EDITORIAL COMMENTARY

In Pharmaceutical Pricing, Scarcity Overrules Regulation

Pharmaceuticals are regulated because they can be dangerous, but one of the dangers is the impulse to regulate drug prices at the same time.

By THOMAS G. DONLAN
Oct. 31, 2015 12:44 a.m. ET

To confront the great problems in economics, we often think back to the 1950s and the works of great literature from the period. Let's turn now to Carl Barks, who illustrated the practical limits of pricing in two classic Uncle Scrooge comic books.

Scrooge McDuck, Donald Duck's uncle, is the richest duck in the world, and he is fully aware that scarcity is the mother of value. To prove this to Donald, he sets out to make an ordinary 1916 quarter from Donald's pocket into the rarest, most valuable coin in the world. He advertises incessantly for months, "Scrooge McDuck will pay double for 1916 quarters." Scrooge gets all the other quarters and dumps them into the ocean.

When Scrooge tries to sell his unique coin, a dealer tells him it's worth "10 skyrillion dollars," but the dealer can't afford to buy it himself. In fact, there's only one possible buyer: "an eccentric old jillionaire named Scrooge McDuck."

In another story, Scrooge visits Tralla La, an isolated place that's wonderfully peaceful until someone finds a bottle cap that McDuck threw away. The finder shows it to neighbors, who become envious. When they find out Scrooge has lots of bottles and bottle caps, they want them. First they beg, then they demand, then they steal, and finally they fight each other for the few available bottle caps.

After fleeing the crazed community, Scrooge teaches the inhabitants a further lesson about the price of scarce things. Returning to so-called civilization, he buys a billion bottle caps and hires an airplane to dump them into the Tralla La valley, crushing crops, choking rivers, and ruining the place. The inhabitants see that bottle caps are not worth much unless they are scarce. They clean up their valley, bury the bottle caps, and return to their nearly heavenly existence.

Prices and Values

Now we come to another odd duck, Martin Shkreli. He's the guy running just ahead of a mob of presidential candidates and other politicians, because he tried to charge too much for a drug called Daraprim. Too much, as in $750 per dose for a generic drug, unprotected by patent, which used to cost $13.50 per dose before he bought the only U.S. firm licensed by the Food and Drug Administration to manufacture and market the drug.

Price gouging on such a scale conducted by a person who seems to relish bad publicity made Shkreli the biggest unpleasant word on the Internet, and the bad words were only somewhat cleaned up for the Democratic debate and other political performances.

Condemning the threat of excessive profits, Hillary Clinton and Bernie Sanders have put pharmaceutical manufacturers on their enemies lists.

Clinton supports empowering the Medicare program to "negotiate" prices, including forcing rebates to the government for drugs purchased for low-income beneficiaries.

Perhaps the most dubious point in a long list was her proposal to regulate ads for prescription drugs that are aimed at consumers. Never mind the First Amendment, and never mind that competition usually is the best source of lower prices.

When government drives down prices, it drives down profits, investment, and the number of new products.

Disproportionate Concern

High prices for prescriptions have been worrying Americans for years, with peaks coming every four years as candidates advance unfounded solutions to a small problem.

A poll released last week by the Kaiser Family Foundation found that 77% of Americans surveyed considered high drug prices to be their primary health concern, and 63% said they would support government action to lower prescription-drug costs.

The respondents are missing a few facts:

• Retail prescription medicines account for only $300 billion of the nation's $3 trillion annual health-care bill.

• Prescription-drug charges are largely covered by private or government health insurance.

• Drugs are usually more effective and cheaper than alternative treatments—if there are alternative treatments at all.

We should celebrate the benefits from our drug industry. Most other rich countries do fix drug prices; the U.S. never has. In fact, the prime object of U.S. policy on drug prices is to restrict research and competition, which raises prices.

The FDA requires years of research and evaluation before approving drugs. The Tufts Center for the Study of Drug Development reported a year ago that developing a new prescription drug that gains marketing approval carries average direct out-of-corporate-pocket costs of $1.4 billion (including the cost of drugs that fail) and opportunity cost of $1.1 billion (including the time value of money invested for an average 10 years of development).

Manufactured Demand

As any McDuck knows, production costs are only half the story of prices.

The other part is the scarcity of drugs. FDA regulation restricts production and competition in generic drugs as well as those under patent. The agency controls entry into profitable generic businesses by licensing marketing and manufacturing. Shkreli's monopolistic pricing opportunity with Daraprim was created by the FDA, which takes an average of four years to approve a manufacturer.

Last week, however, another company announced its intention to sell a similar drug for $1 a dose. Imprimis Pharmaceuticals lives in what some politicians call a loophole in the FDA stature. It owns three compounding pharmacies, which produce custom medications for individuals according to their doctors' prescriptions. Compounding pharmacies are regulated by their home states' pharmacy boards, rather than by the FDA.

Compounding pharmacies that operate on commercial scale and do business in many states came under scrutiny in 2012 when one in Framingham, Mass., was the source of contaminated medications that caused fungal meningitis, killing more than 24 people in several states. The proposed remedy was more federal regulation, but nothing has come of it yet.

Danger in pharmaceuticals is the proper subject of regulation, but the result can mean that a high price must be paid.

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