# A Free For All on Drug Patents

**Or, Ron Bailey's Principled Libertarianism**

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In the comment thread to a post by Ron Bailey at Reason Hit&Run (to his credit, actually a criticism of a drug company for abusing IP), quasibill gets off a couple of good ones:

> …much R&D investment is spent on finding ways to create new patentable technology, as opposed to finding new technology that is actually more useful.
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> * * * *
>
> Patents, when you boil them down, are nothing more than a licensing scheme, which seeks to subsidize the profits of a particular group at the expense of another group.

Bailey responds:

> [That's] OK as far as it goes, but as I've argued before patents are more than that:
>
> Abraham Lincoln once described patents as "adding the fuel of interest to the fire of genius." What many people forget about patents is that they are a disclosure mechanism. The monopoly is granted on the grounds that the inventor tell us exactly how he makes his product. This disclosure mechanism removes us from the old economically stagnant world of trade secrets in which inventors could only make money if they told no one how they did something. This allows other people to use those insights to invent other products. Patents are not perfect, but they have worked pretty well.

To which quasibill, in turn, responds:

> Not to argue from authority here, but have you ever read a patent? I have, and have spent many days and months working to re-create what they describe, often fruitlessly. This disclosure element is often vastly overrated, especially in pharmaceuticals, where teams of patent attorneys write descriptions that conclude lots of language like "through a mechanism well known to those schooled in the art" — which is a bald-faced lie, and I can point to several court cases where we proved it was.

> Further, this disclosure aspect could be handled in the free-market — those who think it would be useful, could pay for it, and sign non-disclosure, non-compete agreements. And that way, they'd actually get useful disclosure, and not the crap that currently gets drafted into patents by patent attorneys who have a good idea just how far they need to go.

As for the great Trade Secret Menace, quasibill points out that it's not that easy in practice:

> First, no competent doctor would ever prescribe a medicine that he knows nothing about. Second, reverse engineering, as you note, is always possible. Give me a small lab with a GC/MS and a LC/PDA and I could probably reverse engineer any pharmaceutical on the market. And I'm not even very good at either method anymore.
>
> No, it would quickly become cost and income prohibitive for pharmaceutical companies to engage in massive secrecy.

And, I might add, the Uruguay Round actually brings government into the business of protecting trade secrets, as well. So under current IP law, patents and trade secrets are not so much either/or as the best of all possible worlds, from the corporate standpoint.

Quasibill also restates what is essentially F.M. Scherer's argument that innovation is driven by competition, with or without IP:

> Why do auto companies spend millions of dollars in new vehicle design each year? Why does Sony put out new models of TV each year? Yup. You guessed it. Competition drives innovation, just like it would in pharmaceuticals. You build brand, and as I've noted before, your vision of "just copying" a pharmaceutical and marketing it is so simplistic so as to make it akin to saying playing Risk is like being President. It takes time to reverse engineer (and money). It takes time to formulate. And it takes knowledge to get the formulations right. If a generic puts out a crappy copy, it'll be obvious fairly quickly, and given the possible consequences, will likely be out of business real quick (liability is the least of its problems — reputation or brand would be of the utmost importance in such a market).
>
> Furthermore, as I noted, there is already a lot of charities devoted to finding a cure for X. Why is that? Because pharmaceutical companies don't fund R&D for cures, as a general rule. No profit margins there, as opposed to treatments. Furthermore, the patent system encourages them to engage in otherwise pointless R&D and marketing. Case in point, 2nd gen beta blockers, which were generally no more effective than 1st gen. Yet the pharmas aggressively marketed them based on preliminary, flawed, biased studies because they were still on patent, vs. the 1st gens that weren't.

And (if you'll pardon one last quote from quasibill), his inside description of Big Pharma, with its bureaucratic fat, sounds an awful lot like the internal culture of a military contractor operating on the cost-plus system:

> Have you ever been to a Merck campus (yes, they are campuses, not buildings or sites)? If you look at the structure of the business, the first thing that strikes you is

> that it looks like Detroit, circa 1980. And there's only one reason for that — government protection of their profit margin. A good friend of mine works there — makes over 100G a year in a union job, where he gets written up if he does too MUCH work. And yet while Detroit has suffered and is still paying for employing such a business model, Pharma's been posting huge profits. Why's that?

By the way: it's no surprise that Lincoln, for whom Henry Clay was the "beau ideal of a statesman," would say something like what Bailey quoted above. In announcing his first Congressional campaign, Lincoln set forth a Whig platform ("like the widow's dance, short and sweet") of a national bank, high protective tariffs, and internal improvements. As I say, I'm not at all surprised that a Henry Clay Whig, who saw the promotion of commercial activity as such (rather than free markets) as a positive good, would put forth utilitarian arguments for state intervention to promote profit. It's a little odd coming from a professed *libertarian*, though.

Charles Johnson of RadGeek had this to say, in the context of a similar thread at Samizdat, about such utilitarian views of state intervention:

> My interest here isn't to ajudicate the dispute. Maybe patent monopolies accelerate new drug production; maybe they stifle it; maybe they don't affect it at all. The usual moral and economic arguments against intellectual property apply regardless of what effects patents happen to have on the velocity of pharma R&D. What I do intend to do is once again ridicule self-proclaimed free marketeers who throw it all overboard to indulge in the crudest forms of corporate protectionist argument when it comes to so-called intellectual property…
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> The horrors we face are numerous. Pharmaceutical companies may have to *re-evaluate their business plans.* If people can't make a profit on in-house research and development for new drugs, then drug research will have to be done, God forbid, *out of house or by not-for-profit organizations*!…
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> Because, of course, the world *owes a living* to people "producing information," and what better way to ensure that than by "allocating" them proprietary control over *my* mind and *my* copying equipment?

Perhaps not coincidentally, Bailey thinks it's a good thing we're spending ever increasing amounts of GDP on health care.

> Because we have higher incomes, we demand more gold-plated medical services (private rooms with telephones and cable television) even if they don't cure us. However, if we think we're spending too much on health care, then as we grow ever wealthier, we could choose to spend the $4 trillion in 2015 on fripperies like bigger houses, nicer cars, or cooler gadgets.

The one thing we *can't* spend it on is cheaper health care, because the government patent system that Bailey loves so much outlaws competition in the supply of so much of it. (And as for the "higher incomes" that "we" allegedly have, Bailey must have a mouse in his pocket. Average hourly pay for nonsupervisory production workers hasn't gotten any higher in thirty years. But I'm glad those CEOs have the burden of choosing between bigger McMansions and more gold-plated medical services.)

The title of his piece suggests that if we think healthcare prices are too high, we should consume less of them. But there's a term for a market in which the seller sets the price without competition, and the only restraint on him is the consumer's choice of how much to buy at that price: monopoly.

His defense of the amount of money spent on health care in terms of its value to us is rather lame. A lot of things are valuable to us, but when the supplier of them is able to price them according to how badly we want them, you know something fishy is going on. My life is valuable to me, and in certain hypothetical circumstances I'd pay a lot of money to keep it. But when somebody says "Your money or your life," you can be pretty sure there is a gun involved. In this case, the gun is the patent system and the licensing cartels.

In another post along the same lines (appropriately titled "Drug Companies Don't Get Enough Money"), Bailey quotes with approval a study by Tomas Philipson and Anupam Jena, which assesses the value to consumers of the benefits of life-saving drugs, and compares them to the profits of drug companies. They argue, on the basis of this consumer surplus, that perhaps there should be "better incentives to innovators." Bailey concludes:

> Something to think about the next time you hear a politician demagoguing against "Big Pharma."

Commenter jbd responded:

> Ron, I think this is a misguided way to look at the issue. Many products generate massive "consumer surplus"–benfit to their purchasers vastly in excess of their cost–because competition among suppliers drives the cost down to near the cost of production, rather than up to the level of benefit to the purchasers. That's one of the beauties of capitalism. Innovative drugs evade some of this downward pressure for a time through government patent laws. At least some patent protection is certainly warranted to spur innovation, but comparing the return to suppliers with the surplus to purchasers tells you little about whether there are sufficient incentives for the suppliers. The real issue is how much above a "normal rate of return" the suppliers make, and for how long, and whether that is enough to recoup the costs and risks of development. The amount of "consumer surplus" seems to me to have nothing to do with it. Or is a shot of penicillin worth $1 million? In some circumstances, after all, that shot could save your life.

Bailey used the same argument for at least the third time in yet another post:

> Ahem. Prices are not based on costs; they are based on what people are willing to pay for something. Think of it this way.Your parents probably paid less than $25,000 for their first house. Fortunately, let's say they bought in Chevy Chase, Maryland and stayed there all their lives. Now the average home price is $600,000. If one only took inflation from 1960 into account, the house would only be worth $160,000. Unfortunately, your parents were run over by a Presidential motorcade. As their heir, would you be willing to sell their house for the equivalent of what they paid for it? Would that be fair to you?

As jbd commented above, and as I commented on this post, prices in the short run may reflect what people are willing to pay for something; but if market entry is free and supply is elastic, the supply will increase until what the marginal buyer is willing to pay just covers cost of production. The market price system is a homeostatic mechanism: it operates on feedback. Whenever a price deviates from its "normal" value (cost of production, when supply is elastic), the feedback process pushes it back toward the normal value. And the example of the house is particularly tone-deaf, because land is not a good in elastic supply. Since the supply is fixed, increased demand operates the same way on it as in a collectibles market: it drives the price up. This unique inelasticity of land supply, the basis of the classical theory of rent, is why so many economists, from the early classical liberals to Milton Friedman, considered land rent to be the least harmful object of taxation.

Finally, in yet another twist to all this mess, it turns out Bailey is soft on government funding of R&D. In the comment thread to "Drug Companies Don't Get Enough Money," Cal Ulmann points out:

> The federal government also pays for a significant portion that may have led to the drug's discovery[;] that does not seem to be taken into account from the quoted parts of the article.

Bailey responds with this utterly astounding (at least for a "libertarian") remark:

> It might well also be the case, that government is significantly underinvesting in drug research.

To back this up, he quotes from another of his articles:

> "Government-supported research gets you to the 20-yard line," explains Duke's Grabowski. "Biotech companies get you to the 50-yard line and [the big pharmaceutical companies] take you the rest of the way to the goal line. By and large, government labs don't do any drug development. The real originator of 90 percent of prescription drugs is private industry. It has never been demonstrated that government labs can take the initiative all the way" to drug-store shelves.
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> George Whitesides, a distinguished professor of biochemistry at Harvard University, similarly appreciates the role of often-government-funded research labs at universities in the early stages of drug development. But he stresses that "pure" research rarely translates into usable products. "The U.S. is the only country in the world that has a system for transmitting science efficiently into new technologies," he argues. That system includes research universities that produce a lot of basic science and get a lot of government money. In turn, startup companies take that lab science and develop it further. "Startups take 50 percent of the risk out of a product by taking it up to clinical trials," explains Whitesides. "Industry has an acute sense of what the problems are that need addressing." Without private industry to mine the insights of university researchers, taxpayers would have paid for a lot of top-notch scientific papers, but few if any medicines.

So according to Bailey, the beauty of the "free market" system is that, instead of industry being directly owned and managed by the state, there are nominally "private" corporations to collect all that corporate welfare and tell the government what's best to spend the money on. In other words, the kind of economic fascism, or corporatism, described by Brad Spangler:

> …one robber (the literal apparatus of government) keeps you covered with a pistol while the second (representing State-allied corporations) just holds the bag that you have to drop your wristwatch, wallet and car keys in. To say that your interaction with the bagman was a "voluntary transaction" is an absurdity. Such nonsense should be condemned by all libertarians. Both gunman and bagman together are the true State.

In the past, Bailey has also advocated mandatory health insurance. Isn't *that* a sweet deal? The government's patent system sets an artificial price floor on health care, and then the government's mandatory coverage system requires you to buy it at the seller's price. Again, it's the kind of "private enterprise" you find the ASI wonks advocating a lot of the time: nominally private firms operating in a statist framework that guarantees their profit. What's that word I used? Oh, yeah–*fascism.*

What Bailey advocates sounds less like free market libertarianism, than Jerry Pournelle-style "libertarian" technofascism: a government of engineer-kings channelling a giant chunk of GDP to whiz-bang R&D, government-subsidized nuclear reactors on every block, government-funded space elevators, government orbital lasers to enforce the Pax, etc.

Bailey has gotten hot under the collar more than once in response to past suggestions by Hit and Run commenters that he's a "shill" for the biotech, agribusiness, or drug industries. His outrage is probably genuine. I doubt there's any quid pro quo involved. This is more like an example of the old cliche: it's hard for a prostitute to make a living with all the amateurs giving it away free. Or as s.m. koppelman put it:

> All right, so you're not a shill. You might just be someone who sometimes likes to root for drug makers like other people root for a baseball team, or you may simply subscribe to a political and economic philiosophy that says regulation's bad unless it isn't. What I can say, though, is that considering drug patents self-evidently good and drug price controls self-evidently bad is a combination of positions congruent with those of a shill. ;)

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