

Economics begins with the truths that goods are not produced without work and progress does not occur without saving and constructive investment. To achieve these, experience since the end of feudalism, and recently even in Communist countries, points to the desire to better oneself and one's family as the most effective single motive. Reliance on self-interest also minimizes compulsion, conscription and penalties.

Although this incentive is clearly important to labor, people being eager to go wherever their wages or salaries (after considering other aspects of the job) will be highest, it is the application to capital that concerns us here. Self-interest tells people to invest where the outlook for profits (after taking account of risks) is best; and this in turn is normally where consumer demand is greatest. Adam Smith spoke of "an invisible hand" by which the search for profit leads to the general good, and also wisely said that we expect our dinners from the self-interest, not the benevolence, of butchers and bakers.¹ Our standard of living is proof that, on the whole, the process has worked. Countries which condemn the profit motive are glad to draw from us some of the surpluses which this motivation produces.

How does this apply to the questions before the Subcommittee? Quite simply, drugs are too important to the public welfare for us to withdraw or dampen the incentives which have created and multiplied all our goods. Any university teacher of economics denying the contribution of profit in attracting capital—and this might happen, since a reputation for originality is prized in my profession—I hope you will ask two questions: First, is he indeed deliberately rejecting the central principles of the science as it is now known? and second, what alternative system does he recommend for inducing owners of capital to put it where consumers want it, and why would this alternative work better?

Several persons interested in the present inquiry concerning the pharmaceutical industry have granted that this industry should be allowed a normal or average profit. But such a profit will not attract investment where it is most needed. Nor will it achieve the second function of profits—stimulating cost reduction and efficiency. These essential jobs are done by differences, not uniformity, in earnings.

How has this worked in practice? From 1950, when analyses of the drug industry were first reported separately in a leading financial publication through 1965 the rate of return on net worth for "all manufacturing" averaged 65 percent of that for "drugs and medicines."² As a result, \$3 of additional stockholders' money per dollar of net worth in 1950 went into drug manufacturing for every \$1 into all manufacturing, and about 25 cents into meat packing, the least profitable major manufacturing industry reported. Comparing drugs with meat packing, 3½ times the rate of earnings brought 11 or 12 times the rate of investment.³ The free market process—consumer demand, profits, attraction of capital—has worked in drugs, brilliantly.

¹ "By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention." *The Wealth of Nations*, Modern Library ed., p. 423. "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest." *Ibid.*, p. 14.

² These are based on arithmetic averages of the annual rates of return given in the First National City Bank of New York, Monthly Economic Letter, April issues (even-numbered years being used, since each issue covers two years). For 1966 (not included because the latest net worth figure is for January 1, 1966) the return for all manufacturing was 67.1 percent of that for drugs. The rate of return of "all manufacturing corporations, except newspapers" in 1966 was 61 percent of that of "drugs" in the Federal Trade Commission/Securities and Exchange Commission *Quarterly Financial Report for Manufacturing Corporations*. This source was not used for two reasons: it did not separate drugs prior to the 2d quarter of 1956; and it includes along with the larger drug companies many smaller ones which do little or no research.

³ From January 1, 1950, to January 1, 1966, net worth of the drug companies included in the First National City Bank list increased by 640 percent; that of all manufacturing by 208 percent; and that of meat packing by 56 percent. Part of the increase was through companies growing large enough to publish reports and be included for the first time: drug companies increased from 19 to 39, the total of manufacturing companies from 1763 to 2279, and meat packers from 19 to 27. The additional companies are usually smaller—thus the April 1962 Monthly Economic Letter added 7 drug companies whose average net worth for January 1, 1960, was only \$15.5 million as compared with \$57.5 million for the 29 companies previously included. The expansion of small firms to the point where they issue public reports, the entry of new firms, capital expansion through issue of securities, and reinvestment of earnings are all aspects of the inflow of capital. Reinvestment is the principal source. Without the profits of the drug industry there would have been no money to reinvest in expansion; had its profit outlook not continued good, earnings would probably have been used for diversification away from drugs.