It is implicit in my argument that prices are not "too high." I shall review briefly what seem to be the three most common reasons given by those who contend that they are: the size of profits, the contrast between some branded and unbranded drug prices, and inability of low-income groups with chronic illnesses to pay.

1. To call higher than average profits a proof of excessive prices overlooks the economic functions of profits, as I have already detailed. It forgets also that in a free market earnings tend to vary with risks. When privately financed R. & D. is several times that of other industries in relation to sales, and when drugs become obsolete so fast that over half the 1966 prescriptions were written for drugs not known in 1956, there is plainly a high built-in risk factor. Any search for the new is more hazardous than production of the old.

According to economic theory, a short to medium term higher-than-average profit is understandable; but entry of new capital will eventually bring it to a long term level which is commensurate with risk.

In this industry, capital has entered. Rising consumer demand, stimulated by the industry whenever it develops a new and effective drug, and the inherent risks of research which have prevented even more money from entering, are sustaining its earnings.

2. Prices of certain drugs of one manufacturer may be higher than those of another producer which are at least theoretically chemically equivalent. Prices could hardly be the same when one company must cover the costs, and be rewarded for taking risks, of research, testing, quality control, and original distribution, and when it makes all dosage forms available where and when needed; whereas the maker of the other drug may only manufacture, and then probably only the most profitable form.

Senator NELSON. On that exact point, that one company must cover the costs of research, testing, quality control, and original distribution. Maybe you can answer the question I asked earlier about Thorazine, where research was done by Rhone-Poulenc, a French firm, and they licensed Smith Kline & French in this country, and they licensed Bell-Craig in Canada. The firm in Canada sells it to the Government for $2.60 a thousand tablets. In the United States it is selling for $32.60 a thousand.

As an economist, can you give me an explanation for this dramatic difference? Can you explain why 15 times as much, almost, is charged here for a licensed product in which neither the company here nor the one in Canada did the research?

Dr. WHITNEY. Is that a fact, that Smith Kline & French did no research on this product?

Senator NELSON. We do not have any evidence of research other than the submissions for the New Drug Application.

Dr. WHITNEY. I happen to have read in the Kefauver hearings about the work they have done. Perhaps not the volume that Mr. Gordon has, but elsewhere.

Mr. CUTLER. I did have a chance at recess to check with one of the SFK people and what I said was a fact, that SFK did undertake a very large proportion of the research work necesary in proving Thorazine valuable in treating some forms of mental illness, and did undertake to obtain the right to manufacture them and in prosecuting their approval in this country.