

# WebMemo



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## Guaranteed Future Pain and Suffering: The Recent Research on Drug Price Controls

*by Derek Hunter*

The United States Senate may soon consider a measure that would strike an important provision of the 2003 Medicare Modernization Act that restricts the government's ability to impose price controls on prescription drugs. While price controls guaranteeing cheap prescription drugs for everyone may sound appealing<sup>1</sup>, the consequences of imposing price controls would harm seniors and all Americans. Economic analysis, such as that conducted by the Heritage Foundation's Edmund Haislmaier, proves the danger of government price negotiation and price controls. As well, other recent research shows that price controls would lead to less research and development in the pharmaceutical industry, fewer new prescription drugs, and the reduced availability of prescription drugs. This tradeoff is one that Americans might not accept.

### Reduced Drug Research and Development

Commerce Department researchers recently examined the prescription drug markets in member countries of the Organization for Economic Cooperation and Development (OECD), a 30-country organization of which the United States is a member and which professes "a commitment to democratic government and the market economy."<sup>2</sup> The Commerce Department study focused on 11 OECD members and determined that these "governments have relied heavily on government fiat rather than competition to set prices, lowering drug spending through price controls applied to

new and old drugs alike."<sup>3</sup> The study found that price controls in OECD countries caused a \$5 billion to \$8 billion annual reduction in funding for drug research and development.<sup>4</sup> Further, the study estimated that a \$5 billion to \$8 billion increase in research and development "could lead to three or four new molecular entities annually."<sup>5</sup>

### The Loss of Future Drug Therapy

The impact of price controls would vary with the degree to which the controls were set below market prices. According to a recent study published by the National Bureau of Economic Research, a 40 percent–45 percent cut in pharmaceutical prices "would have a significant impact on the incentives for private firms to invest in research and development."<sup>6</sup> The study estimated that, under such price controls, "the number of compounds moving from the laboratory into human trials would decrease by 50 percent–60 percent. Because of the uncertainties involved, fewer compounds moving into clinical trials directly translates into fewer new products—the effects of which wouldn't be fully felt for several decades because of the long development cycle. Moreover, because of the spillover effects of R&D, less activity today reduces the pos-

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sibilities for new opportunities in the future. Thus, these effects would likely compound themselves over time.”<sup>7</sup>

In a separate study, researchers at the American Enterprise and the Brookings Institution reached a broadly similar conclusion. Price controls directly undercut new investments in new cures and treatments. If price regulations similar to those enacted in the Veteran’s Administration in 1992 that required “pharmaceutical prices in the U.S. to grow no faster than the general price level” had been in place in the general health care economy from 1980 to 2000, the study estimates that, of the 520 new chemical entities approved for the U.S. market during those years, “198 drugs would have been “lost.”<sup>8</sup>

### Unnecessary Pain and Suffering

Researchers for The Manhattan Institute, in a recent study on drug pricing, estimated that in 2006, when the Medicare Modernization Act of 2003 is fully implemented, “the federal government will be purchasing or paying for nearly 60 percent of all prescription drugs in the United States.”<sup>9</sup> With control over such a large proportion

of the drug market, instituting price controls—even under the moniker “negotiations”—would have serious consequences for the development of new drugs.

The Manhattan Institute study estimates that between 1960 and 2001 there was \$188 billion less R&D in drug therapies than there otherwise would have been because of the various ways that the government already influences drug prices.<sup>10</sup> This loss translates into unnecessary pain and suffering for potentially millions of patients.

### A Slowdown in Drug Availability

Not only would price controls add to the delay in the development of drugs and eliminate any number of new drugs, they would also cause a delay in the introduction of new drugs into the market. A 1999 study by the Boston Consulting Group found that the more interference in the market there was in a given country, the longer it took approved drugs to reach the marketplace. “Greece, Belgium, and France, markets with considerable market intervention, have the longest delays between product approval and marketing, whereas Germany, Norway, the U.S., and the U.K.,

1. Kaiser Family Foundation, “Views on Prescription Drugs and The Pharmaceutical Industry,” Kaiser Health Poll Report (January/February 2005) at [www.kff.org/healthpollreport](http://www.kff.org/healthpollreport). According to the Kaiser survey, 65 percent of respondents favor legal limits on drug prices, and 46 percent of those who favor such price controls say they would still favor them even if it meant less research and development of new drugs. In the face of the increasing challenge of infectious diseases and the rapid growth of chronic illness, this is a remarkable finding.
2. Organization for Economic Cooperation and Development website, [www.oecd.org/about/0,2337,en\\_2649\\_201185\\_1\\_1\\_1\\_1\\_1\\_00.html](http://www.oecd.org/about/0,2337,en_2649_201185_1_1_1_1_1_00.html).
3. “Pharmaceutical Price Controls in OECD Countries: Implications for the U.S. Consumers, Pricing, Research and Development, and Innovation,” U.S. Department of Commerce, International Trade Administration, December 2004. <http://trade.gov/td/chemicals/drugpricingstudy.pdf>
4. *Ibid.*
5. *Ibid.*
6. Thomas A. Abbott and John A. Vernon, “The Cost of Pharmaceutical Price Reductions: A Financial Simulation Model of R&D Decisions,” *NBER Working Paper Series* No. 11114, February 2005 at [www.nber.org/papers/w11114](http://www.nber.org/papers/w11114).
7. *Ibid.*
8. Rexford E. Santerre and John A. Vernon, “A Cost-Benefit Analysis of Drug Price Controls in the U.S.,” AEI-Brookings Joint Center for Regulatory Studies, October 2004.
9. John A. Vernon, Rexford E. Santerre, Carmelo Giaccotto, “Are Drug Price Controls Good for Your Health?” Center for Medical Progress, The Manhattan Institute, December 7, 2004, at [www.manhattan-institute.org/pdf/mpr\\_01.pdf](http://www.manhattan-institute.org/pdf/mpr_01.pdf).
10. *Ibid.*

countries with relatively less intervention, have the fewest delays.”<sup>11</sup>

The study continues, “One of the causes of such delays can be negotiation over price. Interviews with industry leaders confirmed that the time it takes to negotiate pricing was increasingly the bottleneck in launching new medicines. While governments try to achieve the lowest possible price, and companies hold out for a price they will accept, large segments of the population that may benefit substantially from the new treatments are left waiting. The problem is particularly acute in Europe, where parallel trade and cross-country reference pricing can cause uneconomically low prices to spread between countries.”<sup>12</sup>

### Conclusion

With the passage of the Medicare Modernization Act of 2003, the government dramatically increased its activity in the prescription drug market. Not surprisingly, as cost estimates for the Act’s prescription drug benefit soar, some in Congress are looking toward price regulation as a way to hold expenses down. Several times, legislation has been proposed that would allow the federal government

to “negotiate” the prices of drugs covered by the prescription drug benefit. “Negotiate,” however, is misleading. What the term really means is government price controls.

The use of price controls to combat rising costs is an ancient prescription, and in the case of prescription drugs, one that is practiced in much of the rest of the world. No politician, over the course of 4,000 years of experience, has yet devised a humane system of price controls that spares consumers from the risks of shortages and declines in the quality of the controlled goods or services.

The negative impact of price controls cannot be overstated. While further shifting costs to consumers in the uncontrolled sector of the pharmaceutical market, price controls would also sacrifice future medical breakthroughs by stifling incentives for private research. The quality of care available to both present and future generations of patients would decline, and the costs of personal pain and suffering are guaranteed to increase. Price controls a mistake Congress should not make.

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11. “Ensuring Cost-Effective Access to Innovative Pharmaceuticals: Do Market Interventions Work?” The Boston Consulting Group, April 1999.

12. *Ibid.*