the tariffs he imposed on steel imports last year.

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