

hand when pharmaceutical companies choose to introduce new versions of drugs or introduce drugs in already clogged market segments. Both of these actions generally fail to advance public health, keep prices high for consumers for long-existing treatments, and can be anticompetitive. Society needs new clinical trials – not new lawsuits, new mergers, or new extended-release, individually packaged antacids.

Granted, one cannot fully blame companies for engaging in behavior that is strongly in their economic self-interests when regulation is unclear or riddled with loopholes. If society wishes its interests to prevail, then the legal system must bring the incentives of the players into proper alignment with the goals of society, by creating either sufficient incentives or sufficient disincentives. We cannot expect the rats in the maze to run in the direction society wishes if the cheese is located at the other end. And, as the generic system in the United States currently operates, the cheese is poorly located. In this book, we will discuss concerns with current regulation and suggest avenues for reform.

C THE STRANGE ECONOMICS OF PHARMACEUTICALS

Drugs can save lives, improve our well-being, and help us maintain healthy lifestyles. But why do we (and our insurers) pay so much for them? Why are such large price increases possible? Better yet, when we receive a prescription, why don't we know how much it *really* costs, or whether we'll get a brand name drug or its generic? The answers lie in the complicated market structure for pharmaceuticals, where patients require drugs, doctors prescribe what they believe is the most effective medication, pharmacists fill these prescriptions, and an insurer picks up most of the tab. There is a decoupling of who makes drug choices and who pays for them – a classic informational problem of markets and economics.

In fact, the pharmaceutical market does not operate much like a standard market at all. In a perfect world, consumers deciding which drug to purchase would have complete information for the decision-making process. They would know about all the drugs available to treat their particular illness or condition; the efficacy, side effects, and risks of those drugs; the possible competitors and alternatives; and, finally, the price of the medication. Producers would have the same information, and Adam Smith's famous invisible hand would work to bring the market to an equilibrium of supply and demand. "Perfect competition" would occur when there are enough producers and consumers in the market that price is eventually set at the marginal cost of producing the medication.

Using those definitions, the pharmaceutical market, unsurprisingly, is not particularly well-functioning. The problem starts with the initial fixed costs of development even to get one drug to market, which means that sales at marginal cost are nowhere near large enough to recoup the initial investment. If all drugs were