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More Drug Reimportation Folly

by David Hogberg

Governor Tom Vilsack's folly of trying to reimport prescription drugs from Canada continues apace. On November 7, 2003, Governor Vilsack issued a press release citing a soon-to-be released study from the Iowa Department of Human Services showing significant cost savings for state health-care plans and Medicaid if the state could purchase drugs from Canada. According to Vilsack, "We estimate we can cut our drug costs by 16.4 percent, and achieve an initial savings of at least $10 million."[1]

That $10 million is surely overstated. In October the Congressional Budget Office (CBO) released an estimate of how much drug consumers would save if House Resolution 2427 (the legislation that would allow drug reimportation) became law. The CBO found that consumers would see a savings of, at best, $40.4 billion over the next decade. According to the National Taxpayers Union (NTU), that translates into a 0.8 percent savings. If that 0.8 percent is applied to the $54 million that the Iowa State Government spent on prescription drugs in 2002, the cost savings is a meager $432,000, not the $10 million Governor Vilsack proclaims. Indeed, even that paltry amount is probably too high. According to Al Cors of NTU:

> None of the [CBO] studies considered the huge FDA enforcement costs that would occur, the costs of liability from widespread litigation, or the cost of the massive loss of innovation that would follow in the wake of any drug reimportation scheme. If measured, these would likely offset any possible savings.[2]

Much of the motivation for misguided policies like drug reimportation comes from misconceptions about drug companies that are propagated by the political left. Two studies by Public Citizen have provided much of the fuel for such misconceptions.

One such misconception is that the drug companies are *too* profitable. According to Public Citizen the prescription drug industry is the "most lucrative industry in America."[3] And indeed it is. Yet the drug industry needs to be very profitable in order to fund drug research and development (R&D) which is very risky—only one of every 5,000 new chemical compounds makes it to the market, and only three in ten drugs becomes profitable. Public Citizen dismisses this because "For decades the drug industry has topped other industries in measures of profitability, showing that its research could not be too risky, or it would not consistently reap such high earnings."[4] That demonstrates a kindergarten understanding of economics. The fact that drug industries are so profitable is the reason they are able to attract investors to fund their research. Investors weigh risk versus reward, and they will not invest in as risky an undertaking as drug development unless the reward (profit) is very high.

Public Citizen also claims that drug industry R&D is a relatively small expense. According to its estimate, the drug industry spends at most $149.8 million for each new drug that enters the market.[5] Yet

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the Public Citizen study is misleading. First, Public Citizen arrived at its number by dividing the amount that members of Pharmaceutical Research and Manufacturers of America (PhRMA) spent on R&D by the number of new drugs approved by the FDA. The problem is that many of the new drugs approved come from companies that are not members of PhRMA. In short, Public Citizen deflates the numerator, and inflates the denominator.[6]

Second, Public Citizen further reduced the cost by 34% by claiming that R&D expenditures are deductible from the corporate income tax. This is misleading because the corporate income tax is a tax on profits; in other words, the tax has always applied to the amount that remains when expenditures are subtracted from revenue. By applying the corporate income tax rate to expenditures, Public Citizen is using it in a way that it has never been used before. Ultimately, drug R&D is quite expensive. According to a far more accurate study in the *Journal of Health Economics*, the cost of R&D per new drug is closer to $800 million.[7]

It is often bad research and misconceptions that give rise to misguided policies. Governor Vilsack's push for drug reimportation is no exception.

ENDNOTES:

[1]Office of the Governor, "Vilsack Says Iowa Could Save Millions Purchasing Prescription Drugs From Canada," November 7, 2003, <http://www.governor.state.ia.us/news/2003/november/november0703_1.html> (November 10, 2003).
[2]Al Cors, Jr., "Planning to Fail: The Illinois-Canadian Drug Plan," *National Taxpayers Union*, NTU Issue Brief 147, November 3, 2003, p.2.
[3]"America's Other Drug Problem: A Briefing Book on the RX Drug Debate," Public Citizen, n.d., p.33.
[4]Ibid, p.40.
[5]"Rx R&D Myths: The Case Against the Drug Industry's R&D 'Scare Card,'" Public Citizen, *Congress Watch*, July 2001, p.7
[6]Parts of this brief are taken from "Hooked on Reimported Drugs," by David Hogberg. This article first appeared on the American Spectator's website at <http://www.spectator.org>. The original article can be viewed at <http://www.spectator.org/dsp_article.asp?art_id=5702>.
[7]Joseph A. DiMasi, Ronald W. Hansen, and Henry G. Grabowski, "The Price of Innovation: New Estimates of Drug Development Costs," *Journal of Health Economics*, 2003, vol.22.

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