

“There Is No Shortage of Economic Policies, Just Creative People in Policymaking Positions”

Remarks by Dean Baker
Co-Director, Center for Economic and Policy Research (CEPR)

Les Rencontres Économiques d’Aix-en-Provence

July 7, 2017

The title of this session asks if we’ve run out of economic policies. This is a silly question, as can be shown with some clearer thinking on the economy. Debates on economic policy too often get reduced to narrow debates on tax and transfer policy. While tax and transfer policy is hugely important, this focus absurdly narrows the scope for economic policy. This narrowing is especially unfortunate in a country like France, where the use of the euro has sharply limited its ability to run budget deficits, or stimulate its economy through monetary or exchange rate policy. This means that its ability to do much at this point through tax and transfer policy is seriously constrained.

Nonetheless there are many areas in which the French government could implement policies that would both boost growth and reduce unemployment and inequality. In my book, [Rigged: How Globalization and the Rules of the Modern Economy Were Structured to Make the Rich Richer](#), I discuss five areas in which the market has been structured in ways that redistribute income upward.¹ I should caution that this book was written with the U.S. economy as the primary point of reference, however most of the points would apply to France as well, even if the upward redistribution in France has not been anywhere near as large as in the United States.

- 1) **Macroeconomic policy.** Fiscal, monetary, and exchange rate policy largely determine the level of employment and unemployment. Institutional factors, like rules on overtime and vacation policy, can also affect employment levels by affecting the supply of labor.
- 2) **Regulation of the financial sector.** The financial sector enjoys a privileged position almost everywhere, being exempt from much taxation and relying on the government as a lender of last resort.

¹ See <https://deanbaker.net/books/rigged.htm>.

- 3) **Corporate governance.** In the United States, the process of corporate governance has become increasingly corrupted so that it is very difficult for shareholders to put a check on the pay of CEOs and other top managers. Top management has a large voice in selecting the directors who oversee them. Once selected, directors have little incentive to challenge CEO pay, since virtually all slated directors are re-elected. The result is CEO salaries that often reach into the tens of millions annually.
- 4) **Protected professionals.** In the United States, the most highly paid professionals, doctors and dentists in particular, are largely protected from both foreign and domestic competition. As a result, their pay is more than twice the average for other wealthy countries.
- 5) **Intellectual property.** Patent and copyright monopolies often raise the price of protected items by several thousand percent above the free market price. This is especially important in the case of prescription drugs where patent monopolies can make drugs that would be cheap in a free market extremely expensive. These protections not only threaten health care, they also are a big part of the story of upward redistribution.

I will focus my remarks on intellectual property since there is so much at stake and the issues involved are poorly understood.

The United States will spend more than \$440 billion on drugs in 2017 that would sell in a free market, without patents or related protections, for less than \$80 billion. The difference of more than \$360 billion is almost 2 percent of GDP, or almost one-third of after-tax corporate profits. (The markups on drugs will be less in France, where prices are regulated.) There are also huge markups, typically in the range of 1000 percent or more, in medical equipment, pesticides, fertilizers, seed crops, software, recorded music and video material, and books.

In total, the gap between Intellectual Property (IP) protected prices and free market prices in the United States is likely to be more than 5 percent of GDP, or over \$900 billion in the U.S. economy. This is a massive transfer of income from the bulk of the population to the people who are in a situation to benefit from IP protection. The beneficiaries are not only the shareholders of pharmaceutical companies, software makers, and other companies that directly benefit from these protections but also the highly skilled segment of the workforce, such as biochemists and software engineers, who see an increase in the demand for their skills as a result of these protections.

This point is important for two reasons. First, it is far from obvious that patents and copyrights are the best mechanisms for supporting innovation and creative work in the 21st century. These are relics of the medieval guild system that have managed to survive through a combination of inertia and special interest lobbying.

The gap between the IP-protected price and the free market price leads to the same sort of economic waste and corruption that is the predicted result of trade tariffs. But in this case, instead of being 20 or 30 percent, the protection is equivalent to tariffs of 1000 percent or more. Most obviously, this means that many people who could afford drugs, medical equipment, or other items at the free market price, but not at the protected price, are denied access. This is a huge issue in the developing world, but even in the rich countries, there are many people who go without needed medicine because IP protection makes it too costly.

To take a dramatic example, the Hepatitis C drug Sovaldi carries a list price in the United States of \$84,000 for a three-month course of treatment. High-quality generic versions are [available in India](#) for less than \$300.² Many of the new cancer drugs carry list prices in the hundreds of thousands of dollars. In almost all cases these drugs are cheap to produce; it is the patent monopoly that makes them expensive.

But this is just the beginning of the problems with patent protection in the case of prescription drugs. The huge markups encourage drug companies to push their drugs for conditions where it is not appropriate. There are many instances where they have made payoffs to doctors to promote their drugs in talks or articles for medical journals. They also misrepresent research findings, concealing evidence that their drugs may not be as effective as claimed or even harmful in some circumstances.

Patent protection also encourages secrecy in research, as companies want to maximize their own ability to profit rather than giving away information to potential competitors. And it leads to unnecessary duplicative research, as drug companies may seek to innovate around the patent of a major breakthrough drug in order to get a portion of the patent rents. While the increased competition may be desirable in a world of patent monopolies, if drugs were selling at their free market price it is unlikely that we would devote large amounts of resources to developing the

2 See <http://www.thebodypro.com/content/78658/1000-fold-mark-up-for-drug-prices-in-high-income-c.html>.

second, third, and fourth drugs for a condition that can already be treated, as opposed to spending the money to develop a drug for a condition for which no treatment exists.³

There are alternative mechanisms to patent financing for prescription drug research, most obviously direct government funding. The United States is already spending more than \$30 billion annually through the National Institutes of Health (NIH). This compares to around \$50 billion that the pharmaceutical industry claims to spend on research each year. The NIH funding is overwhelming focused on basic research, but there are instances where it has actually funded the development of drugs and paid for clinical trials.

There is no reason why public funding could not be expanded and focused on the later phases of research and clinical testing. The new drugs could then be sold at generic prices since the research has already been paid for. An alternative route is to establish a prize system under which patents for important drugs are purchased by the government and placed in the public domain so that they could then be sold as generics.

Under both these systems, the research findings and clinical test results could be made completely public. This would be a huge benefit to doctors, who would be able to make more informed decisions in prescribing drugs. Some drugs may be more effective for some groups of people than others, or have bad side effects when mixed with other drugs. Full disclosure of test results would make this information available to doctors.

The case of prescription drugs is worth highlighting because it is probably the most egregious example of the waste and corruption of the current IP system, but there are many other instances that could be cited. In the tech industry, for years Apple and Samsung were competing as much in the court system over competing patent claims as in the market for smartphones. Patent trolling, buying up rights to a patent and hoping to be able to get a suit against a major company into court, is a major form of livelihood for many lawyers.

In the case of copyright, the United States has made the monopolies ever longer (now 95 years) and the penalties for infringements ever greater. Here too there are alternatives. The U.S. system of a tax deduction for charitable contributions presents an obvious model. A tax credit could be allowed for

³ Having multiple drugs for a condition is desirable, since patients will respond differently to the same drug, but the question is the amount of resources that should be devoted to duplicative drugs.

contributions to support creative work, with the condition of receiving the money that the work is in the public domain.

The relative merits of alternatives to IP for supporting innovation and creative work can be debated. I mention these to point out that the IP system is a policy option and is not the only known mechanism for these purposes.

However, there is an even more basic point that must be recognized. The strength and length of IP rules are things directly determined by public policy in large part. There has been a conscious decision in the rich countries to make these rules stronger in the last four decades. This has benefited highly skilled workers and IP related industries at the expense of everyone else.

In principle, there should be a payoff to society from stronger IP rules in the form of more rapid productivity growth. This is a very questionable proposition, especially given the extremely weak productivity growth we have seen over the last decade.

However, even if there were a dividend from stronger IP protection in the form of more rapid productivity growth, this should still be an explicit topic for public debate. In other words, we should be asking how much upward redistribution we are willing to tolerate in exchange for a predicted gain in productivity growth.

This debate has not taken place in the United States, France, or to my knowledge any other country in the world. The bottom line here is that it is clearly not true that it is just technology making some people very wealthy and making many others less well off. This outcome is the result of clear policy choices that unfortunately have been largely left out of public debate.