Hitotsubashi Journal of Economics 43 (2002), pp.163-172. © Hitotsubashi University

CURRENT PENSION AND ITS REFORM IN THE TRANSITION CHINA

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Received July 2002; Accepted October 2002

Abstract

Basically, the current pension in China is still pay-as-you go. So, reform should not dodge the financial issues of old person. China should reform its pension management mechanism through defining the role of state, market and NPOs in social security and pension management, in order to increase the value of pension. Establishing a healthy financial market is very important for guaranteeing the value increase and avoiding risk. NPOs can play a role in monitoring pension funds as a watchdog. Rural pension should be seriously considered like the issue of urban residents.

Key words: China, Pension Reform, Pension funds
JEL Classification: H55

I. *Grim Challenges from Aging Population*

The population in China comprises almost 21percent of the total world population. The increasing and huge population is a grim challenge relating to China economic and social development. The base of China population is so great that during the period of *Ninth-Five Year Plan* (1996-2000), the average annually net population increase was still over 13 million. At the same time, China has become an aging society with the improvement of living standard and health care facilities, technological development, and implementation of family planning policy. By 2000, the Chinese people aged 60 and older was 10% of its total population, exceeds 130 million, 65 and older was 7% of the total population.

It was estimated (*Zhang Benbo, 2001*) that the aging society in China would go through the following four stages (Table-1):

From 1990 to 2000, during the transition period characterized by the transformation to aging society, population aged 60 and older was 10% of the total population, and population aged 65 and older was 7%. China initially entered a society with higher proportion of the elderly. During the second stage from 2000 to 2010, China becomes a typical aging society with 12% population aged 60 and older, and population aged 65 and older will reach 8% within this period. The third stage from 2010 to 2040 is the peak of the aging society with 26%

TABLE 1. THE PREDICTION OF CHINA'S ELDER POPULATION FROM 1990 to 2050

	Population (10,000)			Proportion		Dependency ratio	
Year	Total	60+	80+	60+	80+	65+	Total
1990	114,333	9,823	755	8.59	7.69	8.35	49.72
1995	121,121	11,496	947	9.49	8.24	9.28	48.80
2000	127,115	12,975	1,296	10.21	9.99	10.35	47.58
2005	131,858	14,181	1,557	10.76	10.27	10.65	42.31
2010	136,028	16,411	1,700	12.06	10.36	11.08	39.50
2015	139,961	20,181	2,017	14.42	9.99	12.66	39.77
2020	143,503	22,815	2,269	15.90	9.95	15.88	43.21
2025	146,267	27,599	2,557	18.87	9.26	17.94	45.27
2030	147,939	33,014	3,286	22.32	9.95	22.35	49.63
2035	148,728	36,876	4,539	24.79	12.31	27.77	54.86
2040	148,478	38,001	4,993	25.59	13.14	31.54	58.48
2045	147,517	38,877	6,540	26.35	16.82	32.41	59.21
2050	145,647	40,608	8,063	27.88	19.86	33.23	60.37

Note: the proportion of 60+ was proportioned by the total population; the proportion of 80+ was proportioned by 60+.

Source: Qiao Xiaochun, "China entry Aging society", 1999.

of population aged 60 and older, and 20% population aged 65 and older. During the slow-moving fourth stage from 2040 to 2050, 28% of population will be aged 60 and older, and 21% of population will be aged 65 and older. After 2050, the growth of elderly population will slow down and remain in stable level.

II. *Current Pension System in China*

The current pension in China is the system mixing three elements: basic public pension funded on a pay-as-you-go basis, fully funded pension financed by mandatory contributions, and voluntary personal savings. The basic public pension has been playing its crucial role since it was established earlier than the other pillars and is the main pillar of current pension; basically, it was the sole pension system before the reform and open-up. Now, the basic public pension is in the process of transition from state defined contribution formula with determined benefits to state, enterprises and individuals defined contribution formula with determined benefits. At the same time, the coverage is expanding from state-owned and urban collective enterprises to other type ownership of enterprises including foreign funded, private enterprises and individual businesses. The other two pensions are emerging during the last ten years, with a little coverage, and have not become the focus of government policy-making yet.

Owing to the institutional segregation between rural and urban areas, and different ownership among enterprises, the current pension system in China is one of the most complicated one in the world. Usually, the Chinese government formulates rules and regulations based on the difference between rural and urban areas and the difference among different ownership. For example, the earlier (in 1991, 1995) rules for pension was focused on state-owned enterprises, then expanded to the other types of enterprise including foreign funded and private enterprises with the quick development of those non state-owned enterprises. The establishment of rural pension began in 1991 with experiments in several regions,

TABLE 2. COVERAGE OF PENSION BY OCCUPATION: URBAN AND RURAL AREAS (%)
(Tell us if you participate in old age insurance or not?)

	Participated	Not yet	Unclear
Total	50.90	40.61	8.49
Self-employed full-time	50.20	41.63	8.16
Self-employed part-time	34.69	59.18	6.12
Work for someone else full-time	72.24	21.88	5.88
Work for someone else part-time	56.00	44.00	
Not employed	39.22	54.90	5.88
Retired	68.91	26.89	4.20
Employed by agriculture	13.59	72.33	14.08
Employed by agriculture part-time	14.06	60.94	25.00
Student	8.38	77.84	13.77
Others	34.78	52.17	13.04

Source: 2001 Survey, Research Center for Social Policy at Academy of Macroeconomic Research, State Development Planning Commission.

but it is still in slow action. "However, the institutional patterns and dominant principles of social provision differed between urban and rural areas". [*UNDP* (1997)]. But, at any times, past and present, farmers are always ignored and have disadvantaged position in China's economic development (Table-2).

Basic public pension in China

Legally, the current public pension system in China tries to cover all of the employees in urban areas, based on the decisions on Deeply Reforming Pension System of Enterprises promulgated by State Council in 1995. For implementing the regulations, the Ministry of Labor and Social Security issued the appropriate policies' Rules of Enlarging Pension Coverage (1999), which tries to expand the basic pension and individual accounts to all of the enterprises in urban areas including state-owned enterprises, foreign funded enterprises, private enterprises and individual business, etc.

Definitely, the basic pension including basic pension and individual accounts in China should cover those who were employed and retired before the reform (old person), those who were employed before the reform and retried after it, and the new employees who were employed after the reform.

But, practically, the system could not cover all of the employees in urban areas, because a large number of non state-owned enterprises are reluctant to contribute basic pension for their employees owing to worrying about not being able to benefit from their contributions [Wang Dongjin (2001)] and a lot of them are in arrears in paying basic pension funds [*People's Daily, January* (4,2002)]. Based on the statistical data by the end of 1998, 84.75 million employees who participated in basic pension was 68.7% of total employees in China. The participation rate of state owned enterprises was the highest with 80.8%; urban collective enterprises was 53.8%; the other ownership including foreign funded, private enterprises and individual businesses was 32%. The other two reasons why non state-owned enterprises were reluctant to pay basic pension funds were: first, some enterprises have not contributed pension funds due to facing bankruptcy, second, some enterprises could not contribute due to business failure. In 2000, 40 billion pension funds were behind in payment by enterprises [Zhang Zuoji (2001)].

For enlarging the coverage of basic pension, on January 22, 1999, China State Council issued an order, No.259 Order of State Council -the Provisional Regulations on Imposing Basic Pension, tried to promote the enlargement of basic pension. According to the No.259 order, the Ministry of Labor and Social Security drafted relevant work plans to enlarge the coverage, but it still faces tremendous difficulties. Enlarging the coverage in urban areas is one of the key missions of current pension.

Supplement pension

The supplement pension, a fully funded pension financed by mandatory contributions, was established in 1995 according to the Roles on Establishing Supplement Pension for Enterprises in December 29, 1995 [MOLSS (1995)].

The supplement pension is one that employers willingly establish as a pension plan for its employees based on the regulations of state, and employees also pay a part of the pension. Employers and employees deposit pension funds into individual accounts. The individual accounts belong to individual and will be received by the individual after retired through one time or several times. The account also can be transferred with transfer of the individual.

- The following organizations in urban areas can establish enterprises supplementary pension: state-owned enterprises, foreign funded, private enterprises.
- The prerequisites for those enterprises which want to participate in enterprise supplementary pension: having participated in basic pension funds and public pooling funds, and contributing basic pension on time; well doing in business and management.
- Both employers and employees make the final decisions on participating in enterprise supplementary pension on the state regulations and policies;
- The worker union should be created for participating in managing or supervising the enterprise supplementary pension;
- The source of enterprise supplementary pension may be raised by employers or both employers and employees, but the percentage of individual should not exceed 50% of the total enterprise supplementary pension.
- Generally, enterprise supplementary pension should deposit into individual accounts;
- Contribution decides benefit;
- The proportion of enterprise supplementary pension will be decided on the basis of the business conditions of enterprises and the wage of employees;
- Enterprises can select national financial organizations to manage the funds, or manage by themselves;
- The enterprise supplementary pension can be invested in markets for increasing value;
- The individual account can go with employees.

By the end of 2000, 5.6 million employees have participated in enterprise supplementary pension, and the balance was 19.2 billion yuan.

Voluntary individual savings

The Rules of Reforming Pension of Enterprise's Employees promulgated by the State Council in 1995 also encouraged employees to participate in individual saving pension [State Council (1995)]. China also tries to establish the third pillar for those people who are uncovered by the current pension system.

People aged from 12 to 50 can participate in the pension. Current individual pension has four minimum aging levels for receiving pension that are 50, 55, 60 and 65. People can voluntarily make their decisions on minimum aging choice and amounts of deposit-monthly, quarterly or one time. The fixed number of years should not be fewer than 15 years, if not, people can only receive the total their deposits one time.

Based on the Tenth-Five Year Plan for Population, Employment and Social Security, the special plan of the Tenth-Five Plan for National Economy and Social Development of People's Republic of China in 2001, the individual saving pension would be established in some rural areas:

- Developed rural areas and rural enterprises can explore the multi-pension system based on the voluntary participation of farmers, including commercial insurance.

There are 30 provinces and more than 2000 counties are exploring this kind of pension in rural areas [Liu Guiping (1999)].

But the rural pension is still in the exploring stage and is facing several challenges from: the first, its has a smaller coverage, the contributors aged 20 to 60 are 1% of those who should contribute. The second, the level of pension is very low, only 50 or less yuan for each pensioner. The third, state has no any financial supports to rural pension except policy supports.

III. *China's Pension Reform*

Since mid 1980s, the Chinese government has placed the pension reform on the agenda for promoting the reform of state-owned enterprises, marked by issuing several regulations and rules. The initial motivation of the reform was to reduce the burden of state, because with reforming state-owned enterprises, the social functions of enterprises were or should be separated from enterprises, including pension as well as health care and unemployment insurance, etc. Who should bear this burden; government, employees, or employers? The answer given by the Chinese government was state, enterprises and employees to work together.

But entering 1999, China faced a different situation. With quick growth of elder population, China entered an aging society; the Chinese government re-thought about the pension and aging problem from a point of challenging aging society. To be prepared for entering into a society with a higher proportion of the elderly, the Chinese government has stepped up the structural reform of the pension system for urban enterprise workers since the middle of the 1990s. The reform during this period features mainly a combination of public pooling funds with individual accounts in raising money for the pension as we have discussed. The basic pension fund has been set up partially through accumulation. The government has also deepened the reform in accordance with the principle of combining the public pooling with individual accounts and introduced a single basic pension throughout the country.

China's current pension system, or the pay-as-you-go system in reality, was adopted in the 1990's. It consists of public pooling and individual fund accumulation, with money coming from employers and employees. Employers and employees must deposit money into the accounts regularly. However the public pooling system has always been short of money because some enterprises or government institutions do not have enough money and some funds have been diverted for non-social security uses. Individual funds were often transferred to social accounts to pay pensions of retired people, draining the accounts. The situation is growing more explicit, because the proportion of China's elderly population to the total population is growing larger by the day.

A long way for pension reform

China's pension reform has gone through the following stages since its first urban formal pension system established at early of 1950s on the basis of the Regulations regarding Labor Insurance of People's Republic of China. It was also the time that the Socialism was founded [Wang Dongjin (2001)].

Before reform and open-up, from 1951 to 1965, the characters of the pension system (DC) were that employers contributed 3% of total wage of the enterprises as labor insurance funds, 70 % of which was kept by enterprises as pension funds and 30% was handed into the State Fund. China Workers Federation, a non-government organization which has strong relation with the Communist Party, managed the 30% funds. In 1955, based on the Rules of Retirement for Civil Servants in Government Organizations and Working Personnel in Institutions, the pension expanded to government organizations, institutions and the enterprises with less than 100 employees. The pension system was pay-as-you go, without individual deposit. From 1966 to 1977, during the period of Great Revolution, a disastrous period in China, the pension system was broken off, even went backwards.

From 1978 to 1985, the original pension system which started in 1950s was resumed. And from 1984, several regions including Guangdong Province, Hubei Province and Liaoning Province began their reform experiments in public pooling funds at county level. By 1994, there were 13 provinces realized public pooling funds within their provincial limit.

In 1986, the State Council issued 4 regulations on labor insurance, which marked that the pension issue was put into the core of social security reform agenda, began a new exploring stage. The Rules of Labor Contracting at State-owned Enterprises ruled that enterprises should contribute 15% of total wage of the workers and individual should contribute 3% of individual basic wage as pension funds (DC). This is the first individual contribution in China. In 1991, the State Council promulgated the Decisions on Reforming Pension System of Enterprises established the basic framework of China's pension system supported by state, enterprises and individuals; the core of this system was legislated by state, enforced in whole nation and was suitable for the employees in urban areas. At the second level, enterprises contributed their pension funds based on their concrete situation. And at the third level, individuals contributed their pension funds based on their wages.

The significant reform in pension system happened in 1993, which is marked by creating the principle that public pooling and individual accounts should be combined. In 1997, the State Council decided to pursue the unified basic pension system in the whole nation, including unified contribution proportion both of employers and employees, the unified percentage of individual accounts and unified formula of basic pension.

Ongoing pension reform

Based on the Tenth Five-year (2001-2005) Plan for Labor and Social Security Development of People's Republic of China which has approved by the National People's Congress at the beginning of 2001, the pension system will be reformed from the following aspects [*China Labor and Social Security* (No.5, 2001)]:

— Based on the requirement of the Experimental Plan on Further Perfecting the Urban Pension System issued by the State Council, the contribution from enterprises should be brought into public pooling funds, while the individual contributions should be allocated into the individual accounts. The public pooling funds and the individual accounts should be calculated independently and managed respectively, with establishing and standardizing pension database for individual accounts in an all-round way. Based on the rules above, the experiments have been made in Liaoning Province in north China and other areas;

— To expand the coverage of basic pension funds on the basis of regulations and relevant policies. All the enterprises including state-owned enterprises, urban collective owned enterprises, foreign funded enterprises, private enterprises and others should be brought into public pooling fund system that is pooled at provincial level. The pension system of governmental organizations and institutions should be reformed and perfected in due course.

— To establish multi-pillar pension system step by step, some enterprises which have mature conditions may create occupational pension (enterprise supplementary pension) for their employees (second pillar), and the funds may invest in financial market. The occupational pension will be established by completing accumulation and managing on the basis of individual accounts. Meanwhile, individual pension deposit should be encouraged (third pillar);

— Government will promote the establishment of rural pension system, reestablish the pension system in the areas where rural pension system has been established based on concrete situations, make appropriate promotion and explore the pension system which to be suited to China's facts.

Based on the plan, the Ministry of Labor and Social Security put forward a detailed reform package as following [*Zhang Zuoji* (2001)]:

— The current size of individual account will be reduced from11% of the individual contributory wage to 8%, and the individual accounts are fully-funded, reserved in advance system that will be financed by contributions from employees equivalent to 8% of individual wage. The assets in individual accounts belong to individuals. The original 20% contributed by employers will be enhanced, and not be deposited into individual account, but public pooling funds;

— Social-pooling funds will not overdraw the individual accounts no longer, and the individual accounts will be managed and increased in value as accounts full of money. The total 190 billion yuan that has been overdrawn from individual account will be made up for a deficiency in due course;

— Raising the level of basic pension; after reducing individual contributory wage to 8%, for keeping the basic pension of employees at retirement, the basic pension that is 20% of the social average wage at present will be defined as 30%;

— The funds in individual accounts will be managed by the social security supervisory agencies at provincial level. For avoiding risk, the organizations can not put the funds into stock markets and should promise a higher return than bank interests.

— Establishing a unified pension system for civil servants and working personnel (employees working in those institutions such as research organizations, universities owned by state) including establishing a occupational pension for those people who work in governments organizations or institutions affiliated to government organizations. The other institutions may establish working personnel supplementary pension. The basic pension of the civil servants will be borne by state and individuals; government budget contributes 20% and individuals contribute 8% of their contributory wage, both of them are accumulated in the individual accounts. But considering the complex nature of civilians and working personnel, the State council decided that pension system for civil servants and working personnel would temporally maintain the current status.

Evaluation of Pension Reforms

The new reform packages have made a great progress in funds management-separating public pooling funds and individual accounts, which will ensure the individual accounts become the fully funded accounts and guarantee that next generation can receive their pension when they are at retirement. But, the state has not found the way to raise funds for those old people yet. Since overstaffed government organizations and institutions are the biggest obstacle of China's reform and development, the reform of these two organizations should be started as soon as possible; if so, the relevant reform in other fields could be speeded up. In fact, overstaffed government organizations and institutions and bureaucratic style of work are the biggest problems of China development. Without a detailed plan for establishing rural pension system, China will be facing a great challenge after entering WTO, since agriculture is the sector which will be fiercely challenged by international market. A country with 69% population in rural areas without pension is dangerous. Since the current pension heavily rely on the state owned banks, the questions are that the state owned banks are dependencies of governments with no competitive ability in financial markets. At present, the stock markets in China focuse on reforming state owned enterprises, the stocks in the market are doing a bad job. So, current banks and stock markets are not able to guarantee the reform of pension system in China today.

IV. *Recommendations*

Strengthening institution of pension

• Define the roles of central and local governments, financial departments and social security departments in pension management. The responsibility of paying the implicit pension debts should be clearly attributed to either central government or local government, or both central and local governments. Old person's pension should be maintained at the previous level they have had. Their pension should be increased with price increase instead of taking temporary measures to increase their pension;

• Encourage employees to participate in voluntary pension by saving through perfecting regulations and rules for establishing a multi-pillar pension system.

Further reform should consider followings;

• To establish a mechanism for avoiding the risk, a supervising and inplementing mechanism for pension is necessary.

• Establish social security tax on the basis of reforming the means of fundraising, the sources of fundraising and pension management.

- Encourage the development of supplement pension and individual voluntary savings by formulating active measures depending on the different income levels.

Considering the pension issue of migrants

The migrants have become a very important migration movement in China, which is enhancing the urbanization and population redistribution. The total population of them is between 60 to 80 million. In the next 5-10 years, the migrants will increase by 5 million each year and will amount to 130 million in 2005 and 160 million in 2010. Migrants are becoming a disadvantaged and marginal group owing to the difference of institutions between urban and rural area. So, social policy should consider the pension for those people.

Promoting three sectors to work together

Recently, relevant departments in China are thinking about integrating the service of non-profit organizations into social security system, placing it at supplement status in the system. It is completely necessary to establish an social protection mechanism with participations of NPOs in this field. Non-profit organizations also can play monitoring role in using pension funds.

V. *Conclusions*

With facing quick economic growth and rapid aging challenges, China started its pension reform at the mid-1980s. Not surprisingly, this country should be listed as the initial stage countries which reformed their pension system in the worldwide. But China is a nation with both huge population and aged population in the world. With the lower income, huge poor population and huge rural population, and different ownership of industry, China has a long way in establishing its social pension system, which could meet the needs of all residents. Especially in its rural areas, establishing a pension system is a great challenge for this country. Rural pension should be seriously considered like the issue of urban residents. Rural pension is one that is more complicated than the issue in urban areas for its relation to land, family planning and population control, etc. Although China began reforming its pension based on the establishment of basic pension and individual accounts, but, mostly, the individual accounts in current pension system are accounts in name, but empty account in reality, since funds in the accounts are diverted to pay the debts of old person. Basically, the current pension in China is still pay-as-you go. So, reform should not dodge the financial issues of old person. Longer play for time, more difficulties it will meet. China should reform its pension management mechanism through defining the role of state, market and NPOs in social security and pension management, in order to increase the value of pension. Establishing a healthy financial market is very important for guaranteeing the value increase and avoiding risk. NPOs can play a role in monitoring pension funds as a watch-dog. Public pooling funds should be separated from individual accounts as an independent account, since the current pension put two accounts together and mix up the types of functions: public pooling funds that are ensure basic pension for retirees with the fundraising model of pay-as-you-go, and individual accounts that are lifetime long term savings. Mixing up two funds must be lead to the failure in funds management and value increasing. Therefor, individual accounts should become the second pillar for pension on the basis of separating public pooling funds from individual accounts.

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