

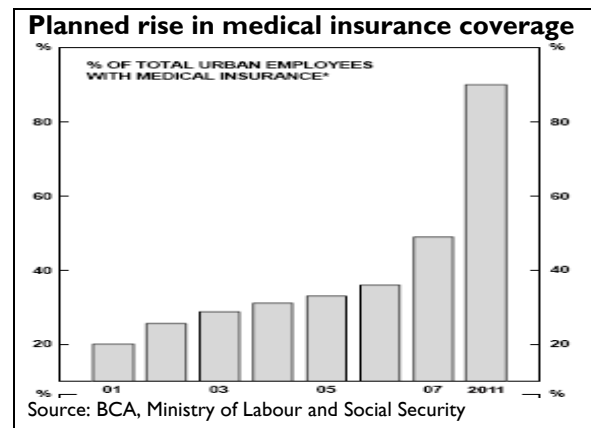
**Healthcare reform – China, not the US, is key**

While Obama’s healthcare reforms are generating the headlines, we believe that healthcare reforms currently underway in China are more significant for the longer-term outlook of the world economy. Healthcare reform is part of a process that could lead to a huge increase in the level of consumer spending in China, creating a new source of demand growth for the Chinese and the global economy. The key is improved provision of social security (healthcare, pensions and unemployment benefits) that would reduce the need for Chinese consumers to hoard savings against these risks and so encourage a greater level of consumer spending.

The move to a market-oriented economy in China has involved a sharp reduction in the proportion of the population working for State Owned Enterprises (SOEs) which provided their employees with a package of jobs, pensions and healthcare known as the ‘iron rice bowl’. The closure of many SOEs around the time of the Asian crisis and the curtailing of generous pension schemes caused a sharp jump in the savings rate. This has been sustained as the subsequent growth of employment has been driven by the private sector. With the exception of state employees, there is very limited provision of social services. By one calculation the cost of the average hospitalisation would consume most of an average year’s salary, which provides a driving motivation for household savings rates of a quarter of income. As a consequence, total household savings are in the order of \$2 trillion or two years’ spending.

While the Chinese government shows little desire to fund a national health service, it has doubled spending on healthcare over the past three years and sought to promote expanded coverage of health insurance. The aim is to achieve 90% coverage of the urban workforce by 2011, up from

around 50% in 2007 and less than 20% only a decade ago. This compares with current US coverage rates of some 85% of the entire population. While this still leaves issues (such as lower coverage for the other half of China’s population that is defined as rural), it represents a major advance. It also provides clear support for a gradual decrease in the level of precautionary savings and an increase in the proportion of consumer spending.



China is the world’s fifth largest consumer market, but consumption is only 36% of GDP – half the level of the US, but also only two-thirds the level of the relatively thrifty Japanese and Europeans. China’s consumption used to account for a more normal 50% of GDP until 1990, the start of its huge investment and industrialisation (and export) surge. We therefore see the current healthcare reforms as part of a programme of changes that will help the Chinese economy shift back to a greater emphasis on consumer spending as the population enjoys the fruits of its hard work and savings. This would help reduce China’s current reliance on exports and, on the other side, other countries’ trade deficits, such as the US. This rebalancing of trade flows is likely to have an influence on currency markets, favouring an appreciation of the renminbi, especially against the US dollar.

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