

China Economic Update

by NAB Group Economics

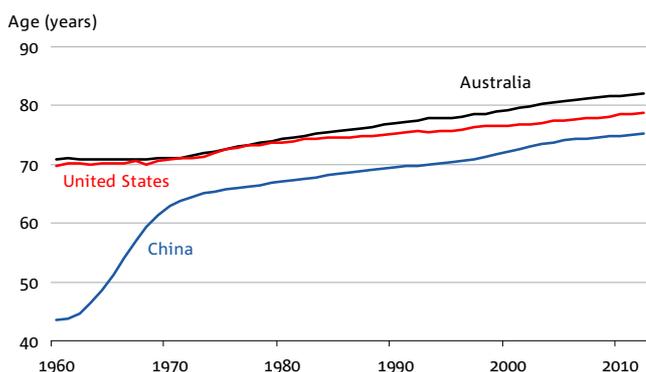
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China's changing healthcare needs require major changes to the system to avoid economic pain

We have [previously](#) outlined the major demographic changes that are transforming the population profile of China. The population is ageing and life expectancy is rising. With these two trends, demand for healthcare services is set to increase – particularly given the growing incidence of non-communicable diseases. China began to reform its healthcare sector in 2009, however this process is far from complete. Further reforms to healthcare will be required to expand and improve the access to the system and improve patient outcomes.

China's life expectancy is rising, contributing to the changes in health needs

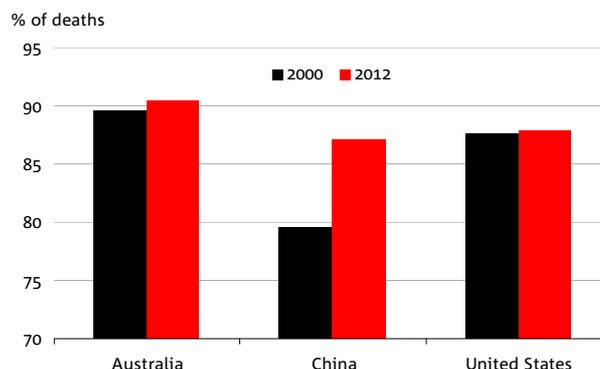


China's health needs are changing – the disease profile is becoming more complex

Over the past few decades, the profile of China's health needs have changed considerably, in line with China's industrialisation and rising levels of wealth. Fewer people are dying from relatively readily treated acute and infectious diseases and instead the rates of death from non-communicable diseases (NCDs) have increased significantly. According to World Bank data, deaths from NCDs have increased from around 80% of the total in 2000, to around 87% in 2012 – a level that is closer to trends in advanced economies than developing ones.

In particular, there have been considerable increases in the rates of cardiovascular disease, diabetes and chronic lung conditions (including cancer). A range of factors have contributed to these trends, including the increasing levels of urbanisation, changing dietary patterns (with improved food security and increased consumption of salt and fat), rising rates of obesity, smoking rates and pollution.

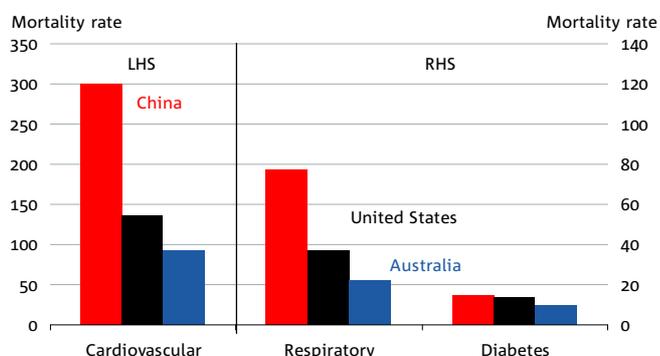
Death rates of non-communicable diseases are rising in China – closer to advanced economy levels



Source: World Bank, NAB Economics

Of considerable concern are the generally higher mortality rates from these conditions. This indicates that when compared with advanced economies, China's NCD patients are generally not receiving adequate healthcare – particularly early stage preventative health measures.

Mortality rates from NCDs considerably higher in China than in advanced economies



Source: World Health Organisation, NAB Economics

Poorly managing non-communicable disease carries an economic burden

The World Bank notes that there is a substantial economic burden associated with NCDs, some of which is avoidable. The organisation's analysis suggests that reducing just cardiovascular disease mortality (for example) by 1% a year between 2010 and 2040 would generate an economic benefit in excess of US\$10.7 trillion (equivalent to around 68% of China's real GDP in 2010).

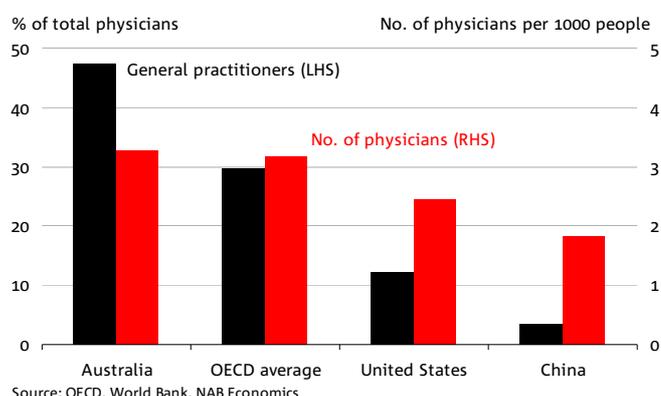
Improving individual health outcomes has a significant impact on labour productivity and incomes. Based on Chinese health surveys, the World Bank suggest that an improvement in health status (based on a five point scale) increases average hours worked by 16% and income by

20%. An improved management on NCDs may be critical to achieving China's goal of rebalancing economic growth towards consumption – particularly given the ageing population which will place a greater burden on a shrinking working age population.

The model of health provision is no longer suitable

China's health system is currently built around hospitals, as opposed to the primary care model more common in advanced economies – where general practitioners act as a central contact point for patients. According to Xinhua, around 90% of China's medical services are currently provided by public hospitals. A hospital based system is typically capable of treating individuals with acute and infectious diseases, but is not well aligned to the treatment of non-communicable diseases, which generally require more complex and ongoing treatment combined with a system of preventative health measures.

China currently lacks sufficient numbers of General Practitioners to implement primary care model



Developing a primary care based system is currently limited by a shortage of general practitioners (GPs). Chinese GPs comprise just 3.5% of total medical employment – well below the average levels of advanced economies (30%) and Australia (47%). An effective transition to a more modern health system will be constrained until China can train sufficient GPs to service the population. According to the World Bank, China will require around 600,000 general practitioners by 2030 (around ten times the number in 2010) in order to achieve OECD standards.

Despite near universal insurance coverage, affordability and access to care remain issues

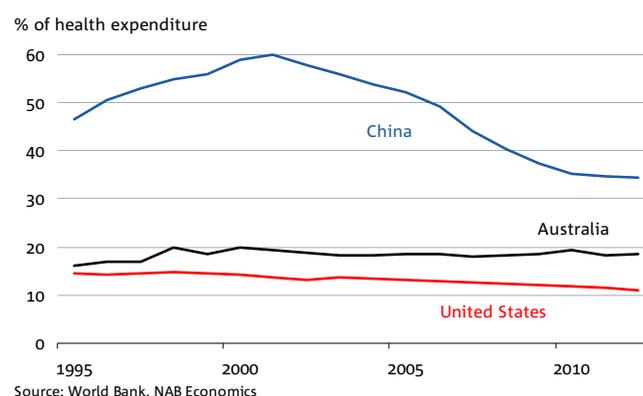
Affordability has been a major issue within China's healthcare system for a number of decades. Reforms in 2009 expanded the coverage of health insurance, particularly in rural areas, where it rose from around 20% of the population in 2003 to 95% by the end of 2010 (World Bank). While insurance coverage is now wide (in terms of population coverage) it is also shallow, with considerable out-of-pocket expenses for patients.

The growing incidence of non-communicable disease has been a major contributor to the increased out-of-pocket expense. According to the World Bank, health expenditures

associated with cardiovascular disease rose at an annual average rate of 17.3% between 1985 and 2005, whereas total health expenditure grew by 11.8% a year.

Out-of-pocket expense (as a share of total health expenditure) has declined since 2001 (when it peaked at 60% of the total), trending down to 34% in 2012 (the most recent data available). China's government aims to reduce out-of-pocket expenses to 30% of total expenditure by 2015 – a level that would still remain well above that of Australia (which was around 19% in 2012).

Out-of-pocket expenses have declined in line with expanded insurance coverage, but remain high



Access to care is also a challenge. A range of surveys and anecdotal reports suggest that China's major hospitals suffer from long queues and limited consultation time with medical staff, reducing the quality of care.

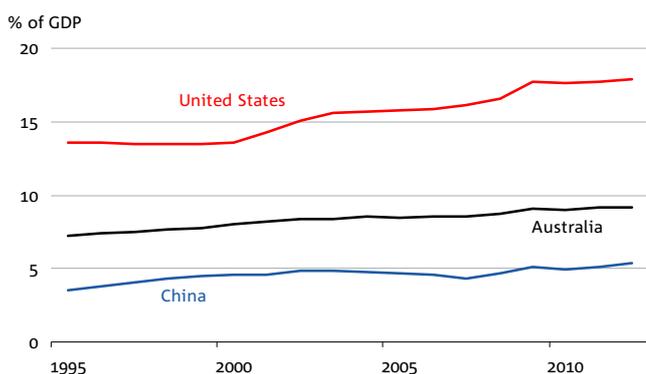
Expenditure on healthcare remains low and variable across the country

Compared with advanced economies, China's expenditure on healthcare is quite low. In 2012, China's total expenditure (as a percentage of GDP) was 5.2% - ranking the country at 127th worldwide. In comparison, the United States spent almost 18% of GDP on healthcare (an extremely high level) and Australia 9.1% (closer to the average for advanced economies).

Government funding for healthcare is conducted at the local level, resulting in highly different outcomes across the country. We've previously discussed the challenges faced by local governments – who have significant spending obligations but poor revenue due to the taxation framework. Recent reforms to the Central-Local financial relationship may improve the capacity of local governments to fund health programs.

That said, considerable efforts will be required to provide equitable health outcomes across urban and rural areas of the country. Researchers at the Wharton School at the University of Pennsylvania note that doctors find considerable disparities in income, status and technology between urban and rural hospitals and that they naturally prefer the better opportunities in China's cities. Attracting quality professionals to rural areas is extremely difficult.

China's healthcare expenditure lags the levels of advanced economies



Source: World Bank, NAB Economics

Existing reforms have been largely unsuccessful, in part due to poor incentives

Since 2009, China's government has invested the equivalent of US\$371 billion in the healthcare system. According to the Council on Foreign Relations, the reforms so far have failed to address the problems around access and affordability for most people. They note that two-thirds of this investment has been directed toward healthcare providers, and despite this, the government contributes less than 10% of public hospital revenues – compared with around 45% from selling pharmaceuticals.

Although China's government has attempted to control pharmaceutical prices by creating a list of 'essential drugs' with regulated pricing, there are incentives for doctors to prescribe more costly alternatives – including illegal measures that are the subject of high profile bribery cases.

In addition, the fee-for-service model currently employed by the healthcare system provides incentives for providers to offer more profitable high-tech services over basic ones, in addition to over-servicing and over-examining patients to drive revenue growth. Similarly the system provides minimal incentives to improve efficiency – according to the World Bank, the average length of hospital stays in China are around double the OECD average.

As China's population continues to age, and the complex requirements of non-communicable diseases become more commonplace, reforms to the financing model of healthcare will become more critical – ensuring that incentives are in place provide appropriate and quality healthcare services in a cost efficient fashion.

Can competition drive an efficiency campaign?

In late August, China's government announced it will allow overseas-owned private hospitals to open in major developed cities, including Beijing, Tianjin, Shanghai, Jiangsu, Fujian, Guangdong and Hainan. It is hoped that the introduction of these hospitals will encourage the development of high-end medical services and encourage public hospitals to lift standards.

Current private hospitals are mostly joint-ventures with domestic investors, and tend to serve foreign workers and

high wealth Chinese – reflecting the comparatively high costs of these services which are not covered by basic medical insurance schemes. High cost could remain a constraint on the sector.

A second challenge to the growth in the private sector is the availability of qualified medical staff. According to Reuters, across most of the country, China's doctors require permission from state-owned hospitals in order to practice in the private sector – and that many public hospitals are reluctant to let their better doctors go. That said, in August Beijing became the first municipality to allow doctors to work in multiple locations without permission from their public employer.

Conclusions

China's healthcare system is no longer adequate to service the needs of its population – reflecting the changes to the disease profile over the past decade.

Failing to reform the system is likely to cause a significant drain on China's economic growth over the medium term – with negative impacts on labour productivity, income and consumption if the country's shrinking working age population has to support a system that can not adequately treat NCDs.

Improving the management of NCDs may be critical to achieving the government's goal of economic transition towards a consumption led economy.

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