Healthcare Reform and Expenditure on Drugs
The German Situation

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Summary

Germany is in a period of transition with regard to healthcare reform. The number and intensity of cost control interventions increased during the last decade in an attempt to contain healthcare expenditure. The German legislature has implemented long term macroeconomic measures such as contribution rate stability and global budgeting. The mid-term goal is to reduce the structural deficits of the current system. This paper argues that reference prices, introduced in the 1989 Healthcare Reform Act, did not produce the expected savings. An analysis of the effects of the 1993 Healthcare Structure Act on pharmaceutical expenditure is also presented. Compared with the implementation of the reference price system, the introduction of global budgeting in 1993 has had a more effective and lasting cost-containment impact. The paper concludes with a review of the main aspects of the current reform discussion.

1. Means of Coordination and the General Economic Framework in Germany

The German healthcare system, and the Statutory Health Insurance (SHI) in particular, are characterised by a variety of coordination instruments. Pharmaceutical companies generally compete on the basis of the prices and quality of their products. In contrast, a collective bargaining process between physicians’ and insurers’ associations settles the allocation of resources for ambulatory care. For hospital care, public planning represents the predominant instrument of coordination.

The coexistence of different coordination devices leads to additional problems since the various sectors of the healthcare system are not isolated, but rather are highly interdependent. A good example is the production of healthcare. Here, ambulatory care, hospital care, and medicines are either substitutional or complementary factors of production depending on the specific production function for healthcare. Given the technological and organisational interactions sketched above, it is impossible to analyse the pharmaceutical market on its own. Rather, one must take into account the coordination devices present in the ambulatory and hospital care sectors, respectively. With respect to the factors of production, primary care physicians occupy a key position, since, in most cases, they are the first to be contacted by the patient. They are responsible for the prescription of drugs and they also decide whether referral to either a specialist or hospital is necessary. Thus, in Germany, primary care physicians act as gatekeepers who initiate expenditures that are 3 times greater than their own revenue. While physicians determine the quantity and the quality of their services, fees are determined...
through negotiations between the associations of physicians and the sickness funds, i.e. through a collective bargaining process.\textsuperscript{1,3,4} Therefore, from the point of view of coordination, the pharmaceutical market is bounded by both corporate and governmental regulation.

Medicines are distributed by manufacturers to retailers via wholesalers, but directly to hospital pharmacies. At the end of 1993, there were 649 hospital pharmacies and 20 648 registered retail pharmacies involved in the provision of drugs. The latter figure includes 18 193 pharmacies in the old Länder (states) [i.e. the western part of the Federal Republic of Germany]\textsuperscript{2},\textsuperscript{5} where, on average, there is a retail pharmacy for every 3600 inhabitants. This figure has declined to the current level since 1975. There are 2 important regulations affecting retail pharmacies: first, pharmacists are not allowed to own more than one pharmacy; and, second, any retail pharmacy must be wholly owned by one, and only one, pharmacist. From the viewpoint of quality assurance, these regulations are intended to ensure the presence of the responsible owner. Moreover, they preclude the formation of pharmacy chains.

The Medicines Price Ordinance specifies the wholesaler’s maximum percentage mark-up on the manufacturer’s price. Retail pharmacies then add another percentage mark-up, which varies inversely with the manufacturer’s price. Furthermore, wholesalers (3 of which command 66% of the total turnover) offer discounts to retail pharmacies in order to ensure long term relationships. As a consequence, retail prices of medicines are fixed uniformly by law. Finally, the insured consumers, as the last link in the distribution chain, obtain all therapeutically necessary and economically efficient drugs, for which they pay only a small out-of-pocket prescription fee. The amount charged depends on the quantity dispensed.

2. Recent Developments in Pharmaceutical Expenditure

In 1993, there were approximately 1200 pharmaceutical producers in Germany, ranging from small enterprises to about 3 dozen multinational companies that market their products globally. The 5 largest independent producers accounted for 14.2% of sales by pharmacies; the 10 largest accounted for 23.6%\textsuperscript{,7} When sales by subsidiaries were included, these proportions increased to 19.9% and 32%, respectively. In comparison with other domestic markets, as well as foreign pharmaceutical markets, the German pharmaceutical market has a fairly low level of concentration with respect to pharmaceutical producers. This is not the case, however, if one looks at particular therapeutic classes (e.g. \(eta\)-blockers, ACE inhibitors, lipid-lowering agents), which often have a rather narrow oligopolistic structure. The number of pharmaceutical products available in Germany has fallen from 145 000 in 1978 to about 50 000 in 1993, with the 500 and 2000 best-selling drugs accounting for 59.9% and 89.6% of sales, respectively. This decline is due to tighter control of market authorisation and changes in the registration of pharmaceuticals.

In 1993, the German pharmaceutical industry produced drugs with a value of DM30.9 billion, calculated at factory prices. 44.8% of these drugs (DM13.86 billion) were exported, and pharmaceutical imports amounted to DM7.51 billion. This led to a record export surplus of DM6.35 billion. However, 47.5% of pharmacy sales were made by foreign companies through their German subsidiaries and wholesalers. In the old states, the value of sales covered by the SHI, calculated at pharmacy prices, was DM21.9 billion, whereas the value calculated at producer prices was only DM12.2 billion. Thus, of each DM100 paid to the pharmacy, producers received only DM55.50. The difference was split between wholesalers (DM8.90), pharmacies

\textsuperscript{1} The statutory insurance scheme is highly decentralised and comprises hundreds of insurance or sickness funds. Approximately 90% of the population is insured with one of these compulsory sickness funds.

\textsuperscript{2} This manuscript concentrates on medicines distributed by retail pharmacies, which form a category of their own in official statistics.\textsuperscript{,6} Medicines distributed by hospital pharmacies differ with respect to both pricing and distribution. Thus, their corresponding expenditure is included in the category for hospital care expenditure.