

# Health Is Wealth: Health Care Spending As An Emerging Market Growth Engine

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## Introduction

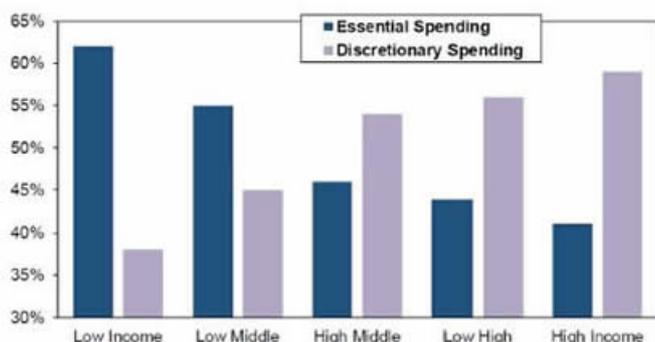
We have little doubt that domestic consumption will drive the next leg of emerging markets growth. What we do question, however, are the consensus measures used to gauge which particular markets will actually succeed on this front. The traditional measures, including demographics, income levels, and macro vulnerability, are of course useful, but we think that one important factor is being overlooked: public health care spending. Our argument is based on a simple trickle-up effect: we believe a population with fewer health care concerns would equate to a population with healthier pocketbooks and, ultimately, to healthier domestic markets.

Below, we present various data showing the high correlation between public health care spending and domestic consumption. Selecting countries with high domestic potential is essential given that consumption growth is related to stock returns. We conclude that one of the most effective – and efficient – ways of boosting domestic consumption in emerging markets is through “efficient” government spending on health care.

## A simple equation

In most developing economies, the population has little choice but to spend the bulk of its income on essentials such as children’s education, medical expenses, and filial support, as well as to build a buffer against adverse life changes (see Exhibit 1). Imagine, however, if some of the income that is currently earmarked for essentials is freed up for discretionary spending. For example, what would happen if households did not need to worry about medical expenses because the government provided universal health care?

**Exhibit 1**  
Household Consumption by Income Level



The proportion of household spending shifts as incomes increase or decrease. The underlying reason is that demand for basic goods (e.g., food and health care) is less elastic than demand for discretionary goods (e.g., cars).

Source: World Bank, GMO As of 12/31/08

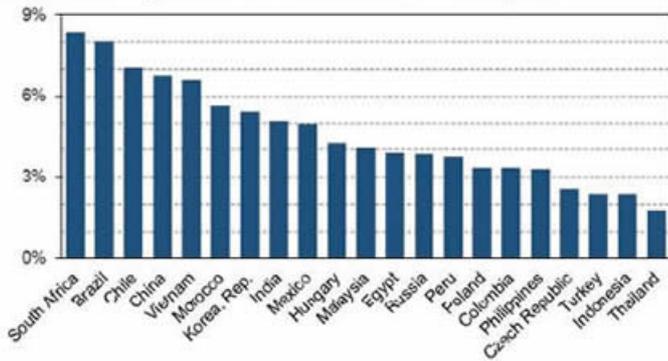
Health care is both costly and necessary, and thus represents a heavy burden on consumers where public health care is not available (see Exhibit 2). Increased public health care expenditure has a direct positive impact on consumption, through three different channels :

- **Income effect:** The money that a family saves from not having to pay for medical bills will be spent on other goods and services, leading to a shift in the aggregate consumption pattern. According to the World Bank, in China, for example, shifting health care expenditure from the private to the public domain through health insurance would translate into economic activity amounting to as much as 80% of the original spending. More importantly, most of these activities would be classified under domestic activity.
- **Insurance effect:** With consumers assured that their medical needs are taken care of, they are likely to reduce the amount of their precautionary savings. One of the reasons often cited for China’s low private

consumption, which has decreased from 55% of GDP in the 1980s to less than 35% currently, is that citizens feel insecure about their financial future given the limited health care, pension, and education benefits available to them.

- **Redistributive effect:** As the main beneficiaries of universal health care coverage, lower-income households would gain the ability to buy goods that they previously did not have the means to acquire.

**Exhibit 2**  
Private Health Expenditure as % of Household Consumption



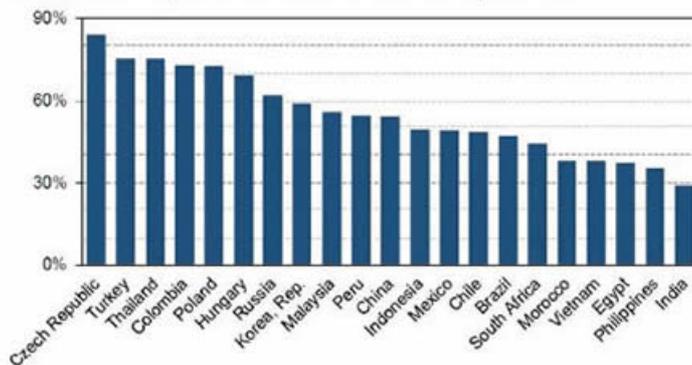
Private health care expenditure represents a significant proportion of total consumption in Emerging Markets. Therefore, eliminating this expense would mean an immediate increase in consumers' income.

Source: World Bank, GMO As of 12/31/10

### The Thailand example

Exhibit 3 shows Thailand as having one of the highest levels of public health care expenditure in Emerging Asia.

**Exhibit 3**  
Public Health Expenditure as % of Total Health Expenditure

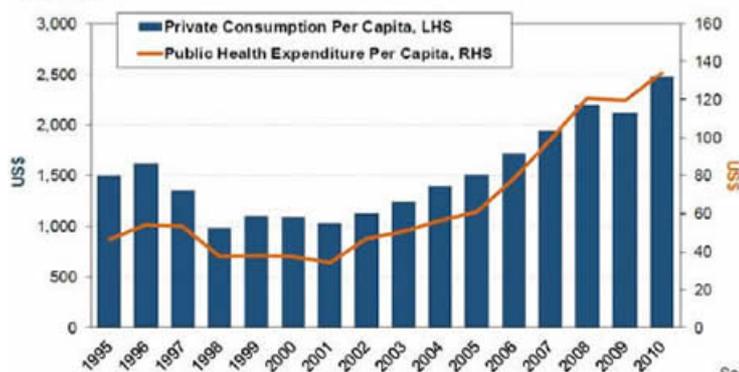


Thailand has one of the highest levels of public health care expenditure (vs. private health care expenditure) among Emerging Market countries. In contrast, countries such as the Philippines, Vietnam, Indonesia, and India continue to have low ratios.

Source: World Bank, GMO As of 12/31/10

Thailand implemented its Universal Coverage Scheme in 2001-02. In a paper<sup>1</sup> published in 2008, Asian Development Bank measured the effect of high levels of out-of-pocket health care expenditure on the consumption of Thai farmers. While the share of basic goods expenditure was roughly similar for households with and without catastrophic expenditure, their spending on education and discretionary goods, such as household appliances, transportation, and communications, would decrease significantly with the need to cover medical expenses; medical expenses had then made up the bulk of their expenditure. According to the World Health Organization, the introduction of the Universal Coverage Scheme has resulted in a drop in catastrophic health care expenditure from 6.8% in 1996 to 2.8% in 2008. Further, Thailand has achieved universal health care in an efficient way, maintaining a stable level of total public health expenditure as a percentage of GDP.

**Exhibit 4**  
Thailand



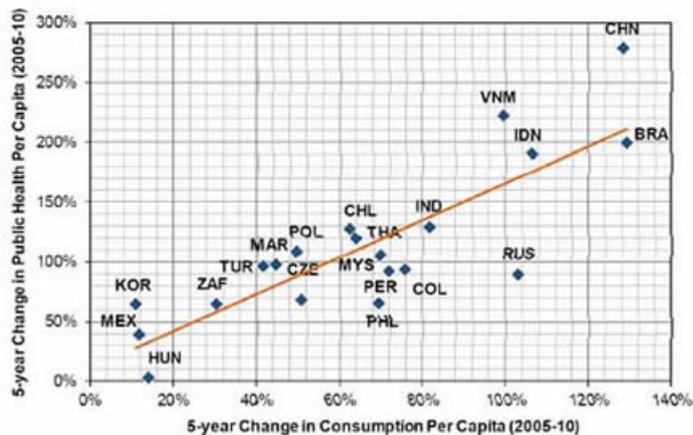
Private consumption evolution in Thailand has clearly followed the same trend that public health expenditure has, as shown in the chart. Consumption per capita in Thailand has increased from 2001, following the rise of public expenditure after the implementation of the Universal Coverage Scheme.

Source: World Bank, GMO As of 12/31/10

Indeed, there is a positive correlation between health care expenditure and private consumption in Emerging Markets, as illustrated in Exhibit 5. It is worth noting that Thailand is the only such market in Southeast Asia where lower-income consumers have increased their share of total consumption over the last decade. It is also the only country in this group that offers universal health care coverage (Exhibit 6).

It can thus be reasonably expected that in a market where the level of consumption is increasing, the demand for elastic goods (such as discretionary goods) will increase more than the demand for basic goods. In our view, economies that increase public health care spending also increase their chances of achieving more resilient domestic consumption growth, which in turn should lead to more sustained overall economic outperformance over those economies that choose to pour resources into less productive sectors. Among the many variables we consider when assessing the countries we believe to have the highest potential for domestic consumption growth, public health care spending plays an important part in our analysis.

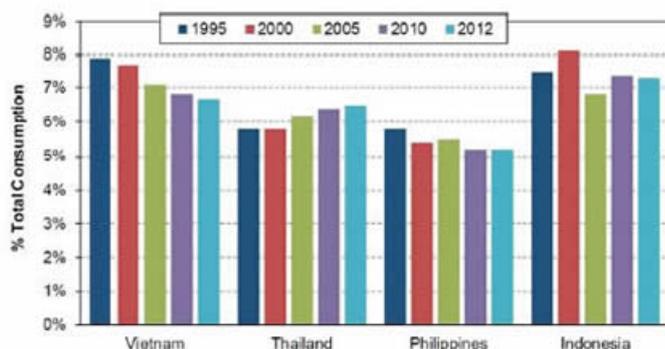
**Exhibit 5**  
Public Health Care Spending and Household Consumption



Public health care spending has a positive correlation with household consumption in Emerging Markets.

Source: World Bank, GMO

**Exhibit 6**  
Consumption of 20% Poorest



It is worth noting that Thailand is the only emerging country in Southeast Asia where lower-income consumers have steadily increased their proportionate share of total consumption over the last decade. It is also the only country in this group that offers universal health care coverage.

Source: World Bank, GMO

<sup>1</sup> S. Setboonsarng and R. Lavado, "Does Organic Agriculture Lead to Better Health among Organic and Conventional Farmers in Thailand? An Investigation

of Health Expenditure among Organic and Conventional Farmers in Thailand," ADB Institute Working Paper No. 129, December 2008.

Mr. Bhartia is a portfolio manager for GMO's Emerging Markets Equity team and oversees fundamental research. Prior to joining GMO in 1995, he worked as an investment advisor in India. Mr. Bhartia earned a Bachelor of Engineering at the University of Bombay and an MBA at the Institute for Technology and Management in Bombay. He is a CFA charterholder.

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