Price Controls and R&D Intensity

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Abstract

Within the U.S., the high cost of prescription drugs has become a 'hot' political topic. TV news reports show busloads of seniors heading to Canada for low cost drugs. The internet has made it possible for consumers to shop online for prescription medicines from their home. A number of states, cities and local municipalities have set up plans to import lower cost prescription drugs from Canada — in possible violation of federal law. There have been recent proposals put forward in Congress to allow the importation of prescription drugs from Canada as well as other countries. Needless to say, the major pharmaceutical manufacturers oppose such initiatives and have even taken steps to cut off the supply of prescription drugs to Canadian pharmacists who supply the U.S. market.

The U.S. is the only major industrialized country which does not have some form of price controls. U.S. pharmaceutical firms complain that foreign consumers, through price controls, are being subsidized by U.S. consumers and are getting a 'free ride.' The primary concern of U.S. pharmaceutical firms is that the importation of less expensive foreign drugs or the imposition of price controls, would severely limit their ability to conduct R&D. They argue that a free market is required to reward the significant risks assumed by pharmaceutical companies in the pursuit of new drugs. U.S. pharmaceutical companies spend approximately 25 percent of their profits on R&D and only three in ten drugs earn back their investment.

While no one disputes the necessity of intellectual property rights to motivate and reward R&D, what is an acceptable rate of return on investment is up for discussion. What makes this discussion more difficult, for prescription drugs than for software or other technology based products, is the often life saving or life enhancing nature of the products.

This paper will look at R&D intensity in four countries — three with some form of price control (Canada, Britain and Switzerland) and one without (the U.S.) — to determine the impact of price controls on R&D intensity.