B. Market performance

The other side of performance is what we have called market performance. Though it is related in varying degrees and manner to product performance, such a distinction is a useful one for this study. Market performance concerns primarily the efficiency with which the industry uses the economic resources available to it in the development, production, and marketing of its output, and the relationship between prices charged and costs incurred in making goods available to consumers. The criteria of good market performance are quite traditional in economic analysis:—that (1) the costs incurred by sellers be closely related to activities from which consumers derive benefit, be they expenditures needed to develop new and better products, direct and indirect cost of manufacture, or marketing outlays that lead to better product selection or expansions in demand that justify larger-scale, but lower-cost methods of production; and that (2) the prices consumers pay bear a reasonable relation to these costs; that is, prices provide profit margins that are sufficient to reward enterprising firms for activities that serve consumers, but not so large as to represent gains from behavior not in the consumers' or society's interest.

These criteria are now used to evaluate the drug industry's performance. First, in regard to the cost elements it has been indicated above that research and development and selling outlays are large, although quite unequal. Further, criticism that the research outlay is, at least in part, wasteful has been noted. While the extent of such waste from misdirection of outlay may not be closely determinable, there appears to be logical support for the contention that the goal of obtaining patentable specialties may conflict with that of achieving maximum therapeutic gain from research effort, particularly since the commercial rewards for "new" products are sizeable. Protection of an oligopolistic position by imposing patent barriers around existing key products and processes also seems to influence the direction of research effort to some extent. Again, the question as to frequency and extent of wasteful research effort is incapable of precise answer; yet the large financial rewards awaiting new products, coupled with the large promotional outlays preceding, accompanying, and following their appearance, means that significant therapeutic progress need not be a necessary condition for large profitability.

Second, as noted above, selling expenses in the industry are about four times as large a cost factor as is R & D. The promotion part of selling and the advertising element are roughly equal and each is twice the R & D component. Promotion and advertising, both of which may be important marketing functions, nonetheless include very costly outlays for activities that may provide the consumer no benefit, directly or indirectly, or may actually do him a disservice. There is considerable opinion that promotional excesses are closely related to the appearance of new products that are of limited merit but which might become profitable through large-scale promotions.

The costs of promotion are, perhaps to a large extent, necessary under present institutional arrangements. Physicians have, for reasons already noted, become dependent on drug firms for their information on new products. Thus much promotional effort, particularly that providing information on new and old products, on the incidence and nature of side effects, and on other technical matters, is necessary. But advertising, whose function is to popularize and remind physicians of trade-named specialties, serves merely to raise the costs that ultimately become part of prices while not improving the drug selection process. Also, the quality of information conveyed has been questioned, largely by the physicians at whom it is directed. Incomplete information, excessive claims, and non-reporting of side-effects are frequent among their criticisms. Thus, advertising may even be detrimental to sound drug therapy.

That there is excessive, wasteful, and mis-directed expenditure for research and promotion in the industry, and that such waste is of sizeable proportions has been reported numerous times in the hearings involving the industry. Prices conditioned in large part by these costs are, therefore, necessarily higher than they otherwise would be.

Drug prices are uneconomically high for another reason. They provide drug firms with profits that are consistently well above those of most other industries. There is little justification of the profit levels that prevail. With rapid turnover of products and successful research results uncertain, the industry has been described as one of high risk, in which fortunate firms can be expected to earn