Intelligence MEMOS

From: Åke Blomqvist and Rosalie Wyonch

To: The Hon. Ginette Petitpas Taylor, Federal Minister of Health

Date: March 1, 2019

Re: **Is Canada a Free-Rider on Pharmaceutical R&D in the U.S.?**

The main reason why health and general living standards in the world's developed countries are so much better than in earlier eras is that today's technology is much more advanced. But new technology does not come for free. Most of it, in healthcare and elsewhere, comes about because large amounts of resources are spent on research and development.

All countries, especially those with high per-capita incomes, face an inevitable tension between their obligation to contribute their fair share to the global revenue of the pharmaceutical companies who do the R&D spending to develop new drugs, and their desire to save money for the taxpayers, private insurers and patients who pay for the drugs.

In in our new C.D. Howe Institute report, we compared how patent law, regulation, and government purchasing policies help determine drug prices in Canada, the US, and major countries in Europe and Australasia. Different countries respond in different ways to balancing the need to contain drug spending with contributing to global R&D financing. Government policy in many other countries plays a more comprehensive role than it does in the U.S. and Canada, either in the form of direct regulation of drug prices or via the government's role, direct or indirect, in negotiating with pharmaceutical companies about drug purchasing and pricing.

With complex interactions between regulations, patent laws, and R&D tax incentives and subsidies, it is difficult to determine whether Canada's contributions to global pharmaceutical R&D are "optimal." Drug prices and per capita spending on pharmaceutical R&D is higher than in the U.S. than elsewhere, so U.S. consumers and taxpayers contribute more than their fair share towards the cost of global pharmaceutical R&D. In the terminology of economics, countries in which patients and insurers are able to access new drugs at lower prices are "free riders" who get the benefits from these drugs even though they contribute a lower share of the R&D costs.

It is clear, however, that Canada is less of a free-rider than other countries that employ more restrictive drug pricing policies. Though lower than in the US, published prices of patented pharmaceuticals in Canada are comparable to or higher than in most other developed nations, as are our contributions to business R&D through direct funding and tax expenditures.

We recommend that Canada pursue a two-track strategy. In the short run, we benefit from and, therefore, should aim for, the lowest drug prices that we can get without inviting vociferous opposition from the U.S. and our other trading partners. In negotiating and regulating drug prices, we should be transparent and make systematic use of cost-effectiveness comparisons and value-based pricing, as well as external reference pricing.

But we should simultaneously work with our trading partners and international agencies toward a model of global R&D funding that overcomes the free-rider problem and moves us closer to a more efficient management of this aspect of the global commons.

Beyond that, if Canada is moving toward a national pharmacare model with a continued role for private insurance and provincial plans, private insurers should have access to the same price concessions, confidential discounts, and rebates as the provincial plans. Centralized price negotiations would be a more flexible approach than explicit price regulation.

Åke Blomqvist is Adjunct Research Professor at Carleton University and Health Policy Scholar at the C.D. Howe Institute; Rosalie Wyonch is a Policy Analyst at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.