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Silicon Valley is nation's costliest place to make medical devices

Premium content from Silicon Valley / San Jose Business Journal - by Lisa Sibley

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Silicon Valley has earned another recognition, and one the region might prefer not to have. It has been singled out as one of the most expensive places worldwide for manufacturing medical devices.

A study by Princeton, N.J.-based The Boyd Co. Inc. examined 55 locations in the U.S., Canada, Mexico and Latin America to compare costs of device manufacturing, and the San Jose/Palo Alto area tops the list. It had the highest overall costs in labor, power, land, taxes and shipping for an average 325-employee production plant.

The Bay Area has always been known as an expensive place to do business. But the study and experts suggest the region is losing manufacturing and jobs to more competitive parts of the world as more companies use comparative costs to determine site selections.

“The migration of corporate manufacturing isn’t new,” said **John Boyd**, president of The Boyd Co., which provides corporate location consulting services. He said it has been going on for the past decade, but it is a whole new ball game because of California’s shaky economy.

“It might accelerate the decentralization of the medical device industry from California,” Boyd said.

According to the report, it costs about $30.7 million to manufacture in San Jose/Palo Alto, compared to $22.6 million in Sioux Falls, S.D., or $17.8 million in Costa Rica — a popular destination for medical device and supply manufacturing.

The most expensive cost by far is for labor. Annual labor costs in the Silicon Valley region are $19 million compared to about $15 million for Sioux Falls and more than double that of Mexico, at $9 million.

In 2005, the medical devices, instruments and diagnostics sector in California employed 107,846 people. In 2009, that number was 107,447, representing a drop of 0.1 percent, according to a U.S. Bureau of Labor employment census.

Health care tax is double hit

The report states that corporate site selection challenges have been compounded by a component of 2010's health care reform bill that adds a 2.3 percent sales tax on medical device manufacturers. The regulations are expected to go into effect in 2013. The tax would generate $20 billion in annual revenue for the federal government.

"This new tax is like adding insult to injury," Boyd said. "What it may well do is cause a shift from high-cost areas like Silicon Valley to smaller, less costly, more manageable locations where (medical device companies) can assume this tax and still be profitable."

Another fear is whether contract manufacturers and subcontracters would also be taxed, and the possibility of double or triple taxation, Boyd said.

The Advanced Medical Technology Association, or AdvaMed, an industry trade group representing medical device manufacturers, has endorsed legislation to repeal the device tax. The association is based in Washington, D.C.

"The medical device excise tax is a serious burden for companies struggling to maintain America's global leadership in the development of medical technology," said AdvaMed Vice President, Policy Communications **Wanda Moebius**.

Varian Medical Systems Inc. CEO **Tim Guertin** said the tax will increase medical costs at a time when they should be reduced.

"It amounts to taxing medical devices in order to pay for medical care. It's a bad approach," he said.

The tax will give unfair advantage to those manufacturing offshore, he said. Components made offshore will only be taxed once, when the item is imported. Domestic component manufacturers will be double-taxed.

"The result will be that more off-shore vendors will enjoy a cost advantage," he said.

Varian's primary manufacturing is in Palo Alto, Las Vegas, Salt Lake City and Haan, Germany, with some additional manufacturing capacity in Beijing and in Crawley, United Kingdom. In most cases, the sites were acquired as part of business acquisitions and kept in place.

The company has been manufacturing in Palo Alto since the early 1950s, where it makes its large systems for treating cancer with radiotherapy and radiosurgery there. Guertin said the company is not looking to add any new manufacturing.

Even with all the challenges in the Bay Area — high operating costs, high cost of living, tough regulations and high tax rates — the strong talent is still paramount, he said.

Lisa Sibley can be reached at 408.299.1830 or lsibley@bizjournals.com.