Professor William C. Hsiao

“Where Does the Marketization of China's Healthcare Lead to?”

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In 2013, China changed its health policy and turned to the unfettered market forces to drive its health sector. Where would this lead to? William C. Hsiao, Research Professor of Economics at Harvard T.H. Chan School of Public Health, analyzes this change with a historical perspective of China's healthcare reforms that swung from central planning to free market during the last three decades. He foretells the problems down the road of marketization.

Hsiao begins with the economic theory that markets are the most efficient mechanisms to allocate resources and distribute goods and services. But is this theory applicable for the health sector? First, healthcare has intrinsic value, being essential to maintain life and relieve suffering; societies aim to assure every citizen has access to the essential services, regardless his or her ability to pay. Second, the assumptions underlie the economic theory are largely violated in healthcare. Most patients only know the symptoms of their illnesses, but not the specific disease or appropriate treatment. Patients seek physician services for their expert knowledge and skills. This asymmetry of information between physicians and patients leaves physicians in powerful positions to exploit patients in a free market. Third, medicine is a highly uncertain science; quality of healthcare is difficult to judge. The same drug can have very different effects on different patients with the same disease because we have different genomics and metabolism. Thus, patients can hardly assess the trade-off between price and quality. These serious market failures forced countries to rely on government actions and public health services.

China's healthcare system went through various degrees of reliance on the market. Before 1978 in a planned economy, the Chinese government and local communes had financed and provided the primary care to most people. This actually produced quite good results, including a dramatic reduction in infant mortality, which was the envy of all the developing nations as China was poor at that time. After 1978, China embarked on massive economic reforms, under which the communes were dissolved and tax revenues drastically reduced. Governments reduced their financial support for public hospitals and clinics, and shifted public health services to rely on the market to survive and thrive.

From the early 1980s to 2009, public hospitals increasingly relied on charges to patients for drugs, imaging tests, and surgery to generate profits and distributed them to their staff as bonuses. Often unnecessary tests, drugs and surgeries were ordered. Today, physicians of tertiary hospitals do triple their compensation with bonuses. These large profits for bonuses were derived partly from illegitimate kickbacks from pharmaceutical and medical supply companies.
Patients gradually realized that doctors did not necessarily do their best for their interests. They began to bribe doctors with red envelopes to create informal obligations for the doctors to do the right things. However, when patients did not get well after giving bribes, the doctors often became victims of physical attack by either the patients' family members or their hired thugs. Meanwhile, almost 90% of Chinese were without health insurance. Every year the healthcare expenses drove about 3-4% of people below the poverty line. Moreover, when healthcare is largely driven by profit motives, primary care and prevention were neglected.

Chinese government recognized these problems by the late 1990’s. From 2005 to 2008, the government internally debated about how to deal with them. After much consultation with experts from universities and think tanks, the government began a major healthcare reform in 2009. It decided to finance a universal health insurance with tax revenues, funded training for primary care doctors, nurses and village doctors down to the village level, and regulated the prices and the distribution of 330 basic essential drugs through competitive bidding at the provincial level. As a result, now about 95% of Chinese have basic health insurance coverage, and primary and preventive care improved.

The new 2013 policy changed the direction of China's healthcare again. Having prioritized economic growth as the number one objective, the government has identified the health sector as growth areas for promoting domestic consumption and creating jobs. The market strategy is to encourage private domestic and foreign investors to invest in the health sector with favorable tax treatment and land uses. Promotion of consumption of health goods and services are widespread. From those abundant and dazzling advertisements in China on all kinds of omnipotent healthcare products and services, including claims of "cure of cancer," one gathers that the Chinese healthcare industry must have found the magic cure or prevention for most diseases. The government aims for the Chinese health expenditure to increase 15% per year from 2013 to 2020, about twice of the annual GDP growth rate; the share of the healthcare sector in Chinese GDP would increase from 5.3% in 2013 to 8% in 2020.

Looking forward, Hsiao thinks that the Chinese government will get what it wishes for its marketization strategy: more domestic consumption, more jobs in the health sector, and more profits for private investors. But he is concerned about creating a two-tier healthcare in China, with overwhelming resources devoted to the top 15-20% of affluent people who are able to pay, and insufficient resources for the other 80%. By allowing industrial policy to drive healthcare policy, China will soon face challenges of social unfairness and greater inequity. Finally, Hsiao believes China will eventually have to craft policies to curb the profit taking of the private businesses in the health sector when the government acknowledges the serious market failures in this sector.