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**STUDY ON THE TRANSFORMATION OF THE RUSSIAN PHARMACEUTICAL  
INDUSTRY TO A MARKET-ORIENTED SYSTEM**

TF/GLO/92/010

General economic context of the project  
A summary

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In the Summer of 1993, Russia's economy appears to be in a dire condition. All available economic indicators - statistical data - seem to blink the red lights: for example inflation, external debt, decline in production, the dismal condition of infrastructures.

**BUT** these indicators only tell the sombre part of the story.

The "pays réel" is infinitely more complex and shows promise of progressive improvement in the future.

A future which seems to have already started. Indeed, behind official Russia, there is the Russian people: they want to use their newly-found freedom and more and more of them try to "do something". A real "economic life", a market, is spontaneously emerging in Russia and this not only in commercial activities but also, though it may yet seem embryonic, in production sectors: agriculture, food processing and distribution, and in the form of small light-industry undertakings covering a large spectrum of sectors. Price freedom - in most areas of economic activity - and the possibility to calculate real production costs have put economic theory to work: a market is emerging and is creating growing solvent demand.

In the more specific area of social security and particularly the health sector, change appears to be slower, more complicated. One major reason for this is rooted in seven decades of all-state provision of social services and the consequent inertia, not to say fatalism, of a large portion of the population accustomed to be at the mercy of an overwhelming and arbitrary centralized system.

**BUT** new developments are emerging also in this sector.

There are three fundamental factors of change.

Russian society is about to start three simultaneous (peaceful) revolutions: it wakes up from the feudal constraints of communism; it is in the process of a 20th century-style industrial revolution; it will, eventually, give birth to a pluralist society.

However painful these developments will be, the social sphere, particularly the provision of health care, will play a vital role.

And there will be a very substantial, growing market for high quality pharmaceuticals. At present, the provision of pharmaceuticals made in Russian is insufficient. Imports of many categories of essential drugs have been increasing. But real, long-lasting improvement can only be achieved in Russia by a strong, innovative and competitive domestic pharmaceutical industry.

It is against this background that the premises of the ICN-OCTOBER project must be analyzed and appreciated.

The "pays réel" is above all its people. Meetings with Russian businessmen, scientists, industry managers, local/regional government officials and "just people" help understand the promise of substantial future

improvement. The true economic story of Russia is in its yet small but feverishly increasing private economy, new companies, joint ventures and burgeoning entrepreneurs. The rearguard actions by enemies of reform will not stop the country's economic transformation.

### RUSSIA'S ECONOMY IN 1993

What is Russia's present national income? For 1992, the World Bank's and the IMF's conservative calculations show a nominal Gross Domestic Product of US\$ 62 billion and a per capita GDP of about US\$ 435. More recently, a respected Anglo-Saxon source, referring among others to the same institutions, estimated per capita GDP at US\$ 3,200 but indicated the total value of Gross Domestic Product in roubles, not in dollars.

The best guess that can be offered by the present author is that total Gross Domestic Product is about US\$ 250 billion. i.e. a per capita GDP of about US\$ 1,650. It is impossible, however, to propose more than these rough estimates. How to take account, for example, of all the major factors that should be included in the determination of the real purchasing power of the average Russian's income.

The structure of the economy of the USSR (extrapolated to Russia) has been changing very slowly and has yet a composition close to some developing country economy.

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#### EMPLOYMENT BY MAIN SECTOR

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	1975	1990	1992/93*
Agriculture and forestry	22.2%	18.5%	20%
Industry, incl. construction and mining	38.2%	39.4%	35%
Services, incl. government	39.6%	42.1	45%

Sources: IMF, IRRD, OECD, EBRD, Interviews.

a: Estimates

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This structure, an apparent weakness, hides of course ample room for change. And change at medium term should be all the more interesting that the general education level of the population, especially when considering the lower strata, is comparable to many a developed country. In addition, it is interesting to note that the contribution of agriculture and forestry to "Net Material Product" was about 20% in 1990, while industry's was about 42%. Behind these facts, there should be large "reserves" of productivity waiting to be deployed. The estimates for 1992/93 reflect a transition or survival situation in which workers become superfluous (if not explicitly redundant) in industry had to find some activity either in the primary or the tertiary sectors.

The unique apparent bright spot is the US\$ 3 billion foreign trade surplus achieved by Russia in 1992. Of course, with over US\$ 80 billion, the country's foreign debt is big, but per capita debt is the lowest in all of Eastern Europe (except Romania) and, more importantly, the debt/service ratio has been consistently decreasing: 28% in 1986, 24% in 1989 (USSR) and, this time Russia: down to 18% in 1992.

All the other conventional indicators<sup>1</sup> are negative for the period 1990-early 1993. Examples:

1. GDP has been declining by 10-15% annually between 1990 and 1992 with industrial output falling 15-20% each year;
2. Gross Fixed Investment collapsed even more dramatically both as regards productive investment and construction;
3. Agricultural production experienced a relatively small drop;
4. Prices - both producer and consumer - exploded as a result of
  - (a) price liberalization and reduction and partial cancellation of subsidies, and
  - (b) most importantly, the Government's generous monetary policy;
5. Unemployment first appeared during this period as a real social phenomenon, new to Russian society: though the numbers are still moderate in statistics, latent unemployment is substantial and it must be expected that official unemployment will increase significantly as a result of:
  - a) the indispensable rationalization of many big industries,
  - b) privatizations and their necessary consequences on manning levels,
  - c) the unavoidable redundancies in the government sector in the broadest acception.

**BUT** there are also positive developments, though they are not all statistically demonstrable:

1. Positive foreign trade balance;
2. New structure of foreign trade (imports and exports):
  - (a) the share of Western (OECD) countries in Russia's foreign trade increased by 61% between 1991 and 1992, particularly with the United Kingdom, Spain, Sweden, Belgium the USA and Canada.

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<sup>1</sup>Russian economic data are characterized by their uncertainty, their lack of sectorial specificity in many cases and divergences according to their sources. In addition, no well-known Russian or international organization is prepared to convert, in their statistics, rouble values into hard currency, for example the US dollar.

- (b) trade with South East Asia developed just as fast.
  - (c) trade with the poorer markets of the former CMEA countries lost much of its importance in Russia's external commercial activities;
3. The emergence of an entrepreneurial class: many small enterprises are being created, both in sectors linked to agriculture/food and light industry and services;
  4. The growing number of successful businessmen working in many a major province/sector in Russia and trading with Western and other foreign countries - the new millionaires;
  5. Between 300,000 and 500,000 Russians now make more than US\$ 2,000 per month, while 4,000,000 to 5,000,000 "earn" over US\$ 500 monthly, a fortune compared to average monthly earning estimated at Rub 50,000 - 70,000, i.e. about US\$ 50-70.;
  6. Another very important observation: foreign-bound capital flows seem to diminish and more and more Russian businessmen appear to invest again in Russia instead of keeping their capital in the USA or Western Europe;
  7. Finally, it is tempting to include here the idea of CONVERSION (of military industries to civilian production) and the "Peace Dividend", but these are far-fetched promises, except probably the Russian version of the "Peace Dividend".

And perhaps the most important: there is good hope that misconceived and wasteful investment either in spectacular infrastructures or in unprofitable industrial projects are stopped. If this is the case, the apparent (statistical) collapse of Gross Fixed Investment is rather good news. In addition, account should be taken of the reduction of military spending - another type of unprofitable investment.

#### RUSSIAN SOCIETY AND THE HEALTH CARE MARKET

This is the specific context of the ICN-OCTOBER joint venture and investment project.

More than a fifth of Russia's 150 million population lives in cities of 1 million inhabitants or more. It is in these - and many smaller cities - that market demand for health care provision is concentrated. It is also there that one finds most of the country's approximately 20,000 pharmacies or drug shops/stations and particularly the growing, if yet very small, number of private pharmacies. (It must be noted that by Western standards, Russia should/could have 100,000 retail pharmacies or more).

The medical infrastructure is vast, if not of high standards: there are about 470 doctors and 140 beds per 100,000 inhabitants. The general health

condition of the population is poor. A very large potential demand for drugs is combined with sparse, unsatisfactory infrastructure to dispense them.

But what is the purchasing power available to satisfy at least part of this demand? We know that average incomes will be slow to grow, just as well as the probable persistence of problems with public finance.

**Overall spending:** both from public finance and through private purchase directly from pharmacies will much depend on national income and on how it is spent.

**Gross Domestic Product** 1992/93 is estimated at US\$ 250 billion annually. Assuming that 3% were spent on health care, the total health market was between US\$ 7-8 billion. The Russian health care system - inherited from the USSR - being what it is, i.e. ill-equipped, not high-tech, with main emphasis on community health care through dispensaries, the share of pharmaceuticals is about 40% in total health expenditure. This, in 1992 (or 1993) probably amounts to US\$ 3 billion<sup>2</sup>.

Is it possible to make estimates for the future? Three years hence, for example! An optimistic forecast would be the following for 1996:

1. **Gross Domestic Product** grows to US\$ 300 billion (from about 250 in 1992/93);
2. **Total Health Expenditure** will reach 5% of GDP, i.e. US\$15 billion;
3. **Spending on pharmaceuticals** will stay at about 40% of total health expenditure; which means
  - **global annual Russian requirement for pharmaceuticals of US\$ 6 billion by 1996.**

This forecast is founded on a number of underlying assumptions about Russia finding a solution to at least some of the following problems or problem areas:

1. The country will give itself a workable Constitution together with a clear definition of what will be the Federation of Russia;
2. Relations with the other members of the C.I.S. will be settled; there will be progress with the currency question, i.e. the potential Rouble Area;

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<sup>2</sup>We have no dependable data on the value of Russian (formerly Soviet) drugs production. A good basis to cross-check the \$ 3 billion estimate is the total annual value of "traditional" USSR imports of pharmaceuticals which amounted to about US\$ 1.5 billion. The main sources of these imports were Poland, Czechoslovakia, Hungary and Bulgaria.



3. There will be progress towards monetary reform, including the status and governance of the Russian Central Bank;
4. The legislative process will be consolidated and fiscal legislation will become more stable, including as regards foreign direct investment;
5. The reform movement continues and privatization, together with the further consolidation of ownership legislation, proceeds further.

Finally, it is necessary to recall, in the guise of a profession of faith, three fundamental ideas:

1. Democracy: there will be growing and irresistible pressures for improved social benefits, particularly for better financed, better provided, more widely and evenly distributed health services;
2. The "Peace Dividend": the Soviet Union used to spend well over 25-30% of Gross National Product on defence, while overall health expenditure was hardly more than 2% of GNP. Even in the first half of 1992, about 25-30% of the Russian Government budget was spent on defence and less than 20% on social benefits, including a few percent on health.

The necessary further shift of priorities should help improve the financial potential of health insurance and the provision of health services. Indeed, it will become more and more difficult to hide the dismal condition of the country's health services from the Russian public and though the problem is not hitting the headlines yet, the Russian (and international) media will inevitably focus on it in the near future.

In addition, improving the general health condition of the population corresponds to the fundamental national interest of Russia. These facts will create relentless pressures to give growing priority to the sector by central governmental and regional/local authorities alike.

3. Private initiatives in the health sector: these has started in the sector of pharmaceuticals. ICN-OCTOBER is a case in point.

What is important is that in addition to the continuous work of the Health Ministry and the continuation of state orders, there is already a very active private wholesale and retail activity in prescription and OTC drugs. It is true that this activity is centred mainly on imported drugs at present, but ICN-OCTOBER will be well-placed to establish credibility, to be competitive and eventually take a substantial share in this private Russian drugs market circuit