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## Potential Effects and Challenges

A Report of the CSIS Global Health Policy Center

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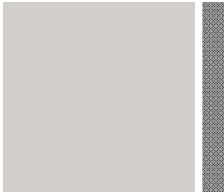

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# CHINA'S HEALTH AMIDST THE GLOBAL ECONOMIC CRISIS: POTENTIAL EFFECTS AND CHALLENGES

*Charles W. Freeman III and Xiaoqing Lu Boynton<sup>1</sup>*

Like everywhere else, the current economic crisis has hit China hard. Although not as dependent on exports as other Asian economies like Singapore or Taiwan, China still relies excessively on exports for new growth. With the collapse of global demand in the wake of the crisis, Chinese exports have plunged at an alarming rate, declining in June 2009, for the eighth consecutive month, falling 21.4 percent on a year-on-year basis.<sup>2</sup>

Particularly in the export-dependent Pearl River Delta, thousands of factories have been shuttered and tens of millions of Chinese have been put out of work. Many of these newly unemployed, migrant workers from rural China have returned to subsistence living in their home villages. But not all newly unemployed are fading into the Chinese countryside. Official Chinese data put the unemployment rate in China's urban areas at 4.3 percent in the first half of 2009—a 0.3 percent rise against the stable 4 percent throughout 2008. However, the statistics only include the registered rates and do not reflect the real unemployment situation, including those migrant workers who have not returned to their home villages. China's central government is thus facing a potentially destabilizing phenomenon in urban unemployment.

Beijing has long maintained that China must achieve growth rates of at least 8 percent in order to keep ahead of unemployment and maintain social stability. With little sign of a resumption of global demand for Chinese exports, the leadership in Beijing recognized early in the crisis that it needed to take aggressive action to ensure growth from alternative sources. In the long term, that growth has to come by restructuring the Chinese economy to stimulate growth from domestic consumption. In the immediate term, however, Beijing leapt into the fray with a massive 4-trillion yuan (US\$586 billion) fiscal stimulus package that it began to implement in November 2008. By

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<sup>2</sup> "China June Exports Down 21 Percent Year-on-Year," *Caijing*, July 13, 2009, <http://english.caijing.com.cn/2009-07-13/110196837.html>.

most accounts, that stimulus has been particularly effective. The World Bank recently raised China's GDP growth forecast to 7.7 percent from its grim prediction of 6.5 percent last March.<sup>3</sup>

Absent the fiscal stimulus, however, there are significant concerns about China's economic well-being. Indeed, when rumors spread in the summer of 2009 that China was prepared to curtail credit expansion, the Shanghai stock market suffered a 5 percent decline on July 29, the largest single-day percentage decline since last November.<sup>4</sup> The leadership in Beijing quickly reassured its population of its intention to maintain a loose fiscal policy until the crisis was solidly in the rearview mirror.<sup>5</sup> The challenge facing Beijing, therefore, is what tools it can deploy to encourage domestic demand-driven growth as it weans the economy off of export and stimulus dependency.

China's high savings rate is a significant deterrent to boosting consumption. The national gross savings rate hovered at 54 percent in 2007, far above the rates in advanced economies and also well above the average of 33 percent among other emerging markets.<sup>6</sup> Private consumption accounts for only 36 percent of the Chinese GDP, whereas it makes up more than half of the GDP in most developed countries (and reached over 70 percent of U.S. GDP in 2007).<sup>7</sup>

## Beijing's Stimulus Plan and Health Care Reform

Without a doubt, the lack of a social safety net is a significant factor influencing people's proclivity to save as opposed to consume. Many believe skyrocketing health care costs, in particular, are a key driver of this phenomenon. China today faces a wide range of health challenges—emerging and reemerging infectious diseases and new noninfectious problems such as cardiovascular disease, diabetes, obesity, and cancer. (See Appendix: Top 10 Causes of Death in China.) Until recently, 90 percent of rural residents and 60 percent of urban residents in China did not have health insurance.<sup>8</sup> Those who are covered by some sort of health insurance are frequently confronted with high premiums and limited coverage. In the meantime, government subsidies to public health facilities have dropped precipitously, now covering a mere 10 percent of costs at such facilities.<sup>9</sup> Management of China's overall health care delivery systems is in a resulting state of relative chaos. In this environment of shrinking revenues and increasing burdens, health care providers are under pressure to generate income from as many sources as possible, creating

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<sup>3</sup> Frederik Balfour, "World Bank Raises China Growth Forecast," Bloomberg.com, June 18, 2009, <http://www.bloomberg.com/apps/news?pid=20601087&sid=adDjraaysa7o>.

<sup>4</sup> "China Central Bank to Maintain Credit Policy after Slump," Agence France-Presse, July 30, 2009.

<sup>5</sup> Ibid.

<sup>6</sup> Leslie Lipschitz, Céline Rochon, and Geneviève Verdier, "The Domestic Solution: Can China's Growth Be Sustained through Good-Neighbor Policies?" *Finance and Development* 46, no. 1 (March 2009): 47–49.

<sup>7</sup> "Building China's Consumer Markets," *China Daily*, July 20, 2009, [http://www.chinadaily.com.cn/bw/2009-07/20/content\\_8447232.htm](http://www.chinadaily.com.cn/bw/2009-07/20/content_8447232.htm).

<sup>8</sup> Venessa Wong, "Health and Wealth," *Insight Magazine*, April 3, 2007, p. 1.

<sup>9</sup> Yanli Liu and Keqin Rao, "Health Insurance in Rural China: From Research to Policy," *Journal of Health Politics, Policy and Law* 31, no. 1 (February 2006): 72.

perverse incentives to, for example, over-prescribe expensive medicines and treatments in order to receive generous kickbacks from pharmaceutical companies and other service providers.<sup>10</sup> A study published in *The Lancet* in 2008 revealed that out-of-pocket payments accounted for almost half of total medical costs in 2006.<sup>11</sup> With the uncertainty surrounding the impact on household income from a catastrophic illness, high savings rates are both rational and extremely difficult to undercut.

In other economies, dramatic improvements in health care delivery have had an immediate impact on savings rates. Taiwan introduced comprehensive national health insurance in 1995 and the average level of household savings fell nearly 10 percent.<sup>12</sup> Hence, a major overhaul of its health care system has become one of Beijing's top priorities as it moves to restructure its economy.

To be sure, Beijing's recent attention to improving health care is not simply in response to the current economic crisis. Faced with public criticism for initially mishandling the SARS outbreak in 2003, the Chinese government has directed significant resources and attention toward public health and healthcare reform since that time. Indeed, health spending more than doubled between 2002 and 2006.<sup>13</sup> In 2007, central government spending on public health alone increased 85.8 percent from the previous year.<sup>14</sup> But the economic crisis has created renewed urgency to Beijing's health care reform efforts.

In April 2009, after over two years of intense debate and repeated revisions, China unveiled its blueprint for health care as part of its US\$586-billion stimulus package. It kicked off the much-anticipated reform to fix the ailing medical system and to ensure fair and affordable health services for all 1.3 billion citizens. US\$123 billion was allocated to invest in China's health care system in the coming three years, doubling the average annual government expenditure compared with 2008.<sup>15</sup> According to the tone-setting "Guidelines on Deepening the Reform of Health Care System," Beijing pledged to provide "safe, effective, convenient and affordable" health services to 90 percent of the population by 2011.

China's new health care reform policy was released after more than 20 years of transition from a socialist planned economy to a market economy, a period during which China's cradle-to-grave social security network was gradually dismantled. Throughout this time, private and quasi-public

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<sup>10</sup> Ibid.

<sup>11</sup> Shanlian Hu et al., "Reform of How Health Care Is Paid for in China: Challenges and Opportunities," *The Lancet* 372, issue 9652 (November 2008): 1849.

<sup>12</sup> "China Looks at Healthcare to Rebalance Economy," Reuters, August 4, 2009.

<sup>13</sup> Charles Freeman and Xiaoqing Lu, *China's Capacity to Manage Infectious Diseases: Global Implications* (Washington, D.C.: CSIS, March 2009), p. 88.

<sup>14</sup> Ibid.

<sup>15</sup> "China's Health Care Reform Aims at Public Interest, Premier Wen Says," Xinhua, February 28, 2009, [http://news.xinhuanet.com/english/2009-02/28/content\\_10917884.htm](http://news.xinhuanet.com/english/2009-02/28/content_10917884.htm).

health care delivery systems became increasingly the norm, rather than the exception. During an online chat with Chinese netizens in February 2009, however, Premier Wen Jiabao called health care a “public good,” signifying a new direction in the government’s approach.<sup>16</sup> The latest step in the reform process is designed to put public interest at the center of the health care system by defining hospitals as nonprofit organizations, as well as giving the government power over medical resource distribution.<sup>17</sup>

Among many other measures, the reform plan calls for the central government to support the construction of 2,000 county hospitals and the construction or expansion of 5,000 township-level clinical centers.<sup>18</sup> The government also hopes to increase health insurance subsidies for Chinese farmers and unemployed urban residents from US\$11.72 to US\$17.59 per person by 2010.<sup>19</sup> A significant portion of infrastructure expenditures made via the current fiscal stimulus package have gone to expand construction of hospitals and clinics, purchase new or improved medical equipment, and expand outlays for health insurance and ongoing care.<sup>20</sup> (For instance, following the government’s investment plan, IBM launched a new industry solution lab in China in April 2009 focusing on the health care market and released four software solutions that could help hospitals establish electronic patient records at reduced costs.<sup>21</sup>) To some extent, therefore, the current economic crisis may be a boon to the health and welfare of Chinese citizens.

For foreign medical device companies, health care reform in China could prove to be an opportunity to increase exports to China and offset lagging demand elsewhere. While the U.S. medical device market has been hit by the financial crisis, for example, China’s market is projected to almost double in size between 2006 and 2014 to US\$28 billion a year, making it a potential growth driver for foreign firms.<sup>22</sup> The U.S. medical device industry exports US\$713 million worth of products to China annually,<sup>23</sup> and hopes are high among industry that a variety of nontariff barriers to increased market penetration can be overcome.

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<sup>16</sup> Ibid.

<sup>17</sup> “Last Minute Challenges for Health Reform,” *Caijing*, March 19, 2009.

<sup>18</sup> Barry Naughton, “Understanding the Chinese Stimulus Package,” *China Leadership Monitor*, no. 28 (2009). See also “Press Conference on the Health Care Reform by Responsible Officials of the NDRC, Ministry of Health, Ministry of Finance, and Ministry of Labor and Social Security,” April 8, 2009, [http://www.ndrc.gov.cn/xwfb/t20090408\\_271261.htm](http://www.ndrc.gov.cn/xwfb/t20090408_271261.htm).

<sup>19</sup> Calum Macleod, “Chinese Health Care Reformers Aim to Help Rural Areas,” *USA Today*, May 8, 2009, [http://www.usatoday.com/money/world/2009-05-06-china-health-care-reform\\_N.htm](http://www.usatoday.com/money/world/2009-05-06-china-health-care-reform_N.htm).

<sup>20</sup> Naughton, “Understanding the Chinese Stimulus Package.”

<sup>21</sup> “IBM Bets Big on Nation’s Health Reform Thrust,” *China Daily*, April 4, 2009.

<sup>22</sup> “Health Care Reform, China Style,” *Business Week*, August 21, 2009.

<sup>23</sup> Ian Wilhelm, “Charities in Asia Work to Keep Donors Engaged during the Recession,” *Chronicle of Philanthropy*, April 23, 2009.

## Challenges to Effective Implementation

The reform plan anticipates improving public confidence in China's health care system and thus creating a multiplier effect through the economy in response to the global economic downturn. Despite these aspirations, however, Beijing's objectives might not be achieved without proper implementation of the plan.

Although there is a desire to shake loose private savings by ensuring a meaningful public option, a key question going forward is how much health care the government is actually prepared to subsidize. According to the plan, the central government provides only 40 percent of total funding while local governments bear the rest of the budgeting burden. However, many local governments are already overextended. Official data in May indicate that local governments have only been able to put up 48 percent of the matching funds so far. Meanwhile, some local governments are heavily in debt to the central government. A study conducted by the Development Research Center of the State Council (DRC) estimates the total debt held by local governments is over 1 trillion yuan.<sup>24</sup> Under the current economic distress, some local governments are using funding from the central government to retire old debts rather than investing in new public projects. This practice is detrimental at a time when government-sponsored investments are crucial for job creation and economic stimulus.

Differences among local governments' relative fiscal strength are also compounding inequities in health care. The April 2009 reform plan establishes a minimal level of coverage, to which local governments may add additional features based on regional economic and health profiles. This offers an opportunity for rich areas like Shanghai to provide higher-quality care to their residents. In contrast, in inland provinces such as Yunnan and Gansu, where the rural population is the largest and the disease burden the heaviest, the local economy is often too weak to generate adequate tax revenue to come up with additional funds. Unless the central government takes local funding capacities into consideration, the health care reform will only reinforce the current service gap, as well as the existing horizontal inequities within the Chinese public finance system. Because regional development and income disparities are already a source of public dissatisfaction and disgruntlement, Beijing's failure to address this issue could become the basis of increased public disquiet.

Another troublesome feature of the proposed health care reforms is the requirement that multiple agencies of the Chinese government variously collaborate and compete in ensuring health care coverage. The Ministry of Health, for example, is supposed to coordinate with the Ministry of Finance on allocation of funds for health care. Bureaucratic disincentives to this kind of collaboration are rife, and the failure of health care reform to address China's notorious bureaucratic stove-piping problems is telling.

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<sup>24</sup> "Local Governments May Issue Bonds," *China Daily*, March 2, 2009, [http://www.chinadaily.com.cn/bizchina/2009-03/02/content\\_7524512.htm](http://www.chinadaily.com.cn/bizchina/2009-03/02/content_7524512.htm).

Many Chinese furthermore doubt the government's ability to change the for-profit scheme that has dominated the system for decades.<sup>25</sup> Indeed, a closer inspection of budget plans for public health care suggests that Beijing's desire to create a public health care system is not matched by its willingness to pay for it. It appears, for example, that much of the proposed "new" funding involves previously approved allocations, not new money. In addition, for-profit incentive structures encouraging over-medication and over-charging on pharmaceuticals that are imbedded into the current structure remain largely untouched by the reforms. While ending for-profit medication sales would fit a reform priority to improve public services, the government needs to significantly increase input in hospitals by covering operational costs. However, the Ministry of Finance's 2009 budget plan includes funds only for infrastructure construction and equipment purchase, leaving out all other items, including proposed increases of worker salaries.<sup>26</sup>

Finally, China's health care reform is primarily directed at satisfying China's current health care burden, rather than taking account of newly emergent burdens (for example, as a result of environmental degradation) and potential savings that might be addressed by a focus on wellness and primary care. In any case, the task of restructuring China's overall health care system is massive. That an initial stab at a comprehensive plan was not completely effective should be neither a surprise nor an impediment to future efforts at reform.

## International/Nongovernmental Health Programs in China

The current economic crisis has brought together governments, international organizations, nongovernmental organizations (NGOs), and corporations worldwide to consider new ways to break out of usual patterns of charitable giving and toward capacity building within recipient countries. China does not, for example, have the same kind of heavy dependence on foreign medical assistance as do some African countries, but it will still benefit from fortifying its own health care system and financing through attention to global best practices that can be made available by donors.

International organizations have offered valuable technical and financial support to China in its battle against infectious diseases in recent years. Over the past years, the Global Fund to Fight AIDS, Tuberculosis and Malaria (the "Global Fund") has provided US\$424 million to China.<sup>27</sup> Notably, the Gates Foundation recently announced a program that will provide US\$33 million over the next five years to help introduce new tuberculosis diagnostic tests, drugs, patient monitoring strategies, and worker's training in China. The program will be effective in 20 Chinese

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<sup>25</sup> "Last Minute Challenges for Health Reform," *Caijing*, March 19, 2009.

<sup>26</sup> Ibid.

<sup>27</sup> Bates Gill, J. Stephen Morrison, and Xiaoqing Lu, *China's Civil Society Organizations: What Future in the Health Sectors?* (Washington, D.C.: CSIS, November 2007), p. 15.

cities, treating 50,000 patients each year.<sup>28</sup> This marks one of the few new funding initiatives established recently, when many sources of international funding are dwindling due to the economic crisis. With the limited international resources, it is important to channel them to areas that will benefit most from foreign assistance, for example in such key areas of challenge as health care systems management.

With the emergence of a more affluent society, China has also witnessed a steady increase in domestic philanthropic contributions over the past few years. Relief donations for the Sichuan earthquake totaled 76.7 billion yuan (approximately US\$11 billion), the majority of which came from within China, one of the largest efforts in the history of the country.<sup>29</sup> However, domestic contributions to health groups are expected to experience a sharp decline amidst the current economic crisis, as is evidenced by the 20 to 30 percent drop in charitable pledges in 2008.<sup>30</sup>

The past decade has seen an evolution in China's engagement in global health, mostly driven by major infectious crises in China, such as the outbreak of SARS in 2003 and avian influenza in 2005, as well as Beijing's expanding presence in Africa. While China's growing efforts have added an important dimension to Chinese diplomacy, leadership, and donor agenda, it is certain that Beijing will take a cautious, inward approach on the global health front in the near term, given the enormous challenge of overhauling its health system at home and the ongoing economic crisis across the globe.

Across-the-board pledge cuts and possible shortfalls in funding are likely to result in concentrated investments in managing a few, high-priority diseases by international and domestic NGOs. However, concentrating improvements in selective health areas is not a cost-free strategy. Primary care in particular is likely to suffer further as emphasis on disease management becomes the focus of international health agencies and NGOs. Recent data indicate that the share of global health assistance to HIV/AIDS more than doubled, while investment in primary care dropped by almost half, between 2000 and 2004. Recipient countries have become increasingly reliant on foreign assistance and incapacitated in organizing their own primary care and disease prevention mechanisms.

To reverse this trend, Beijing might take a more active role in channeling assistance from international and nongovernmental groups into areas that fit within its overall drive to provide for a greater share of its overall health burden. If, as is clear from Beijing's efforts to date, a holistic approach to health care reform is part of an overall effort to restructure its economy to be less reliant on export-led growth, Beijing should consider ensuring that international efforts to assist China to meet its health care burden are directed at establishing effective reform and capacity

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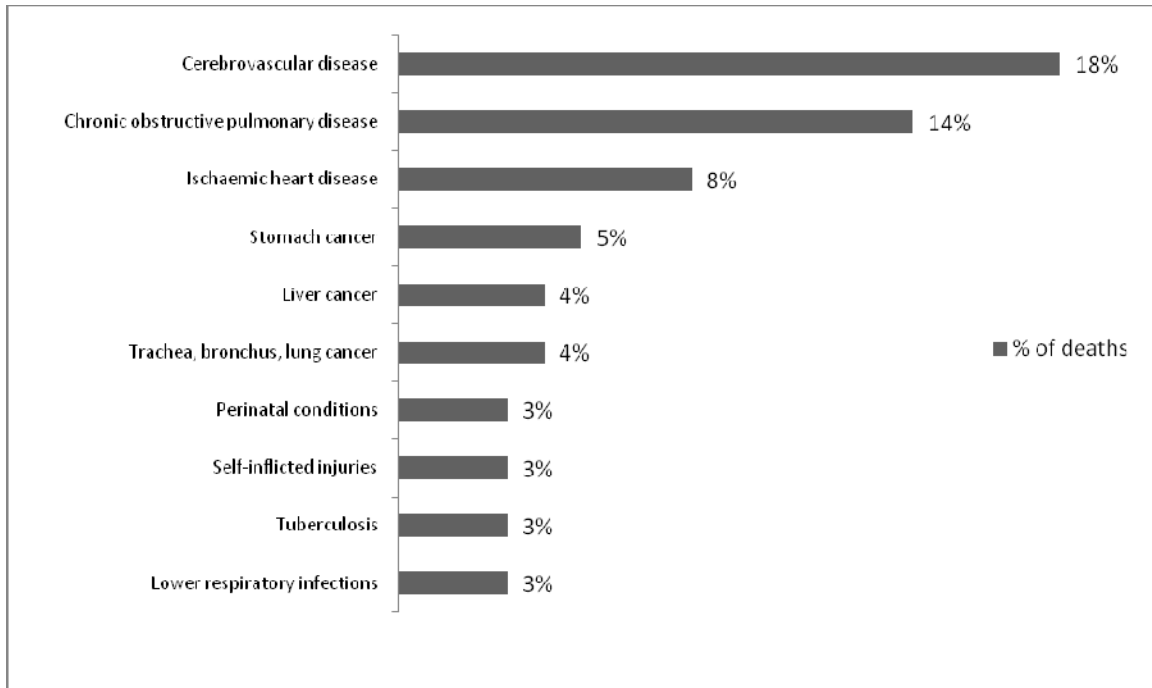
<sup>28</sup> "Bill Gates Joins China's TB Control Efforts," *China Daily*, April 1, 2009, [http://www.chinadaily.com.cn/china/2009-04/01/content\\_7640247.htm](http://www.chinadaily.com.cn/china/2009-04/01/content_7640247.htm).

<sup>29</sup> Juliet Ye, "Sichuan Donations: Where Does the Money Go?" *Wall Street Journal*, August 13, 2009, <http://blogs.wsj.com/chinajournal/2009/08/13/sichuan-donations-where-does-the-money-go/>.

<sup>30</sup> Wilhelm, "Charities in Asia Work to Keep Donors Engaged During the Recession."

building. Decades of a laissez-faire health care policy have meant that Beijing faces a daunting problem as it seeks to fundamentally restructure its economy. A laissez-faire attitude to international assistance going forward is unlikely to be part of the solution to that problem.

## Appendix: Top 10 Causes of Death in China (all ages, 2002)



Sources: WHO, "Mortality Country Fact Sheet 2006: China," [http://www.who.int/whosis/mort/profiles/mort\\_wpro\\_chn\\_china.pdf](http://www.who.int/whosis/mort/profiles/mort_wpro_chn_china.pdf); and WHO, "Death and DALY Estimates by Cause, 2002," <http://www.who.int/entity/healthinfo/statistics/bodgbdeathdalyestimates.xls>.