

BY ROBERT J. BARRO

ATTENTION CONSUMERS: CREATIVITY NEVER COMES CHEAP



FOREVER: Whether you are buying a music CD or prescription drugs, the cost of development has to be part of the price

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What do Napster Inc. and proposals to limit prescription drug prices have in common? Both seek to reduce prices of goods that cost little to produce but were expensive to create initially. Cutting prices today looks great for users and, arguably, for society as a whole. If it costs virtually nothing to copy a CD over the Internet, why should people not be able to copy and listen to the music, rather than having to pay \$15 down at the local store? If it costs only a few dollars to produce and distribute a standard quantity of Prozac, why should people not be able to buy the drug at \$10, rather than at \$100?

The problem is that the "high" price is the reward for the costly, long-term effort that went into the creation of the product. Music companies and artists expend time and money to create hits, and the bulk of the expenses goes into failed projects. To compensate for these efforts and to provide incentives for future hits, the industry has to reap large profits on its few successes.

IT'S ONLY FAIR. Piracy has long been a problem for producers of music and similar items, such as books, movies, and computer software. The incentive to abridge intellectual-property rights reflects the big gap between the prices charged by the copyright owners and the actual costs of copying and distribution. Innovations in the Internet and computer technology have dramatically lowered these costs. These advances are desirable because they allow products to reach a vastly expanded audience.

But there is a downside as well—the threat to intellectual-property rights. These rights are partly a matter of fairness, in the philosophical sense that inventors ought to be able to control the use of their discoveries. But more concretely, if intellectual-property rights disappear and no other effective method of compensating creativity is adopted, we will see much less brilliance in future music, books, movies, and software.

It may be that the Internet makes impossible the effective enforcement of intellectual-property rights in certain areas. If so, we are likely to be in trouble with respect to future creations. However, the best policy for now would be to maintain the highest feasible degree of property rights, and the pursuit of the legal case against Napster is a helpful part of this policy.

Prescription drugs are similar in many respects, although the Internet has not yet figured out how to physically copy drugs. However, the costs of sale and distribution will likely be reduced significantly because of the Net, once ef-

fective ways are developed to ensure the identity of the buyer.

One way to see that prices of patented drugs exceed current costs of production is to compare U.S. prices with the lower ones in some other countries. For example, Prozac sells in Canada for less than half of its U.S. price. Some people deduce that the U.S. ought to adopt Canada's single-payer policy for prescription drugs or, alternatively, allow reimportation of the cheaper pharmaceutical drugs back into the U.S. A more reasonable view is that the incentives for drug research and innovation created by high U.S. prices give Canada, Mexico, and other countries a free ride. If the U.S. were to follow Canadian policies, then fewer new drugs would be available in the U.S. and the rest of the world.

Complaints about high drug prices are on the rise, and the irony is that pharmaceutical companies would be facing fewer attacks if they had been less successful at developing new drugs. The winners of recent years include antidepressants, ulcer medications, agents to lower cholesterol levels, new types of antibiotics, and protease inhibitors to fight HIV. One would have thought that people would prefer the current environment, with many effective new drugs at high prices, to one with few or no new drugs at low prices. This choice is the relevant one for society, but many people pretend that they can have both low prices and many new drugs. It isn't so.

WHO PAYS? Particularly depressing are current suggestions for "solving the problem" by subsidizing purchases of prescription drugs through Medicare. If we have decided (I would say wisely) not to reduce the rewards to pharmaceutical companies for effective drugs, then the question becomes: Who shall pay for them? Adding drug purchases to Medicare means that payment will come from the general taxpayer rather than elderly users.

This shift might be defensible, despite the budgetary costs, if seniors were poorer than average. However, the opposite is now true, particularly because of the past expansions of Social Security and Medicare. The elderly are among the more well-off groups in America today.

Proposals for additional public spending on new health-care entitlements makes one yearn for the bad old days of budget deficits. At least at that time, attention was focussed on effective ways to curb Medicare, rather than on ways to expand it.