Regulating Medical Services in China

by Hong Wang, Yanfeng Ge, Sen Gong

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Development Research Center (DRC)
The State Council of P.R. China

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FOREWORD

This report describes the problems of access, quality, and cost of health care service during the process of transforming the economy of China to a market-oriented economic system. These problems are highly related to the absence of effective regulation of medical services in China. The report then describes how experience in other countries could inform senior officials of the Central Government of the People's Republic of China as they reform regulatory policy.

The report is the result of collaboration between the Department of Social Development at the Development Research Center (DRC) of the State Council of P.R. China and the Milbank Memorial Fund. The DRC is a comprehensive policy research consulting institution within the government of China. Its main function is to undertake research on overall, comprehensive, strategic, and long-term issues in national economic and social development and to provide policy suggestions and consulting advice directly to the government of China.

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The staffs of both the Fund and the Department of Social Development at the DRC organized a meeting of senior Chinese officials and their counterparts from other countries, which was held in Beijing in July 2006. The purpose of the meeting was to identify the challenges of regulating health delivery in China and to exchange experiences with regulating medical services in both China and other countries. The Department of Social Development at the DRC invited to the meeting policymakers from six national ministries and five provinces, as well as professional associations. The Fund invited senior policymakers from Australia, Canada, Scotland, and the United States. The participants' names and titles are listed at the beginning of this report.

Hong Wang of the Milbank Memorial Fund outlined the report on the closing day of the meeting in order to stimulate the participants to synthesize the discussion that had occurred. Then he, together with Yanfeng Ge and Sen Gong of the Department of Social Development at the DRC, wrote the report. We thank them for their work in preparing both the meeting and the report.

The meeting and this report, however, do not conclude the project. The discussion at the meeting is continuing to inform the Chinese government's work on regulatory reform. The DRC and the Fund anticipate other projects in which policymakers from China and other countries learn from one another.

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REGULATING MEDICAL SERVICES IN CHINA

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SUMMARY

This report describes the major challenges in regulating medical service delivery in China. Section I looks at how the organization and financing of medical services in China have changed during the past quarter century. Section II summarizes the main reasons why regulation is needed, its objectives and scope, and current regulatory policy and its implementation in China. Section III explores the challenges of improving that policy. The last section suggests how the experiences of other countries might help China regulate its medical services.

I. INTRODUCTION

Over the past twenty-five years, China's delivery of medical services has changed dramatically. Most experts attribute these changes to the introduction of market-oriented health reforms as part of China's economic transition, beginning in 1978. A series of market-based incentives have been introduced into the medical delivery system in order to mobilize health providers to improve their productivity, increase overall health investment from multiple sources, and alleviate the government's financial burden of subsidizing the providers of care. These incentives have made possible the following:

- Health facilities now rely more on users' fee-for-service payments to raise revenue without the government's increasing its direct investment.
- Health facilities have become more financially independent and have improved their competitiveness in the marketplace because the government has allowed them to generate surpluses and use them to pay bonuses to their employees and to purchase new technologies.
- Health facilities (both hospitals and clinics) have become individually responsible by tying their employees' performance (for example, the quantity of services each facility provides and its contribution to the facility's overall revenue) to their bonuses.
- Prescription drugs and diagnostic/treatment technologies are now regulated by a cost-plus-price mechanism. This mechanism was an incentive to health care providers to provide more services and improve their productivity. It also encouraged providers to use more expensive services that generate more revenue.

As a result of these market-based incentives, health facilities have become innovative, "public-owned-for-profit" health care providers. These incentives also have encouraged investment in the medical delivery system, thereby increasing both capacity and consumer choice. But these market-based incentives have also had negative effects as well, causing both social and political problems in China. The cost of services has risen, the utilization of appropriate services has declined, access to services has become more uneven, and the overutilization of inappropriate services has lowered their quality.

Although the government of China did benefit from having to spend relatively less on the public's health care because of the market-oriented health system reform, it also became increasingly aware of the problems caused by these market-based economic incentives. Therefore, beginning in the late 1990s, the government implemented policies to improve the quality, efficiency, and equity of medical services. The results of these policies have not yet, however, been systematically reviewed, and the problems just described still exist or have become worse. Moreover, the population's overall satisfaction with the medical delivery system has not improved.

Chinese officials in many government agencies are currently reviewing the impact of market-oriented health care reforms in order to revise them or to create a new regulatory policy. An assessment of how the delivery system is regulated is central to this review. If market forces are to continue to be important to the delivery system, improving the access to and the quality of health care will be critical.

II. THE CURRENT STATUS OF REGULATORY POLICY FOR MEDICAL SERVICES IN CHINA

THE NEED TO REGULATE MEDICAL SERVICES

The Chinese government should use its power to regulate medical services in order to influence the behavior of providers. Indeed, the need to regulate medical services is recognized around the world. The purposes of such regulations are (1) ensuring the fairness of market exchange in the delivery system, (2) correcting market failures in the delivery system, and (3) ensuring equity in the delivery of medical services. Although these purposes have gradually been accepted in China, some local government officials want regulations to be relaxed even more in order to give health providers more autonomy. These officials claim that government should not interfere so much in the market-based health care system, but the Chinese government has nonetheless accepted the necessity, as well as the difficulty, of regulating the health system. The government also knows that it is important for regulations to redistribute benefits among different interest groups. But redistribution also means that a more effective regulatory system will be resisted, and the government is likely to take stronger action to overcome such opposition.

THE REGULATION OF MEDICAL SERVICES

The three objectives of regulatory policy are quality and safety, equity of health services, and cost-effectiveness or value for money. Table 1 (see page 9) summarizes China's current policy regarding these three aspects of regulation.

Regulations related to quality and safety must address:

Market entry (including the licensing of doctors, hospitals, and pharmaceutical companies). The Chinese government currently regulates market entry, but the implementation of these regulations is not assessed rigorously and the assessment that is done is not made public.

Practice guidelines and procedures. Through the Ministry of Health, the government currently delegates authority to the medical professional associations to establish guidelines and procedures. Although draft guidelines were completed two years ago, they still are not regulations but only guidance. Guidelines for medical procedures are still being drafted.

Drug quality control. Drug production is licensed by agencies in the provinces, each of which is equivalent to the U.S. Food and Drug Administration (FDA). These agencies are responsible for controlling drug quality only within the province, even though the market for most drugs covers the entire country. These provincial agencies try to balance the tension between drug quality control and the contribution of pharmaceutical factories to local economic development.

The second objective of regulatory policy is to promote equity in service delivery. Because markets cannot provide services to people who cannot pay for them, in order to achieve greater equity the government must establish a safety net of basic health services for the poor. This safety net includes regulation as well as direct government financing and the provision of services.

China has established two sets of regulations to promote equity. The purpose of the first set is to ensure an adequate supply of services in underdeveloped regions. To do this, large hospitals located in relatively wealthy, mainly urban areas are required to support institutions located in relatively poor, mainly rural areas. The reason for the second set of regulations is to make sure that patients are not refused emergency services if they are unable to pay for them. But who should cover the costs of services for patients not able to pay for them is still being debated. A systematic assessment of the results of both sets of regulations has not been undertaken.

The third objective of regulatory policy is ensuring the cost-effectiveness of medical services by controlling prices, provider payment methods, capital investment, and the use of surpluses.

Price control. In China, the governments regulate prices. The central government issues guidelines for setting prices, and then the Bureau of Pricing in each provincial government actually sets the prices of medical services and drugs in that province. In the past several years, in order to reduce patients' burden to pay for medical services, governments at both levels announced, for example, several reductions in drug and medical service prices. Because the providers choose which drugs to prescribe and in what quantities, they also can replace less profitable with more profitable drugs and can prescribe large quantities of drugs in order to generate a higher profit. But without rigorously implementing the practice guidelines and changing the incentives to limit prescriptions and the profits from them, price regulation cannot ensure that patients' or third parties' money is spent effectively.

Provider payment. China lacks nationwide payment regulations to ensure the cost-effectiveness of medical services. As mentioned earlier, in the first stage of health reform, payment regulations were relaxed in order to encourage providers to increase productivity. That is, the government allowed institutions to make a profit and to use it to improve their competitiveness as well as to increase bonuses for doctors, nurses, technicians, and other staff members who improved their productivity. Payments to individual practitioners are based on performance, which is measured by the volume of services or the practitioner's contribution to a facility's revenue or, less precisely, the quality of its services. These incentives for bonus payments also have increased the volume and hence the cost of services and may have reduced their quality as well.

Capital investment. China has few regulations controlling capital investment in health services. The government encourages investments by multiple sources to replace public capital, and because investors seek profits from health care, providers raise the charges to patients in order to service their own debt.

Regulating surpluses (profits). About 95 percent of hospitals and 50 percent of clinics in China are publicly owned and theoretically not-for-profit. By regulation, their surpluses can be used only to improve the delivery of services. These regulations, however, do not define improvement precisely. For example, hospitals and clinics can claim that their reinvestment and bonus pay are being spent to improve services. The consequence of this imprecision is that profit or surplus can be used to generate more profit, thus increasing the burden on patients and third-party payers.

III. THE CHALLENGES OF IMPROVING THE REGULATION OF MEDICAL SERVICES IN CHINA

Although the Chinese government has gradually recognized the need to regulate medical services more effectively, there still are barriers to significant improvement, especially in the short run. The main obstacles are conflicting objectives, fragmentation of the regulatory system, and lack of capacity to implement regulatory policy.

CONFLICTS OF OBJECTIVES BETWEEN ECONOMIC AND SOCIAL DEVELOPMENT

China's goal is to improve the economy and society at the same time, although economic development has been the governments', especially the local governments', first priority. Moreover, progress toward each of these goals is made at different rates in different places. If investment in the health sector is increased, both the people who need health care and the overall economy could benefit. Conversely, however, such economic development might not always contribute to social development. If investment in health services is driven by profit and is not well regulated in the public interest, patients may have to pay more for services. Higher payments are equivalent to making vulnerable people pay higher taxes in the interest of economic development.

A typical example is the pharmaceutical industry. Many local governments want new pharmaceutical factories in their jurisdictions. Although most of these factories are small and produce only generic drugs using low-end technology, any new factory will provide jobs and hence lead to economic growth. Encouraged by the government, between five thousand and six thousand small pharmaceutical manufacturers now operate across the country. In order to sell their drugs to providers, these manufacturers engage in intensive marketing, which includes kickbacks and bribes. As a consequence, the cost of drugs has increased. The cost of drug marketing has become the major cause of high drug prices. These costs eventually become a financial burden for patients.

Economic development and health improvement also conflict at the providers' level. In theory, doctors act as their patients' agents in deciding what services they need. In reality, however, doctors may not act in the best interest of their patients if their income is directly linked to the volume and price of the services they recommend, such as linking doctors' bonuses to the number of drugs and the price of drugs they prescribe. Moreover, the quality of care may be compromised and the financial burden to the patients will increase.

Economic development and health improvement also conflict at the health care administration level. Regulation of the medical delivery system is complicated further by the government's dual role. The medical delivery system in China is still largely owned by the government, which administers it through the Ministry of Health on the central level and the bureaus of health on the provincial level. These government agencies also are responsible for regulating the delivery systems that they own, and the conflict between these two roles reduces the effectiveness of regulatory policy.

THE FRAGMENTED STRUCTURE OF THE REGULATORY SYSTEM

The government's fragmented structure is another complicating factor in regulating policy. At least eleven ministries are involved in developing the health system, the most prominent being the Ministry of Health (MOH), National Development and Reform Commission (NDRC), Ministry of Finance (MOF), Ministry of Labor and Social Security (MOLSS), Ministry of Agriculture (MOA), Ministry of Civil Affairs (MOCA), Administration of Chinese Medicine (ACM), State Food and Drug Administration (SFDA), and the General Administration of Quality Supervision, Inspection, and Quarantine.

Although these agencies share the national goal of improving the health of the Chinese population, each of them has its own objectives, approaches, and agendas in regulatory policy. For example, the MOLSS operates Urban Employees Basic Health Insurance, which is responsible for covering access to basic health services, for maintaining the quality of these services, and for containing their cost. The MOH is responsible for quality control, and because it owns the hospitals and clinics, it must protect the financial interests of the delivery system in order to sustain it. Balancing these multiple objectives within and across agencies is difficult.

Another example of the fragmented structure of the regulatory system is lack of coordination of the SFDA and the MOH, both of which are responsible for the quality and safety of drugs. The SFDA is accountable for the quality and safety of drugs only as chemicals, however, and the MOH has authority for the quality and safety of drug utilization, which is part of the delivery system that the MOH owns and regulates.

LACK OF CAPACITY

Regulating the delivery of services requires clear and operable policy; the collection, assessment, and dissemination of transparent information about violations; and the effective use of evidence gathered by regulators to improve performance. All of these regulatory tasks need to be carried out by high-quality staff members in regulatory agencies. Although China has made great advances in each of these areas, four problems limit the effectiveness of its regulatory policy:

Inoperable regulatory policy. Although China has many policies to regulate medical practice, many of them are conceptual rather than operational. Many policies do not rigorously define their underlying principles or explain how they will be implemented. This problem has two main causes. First, because of the large variation across China, policymakers believe that only broadly defined and flexible policies can be effective. Accordingly, such policies are open to a range of different interpretations, which makes it difficult to monitor their implementation and to determine whether their objectives have been achieved. Second, some regulatory policies are intentionally self-protective. An example is protecting medical providers from disputes and lawsuits by overemphasizing the complexity of health problems and the uncertainty of their

treatment. Such regulatory policies, however, compromise the principal objective of the guidelines, which is, again, to improve the quality of health services.

Lack of transparent information. China has not developed information systems to help regulate medical services. The majority of medical facilities lack electronic information systems, making it difficult to implement the regulatory methodology. In addition, the government permits providers to treat information about costs and payments as a commercial secret, thereby making it unavailable to the public or to regulators.

Limited human resources. Although China is rapidly expanding its capacity to regulate medical services, the training and efficiency of regulatory personnel are not as effective as they could be. Furthermore, good regulatory practice also requires that officials have high moral standards, which are difficult to maintain in many environments and regulatory situations.

Penalties rather than incentives to improve services. Although the purpose of detecting violations through rigorous regulating activities is to improve services, China's current system still relies heavily on the traditional approach of imposing penalties. This approach makes the implementation of regulatory policies to improve service more difficult because violators often conceal problems in order to avoid penalties.

IV. INTERNATIONAL EXPERIENCE

China is in a critical stage of reforming its health care system. If it can rein in market forces in the health sector through regulations that are in the interest of the public's health, China can strengthen its delivery system. China also can learn from experiences of other countries with market economies. Officials of the State Council, ministries of central government and for local government, and their colleagues from other countries who met with them in July 2006 identified the following areas of international experience for further exploration:

Defining clear overall objectives for health and social development that balance improvement of the population's health and protection of the safety of medical services with economic development.

Ranking economic incentives to ensure that providers' behavior is driven first by consideration of their patients' health and safety and only second by their personal and institutional financial interests. Policies should be created to ensure the objective selection of medical service and drug therapy options independent of financial conflicts. Achieving this goal will require changes in the budget and payment systems, in investment policy, in the management of surpluses (profits), and in the financial accountability of individual providers.

Using the government's purchasing power to enhance the implementation of regulatory policies that achieve social goals. Through its direct investment in the delivery of medical services and through the provision of funds for health insurance, the Chinese government has become a major stakeholder in the country's health care. Chinese policymakers can learn from other countries' experiences about ways to use the government's purchasing and investment power to help implement regulatory policy in the public interest.

Restructuring regulatory policy and its implementation, especially by multiple government agencies scattered throughout the country. This includes separating the government's role in regulating medical services from its ownership of facilities that provide services.

Establishing a science-based regulatory system that draws on other countries' recent experiences to assemble the best available evidence to inform regulatory policy. An effective regulatory system requires an evidence-based policy, a transparent information system, and corrective measures that rely heavily on education to change providers' behavior.

TABLE 1: SUMMARY OF REGULATIONS OF MEDICAL SERVICES

	Regulations	Regulating Entities
Medical safety	Market entry licenses	MOH, medical university/training institutes
	Practice guidelines and procedures	MOH, medical professional associations
	Drug quality	SFDA
Equity of services	Medical safety net	MOH
	Medical resource reallocation	MOH, NDRC, MOF
Cost-effectiveness	Service prices	NDRC, Bureau of Pricing
	Payment	Bureau of Pricing, health care providers, health insurance agencies
	Profit/surplus regulation	MOH
	Purchasing	MOH, MOF, MOCA, health insurance agencies

Notes: MOH: Ministry of Health • SFDA: State Food and Drug Administration • NDRC: National Development and Reform Commission • MOF: Ministry of Finance · MOCA: Ministry of Civil Affairs

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