rate regulation scheme. Not only would the former assure HEW of low reimbursement costs, it would assure that all consumers would benefit, including those not covered by Medicaid. Indeed, the FTC is actively considering such pro-competitive measures, including ways to enhance retail competition through increased price disclosure. If HEW and the FTC can work together to increase price competition, not only will this decrease federal insurance payouts but will aid all consumers. Avoiding the regulatory process means avoiding its inevitable mistakes and rigidities, as well as its implementation expenses.

Even though the regulatory concept is a second-best solution, the MAC proposal has considerable merit as a temporary measure and staff does support HEW's attempt to promulgate it. Of course, FTC staff have no basis on which to conclude that the present proposal is the best of all regulatory schemes, since staff have not had the opportunity to consider alternatives. Nevertheless, staff is enthusiastic about the proposed price information book for physicians and the maximum allowable cost provisions on multi-source drugs; staff also finds the actual acquisition cost provisions acceptable.

However, serious problems abound with respect to determining the reimbursable dispensing cost. Indeed, any attempt to define a dispensing fee in terms of "operating costs", as is proposed by HEW, would be extremely difficult. No good way exists to accurately measure such costs or a "fair" return on capital, and any empirically based measure of costs will reflect non-competitive inefficiencies and may mean that firms with unnecessarily high costs are protected. The easiest solution to these virtually unresolvable problems is to let the dispensing fee element of reimbursement be market-determined, despite the fact that it may for a short time include some non-competitive padding, hence causing HEW to forego some potential short-term savings. However, if, as is suggested here, HEW reimburses pharmacists for the actual acquisition cost plus their "usual and customary" dispensing fee (i.e. the difference between their usual and customary price and their actual acquisition cost), and if competitive forces in the market are strengthened by the FTC and by other measures, then the competitively determined dispensing fee will fall through time, and HEW will realize savings. In other words, the existence of future savings with respect to the dispensing fee element of the reimbursed price will be based on the success of various procompetitive efforts. With the effectiveness of such efforts, the need for the regulations will dissolve naturally over time and HEW can come to rely more and more on the market-determined price as the basis for the total reimbursement. Thus the regulatory scheme could die a natural death if competitive market forces become strong enough to restrain prices appropriately.

Staff's independent analyses of the potential benefits from programs designed to stimulate competition suggest that action is indeed warranted. Both agencies have basically similar ends that may be achieved by complementary means. Staff encourages HEW to implement the MAC plan as a temporary measure, with the modifications suggested herein. HEW should remain cognizant of the fact that the FTC is working independently to foster beneficial free and open competition in this market. In this regard, cooperation between the FTC and HEW should exist where pertinent and possible in furthering all such work.

II. COMPETITION VERSUS RATE REGULATION ALTERNATIVES

If sufficient competition at both the manufacturing and retailing levels exists, then the prices established by the market would in fact represent the lowest possible price. In the prescription drug market, these are the prices that would be paid by non-insured consumers. Each firm will lower its price, in order to take business away from competitors, until it is constrained by its costs from dropping price further. Any excess profit due to monopoly power will thus be squeezed out and high prices reduced accordingly. Also, firms which set prices high because of unnecessarily high costs will be driven by competition either to reduce their costs or to exit from the market; competition leads to the discipline of efficiency. If sufficient competition existed and thus prevailing prices were reliable measures of the lowest possible price, HEW could confidently reimburse pharmacists on the basis of their usual and customary charges, and avoid the complexities, costs and pitfalls of any scheme which tries to stimulate the results of competition. Of course, it is not clear at either the manufacturing or the retailing level that sufficient competition exists to warrant the prevailing prices to be accepted as reliable measures of the lowest prices possible.

The best policy is to work to generate competition, which would not only insure that reimbursements would be at the lowest possible level but would also