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Health-Care Investment—The Hidden Crisis

When the stock market values companies that make cosmetics and beer far above pharmaceutical companies, you know that incentives are out of whack.

By **MICHAEL MILKEN**

Since 1820, world per-capita income has risen more than eightfold, thanks in part to the spread of democracy, open trading markets, and the rule of law. But a less-noted source of growth—improvements to health that have given us longer, more productive lives—has produced as much as half of the increase in the global economy over the past two centuries, as research by the late British economist Angus Maddison suggests. It would be logical to assume that companies whose products make us healthier would be among the most valued enterprises on the planet, but this assumption is wrong.

Consider companies that make consumer products—things like soft drinks, detergent, cosmetics and beer. While their price-earnings ratios will vary, in today's market their average will most likely be in the neighborhood of 20. But the average P/E of the largest American pharmaceutical research companies (Abbott Labs, Bristol-Myers Squibb, Johnson & Johnson, Eli Lilly, Merck and Pfizer) was recently near 10. Investors must have concluded that pretzels and eyeliner produce faster profit growth than prescription medicines.

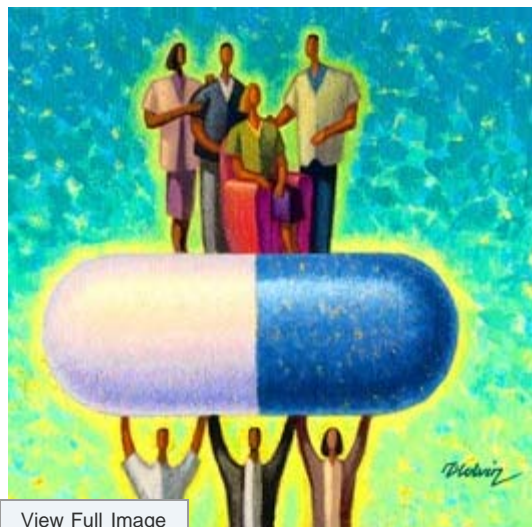
Lower pharma P/E ratios are a recent phenomenon. A generation ago, drug firms regularly topped magazine lists of the most-admired companies in America, a reputation usually reflected in their stock prices. But facing the specter of regulated returns, enterprise values dropped sharply during debates about proposed health-reform legislation in 1993. When the proposals failed in Congress, valuations eventually recovered. In the last decade, pharma P/E ratios dropped again.

Contributing to these lower valuations are patent expirations, regulatory complexity, uncertainty about litigation exposure, and high U.S. taxes on repatriated foreign income. These factors undoubtedly influenced the decision by Procter & Gamble to leave the pharmaceutical business entirely in 2009 and concentrate on consumer products.

Procter & Gamble responded rationally to clear market signals that discouraged development of life-saving drugs. But for people whose health, and perhaps survival, will depend on these medicines—that includes you and me—the implications of the disparity in market valuations are ominous.

We can remove some of the barriers to growth in medical research through several public-policy steps:

- *Match the inducements of other countries.* Many nations offer generous tax incentives, easier recruitment of clinical-trial subjects, strong government partnerships and far less litigation. We cannot and should not stop American biopharmaceutical and medical-device manufacturers from expanding overseas operations. But we can reduce needless bureaucracy at home, implement tort reform, and restructure taxation of foreign income.



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- *Recognize the return on investment in federal health research.* We clearly need spending restraint in Washington. But smart budgeting will factor in the economic gains that come from longer, healthier life spans and the savings from improved therapies. One 2006 study by Kevin Murphy and Robert Topel of the University of Chicago showed that life-expectancy gains since 1970 added \$3.2 trillion per year to America's national wealth. A mere 1% reduction in cancer deaths would be worth \$500 billion, they noted, and the present value to future generations of a full cure is a nearly incomprehensible \$50 trillion—more than three times today's GDP.

Congress doubled the budget of the National Institutes of Health (NIH) between 1998 and 2003. It was money well-spent, and we're now seeing exciting announcements from the nation's medical research centers, including 39 new cancer drugs that have been approved since 2004. In our view at the Milken Institute's FasterCures, the past year has produced the greatest progress against cancer since I first began working with the research community in the 1970s. Progress is accelerating on a range of other diseases as doctors gain traction by using rapidly evolving technology and by collaborating across disciplines.

But the prospects for continuing this discovery bonanza are threatened. NIH funding has trended down in real terms since 2003. Current budget realities portend severe future cuts that will cause some younger medical scientists to either change careers or take their work to places like Singapore that put out the welcome mat for promising researchers. Whether continuing breakthroughs emerge from U.S. laboratories or somewhere else will profoundly affect America's role among nations in the 21st century.

- *Support prevention.* There's great concern with rising health-care costs, yet too often we overlook that the single best way to contain them is to keep people from getting sick in the first place. That starts with recognizing that lifestyles, not genes, are the biggest contributors to disease. Public and corporate programs aimed at even slight reductions in obesity, tobacco use and other damaging behaviors pay large social and economic dividends.

- *Give the FDA adequate resources.* At a recent New York conference hosted by FasterCures, Food and Drug Administration Commissioner Margaret Hamburg told me that imports of products subject to FDA inspection have increased to 20 million from six million shipments in a decade. In fact, an estimated 25% of the U.S. economy is affected by FDA oversight. And the new food-safety legislation that Congress passed in December further expands the agency's responsibilities.

Given all this, the FDA soon won't be able to keep up with the pace of innovation in such areas as medical-device development and regenerative medicine—the use of stem cells to repair damage to tissues and organs. That will further slow the movement of effective drugs and devices from laboratory to patient.

As they seek to bring deficits under control, Republicans and Democrats will disagree on which investments in education and medical research make the most sense to secure our future. But they'd better start agreeing on

something soon. A 2009 study by the Information Technology and Innovation Foundation, "The Atlantic Century," benchmarked the U.S. against Europe on several measures of innovation and competitiveness. Although the U.S. currently ranks sixth out of 40 nations (down from first in previous studies), it's slipping and making the slowest progress toward what the report characterizes as a knowledge-driven, high-innovation economy.

Improved public health translates directly into greater national productivity, which underpins all economic growth. So let's get our priorities straight. America's economy used to be the sun—the gravitational center—in the "solar system" of leading nations. In the future, we'll no longer be the sun. But by investing in our own health, we can help solidify our position as Jupiter, the largest planet.

Mr. Milken is chairman of FasterCures, a Washington-based center of the Milken Institute.

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