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VIEWPOINT

In (Faint) Praise of Pharmaceutical Import Tariffs

James C. Robinson, PhD

President Trump has announced plans to impose import tariffs to raise revenues and encourage the reshoring of advanced manufacturing. A baseline of 10% would be applied to all imported products, and additional duties would be applied to products from selected nations and industries. The pharmaceutical sector has been called out for unwanted attention. The US imports \$200 billion in drugs from nations likely to be covered by the tariffs, and the tariffs are estimated to add \$46 billion to distribution costs.¹ The tariffs have been imposed, increased, reduced, reimposed, and then blocked by court order. But given that the president considers *tariffs* to be the “most beautiful word” in the English language, the centerpiece of his efforts to make America great again, they are sure to be back.

It is hard to find a policy tool less popular among economists than import tariffs. Tariffs raise input costs for domestic producers, dampen consumer demand, endanger military alliances, undermine global environmental policies, and invite retaliation.² These are all serious objections. Yet before joining the chorus of rejection, it is worth remembering that conventional economic wisdom has always opposed active industrial policy under the argument that the government cannot “pick winners,” even as the US lost one technologically advanced sector after another to nations whose governments did just that.

A cogent assessment of tariff policy is of particular importance for the pharmaceutical sector, given the almost complete US reliance on other nations for active pharmaceutical ingredients (APIs) and generic drugs and its vulnerability to specialty drug imports. Tariff policy needs to be assessed as a component of industrial policy and as an alternative to taxes on domestic products or a further increase in the federal budget deficit.

The Trump administration is neither positioning import tariffs within a coherent larger strategy nor committing to reinvest tariff revenues in the innovation ecosystem. Tariffs are not a first-best policy choice and arguably not the second-best. But in the real world in which #RealDonaldTrump confronts #RealChina, it may be the third-best choice and a component of a strategy to revitalize the US life sciences.

Why Is Drug Manufacturing Leaving?

State-of-the-art manufacturing does not move offshore in search of low-wage labor. Pharmaceutical firms require a highly skilled workforce to operate the delicate and expensive capital equipment that generates consistently high-quality medications. Drug manufacturing facilities are highly automated and do not use much labor of any kind.

A major reason lies in the industrial policies of nations that covet manufacturing facilities and have structured corporate tax regimes accordingly. China, in particular, combines investment tax credits; support for research institutes and universities; science, technol-

ogy, engineering, and mathematics (STEM) workforce training; subsidies for product development; credit guarantees for manufacturing facilities; public equity investments in entrepreneurial startups; export incentives for domestic champions; and, yes, import tariffs.³

Manufacturing is important for innovation, and its loss weakens the nation's innovation ecosystem. Advanced manufacturing generates the process innovations that improve productivity and quality and creates a positive feedback loop to the discovery and development of the next product generation.

How Would Tariffs Affect the 3 Pharmaceutical Subsectors?

When considering the effects of tariffs, it is useful to distinguish between the 3 principal industry segments: APIs, generic drugs, and branded specialty pharmaceuticals. These subindustries are distributed in different ways across the globe, contrast in their abilities to substitute domestic production for foreign production, and will make different choices between moving facilities to the US and paying tariff indemnities if they do not.

The prices of active pharmaceutical ingredients have been competed so low that only China and a few developing nations can produce them profitably, and even a large tariff penalty will not make US production economically feasible. A similar reasoning applies to generic drugs. Firms producing APIs and generic drugs will likely continue to manufacture offshore and import their products, now at higher tariff-adjusted prices, to the US.⁴ This will not support President Trump's goal of bringing manufacturing back to the US but will raise tax revenues. The burden of increased prices will fall most directly on public programs and private insurers that purchase drugs and, indirectly, on the individuals and households that pay taxes and insurance premiums. In the short term some portion may be borne by the non-US manufacturers and distributors, but these earn very thin margins and will pull back from the US market if unable to pass forward to US purchasers their increased tariff requirements.

Innovative specialty pharmaceuticals are a different creature altogether. The research-based life sciences, including pharmaceuticals, biologics, vaccines, medical devices, and diagnostics, are one of the technologically advanced sectors where the US retains its dominance. Traditional competitors in Europe and Japan have fallen behind in discovery and development but have retained extensive manufacturing capacity.⁵ Drug firms have been quick to react to the threatened tariffs on these drugs. Europe-based pharmaceutical giants such as Novartis and Roche have promised multi-year, multibillion-dollar investments in the US. Firms based in the US, such as Lilly, Merck, AbbVie, and Johnson & Johnson, have announced large new investments. Major capital projects are based on numerous factors, but the refocus to the US is due to in part to the fear of tariffs. These global firms have made no analogous commitments to new manufacturing investments in Europe. Of course,

there is a gap between announcement and action, and actual investments may fall short of what has been promised.

Tariffs and Innovation Policy

Tariffs are a tax on products manufactured in other nations and imported to the US. Their impact will depend on where the resulting tax revenues are spent. In principle, tariff revenues could be used to support the pharmaceutical innovation ecosystem. A domestic tax on generic drug sales has been proposed as a means of raising revenues to invest in follow-on research.⁶ As demonstrated during the COVID-19 pandemic, the repurposing of generic drugs from one indication to another is a cost-effective form of innovation but is stymied by the sector's low prices and margins.

Even if President Trump does not target pharmaceutical tariff revenues to the innovation ecosystem, it is not obvious that the behavioral distortions caused by tariffs would exceed those caused by taxes on domestic products, services, and incomes. Critics of

import tariffs rarely discuss which mix of domestic tax increases, spending cuts, and deficit spending they favor as the alternative. Import tariffs on pharmaceuticals are a bad idea, except when one considers the alternatives.

If imposed in a moderate and predictable manner, tariffs could function as one component of industrial policy to support the technologically advanced industries in global competition. A sensible strategy would expand tax credits for private research and development investments and subsidies for entrepreneurial startups. It would reduce regulatory barriers, streamline US Food and Drug Administration oversight capabilities, and expand STEM education and blue-collar workforce training.⁷ Unfortunately, the tariffs announced by the Trump administration are immoderate and unpredictable, but they will strengthen incentives to bring the most advanced drug manufacturing facilities back to the US. Innovation is important, and domestic manufacturing is important for domestic innovation.

ARTICLE INFORMATION

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