



Country or Region: Russia

Russian Healthcare Reform creates opportunities for U.S. Healthcare Equipment

Ludmila Maksimova
February 2007
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Summary

On January 1, 2006, the Russian government launched a number of reforms to address critical problems in their health care system. The reforms started with an implementation of the Federal Drug Reimbursement Program known as Additional Drug Supply Program (DLO) for select categories of the population. President Putin has proclaimed health care reform as one of four national priority projects, which represented significant increases in public spending (along with projects focused on education, agriculture and housing). These reforms together represent an important breakthrough in the development of the health care system and offer longer-term opportunities for advanced U.S. drugs, medical equipment and services. While this report is focused broadly on the effects of the reforms, it pays special attention to the positive impact the reforms are having on the Russian market for U.S. medical equipment and supplies.

Overview of the Healthcare System

Until 2005, health care occupied a relatively low position among the government's priorities. The promise of free health care for all citizens that was stipulated in article 41 of Russia's Constitution was in name only. Generally, health care system was inefficient and very expensive, precluding investment into its modernization and development. Even today, total health care spending in Russia at all levels, according to different estimates, is now only about 4 percent of the GDP in comparison to 9-11 percent in developed countries. The World Health Organization said that in 2003, the state spent \$167 on health care for every Russian citizen. The United States spent \$5,711 per capita; Germany, \$3,204; and France, \$2,981. The average Russian citizen's out-of-pocket expenses for pharmaceuticals, medical devices and services are equally low: from 9 to 12 times lower than in Western countries. Recently published statistics show that insufficient health care funding in the country has led to high mortality rates and low average life expectancy: 59.1 years for men and 72.5 for women. The country's population has been sliding by 700,000 annually in the past decade: from 150 million in the early nineties to about 142 million today. Russian men live 15-19 years less than men in leading European countries, USA and Japan. For Russian women the difference is 7-13 years. Forty years ago, the difference was only 2-3 years.

It is currently estimated that only one fifth of the Russian population of 142.4 million has access to quality health care. This is especially problematic since Russia's health care network is already enormous, including 9,663 inpatient hospitals, 16,615 outpatient polyclinics, and 3,252 emergency stations. Further, Russia has 608,588 doctors and 1,388,349 paramedics. The majority of hospitals and polyclinics are public and belong to federal, regional or local governments. There is also a number of so-called agency health care establishments to serve specific large governmental entities such as the Ministry of Transportation, Ministry of Economic Development and Trade, Ministry of Defense, etc.

Though Russia does possess significant numbers of highly qualified doctors and health care professionals, medical equipment in the majority of clinics and hospitals is archaic and hygienic conditions do not even meet domestic standards, let alone established Western practices. Other chronic problems of the Russian health care system include undeveloped health care infrastructure, low wages and inadequate training for physicians and paramedics, especially in the primary-care segment, lack of attention to preventive care and resulting unnecessary shift to hospital-based care.

The country lacks clear-cut standards of medical assistance to citizens, which is guaranteed and paid for by the state. Mandatory medical care insurance and public programs can only support a small portion of medical services as well as related drugs and medical supplies. In reality, only a very limited number of

medical procedures and operations are provided free of charge. Usually patients have to pay for medical devices used during surgeries and operations themselves officially, based on prices set up by each hospital. Patients continue the practice of paying for formally free surgeries and procedures unofficially, with the proceeds going directly to the doctors. Moreover, the majority of medicines and supplies necessary for in-patient treatment have to be paid for by patients out of their pockets. As for high-tech treatments, only a small percentage of the population gets them for free. Long lines for free high-end operations and procedures preclude patients from having them in a timely manner and diminish their effects for patients. Therefore, those who can afford such operations pay for them to speed up the process.

It has become obvious that the imbalances in the health care system are very deep rooted; the current system of mandatory medical insurance has failed to raise health care standards. State guarantees for free medical health care for citizens is now little more than rhetoric; and that unless significant efforts were undertaken to expedite reforms, mortality rates would increase while life expectancy would continue to diminish.

Health Care Funding, Reimbursement and Medical Insurance

At the moment, the two major sources of public health care funding - mandatory medical insurance funds (30 percent) and spending supported by federal and regional budgets (70 percent) do not cover all healthcare expenses. As a result, one-fifth of overall (public and private) health care spending is covered out of patients' pockets. Voluntary health care insurance programs account for approximately one third of the total private health care expenditures. According to long-term reform plans, the country will move to a one-source funding model when mandatory medical insurance funds will serve as the only source of public health care funding, providing transparency and control over cash flow within the system.

At the moment the medical insurance market in general is underdeveloped. There are a few private insurance companies that have access to servicing public mandatory medical insurance funds, such as Maks-M, Rosno, Spasskiye Vorota, and Gasprommedstrakh. However this market segment cannot be characterized as open. The level of competition is restricted due to the lack of appropriate funds and regulations, high level of centralization and corruption. Most of private insurance companies predominantly work with private money through voluntary medical insurance programs. The basic principals of insurance-based health care system – the healthy pays for the sick and a patient has a right to choose a health care provider – are practically not working.

Implementation of DLO Program has been a first step to establishing a healthcare insurance system covering purchases of drugs and providing access to quality medicines. DLO is only accessible for various groups of disabled (pensioners and children with disabilities, disabled soldiers, invalids from trauma at work, etc.). The participants of DLO received a right to choose between getting 450 rubles in monetary compensation or giving it up and becoming part of the DLO program and thus getting access to free drugs which they needed. In fact, the cost of drugs (which a significant portion of invalids get for free under DLO) significantly exceeds the 450 rubles. There are about 14 million invalids and other categories of population on the federal level that are eligible for participation in DLO, yet only about half of them participated in the program in 2005. There are also about 35 million disabled people who receive subsidies for drugs from local budgets. Due to the DLO Program about \$1.4 billion of federal budget money was pumped into the country's pharmaceutical market (planned allocations for the Program were \$1.8 billion). The government intended to spend an additional \$ 1.1 billion on DLO in 2006 and \$1.5 in 2007.

Despite all positive effects of DLO program on the size of the Russian pharmaceutical market (in 2006 it increased by 35 percent mostly as a result of DLO), it only covers a portion of population and pertains primarily to drug supply. However the issue of provision of medical devices and services to population is untouched by this system and urgently needs reforming. According to Nelli Naigovzina, Deputy Head of

the Expert Department of the Administration of the President and member of the Presidential Multi-Agency Task Force on the National Priority Project "Health", the mandatory health care insurance system from its very creation in early 1990s had some fundamental flaws. The major drawbacks are as follows. The unified social tax, which is the main source of financing of the mandatory health care insurance, is too low to meet the demands and scale of the system. Another major obstacle is lack of clear-cut standards for medical assistance guaranteed by the state. In other words, there is no unified description of basic package of medical services, which are provided by the government free of charge to each citizen. According Ms. Naigovzina, the main goal is to develop detailed and concrete standards for medical assistance guaranteed by the state. At the moment it is very difficult to tell what the government guarantees in terms of medical assistance are. Ordinary people have little guidance and do not understand for what type of assistance they should pay and to what extent their participation in sharing costs should be.

Business community and specifically insurance companies and private clinics offer their view on the reform in health care insurance. One of such proposals is as follows. The government together with the doctors' community and the public develops a basic package of medical services guaranteed by the state for every citizen. The cost of the basic package is the same for everybody. This basic package is financed through health care social tax on income of the working population. For low-income citizens, children and non-working pensioners the basic health package is financed out of the state budget funds. All the collections are channeled to one insurance fund and from there transferred to public and private insurance companies. Under such a system, the insurance companies become a real driving force of the health care system. They control the transfer of health care funds within the system, are responsible for selecting clinics and hospitals of different specialization, which are able to provide a wide range of services to patients. Thus, the basic principal of the system is that a patient has a right to choose a medical service provider and insurance company at his/her discretion.

The new system is supposed to encourage competition among insurance companies in order to attract the maximum number of patients, it will stimulate them to work with the clinics and hospitals which provide the best service. They will further strictly control the doctors and invest their own funds in improving the clinics and hospitals they work with. Insurance companies will also be able to provide additional services to patients at a fee, which the patients will bear themselves or with support of their employers. As a result, voluntary insurance costs can be significantly reduced.

Despite significant attractiveness of the above proposals, international practices show that health care insurance systems based on dominant control of insurance companies over the entire process lead to many flaws and imbalances, economical factors start to outweigh effective medical treatment goals. Insurance companies in many cases are interested in offering less expensive treatments, technologies and drugs, which may be detrimental to patients. However it is not the only and the most important obstacle. Many best ideas in Russia are implemented differently from those in the Western countries because of the Soviet times inertia and mentality as well as red tape. One more important factor is the structure of economy characterized as state capitalism, the current high level of centralization and corruption. There is a threat that a small group of insurance companies having strong connection to the government will do their best to eliminate competition in the industry leading to mediocre or low service and uncontrolled growth of health care costs to the population.

Private Health Care Services

Strong demand for private health care services has led to a significant growth in the number and size of private clinics as well as the volume of paid medical services. This trend started back in the beginning of 1990s. The total volume of paid medical services is currently estimated at \$6.5 billion, which accounts for one-fifth of the overall financial resources spent on health care in the country. The paid medical services market is growing by 20-30 percent every year. The paid medical services market includes three major parts: so called pure commercial medical services, medical services covered by voluntary health insurance programs and so called shadow market.

Most of the purely commercial health services are represented by private dental clinics. Other private health care establishments specialize in such areas as ophthalmology, cosmetology, urology, gynecology, and physiotherapy. The current specialization breakdown is due to such clinics not requiring enormous investment (normally from \$100 thousand to \$500 thousand), or large premises with overly expensive equipment. The secondary factor is the demand for such specialties from the population. Treatment of socially important diseases such as cardio-vascular, for example, and transplantology of organs cannot be treated without significant government subsidies and strict control. Since expenses necessary to establish a sound private multi-profile clinic are high (they include high cost of advanced medical equipment, rents, decent wages for doctors), serious investors are slow to invest into such private clinics. The profitability rates are still low, ranging from 10 to 20 percent. It will take some 8-10 years and significant improvement in the management before such investment start to flow.

There are only a few large multi-profile private clinics in the country. Moscow has only three such clinics: AO Meditsina, Center for End surgery and Lithography and Family Doctor Clinic. Small and medium-size specialized private clinics are located not only in Moscow and St. Petersburg. They are spread all over key Russian regions, including Volga region, Urals, Siberia and Far East. Private clinics are completely self-financed, they do not get any access to budget funds which are used by state clinics to pay for equipment, communal services, rents, wages, etc.

Most of the owners of such clinics believe the system is still flawed since private clinics do not have access to any of the budget or voluntary health care insurance funds. They hold that both the quality of health care and the accessibility to modern treatments would much improve if private clinics were part of the voluntary medical insurance system. Patients could use voluntary medical insurance policies to cover part of their expenses in private clinics and pay for the rest out of their personal funds. Currently private clinics do not have access to mandatory state health care insurance programs. Moreover, Regional Health Care Committees (regional health care authorities) are impeding their participation in such programs fearing that unprofitable territorial clinics and hospitals operating under their auspices will lose competition and eventually leave the market. The so-called state funded maternity certificates, which women could use to pay for obstetrics expenses are only valid in public clinics. Private clinics are not reimbursed for such services. Currently proclaimed right of a patient to choose a clinic will remain nothing but a declaration until private clinics have equal access to mandatory insurance funds.

The most dynamic, high technology and transparent segment of the paid medical services market are services covered by voluntary insurance policies. The voluntary medical insurance market has been growing by 25-30 percent annually in the last five years. Its share in the total volume of paid medical services, including the shadow market, is estimated at 20-30 percent. The overwhelming majority participants of the voluntary health care insurance system are represented by corporate clients. The share of private individuals is still very low. Despite all advantages of voluntary health care insurance programs (quality care, modern clinics and hospitals, access to advanced medical equipment and latest technologies, there is still a vivid conflict between doctors who tend to prescribe the most expensive medicines and treatments and insurance companies which tend to offer the most economical solutions. Another drawback of voluntary health insurance is the fact that insurance companies usually work with a same group of clinics and hospitals, which belong to the top category in terms of equipment, service and conditions. However they do not cover federal and regional clinics, which do not meet the top category position, but have the best specialists in a particular field. Therefore, many patients prefer to choose clinics based on the criteria of the best specialist in the certain field. Voluntary insurance programs are not always able to meet this requirement.

Solvent citizens usually prefer neither private clinics nor state clinics, which in the recent years have been allowed to provide paid service causing double standards and vicious practice of faster medical assistance to those who pay. They prefer qualified specialists regardless of which clinic or hospital he/she works for. Such specialists are usually chosen based on the recommendations of relatives, colleagues and friends. Professionals as more efficient also accept this approach since doctors get their payments directly from the patient without official bookkeeping or taxes. Thus, a key reason for the current imbalances is the fundamental lack of free medical assistance standards and strict norms. Many experts agree that the reform of the healthcare insurance system should start from developing basic

medical assistance packages guaranteed by the state and developing clear-cut standards for medical assistance strictly observed by all players.

Key Medical Equipment Market Indicators

The major goals of the National Priority Project “Health” as currently implemented are the re-equipping of hospitals and clinics with advanced medical equipment, building new medical centers, and improving basis for high-end medical assistance. These goals cannot be achieved without significant improvements in the state of the domestic medical equipment market.

A significant portion of the medical equipment and devices used in public clinics and hospitals is obsolete and needs replacement. Russia does not produce many types of high-end medical equipment and relies exclusively on imports of such equipment. While the resulting opportunities in the market are vast, financing remains insufficient to address the needs of the medical industry despite recent health care reforms and significant increase in federal and regional budgets allocations for health care.

The Russian Medical Equipment Market is one of the fastest growing sectors of the economy. Currently, the total volume of medical equipment market in Russia is estimated at \$2 billion. The average annual growth of the market is 15-16 percent. Imports of medical equipment have recently played a significant role accounting for approximately 65-70 percent of the total market. The top five foreign suppliers to the Russian healthcare market are Germany (29%), United States (20%), Japan (15%), Italy (6%), and Switzerland (4%).

Some 90 percent of Russia’s domestic production of medical equipment and devices is manufactured at 660 enterprises having federal licenses for the production of medical equipment and devices, including 220 plants which are primarily dedicated to the defense industry. The Ministry of Health has approved over 20,000 medical products and devices for use in treatment but only 12,000 of those are represented among the list of locally made products. According to market research company TSMI Pharmexpert, in the next three years the Russian medical market will increase three times mainly due to significant improvement of local manufacturing basis and growth in domestic output.

The Russian government allocates significant resources to support local manufacturing of medical equipment and devices. However many times those resources are used inefficiently. For example, according to Profil magazine #40 of October 30, 2006, the federal government has recently allocated \$200 million to build a plasma processing plant in the city of Kirov. However there is no technical basis and plasma available for such production facility in Kirov. Alternatively, such technical basis and raw materials exist in Ivanovo. According to Profil, estimated expenses for constructing a plasma processing plant in Ivanovo are only \$2 million which is 100 times less than in Kirov. Despite that fact, government bureaucrats decided that it would be more appropriate to build a plant in Kirov and buy raw materials for that plant abroad. It is evident that they count to get a notoriously known commission (or simply kick-back) from the suppliers of plasma calculated as a percentage of the transaction (imported raw materials are usually several time more expensive than locally made ones).

Main components of the National Priority Project “Health” and their effects on the medical equipment sector

The National Priority Project “Health” was designed to significantly improve the Russian health care sector by pumping in significant funds and improving medical infrastructure. One of the first steps of the project was focused on upgrading the nation’s primary health care sector by raising wages for general practitioners and nurses in regional and municipal polyclinics whose job is to tend to day-to-day crisis. Further initial steps included providing new equipment and ambulances to regional and municipal clinics and hospitals, and supporting nationwide vaccination campaigns and checkups. Starting in 2007, the Ministry of Health wants to concentrate efforts on building a number of high-tech medical centers and devotes mote attention to high-end medical assistance. The government allocated \$2.2 billion under the priority project “Health” in 2006. For 2007 this figure is estimated at \$4 billion. According to Minister of

Health and Social Development Zurabov, in 2008 the total funding for health care from all sources, including the national priority project funds, will amount to \$37 billion.

The implementation of the Project is supposed to be supported by enacting laws and regulations, which will modify the health care system structure in the long run. The key such laws and regulations include New Law on State Guarantees for Medical Assistance, New Law on Mandatory Health Insurance, Law on Standards of Medical Assistance and others. The work on the laws has not been finished and other laws have been stalled by legislative infighting. One positive change in the health care system restructuring is the fact that starting 2007 the government is launching a series of 'pilot health care management and funding projects' in 17 regions of Russia. The projects include development of most efficient health care funding models, and replacing the old, redundant and inefficient multi-channel health funding system by funding health care from one source.

Following are two major areas of the Project, which directly impact the medical equipment and supplies market:

- re-equipping federal clinics and hospitals with new diagnostic equipment and ambulances (\$1,050 billion);
- building ten high-tech multi-profile medical centers as well as a number of regional less invasive cardiovascular surgery centers; and significantly improving and enhancing high technology medical assistance to population, such as open heart operations, transplantology of key organs, neuro-surgical brain operations and other complex surgeries, treating severe forms of endocrinology diseases and others (\$1,717 billion).

First Vice Prime Minister Dmitry Medvedev, who personally oversees implementation of the four national priority projects, has given several interviews and published articles on the results of these projects in the past few months. In an article published in the January 25, 2007 edition of Kommersant Daily, a leading business daily publication in Russia, Medvedev mentioned that, due to wage increases under the National Priority Project "Health," the number of district general practitioners increased in 2006 by 3.5 thousand. Within the framework of the project 5.5 thousand health care establishments were re-equipped with new medical equipment and ambulances. The fleet of ambulances equipped with all necessary state of the art equipment increased by 6.7 thousand cars. He also admitted that the first steps of the project were not free of mistakes. Raising salaries for general practitioners and certain categories of nurses and aids while leaving them untouched for doctors-specialists and other categories of nurses has led to interoffice tension within clinics, increases in bribe-taking among specialists, and a general deterioration of the workplace atmosphere.

Many aspects of the National Priority "Health" reflect traditional bureaucratic interest in limiting open tenders stipulated by law and assigning large government construction and procurement contracts to those 'court providers and suppliers' who are recognized for their guaranteed kick-backs. The latest example is the decision of the government to build ten brand new large multi-profile medical centers. The cost of the construction is estimated to be 1.5-2 times higher than of that of an ordinary modern medical center. Many leading doctors and heads of key medical centers are confident that such large-scale investment into construction is not necessary. They argue it would be much more economical to designate a top medical center in each field of medicine among the existing medical centers and invest into improving their technical and technological basis. These top centers have significant experience in providing high-end medical assistance, which can be used as a pattern for replicating in their affiliates located in different parts of the country.

At the moment only 15-25 percent of total need for high technology medical assistance is satisfied. The unsatisfied demand for high-technology medical assistance could be met by private and so-called 'agency clinics' which currently do not have access to mandatory insurance funds and thus cannot service the population now covered by mandatory insurance. However these clinics use most advanced concepts,

treatments and technologies which could be used for the benefit of the entire population. Modern treatments and technologies help to solve a fundamental conceptual problem of the Russian health care: over-emphasis on hospital care at the expense of outpatient diagnostics and early prevention. The duration of hospital stay in such clinics is two-three days while treatment of the same disease in an old style municipal clinic requires at least two weeks.

What is taking place with the National Priority Project "Health" now is an attempt to make up for years of neglect following the 1991 Soviet collapse. In the past 15 years, disease and death have skyrocketed while the money for combating them has steadily waned. However, according to the Moscow Times of December 4, 2006, one of the most serious problems facing policy-makers as they seek to improve the nation's health care system is the firmly ingrained nature of off-record payments and bribe-taking that has come to permeate the current medical system.

Corruption scandals

Russian authorities are working fight the perception and to demonstrate decisiveness during the most recent corruption scandals in the Federal Mandatory Medical Insurance Fund. One of the factors, which led to investigation by the Prosecutor General' Office over the Federal Mandatory Medical Insurance Fund, was the enormous debt for drug deliveries under DLO Program that the Federal government had incurred. The investigation showed that contracts to deliver drugs under DLO were purportedly awarded without tenders to companies close to senior levels of the Ministry of Health. Drugs and equipment were supplied at inflated prices with further splitting profits with government officials. The management of the fund was arrested and accused of taking bribes from pharmaceutical distributors in exchange for favoritism in granting government contracts for purchases of drugs.

The toughest criticism of the corruption scandal was given by the first Vice Premier Dmitry Medvedev whose opinion was published on the Kremlin's official web site at: <http://www.kreml.org/news/135133257>. Medvedev expressed overall dissatisfaction with the work of the Ministry of Health and Social Development and characterized the DLO system as cheating. According to Medvedev, some swindlers make medicines; others sell them, and a third group act as middlemen using government program funds to their benefit.

Opportunities for U.S. Medical Equipment Manufacturers

Despite inefficiency and corruption related to spending of additional resources under the priority project, there was a significant increase in the level of health care spending in the country. Foreign suppliers, including U.S, actively participated in procuring medical equipment under the priority project, especially the most advance types of such equipment and newest technologies. Foreign medical equipment suppliers through their authorized local representatives continue working with Roszdrav (www.roszdravf.ru) on participation in tenders. Roszdrav is the main government agency responsible for organizing tenders to procure drugs and medical devices for federal clinics and hospitals.

Foreign medical equipment suppliers, including U.S., continue procuring equipment to both public and private clinics and hospitals through their authorized local distributors/agents. Despite rapid growth of private clinics and private health care services, the Russian health care system remains hyper centralized and overly regulated by the state. Private clinics can solve a lot of country's problems in health care and are considered as more suitable partners for U.S. companies. However since the overwhelming majority of funds goes to public clinics, U.S. companies should consider cooperation with such clinics as a strong factor.

Russian government agencies, including the Ministry of Health and Social Development, have recently made some progress in publishing its laws, regulations, judicial decisions and administrative rulings on their web sites and other open sources as well as administering them in a fair manner. Despite that

transparency is missing, especially with respect to countries mechanisms for healthcare financing; tenders for state purchases and decisions on government reimbursement and price registration.

Conclusion

Reforming the Russian health care system is a challenging task. It is evident that it will take more than one or two years. The authorities have started the reforms by changing those things that are either highly visible or are easier to handle. First of all, additional money was pumped into the system to fund drug reimbursement programs and increase wages for district physicians (general practitioners) and paramedics, which was made possible thanks to the Country's windfall profits from high oil prices. Secondly, they have invested into construction of new medical centers using the considerable experience of extensive development models accumulated during the Soviet time. However the basic element of the health care system – health care insurance – remains under reformed. Russia still has to build a functional and solid system which will take into account and balance the interests of major players: patients, the state, insurance companies and medical centers. Government officials have identified that, in the future, special attention must be given to creating independent controlling bodies that will oversee spending and ensure the efficiency of the system. Another identified next step will be encouraging investments into fundamental medical research and the commercialization of medical technologies.

For More Information

The U.S. Commercial Service in Moscow, Russia is developing a number of events and programs to assist the US medical industry to play an active role in the modernization of Russia's health care system. Our office can be contacted via e-mail at: Ludmila.Maksimova@mail.doc.gov; Phone: 7-495-737-5037; Fax: 7-495-737-5033 or visit our website: <http://www.buyusa.gov/russia/en>.

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