Trade Laws and Pharmaceuticals

ALAN MORAN

TRADE-RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS (TRIPS)

While 11 September generally marked a loss of innocence of the Elysian Western world, one threatening upshot has had little recognition. This was the US Government's forcing down the price of Cipro, Bayer's anti-anthrax drug. The pressure placed on Bayer to reduce its already highly discounted price to the US government included the threat of patent termination. For its part, 'the Peoples' Republic of' Canada actually rescinded the company's patent, before recanting.

The green light offered by the US and Canada to emasculating these property rights was not lost on other nations. The quasi-expropriation greatly strengthened the case that Brazil and other countries had been making in campaigns to have the patents on AIDS and other life-saving drugs suspended. Those campaigns have been strongly supported by anti-business Non-Governmental Organizations, led by the Catholic Aid Agency CAFOD and Medecins Sans Frontières.

The property rights to patented goods are recognized under a specific TRIPS agreement of the World Trade Organization and were an important feature at the November 2001 meeting in Doha, Qatar. The Doha Declaration, which launched a new round of trade negotiations, recognized the value of patents to the development of medical innovations. However CAFOD maintains that developing countries 'faced down the US and big pharmaceutical corporations to ensure that public health needs come before patent protection'. This is code for the existence of provisions that may allow patents to be more readily overruled.

PATENTS AND INCOMES

Ever since the city of Florence granted Filippo Brunelleschi the first-ever patent in 1421, innovation has been a prime source of increasing income levels. The far-sighted act by the Florentine authorities was quickly followed by those in all jurisdictions seeking increased wealth through commerce. It recruited property rights, the rock on which a nascent capitalism was being built, to a whole new theatre of growth propulsion.

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It takes patience and deep insight to recognize the penalties to a nation's well-being when it overrides property rights. A strong, if superficial, case can be made for seizing property rights of assets, intellectual or otherwise, that already exist. Low-cost redistributional benefits are seemingly freely available where assets' production costs are 'sunk'.

As a result, individually owned property rights have, through the centuries, proved enticing targets for forced acquisition—both to political entrepreneurs and to well-meaning social activists. Developments in North America and pressures elsewhere in response to the AIDS pandemic and other medical crises show that patent rights are no less vulnerable.

Patented pharmaceuticals are characterized by considerable 'sunk costs'. According to McKinsey,[1] actual manufacturing and administrative costs (for a vaccine) are less than 10 per cent of the total price. The other costs include R&D and trials at 30 per cent; sales, taxes and royalties 24 per cent; and distribution at 15 per cent.

Hence, ostensibly, an average vaccine could be sold at 10–20 per cent of its present price without the owner being out of pocket. Marginal costs would be covered. But the initial benefits of cheaper access would be engulfed in a subsequent reduction in the availability of new innovations. Expropriating property rights to innovations is no less corrosive to income levels and general welfare than expropriating shares or bank balances. The damage to incentives to save and invest overwhelm the benefits from the original redistribution no less slowly than do the benefits of nationalizing other property.

This makes the reaction of the US to the anthrax scare particularly worrying, given that it is the world's leading exponent of the sanctity of property rights.

IMPEDIMENTS TO CHEAP PROVISION

Two features of modern commerce and law operate to prevent goods being supplied more cheaply to developing countries. These are:

- Delivery costs far in excess of payment capabilities.
- Trade laws impeding the offer of lower-cost drugs.

High delivery costs

In many cases, treatments are not available because the target countries lack the necessary infrastructural support. Even expensive products often require considerably more money to transport, store, administer and supervise than the drug itself.

This appears to be the case with some AIDS treatments. Attaran and Gillespie-White[2] found that only 22 per cent of the possible anti-AIDS drug patents were in fact in force in African countries. Low commercial prospects are a major cause of this. Africa comprises only one per cent of the world pharmaceuticals market and the whole of the Third World constitutes only 0.5 per cent of the world market for anti-AIDS drugs.

In light of the poor commercial demand, many pharmaceutical suppliers already offer these products to poorer countries at cheaper prices. Although no business could survive in the longer term by simply covering its marginal costs, many pharmaceutical firms offer very sharp discounts on their brand name sales of certain drugs to the poorer countries. The problem is that even at rock-bottom prices, funding is not available for some of the highest-profile needs—Tanzania and Nigeria, for example, have total annual health budgets equivalent to $US8 per capita compared with the cheapest generic AIDS treatment of $US350.

Given the poor commercial possibilities for drug sellers within most Third World markets, many pharmaceutical businesses are evidently willing to discount their products heavily, but it is unreasonable to expect them to incur losses. Obligating them to do so would constitute a discriminatory tax on a particular industry, a measure that would tend to reduce its capacity to compete for capital and other resources *vis-à-vis* other industries. The major task is for international aid agencies, and private donors such as the Global Alliance for Vaccines and Immunization (GAVI) to offer incentives.

One development in the second half of the twentieth century that has markedly increased costs and reduced the availability of drugs has been changes to liability law. These were the outcome of increased aggression in pursuit of damages at law from goods, including medications, that failed to provide the advertised relief or which have had untoward side-effects. Peter Huber calls the outcome a 'liability tax', arguing that

> If the courts declare there is to be a safety tax on a vaccine at such and such a level, the tax will surely be paid, whatever other arrangements the buyer or user of the vaccine or the FDA, let alone the manufacturer, may prefer or can afford.[3]

Court claims have vastly increased the risks of developing new medical treatments. It is not possible to counter these increased costs by buyers agreeing to waive their rights to sue for compensation. Nor do courts confine themselves to granting damage compensation to those in their own country. As Union Carbide found in the 1984 Bhopal catastrophe, a well-heeled business is hostage to lawyer-financed claimants even when a Government bears responsibility for such claims. The development of the law on liability makes it particularly unlikely that any medical business would find it prudent to develop products purely for the use of people in developing countries.

Third World nations will be the heaviest losers from requirements that force down prices by compromising property rights

Trade laws impeding the offer of lower-cost drugs

A great deterrent to selling goods cheaply in some markets is the prospect that these goods may be re-exported and undermine profitability in other markets. Such fears are considered to be less pressing in the case of vaccines, which require controlled distribution channels to ensure the product's quality. But vaccines comprise only 1.6 per cent of global pharmaceutical sales, and most other products require less precise handling.

Government competition officials have often exacerbated this deterrent on supplying low-priced goods to selected markets. Trade practices officials tend to be strongly opposed to price discrimination. The knee-jerk reaction to a dissimilar price for a similar product is that the barriers allowing this should be removed.

In Australia, Allan Fels personally led the ACCC assault to allow parallel importing of compact discs. In that case, the ACCC argued that higher prices to Australian customers were only possible because the record companies were improperly preventing material from being imported from countries that enjoyed lower prices. Eventually Parliament legislated to forbid companies contracting to prevent exports into Australia of product that had been sold in other countries.

This meant that CDs in Australia would be no dearer than those in any other country, an outcome that naturally attracts considerable populist appeal. But the outcome for the production chain is a reduction both in revenue and in the incentive to produce the innovative works.

Much the same goes for other products. If title is fully transferred on sale, there are no opportunities to control subsequent resale. The seller faces the prospect of a niche market price, designed to cover marginal costs only, becoming the general price.

In the case of a pharmaceutical manufacturer, selling at a heavily discounted price into a Third World market presents considerable risk to commercial viability unless subsequent on-sales can be controlled.

CONCLUDING COMMENTS

Property rights have allowed considerable advances in pharmaceutical development. These advances have contributed massively to longevity and the relief of suffering. But future advances will be denied by weaker property rights in the form of diminished patent protection or attenuated rights to control on-sales of supplied products.

Third World nations will be the heaviest losers from requirements that force down prices by compromising property rights, and their self-appointed champions are doing a great disservice pursuing such goals.

NOTES

1 Batson A. and Bekier M.M., 'Vaccines where they're needed', the *McKinsey Quarterly*, 2001 Number 4.

2 Attaran A. S. and Gillespie-White L., 'Do Patents for Antiretroviral Drugs Constrain Access to AIDS Treatment in Africa?', JAMA, 17 October 2001.

3 Peter W. Huber, *Liability: The Legal Revolution and Its Consequences*, Basic Books, 1988. http://www.phuber.com/huber/liab/chap1.html

Dr Alan Moran is Director, Deregulation Unit, at the Institute of Public Affairs.

IPA

Cultural Wars

RON BRUNTON

Why We Weren't Told

Public discussion of Aboriginal issues has undergone a major shift over the past couple of years. Commentators who would never identify themselves as being from the 'right' now talk about the catastrophic social conditions that exist in many Aboriginal settlements without placing all the blame on mainstream Australian society. Some even raise the possibility that aspects of Aboriginal culture may be dysfunctional in the modern world. Certainly, a few prominent 'protectors of the Aborigines' have not yet caught on to what has happened and still demand that white Australians continue with the self-flagellation regime. But when someone such as Hal Wootten, the most 'caring' of the five Black Deaths in Custody Royal Commissioners, and one of the early promoters of the 'child removals were genocide' line, is reported as saying that Australians need to ask whether Aboriginal child-rearing practices encourage later violence, the world has clearly changed.

Although even in the worst years of political correctness there were occasional articles in the popular press providing honest portrayals of the conditions that many Aborigines faced, there was a considerable degree of self-censorship amongst journalists who knew what was going on. In some ways this was not surprising, for the consequences of offending the Aboriginal industry could be serious. Recently, Rodney Henderson, an old mate from Sydney, told me about how his friend Graham Gifford was banned from the pages of all Fairfax publications nearly a quarter of a century ago, after writing articles describing conditions in Arnhem Land. Graham died just a few weeks ago, and it is fitting to remember a decent man whose distress at what he saw when he was living at Maningrida caused him to become one of the early victims of the destructive sentimentality that has afflicted Aborigines for so long.

In 1977, Gifford wrote two articles for *The National Times*, one under a pseudonym. The first, called 'True tales of modern tribalism', dealt with child sexual abuse and violence against women at outstations, and fairly pointed to the incompatibility between traditional culture and human rights for women and children. This caused an outcry from the caring classes. The anthropologist Ian Keen saw the piece as part of a backlash against Aboriginal land rights, and expressed his sorrow that *The National Times* had chosen to publish 'ill-researched, biased and inflammatory nonsense'. A Christian minister said that the article contained 'monstrous lies'. Another writer was distressed that it was not illegal to publish such a story. *The National Times* received only one letter of support—from Elizabeth Durack, who praised the article for lifting 'just the corner of the wrap' from a situation that others were ignoring.

The second piece, 'Grog and petrol sniffing' was published under his own name. As well as describing the extent to which Maningrida was being devastated by these two scourges, Gifford condemned the noble savage fantasies that were inspiring many white proponents