

March 30, 2020

The Pharmaceutical Industry – Watch What You Listen For

Your blogger does not customarily spend much time watching Financial TV. He (and his wife) have a diversified portfolio, and they are in the market for the longer term. No “market timing” for them. In the last month or so, however, in part due to increased home time, and in part due to extraordinary changes in asset valuation, he has watched more, and paid more attention.

This morning (March 30) he was watching CNBC personality Jim Cramer talking about several pharmaceutical companies announcing that they are testing possible vaccines/treatments/cures related to the COVID-19 virus. Paraphrasing Cramer, “This must be the case” because “they are strong companies and they don’t have to say anything.” Really?

Although the pharmaceutical industry seeks and receives considerable patent protection for specific drugs, the companies are still competing for consumer, insurer, and investment dollars. There are always various drugs in various stages of development. If Company A announces that it is testing a COVID-19-related drug, then it is certainly in Company B’s interest to announce that it has something. While it would be foolish to announce development is NONE is going on, it is hard to believe that the big players have no drugs in their portfolio that could address COVID-19. Whether those drugs are at all efficacious is another story entirely ... but it doesn’t hurt to announce ... at least now.

Secondly, the pharmaceutical industry, and its analysts have argued that the costs of developing a drug are enormous, in part (to mix metaphors with the oil industry) because they must drill so many dry holes before hitting a “gusher”. Joseph A. DiMasi, director of economic analysis at Tufts Center for the Study of Drug Development has made a cottage industry over the years of estimating drug development costs. In a 2016 *Journal of Health Economics* study, DeMasi and colleagues argue that it cost \$2.6 billion per approved compound. The component parts are average out-of-pocket cost of \$1.4 billion and time costs (the expected returns that investors forego while a drug is in development) of \$1.2 billion. Your blogger and many health economist colleagues have raised eyebrows at these orders of magnitude, in part because the authors are beholden to the industry for the proprietary data that they use, and the results are almost impossible to replicate. However, whether the cost is \$2.6 billion or even one-quarter of that, they reflect the reality that it takes lots of time and considerable resources to develop new drugs.

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What are the takeaways? First, it is not surprising to see a lot of announcements – talk is cheap. Second, believe the experts who tell you that COVID-19 vaccines/treatments/cures are not months but years away, and believe it that they will be expensive.

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Reference

DiMasi Joseph A. ,Henry G.Grabowski, Ronald W.Hansen, "Innovation in the pharmaceutical industry: New estimates of R&D costs," *Journal of Health Economics* 47, May 2016, 20-33