



If a million people believe a foolish thing, it is still a foolish thing.

Anatole France

A short five years ago the health care industry was viewed as a desirable investment area. We were beyond “Hillary Care” and aging baby-boomers were expected to be big consumers of all things related to health. To supply the coming demand, drug company research and development expenses were growing faster than revenue. Corporate research efforts were paying off with new drugs passing an agreeable Food and Drug Administration in record time. Genomics and other new research techniques aided the development of new drugs. Hospital and medical services management was a promising growth area also. An aging population demands long term care whether from in-home care or from assisted living facilities.

About the only thing that happened is that the baby-boomers got older. In the last five years most of the big drug stocks and hospital stocks have gone nowhere if not down. Poor stock performance is just a symptom of a sick health care industry and I am not optimistic that it can be healed. The bad news just keeps on coming. Despite the Food and Drug Administration’s PR campaign that “fast tracking” of new drugs brings them to market sooner, it still takes years from discovery to approval of a new drug.

Health care is an interconnected system of doctors, hospitals, pharmaceuticals, insurance and, growing in importance, government intervention. The daily news is peppered with items about yet another Medicare “overhaul” and now we learn about the so-called “prescription drug benefit.” Any senior who pays less than \$670 a year for medicine will find that \$670 is now their minimum expense after the monthly premium and the deductible. (That’s about the annual cost of a cell phone.) Seniors covered by an employer’s health plan may find the employer dropping the coverage to let Medicare pick up the tab.

How did we get in this predicament in the first place? Good intentions. After World War II, employers offered a health care benefit to attract and retain employees. When the employee stopped paying for doctor visits, the employee lost interest in the cost of the visit. Same with medicine and hospitals. Today the cost of a visit to the doctor is still pretty reasonable. It is still reasonable because someone else picks up the tab. The bad news is that doctors are now paid so little by Medicare and some of the insurance companies that they allocate about seven minutes to each patient just to cover office overhead. That assumes that the patients can even get a doctor. It has been reported that 60% of Colorado’s doctors are not taking new Medicare patients. According to the American Academy of Family Physicians, seventeen percent of family doctors nationally are refusing to take new Medicare patients. One doctor in Kirkland, Washington reported that Medicare pays his medical group \$60 for an office visit. He calculates that he pays \$70 for office expenses and pays the attending doctor \$30 per patient. You don’t need to be an accountant to know that this can’t continue for very long.

Then we have nursing. Arizona’s growing population has created a true nursing shortage. Each nurse typically cares for five to ten patients but the ideal is four patients per nurse. Few hospitals are at four patients. That makes the job with its mandatory overtime so demanding and unrewarding that hospitals cannot keep nurses on the staff. Nursing schools are short of faculty because the pay is so low. Since 1995 the number of nursing school graduates has dropped 23%.

Hospitals are in crisis. Cochise County, Arizona has only one delivery room for 118,000 residents. A six doctor clinic in Bisbee decided they couldn’t afford the increased malpractice premiums and stopped delivering babies. This forced the closure of the Copper Queen Community Hospital’s delivery room. The closest hospital is in Sierra Vista, thirty miles away. Phoenix Memorial Hospital closed it’s maternity ward last year but plans to reopen at the beginning of 2004.

Malpractice insurance costs are being blamed by many doctors for their unwillingness to continue the practice of some high risk procedures. Malpractice insurance premiums can be as high as \$283,000 per year for a neurosurgeon in Chicago. This compares to \$36,000 per year average premium for a general surgeon. (Imagine getting up every day of the year \$100 in the hole before you get to the office.) In early May, thousands of Pennsylvania physicians went on strike, forcing patients into the emergency rooms. Doctors in Jacksonville, Florida closed their offices in protest on

May 3, also forcing patients into emergency rooms. Last July, most of the surgeons who worked for the University of Nevada Medical Center resigned because of the high costs of insurance and the lack of caps on jury awards. Trauma patients were flown by helicopter from Las Vegas to Phoenix and southern California for critical care. Only when the governor of Nevada ordered a liability limit on malpractice suits did the doctors return to work. Malpractice awards are so out of control in Mississippi that it is almost impossible to recruit new doctors to the state.

The insurance companies have given up, too. MIIX, New Jersey's largest medical malpractice insurer, has announced that it is quitting the business, leaving 9,000 of the state's doctors without insurance. The company reported that it lost \$200 million in fifteen months. MIIX joins three others that stopped doing business in New Jersey since 2001. In December, 2001 St. Paul Companies, the largest national insurer of physicians, left the business stranding untold thousands of physicians.

Pharmaceuticals are yet another problem. A drug is nothing more than a molecule that is invented and patented after an expensive research effort. When drugs go "off patent," the price crashes as new producers of the molecule take the market. The costs of research are sunk costs that need to be recovered which explains why prescriptions are so expensive. Because of the red tape involved in getting a drug approved, it can cost from \$250 million to \$800 million from idea to market. By the time a drug is approved, it will have gone through 60 clinical trials on almost 6000 test patients. If we assume that a pill costs \$1.00, which many people think is still too much, a company would have to sell hundreds of millions of pills to cover the research, the factory, marketing, and inevitable lawsuits.

It will come as no surprise that a majority of the new drug discoveries are made in the United States where we account for almost half of all the new drugs sold globally. In effect, our pharmaceutical industry provides research for the world. Why don't we hear of blockbuster drugs from France, Britain, New Zealand or Canada? They are all countries with national health care schemes and price controls. New Zealand's health guidelines state that cancer patients must see a specialist in twenty working days. The wait is eighteen weeks! In Canada, "universal" (socialized) coverage has placed Canada on a par with medical care available in Turkey, Hungary and Poland, according to Canada-based Fraser Institute. Want your hip replaced in a Turkish hospital? In Canada, you can wait as long as seven months for an MRI after the referral. I just had one and I waited four days here in Scottsdale. In France, by 2020 there will be one worker for every retiree. Why does anyone in or out of Congress envy foreign health care?

It should be obvious that I am not in favor of whatever prescription drug plan comes out of a too eager Congress. I own drug stocks and I wonder why. The first thing that will happen, and it has been on TV already, is that the big government buyer will "negotiate" lower drug prices for "all of us." Perhaps, but there is nothing in our free enterprise system that mandates research to find new cures for what ails us. And if found, drug companies are under no obligation to sell their treasure to anyone for any reason. Remember the clamor a few months ago for an instant SARS vaccine? Any company that came up with it would have it confiscated for the benefit of the public, not unlike the AIDS drugs that are being given away in Africa with the help of Nelson Mandela. Mr. Mandela wants access to HIV-fighting drugs "for all those that need it, wherever they may be in the world, regardless of whether they can afford it." Pharmaceutical companies are being pressured to give up their patent rights on AIDS drugs so poor countries can produce cheap generics. So much for property rights.

What we are forgetting in the rush for cheap health care is that there is nothing in our system requiring that a certain number of college graduates go on to medical school. For the life of me, I can't imagine why any talented youngster would stay in school a dozen years after college graduation so they could work for the government filling out Medicare forms, risking jail time for making a clerical error. Just as consumers of a product will react to price, the suppliers of a service will act on price. Doctors expect to be paid for all those years in school and you can't blame them. Can they be forced to see Medicare patients and not be paid? Article XIII of the Constitution prohibits slavery.

Our lives are being prolonged by the very processes and procedures that our citizens don't want to pay for. Even if a million people foolishly believe government can allocate scarce medical resources better than the free market, that doesn't make it any less foolish. Health care stocks may not be growth stocks after all.

Happy July 4!

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