Drug price cuts won't kill industry
By Derrick Z. Jackson, Globe Columnist, 9/22/2000

Drug companies turn all talk of cutting prices into visions of an apocalypse. "Price controls have been tried numerous times over the past 4,000 years but have never worked," the Pharmaceutical Research and Manufacturers of America reports. "Instead, they produce shortages and black markets. Price controls on oil and natural gas in the 1970s led to widespread artificial shortages and long lines at the gasoline pump. Price controls on rental property led to housing shortages and the deterioration and neglect of existing housing."

"Price controls would discourage investment in drug research.... Unless there is a possibility of a return on that investment ... investors will probably put their money elsewhere."

Somebody fan the drug companies before they faint. There is no evidence that cutting costs of prescription drugs, one of the hottest topics of the presidential campaign, will bankrupt the world's most profitable industry. This is not the conclusion solely of liberal or left-leaning health policy advocates. It is also the conclusion of Wall Street.

Last summer, as members of Congress began railing against the drug companies for gouging senior citizens, Merrill Lynch published a report that should have extinguished the flaming rhetoric of the pharmaceutical industry.

"Volume increases could overwhelm negative pricing impact," the report said. "On a worst-case basis we believe the top-line impact could be negative 6 percent if all Medicare recipients had access to drugs at a 40 percent discount to the manufacturer's price."

"On a best-case scenario the sales impact could be slightly positive. It is our belief that when you either cut drug prices, provide a prescription benefit, or both, then volumes will go up with increased drug utilization."

The report, which assumed a drug price cut of 40 percent, similar to the 42 percent discount already available through the Veterans Administration, cited data from The New England Journal of Medicine and other sources to remind investors how volume goes up as more and more people can afford drugs. It noted how the volume of drug sales increased significantly in the early years of managed care, when people began getting prescription drugs with small copayments.

Last month a Merrill Lynch health care specialist, Jordan Schreiber, said he foresees "a resurgence next year" in drug stocks. "Even with drug price cuts, I think there's a good chance the pharmaceutical group will actually come out a net beneficiary as the presently uninsured become customers, albeit less profitable customers," Schreiber said.

"I could see pharmaceuticals maybe being somewhat subdued in the near term but picking up after the election."

Some analysts are not worried about drug stocks because they assume that a Republican-led Congress would block serious price cuts. But other analysts such as Len Yaffe of Banc of America Securities, Barry Hyman of Ehrenkrantz King Nussbaum, and Richard Evans of Sanford Bernstein agree that price cuts will be offset by sales to millions of new customers.
"With earnings expectations positive relative to the broader market and feasible prescription benefit policies likely to have a slightly positive effect on drug earnings, we recommend buying drug stocks on dips created by political rhetoric.... We would be buyers on these discounts," Evans said.

Mario Corso of ABN Amro, a Dutch bank, said, "I don't think pharmaceutical companies should be quaking in their boots." Ira Loss of Washington Analysis said, "If anyone fears Gore's attacks spell destruction for the pharmaceutical industry, those are misplaced fears." Corey Davis of Chase Hambrecht and Quist said, "Although it sounds pretty scary to Wall Street, even a worst-case scenario is really not that bad."

When Wall Street analysts say price cuts are manageable, the drug companies are only setting themselves aflame with their rhetoric. The Pharmaceutical Research and Manufacturers Association says, "Just about any economist will say price controls won't work." The association is not reading the business pages. Analysts say price controls work for everyone, including the drug companies.

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