This argument is faulty in several respects:

First, drug prices are not related to drug costs, but instead to demand and ability to pay.

Second, while drug quality obviously depends upon care exercised in manufacture, the cost of quality control has been shown to be a very small part of the total costs, and the difference in cost between a minimal satisfactory program and a deluxe program would not begin to account for the difference in prices between the generic drug and its brand name equivalent.

But to return to the question: What can an economist contribute to drug law reform hearings?

If the data were made available, he could analyze cost-price conditions within the individual drug firms, and the pattern of interfirm price and product competition, and arrive at an informed judgment regarding the status of competition in the industry. But such data have not been made available, even to economists retained to defend the industry.[1]

In view of the absence of the data in the analysis of which the economist has a comparative advantage, what constructive role can he play? Primarily that of coordinating and synthesizing the economic aspects of the data which is in the record, and evaluating the economic relevance or credibility of certain of the arguments advanced by the drug interests.

It is noteworthy that drug spokesmen produce arguments in their defense which either stress or ignore similarities or differences between drugs and other industries to suit their convenience. Thus, in the PMA studies presented last month, one study treated the drug industry just like any other industry in relating the variance of the earnings of member firms in an industry (rather arbitrarily called "riskiness") to the average rate of earnings in that industry, while the other analyzed product competition in drugs in a vacuum as it were, without introducing comparative data from any other industry. But both the similarities and the differences of the drug industry should be analyzed and allowed for before making any comparative study of drug prices, costs, and profits in relation to those of other industries.

---

[1] As Professor Markham stated before this Subcommittee on December 19, 1967, in response to just such a question, "you are just not going to get those data, and I do not think—I would be less than honest if I said I would try to get them, implying that I could get them for you." (Transcript, volume 23, p. 2805.) Markham apparently referred not only to the confidential status given the information, but also questioned whether or not drug firms bothered to make all the cost allocations involved. Although it is to be admitted that many of the calculations can be made only on the basis of arbitrary assumptions, one would expect that well-managed firms would find it prudent to undertake such analyses for their own information. In fact, Dr. M. A. Phillips, in his Sainsbury Committee memorandum to the British Ministry of Health stated that the drug industry was no different from other organic chemicals industries in observing the customary precautions of making detailed cost studies prior to engaging in producing projects. These studies include the costs of research and development and of promotion. Dr. Phillips' statement is unusually authoritative in that he is a drug industry conslutant who has made many economic evaluation studies for drug firms. Phillips complains that "It has been found very difficult to obtain figures for the cost of research and development and of promotion and advertising, although this must be known to those who have to spend this money in these ways . . ." and explains that even with the approximations his organization has to use in estimating these costs, he is satisfied that the accuracy of the estimates for these items is within 25 percent. *See Competitive Problems in the Drug Industry,* Part I, pp. 54–55, of the *Hearings* before this Subcommittee on the present matter. (It might be observed that only if there is a very large gap between cash flow and expenditures is a company actually likely to indulge in some carelessness or negligence in the relating of total costs to individual items sold.)