Intelligence MEMOS

From: Åke Blomqvist and Paul Grootendorst

To: The Honourable Patty Hajdu, Minister of Health

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Re: **Selling Drugs to the US**

President Joe Biden recently announced his intention to work with state governments to encourage American buyers to import pharmaceuticals from Canada, where drug prices are lower.

The government of Canada should try to dissuade him from pursuing these plans and instead urge him to join Canada in an effort to establish a better system for international sharing of the cost of the research and development needed to develop new drugs.

Sellers are able to charge very high prices for many newly developed drugs because the drugs can only be legally sold by the firm that owns the patents on them.

This is by design: it is the prospect of future monopoly profits that motivates pharmaceutical companies to undertake the risky and expensive research that leads to new drugs.

Available data show that listed drug prices tend to be highest in the US, markedly lower in a group of other high-income countries including Canada, Switzerland, and Germany, and lower still in countries with lower per capita incomes (Greece, South Korea, Turkey). International comparisons of list prices can be misleading because they don't take into account the confidential discounts that are negotiated by many buyers. But even without knowing the precise transaction prices, it is clear that on average, drug prices tend to be high where national per capita incomes are high.

This form of price discrimination seems reasonable. If the net revenue that the patent-holder earns in each country is interpreted as that country's share of the patent-holder's reward for developing the drug, it makes sense that this contribution should be proportionately higher from high-income countries than from less wealthy ones. Charging different prices between the rich and the poor should be part of an equitable model of international cost-sharing for the world's pharmaceutical R&D based on the patent system.

Price discrimination of this kind, however, is difficult to sustain for products that can be resold by the original buyer. If resale cannot be prevented, buyers in low-price markets can buy more than they need and resell the surplus to buyers who otherwise would have to pay a higher price. The pharmaceutical industry calls this resale from lower-price countries to buyers in high-price countries 'parallel trade.' The Biden administration's proposal that US states try to save money by importing lower-priced drugs from Canada amounts to encouraging a form of parallel trade.

Parallel trade reduces the net revenue of the sellers because it increases the share of total sales that occurs in markets where the price is lower. It therefore reduces the incentive to develop new drugs to some extent. It may also, indirectly, end up having adverse effects on buyers in lower-price markets.

Shortages may arise in Canada if a substantial portion of drugs initially sold here are exported. Another worry is that it may cause sellers of newly developed drugs to delay launching them in Canada, in order to prevent resale to a higher-price market (i.e., the US). Recent studies have provided some evidence that such delays already exist in the Canadian market. If the Biden administration proposals were to result in a major increase in parallel trade, the problem is likely to get worse.

The Canadian model for regulating and negotiating drug prices is currently in a state of flux, with a controversial set of long-delayed patented drug price controls by the Patented Medicine Prices Review Board being scheduled to take effect in January 2022.

This is compounded by the uncertainty about the role for the new federal Canada Drug Agency as Canada moves toward some form of universal drug insurance coverage. The Biden administration's proposal, while well-intentioned, just throws an additional spanner into the works. Canada should announce its opposition to it and push for a long-overdue negotiation of a new and more rational model of sharing the global burden of paying for pharmaceutical research and development.

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