but not by so much as to prevent licensing from being an effective check against exorbitantly high bulk prices. Patentees would earn sufficient profits by charging high bulk prices or imposing the most favorable royalty rates permitted. But the cost of bulk ingredients is only a small fraction in total cost of production, and high bulk costs or royalties would be more than offset by the economies in resource use and by the smaller profit and selling elements in drug prices that price competition would bring about.

Either of these proposals would lead to lower prices for consumers while maintaining the profit incentive for drug discovery and development. Of the two, perhaps the first is more feasible politically, but that is another consideration, for examination at another time.

Senator NELSON. I want to thank you very much for a most thoughtful and valuable contribution to these hearings.

We appreciate this very much.

Do you have any questions, Mr. Gordon?

Mr. GORDON. I have just one.

The drug industry very frequently states that high profits are necessary to finance its large research expenditures.

What do you think of that argument?

Dr. SCHIFRIN. Well, I think it is entirely fallacious, deliberately so. Profits, of course, are the residual between revenues and costs. Thus you have profits only when all your costs are met. Research is part of your cost. Thus, the high profit exists after the research outlay has already been accounted for.

A twist of this is to say tht high profits are necessary to finance future research. But, of course, in future prices, there is an element that covers the research going on. To justify a high price because it is necessary for future research is in fact to charge the consumer twice for the research. He is paying for the present research and future research. The future consumer will also pay for present and future research, and on and on.

It is an argument that does not justify the consumer paying double in the cost.

Mr. GROSSMAN. We talked about proliferation of products before.

You stated—that at least that brought in competition. But I think the point you discused with Senator Nelson before was very important and I wonder if your solutions really cover it. That is the failure of the small firms really to be able to compete due to the promotional problem.

Dr. SCHIFRIN. Sir, do you want me to comment on how my proposals——

Mr. GROSSMAN. Yes; can we ever meet this?

Dr. SCHIFRIN. Yes. You see what keeps the small firm from being effective in the market now are two barriers. The patent may keep him out of the market. If there is no patent barrier, the emphasis on trade names keeps him out because he can't promote his trade name. As I say, compulsory licensing is necessary, but not sufficient. They cannot be an effective competitor as long as prescribing is done by trade names. Thus I think trade names have no basis for existence.

If brand names are used, they will clarify the matter as to generic equivalency. Once that is established, the small firm with a generic product will have a better chance of getting its items selected, certainly once its low prices become recognized.