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Price Controls Can Be Lethal

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Are drug prices too high? In recent months, as the Medicare prescription drug benefit winds its way through Congress, a number of politicians, including some members of Congress and even several governors and mayors, claim drug prices “are too high,” and demand price controls.

When people say the “price is too high,” what do they mean? They normally mean the price is higher than they are willing or able to pay. If they think the price of olive oil is too high, they will normally substitute a lower-priced oil.

However, with drugs there is often no good substitute, so one either pays the price, or forgoes the drug, or demands the state force the pharmaceutical company to sell the drug at a lower price, which is known as a price control.

If you are not a pharmaceutical company, you may like the idea of price controls. But if you learn price controls may kill people, will you have the same opinion?

A price is information. It tells buyers what they can purchase a good or service for. It tells sellers how much money they can receive for their product.

If the price is well above costs, sellers will try to produce more of the product, inducing new and other businesses to enter the market. If the price is below full costs, sellers will produce less and some producers may decide to leave the market. Price controls reduce or destroy the profits of producers; hence, producers will produce less and perhaps nothing at all. Lower production hurts the consumer and most often leads to “black markets.”

In the case of the pharmaceutical industry, price controls end up reducing innovation and investment in new and better lifesaving drugs. It may only cost pennies a pill to produce a new drug, but the investment required to develop the drug may have been in the hundreds of millions of dollars. If the price of the drug is not sufficiently high to cover the cost of the original investment, the company will not have the funds for research and development of other lifesaving drugs.

Assume you want to help your fellow man and decide to become a biochemist.

You spend years in school and a couple of hundred thousand dollars obtaining your doctorate. After a few years of experience in the lab, you think you may have come upon a cure for a certain type of cancer that affects 100,000 people per year. However, you know it will take at least five years and \$50 million to develop your idea. You then go to a venture capitalist and tell him you want \$50 million for an idea that only has a 50 percent chance of working after five years, and if it does work, it will cost another \$50 million and another five years to get FDA approval to sell the drug. In addition, if the drug is effective, 99 percent of the patients will be better off, but 1 percent will be worse off and are likely to sue you.

The government insists the people in the venture capital pool pay a substantial tax on any profits but sharply limits the deduction on any losses to just a few thousand dollars per year. How much will you need to charge per pill to cover these expected costs and provide your investors with a reasonable rate of return given the risks?

Many countries impose price controls on drugs. The result is that few, if any, new drugs are developed in those countries — France and Canada being good examples. France used to have a vibrant pharmaceutical industry, but now it is almost dead. The U.S. and Switzerland provide a disproportionate share of all new drugs, in large part because they have resisted price controls. How many important new drugs were ever developed in the socialist countries or countries with state-controlled pharmaceutical companies? Almost none.

Some politicians demand we import lower-priced drugs from Canada.

The Canadian government requires that pharmaceutical companies sell drugs to them at very low cost, under the threat of taking away patent protection. The Canadians do not pay their full share of R&D; costs — they are in effect parasites.

If you want more new and lifesaving pharmaceutical products, you will want the industry to be more profitable, not less. A more profitable industry means more financial and intellectual investment in new and better products. Threatening the industry with price controls or imports from parasitic countries scares away needed financial investment and talent.

The correct solution to high drug prices is to enable low-income people to buy necessary drugs and to institute tort reform to lessen the rapacious activities of trial lawyers who are unnecessarily driving up costs.

Price controls are weapons of mass destruction, which is the reason good economists vigorously oppose them. Rent control has made a mess of New York City's housing. Jimmy Carter's gasoline price controls produced the horrific misery of the gas lines. Drug price controls will quite literally kill people.

What is the right name for politicians who advocate such policies?

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