

But if the drug industry is permitted to retain its present special position of institutionalized protection in the economy, it will continue to display elements of both monopoly and rivalry. Spokesmen for the industry habitually refer to the intense degree of competition among firms. Unfortunately, however, the "competition" referred to is of the type which raises costs instead of reducing prices. This category of activity is generally referred to by economists as "rivalry" rather than "competition" since the latter term is usually reserved for the economically beneficial activity specifically of *price* competition. Obviously, the industry which is subject to intense price competition at all times is the exception rather than the rule in today's economy. Nevertheless, the perennial threat, and occasional outbreak, of price competition does much to keep the price policies of the typical industry on the side of moderation. My research and consulting experience in the field of industrial organization during the last ten or twelve years has been such as to convince me that the great majority of product markets in the United States are more or less workably competitive, but the special legal and marketing arrangements which the drug industry enjoys are such as to make it virtually a foreign body in an otherwise workable competitive economy.

As I have elsewhere stated, the market characteristics of the drug industry bias it in the direction of inefficient and non-competitive performance in five major respects.⁵

(1) Essential to the effective operation of a free market is the ability of the buyer to choose among suppliers on the basis of an adequate knowledge of the price and quality of the alternative products which they may provide him. But in ethical drugs, the buyer has no practical means of gaining access to knowledge of the range of price and quality alternatives in the market; indeed, his purchasing agent, the prescribing physician, is constantly oversupplied with biased information and even misinformation which facilitates confusion and ignorance of prices.

(2) The price-conscious buyer should be able to identify the lowest-priced seller and purchase from him without artificial impediments. Instead, the possessor of a newly-written prescription is unable to buy any but the specified drug, regardless of price. The willingness of the price-conscious physician to prescribe lower-priced drugs may be compromised if he has been exposed to repeated attempts to disparage low priced drugs on the part of representatives of brand name drugs who contend that low price means low quality. And even if a generic prescription is written, the buyer has no power to compel the dispenser to sell him a reasonably priced generic drug instead of substituting a less reasonably priced brand name equivalent.

(3) There must be freedom of entry into the industry by new firms, such that high profits being made by existing firms will attract new competitors who will, by engaging in price competition, drive profits down to competitive levels. But freedom of entry in drugs is greatly lessened by the existence of the patent privilege, the trademark device, and the necessity for newcomers to match the enormous advertising outlays of existing rivals.

(4) There should be an adequately large number of competitive sellers offering buyers genuine alternatives in terms of product price and quality; none of the sellers should be so large that he overshadows the magnitude of his competitors and poses a potential threat should they incur his displeasure. In drugs, restricted entry limits the number of sellers, and while there are few if any genuine product monopolies, the size of the major firms is certainly appreciably greater than that of their smaller generic-name competitors.

(5) A market is not workably competitive unless all firms act independently—there must be no overt or tacit collusion, no passive acquiescence in prior decisions arrived at by others and established by mutual consent . . . (in the drug industry there are) two circumstances which act to hamper independence of action. First, there is the practice of price leadership and the pricing of new medications at exactly the same levels charged for existing substitute drugs. Second, there is the fertile field of patents. While an individual patent confers a monopoly, the scope of the monopoly privilege is limited. But in an industry with complex technology, the efficient production of a drug may require the use of processes controlled by rival patent-holders. The negotiation of the resulting

⁵ Submission of the Government of the Province of Alberta to the Special Committee on Drug Costs, and Prices of the Canadian House of Commons, Minutes of Proceedings and Evidence, No. 33, pp. 2427-2429, Feb. 14, 1967.