AT A GLANCE:

HOW THE RULES OF OUR ECONOMY ENCOURAGE THE PHARMACEUTICAL INDUSTRY TO VALUE PROFIT-SEEKING OVER PEOPLE'S HEALTH

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The pharmaceutical industry is failing most Americans. People in the U.S. are taking more prescription pills than ever and are paying six times more for brand-name drugs than other countries,[1] yet we are seeing poorer health outcomes. The U.S. ranks 34th globally for life expectancy—declining for the second consecutive year as of 2016.[2] High-cost prescription drugs are not the price we must pay for drug companies to innovate, find cures, and produce affordable medicines. Instead, it is the price tag for an industry that values profit-seeking to the benefit of CEOs and shareholders over people's health.

Today's pharmaceutical industry arose, in part, from the rules that govern it—the laws, regulations, and institutions that shape corporate decision-making, driving runaway profits and inadequate corporate investment that put drug prices out of reach for most Americans. These rules—found in our tax code, antitrust laws, and corporate governance regulations—reinforce extractive behavior and drive profit-seeking at the expense of our health care system, economy, and people's health. Health should not be for sale but available to all, and policymakers can rewrite the rules of our economy to ensure that drug companies put health before profits.

The Rules of the Economy Have Contributed to an Increasingly Financialized Pharmaceutical Industry at the Expense of Lower Drug Prices and Innovation

Pharmaceutical companies are increasingly financialized; that is, they earn a larger share of their profits from financial activities rather than innovating and making or selling lifesaving medicines. In turn, these high profits are paid out to CEOs and shareholders at the expense of lower drug prices and corporate investment.

Financialization in the pharmaceutical industry, and in our society more broadly, is the result, in large part, of a series of changes to laws and policies that govern our economy. One example is the law that regulates stock buybacks. Prior to 1982, stock buybacks—one of the primary ways that today's pharmaceutical industry drives profits to shareholders—were considered largely impermissible because regulators viewed companies buying back their shares as market manipulation and companies faced potential liability for conducting them. A rule change in 1982 ultimately shielded companies that engage in the practice.[3] Between 2006 and 2015, the 18

largest U.S. drug corporations spent $516 billion on payouts to shareholders through buybacks or dividends, compared to the $465 billion spent on research and development (R&D).[4] The billions spent on buybacks in the last decade could have been returned to households in the form of lower drug prices or invested in R&D, rather than in payouts to shareholders.

The Rules of the Economy Have Contributed to Less Competition Within the Pharmaceutical Industry, Leading to Higher Prices and Less Innovation

High drug prices and insufficient investments are, also in part, a product of patent monopolies—in the form of intellectual property (IP) rights—and antitrust laws that shape the industry and give it market power. Patent monopolies, in theory, generate innovation by rewarding exclusive access to the market to the first to develop a popular drug for a limited amount of time. As a result of drug-patent monopolies, however, patients are paying several thousand percent above what would otherwise be market price.[5] In addition to exorbitant prices, patent-protected monopolies incentivize pharmaceutical companies to engage in other profit-seeking behaviors, such as suppressing internal findings about their drugs that may jeopardize their monopoly—behaviors that could harm patient health.[6]

Lax antitrust enforcement—premised on the inaccurate view that corporate consolidation increases market efficiency and benefits consumers—has led to a more consolidated and less innovative industry. Between 1995 and 2015, 60 pharmaceutical companies merged into 10.[7] One study of the pharmaceutical industry from 1988 to 2004 found that merged companies spent less on R&D than non-merged companies,[8] and another study found that merging companies' competitors also spent less on R&D after the merger. Even more insidious are "killer acquisitions," whereby one company purchases another to suppress research and the development of rival drugs, which account for approximately 7 percent of all mergers and acquisitions in the pharmaceutical industry and prevent the availability of 5 percent more drugs a year.[9]

The Rules of the Economy Have Resulted in Tax Policies that Encourage Predatory Hedge Funds and Other Forms of Profit-Seeking, Leading to Higher Prices and Less Innovation

Current tax policies encourage predatory hedge fund and private equity (PE) behavior, runaway CEO pay, and unproductive offshoring of profits—all of which contribute to higher drug prices. Tax law enables financial institutions, like hedge funds and PE, to classify their income as capital rather than labor income in order to avoid higher labor tax rates. Because of this, these

firms have increasingly invested in pharmaceutical companies and demand that management implement aggressive profit-maximization strategies, including more buybacks and dividend payments to shareholders, which divert resources from R&D and contribute to higher drug prices. Between 2013 and 2015, 20 of the 25 largest drug price hikes—those between 400 and 600 percent—came from firms with strong ties to the financial sector, either through associations with venture capital firms or through substantial hedge fund ownership.[10]

Lower income and capital tax rates also contribute to the explosion of exorbitant CEO pay by incentivizing CEOs to bargain for higher compensation. When top income tax rates were at 90 percent, CEOs had little reason to bargain for each additional dollar. As tax rates fell to today's 37 percent and CEO pay was tied to stock options, executive compensation exploded. Biotech and pharmaceutical CEOs earn, on average, 71 percent more than executives in other industries—resources that could be far better spent in the pursuit of drug innovation or lower drug prices for the patients who need it.[11]

For too many Americans, the failures of our pharmaceutical industry can be fatal. From high drug prices and insufficient investment to skyrocketing CEO pay and shareholder payouts, the problems in this industry are not inevitable results of markets. These problems are the result of policy choices—which means that policymakers can, and must, make different choices in order to restructure the industry and put people's health ahead of profit-seeking.

For the full issue brief, see "Profit over Patients: How the Rules of Our Economy Encourage the Pharmaceutical Industry's Extractive Behavior."

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