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benefit schemes**

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Background, challenges and proposed measures*

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China's Old-Age Social Insurance Scheme: Background, challenges and proposed measures

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Background

The old-age social insurance scheme is the most important item in China's social security system because of its great impact on socio-economic development. The Chinese Government attaches high importance to this programme. In the early 1950s, China put in place an old-age insurance scheme compatible with the productivity level and economic system. Since the 1980s, the Government has made great efforts to reform the old-age social insurance scheme aimed at establishing one which is compatible with the socialist market economic system.

China's social security system

At present, China's old-age insurance scheme consists of three parts:

- old-age insurance for urban enterprises;
- old-age insurance for state organs and institutions;
- old-age insurance for rural areas.

The old-age insurance scheme for urban enterprises, which is the main part of the scheme, was instituted in the 1950s and reformed in the 1980s. In the mid-1990s, China adopted the model of combining the social pooling system and the individual account system.

The contribution rate for enterprises is normally no more than 20 per cent of the total payroll while for individuals, it is 8 per cent of wages. The basic old-age pension is composed of the base pension which is 20 per cent of the workers' average wage in

the respective localities in the previous year and the individual account pension which is 1/120 of the accumulation in the worker's account.

The desired replacement ratio is around 60 per cent. By the end of 2004, the number of active workers and retirees covered by the urban enterprise old-age insurance scheme reached 109.04 million and 37.75 million, respectively.

A different old-age insurance scheme is currently applied in state organs and institutions. The main features of the scheme are as follows:

- pension expenditures are borne by the state or the working units;
- pensions are based on the wages of the individuals and calculated according to the years of service.

In the mid-1990s, a pilot project where individuals were also made to pay contributions was introduced in some provinces. By the end of 2004, 13.46 million active workers and 3.28 million retirees were covered.

The provision of old-age security protection in China's rural areas is centered mostly on the families. In the 1990s, China began to experiment with an old-age insurance scheme in some rural areas. The system is financed mainly by an individual's contribution with some financial support from the community and policy support from the state. At present, 53.78 million people are covered by this scheme.

Accomplishments over the past 20 years

After 20 years of exploring new ways of providing social security protection, the following have been achieved:

Adopting the old-age social insurance model

Ten years ago, China replaced the pay-as-you-go system of financing the basic old-age social insurance scheme with the partial funding system which combined social pooling with individual accounts. The pension from social pooling is a proportion of the local average monthly wage, mainly reflecting justice and regulation. On the other hand, the individual account pension is based on the amount accumulated in the individual's account, a main expression of the difference in the contributions paid and is closely linked to rights and obligations.

Expanding the coverage of the old-age social insurance scheme

Under the planned economy, only workers in state-owned enterprises are entitled to social insurance benefits. With the reform and opening up of the economy, along with the development of multiple forms of business ownership and diversified forms of employment, the old-age social insurance scheme experienced a steady expansion in coverage. The basic old-age social insurance scheme covers all workers in urban enterprises, the self-employed and people in flexible employment. By the end of 2004, the number of participants under the basic old-age social insurance scheme in urban areas was 164 million, of which roughly 40 million were pensioners, making it one of the biggest old-age insurance schemes in the world.

Establishing a funding mechanism shared by multiple parties

In the past, the old-age social insurance scheme in China was financed by either the government or the employing unit. Since the 1990s, a new funding mechanism has gradually evolved whereby costs are shared by the state, the employing unit and the individual worker. In the present old-age social insurance scheme, both the employer and the individual worker pay contributions. Moreover, the central and local governments also provide special subsidies to the scheme.

In 2000, the Chinese Government established the National Social Security Fund, which was to be financed from the central budget, sales of state shareholdings, and other sources. The National Social Security Fund is an important financing source of the old-age social insurance scheme. By the end of 2004, it had accumulated about 170 billion Yuan (approximately US\$ 20.0 billion). The new funding mechanism expanded the financial channels and strengthened the public's awareness of social security.

Promoting socialized management and service delivery

In 2000, the payment of old-age pensions by enterprises was replaced by payments through banks and post offices. Since 2002, greater efforts have been given to the socialized management of the retirees. At present, labor and social security agencies have been set up in more than 95 per cent of the neighborhoods and labor and social security staff been equipped in over 80 per cent of the communities. They provide socialized management service to the retirees. The socialized management service has lightened the social burden of enterprises and created favorable conditions for the elderly population to be integrated in society.

Establishing a multi-layer old-age insurance system

In recent years, the Chinese Government has made great efforts to build a multi-layer old-age insurance system. In addition to their coverage under the compulsory basic old-age social insurance scheme, enterprises with suitable conditions may set up annuity schemes for their employees. Both enterprises and individuals contribute to the annuity scheme which will be managed like personal accounts. The funds of the annuity schemes will be managed and operated in accordance with the market mechanism. An estimated 7 million people participated in the enterprise annuity schemes which at present has an accumulated fund of almost 50 billion Yuan (approximately \$ 6.0 billion). In addition, the state also encourages personal savings for old age.

Streamlining the administration of the social security system

In March 1998, the Ministry of Labor and Social Security was established. The various social insurance schemes for enterprise workers, employees in government organs and institutions, workers in the rural areas and in industries as well as the medical insurance scheme were all brought under the management of the Ministry of Labor and Social Security, resulting in a unified social security administrative department.

In the same year, the industry-wide basic old-age insurance scheme covering 14 million workers and 4.2 million retirees in 11 industries, i.e., railway, power, post and

telecommunications were handed over to the local governments. At the same time, in order to strengthen fund regulation, efforts have been made to raise the social pooling level.

Undertaking experimental reforms in selected areas to improve the basic old-age social insurance scheme

In 2001, the Chinese Government carried out a pilot project in Liaoning province whereby funds were injected in individual accounts so as to put in place a long-term, effective and sustainable old-age insurance scheme. The total accumulation in the individual accounts amounted to 14 billion Yuan (approximately \$ 1.7 billion) by the end of 2004. The pilot project was expanded to Jilin and Heilongjiang provinces in 2004. Besides injecting funds in the individual accounts, the pilot project in the two provinces also studied the manner of calculating the amount of basic pension such that the amount of basic pension is more closely linked to the period of the employee's contributions. If an employee has contributed to the basic old-age social insurance scheme for 15 years, he or she will be entitled to a higher rate of pension for every year in excess of the 15 years. The pilot project in the three provinces perfected the old-age social insurance model with innovations in the funding mechanism and increasing the social insurance awareness of the covered workers.

Challenges and opportunities for China's old-age insurance development

China faces serious challenges from the following factors:

Population ageing

Population ageing in China is characterized as rapid, large scale and with "being old before getting rich". The accelerated population ageing has resulted in a huge fund shortage for the old-age social insurance scheme. The ratio between the workers who pay contributions and the pensioners decreased from 5:1 in 1992 to 3:1 in 2004. It is projected that in 2020, the urban dependency ratio will become 2.5:1 and the number of retirees will surpass 100 million.

Urbanization

The number of farmer-workers in urban areas stands at 100 million, farmers whose lands were taken over for other uses at 40 million, and farmers working in village and township enterprises at 130 million. It is estimated that in 20 years' time, China's rate of urbanization will increase from 40 per cent to 60 per cent. To accelerate the urbanization process will create a well-off society but this may also cause additional problems to the administration of the old-age social insurance scheme.

Diversified forms of employment

Economic structure adjustments, deepening of enterprise reform, a change in the structure of business ownership, and a new employment pattern have emerged. The non-public sector has become the major source for absorbing the labor force and a large number of workers have taken flexible forms of employment. The traditional and enterprise-based old-age social insurance scheme fails to keep in pace with the

new employment pattern and increasing job mobility. A large number of employees in the non-public sector and in other flexible employment are left outside of the old-age social insurance scheme. How to adapt the scheme to changes in economic ownership and employment forms is an important issue to be addressed in the formulation of China's old-age insurance scheme.

Realizing the urgency and gravity of the challenges, the Government is also aware of the historical opportunities to develop China's old-age insurance scheme. These are:

- The Government attaches high importance to the issue. The strong organization and promotion by the Government is critical to the development of a sustainable social security system. In 2003, the new central leadership adopted the scientific development concept highlighting a coordinated approach to social and economic development. Employment and re-employment have been put as a top priority in the Government's agenda and considered as a key macro-control indicator of national economic growth and social progress. The Government has set parameters and introduced a series of policy measures for the accelerated establishment of a social security system compatible with the current economic development level. The functions of Government have been adjusted and more inputs made on social administration and public services including social security.
- The economy continues to develop. China has experienced an average annual GDP growth rate of 9.4 per cent since the reform and opening up of the economy which has, in a large part, brought about a well-off society. The Chinese Government has set its grand task to build a well-off society in the first two decades of the new century. By the year 2020, China's GDP will quadruple from the 2000 GDP rate, to reach USD 4000 billion. The sustained and rapid economic growth will contribute to the expansion of social security coverage, contributions collection, an increase in the security level for citizens and increased financial support. All these will lay down a solid basis for the development of social security.
- There is a consensus and expectation from the public. The old-age social insurance scheme has provided tangible benefits to the general public which in turn, has given it support. Moreover, the public has higher expectations from the scheme and has actively participated in the People's Congress and the Political Consultative Conference as well as in trade unions, employers' organizations, women's and youth organizations. Public support provides a solid social basis for the further development of the old-age social insurance scheme.
- Intensified international exchange and cooperation continues. The industrialized countries have a long history and experience in the development of old-age insurance. Since the reform and opening up to the market as well as since becoming a member of the ISSA, China has witnessed intensified exchange and cooperation with other countries which enables it to learn from the other countries' wide range of experiences and accelerate its own development.

Proposed measures

China at present has the opportunity to perfect its old-age insurance system. Following are the measures it proposes to undertake:

Injecting funds into individual accounts

Although China established a partial funding system, the reform was not enough. The ageing process has resulted in an increased ratio of beneficiaries to contributors. The current deficit in the old-age insurance scheme increased sharply. Since the social pooling fund could not afford to cover this deficit, the individual account fund has been diverted to ensure payment of pensions. In the past ten years, China has established individual accounts for more than 100 million persons, and by the end of 2004, the total accumulation in these accounts reached more than 700 billion Yuan (approximately \$ 80.0 billion). However, most of this amount is nominal. To achieve long-term financial balance, economic development and social stability, China has to change the financing model completely. From 2001, a pilot project on injecting funds into individual accounts were carried out successively in Liaoning, Jilin and Heilongjiang provinces. The results of the pilot project proved that injecting funds into individual accounts is feasible. After 20 years', China has the basis for perfecting old-age insurance. Great efforts will be made to realize the model transfer by injecting funds into individual accounts.

Broadening investment channels to preserve and increase the value of the funds

Investing and increasing the value of the funds is the internal requirement of an old-age insurance reform and is very important to the long-term financial balance of the system. By the end of 2004, the accumulated old-age insurance fund has reached more than 500 billion Yuan (approximately \$ 60.0 billion). When the pilot project of injecting funds into individual account is extended to other parts of China and the National Social Security Fund is increased, more funds will be accumulated. Based on the current situation in the financial market, China will explore an effective investment model which will put importance to safety. Different types of funds will be invested in different portfolios. According to the regulations, the balance of the social pooling fund, after setting aside a reserve equivalent to the 2 months' of expenditures, should be used to purchase state bonds and be deposited in the special accounts. Investing the funds in other financial markets and businesses is prohibited. The individual account fund, which is very large and which will be used over a long period of time, can be used to support economic construction to increase its value. The National Social Security Fund is a strategic reserve established by the central government. Its investment channels need to be broadened to increase returns. The accumulated fund for enterprise annuity should be invested through the market.

Expanding the coverage of the old-age social insurance scheme

With the economic structure adjustment and diversification in employment, the number of the self-employed and workers in flexible employment have increased. But the policies for their coverage, which are currently determined by the provincial government, are not unified. Most of them are not covered under the old-age insurance scheme. Because their contribution base and contribution rates are lower, there is a hidden debt risk due to the imbalance of input and output. To promote flexible employment and ensure financial balance, there is a need to unify the old-age insurance policies for these types of workers. Covering them under the old-age insurance scheme will enable more people to enjoy social security protection. With

the unification, the contribution base will be the local average wage and the contribution rate will be 20 per cent. In the meantime, there is a need to explore the rural old-age insurance scheme and to perfect the farmer workers' old-age insurance scheme. After the reform, different but linked old-age insurance schemes in the urban and rural areas will be in place.

Improving the formula for the basic old-age pension

Under current regulations, 15-years' contribution is the minimum condition for a monthly pension. This requirement will not encourage workers to continue their contributions beyond the minimum, they would just wait to reach retirement. The individual account pension, which is 1/120 of the accumulation in the account, is based on a life expectancy of ten years. Currently however, life expectancy is 20 years. To make the formula scientific and rational, a new formula will be considered for the base pension where an amount equivalent to 1 per cent of the average of the individual contributory wage and the average local wage will be paid for each year of contribution. Thus, the longer the period of contribution, the higher the pension. The individual account pension will be computed using different ratios based on the person's retirement age, the average life expectancy for the urban population and the prevailing interest rates. Workers will thus be encouraged to retire older. The new formula can play a very important role in encouraging more contributions, strengthening the fund and combining fairness with efficiency. Meanwhile, China will perfect the pension adjustment mechanism. The State periodically raises pension levels according to socio-economic conditions and wage increases so that retirees can also share in the social progress.

Adjusting the retirement age

In China, the statutory retirement age is 60 for males, 55 for females who are engaged in managerial or professional work and 50 for females who undertake production or supplementary work. Workers who do special work or have lost their working ability due to sickness can retire five years earlier. In general, actual average retirement age is around 53. Early retirement severely affects the fund balance of the old-age insurance scheme. To normalize the retirement system and lessen the burden on the old-age insurance fund, the women's retirement age will be gradually increased to 55.

Strengthening the fund regulation by raising pooling level

The short-term aim is provincial level pooling. In China, provincial level pooling exists only in some provinces. In other areas with city or county level pooling, the fund remains unregulated. The structural imbalance becomes more and more dominant. To realize fund regulation and balance, county level pooling will be abolished while city level pooling will be perfected and provincial level pooling will be promoted gradually. Our long-term aim is a national level pooling for base pension.

Perfecting a multi-layer old-age insurance system

Generally speaking, the speed of development of enterprise annuity is slow due to the lack of preferential policy for taxation. To hasten development, the plan is to extend the taxation preferential policy in the pilot project areas of Liaoning, Jilin and

Heilongjiang provinces.¹ At the same time, the management of the enterprise annuity funds will be strengthened.

Reforming the old-age insurance system for State organs and institutions

The aim is to adopt a unified pension insurance system for both enterprises and state organs and institutions to facilitate labor mobility. In the reform, three principles will be adhered to: stable transition, reflection of the characteristics of state organs and institutions, and connection with urban enterprise old-age insurance system.

Strengthening legal construction and management of old-age insurance

China will apply the proven and effective experiences and work hard to improve the legal framework. The Government will draft laws and regulations as necessary, such as the Social Insurance Law, Regulations on Old Age Insurance, and Regulations on Social Security Fund Management. Meanwhile, attention will be paid to strict law enforcement and raising social security awareness. Sound management is the guarantee for the effective operation of the old-age insurance system. The guiding principles are that of putting people first, strengthening the capacity of the social insurance agencies, and undertaking professional training for the staff so as to raise work efficiency and service quality. The construction of the social security information system will be speeded up so as to achieve a nationwide computerized network with upgraded ways of management.

¹ The part of enterprise contribution that is less than 4 per cent of the total wage can be considered as cost.