12. Building Social Welfare in China:

Providing retirement incomes in a transforming economy

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Introduction

Rapid growth and structural reforms since 1978 have transformed the economic and social basis of China's welfare system. A sedentary population serviced through the unit of employment has been replaced with a mobile labour force, a market economy and greater reliance on user-pays principles. Until the 1980s, China's welfare provision was based on the planned economy model, whereby the employer was responsible for all aspects of the employee's welfare, including old-age retirement income. In urban areas this revolved around the work unit—be it enterprise or government organisation—and in the countryside the people's communes provided for their members (Dixon 1981). Once the market reforms were introduced, such a system could no longer be sustained. Labour became mobile, enterprises became profit oriented, the people's communes disappeared and the sources of poverty and disadvantage changed. China thus faced the need to rebuild its welfare system by creating services that are more standardised across society as a whole, are accessible to all citizens, are linked to the government's budget and are operated through specialised service providers. In effect, the work unit could no longer supply employees and retirees with the full range of housing, medical, welfare and retirement benefits that had been the norm. China had to build a social welfare system with the familiar range of services found in market economies: unemployment benefits, health insurance, work injury cover, maternity support and old-age retirement incomes.

Alongside its role in maintaining social justice, equity and stability, the provision of social welfare can be seen both as a basic safety net to provide *ex-post* support to citizens in need and as developmental to provide *ex-ante* preparation for the challenges created by structural economic change (Cook et al. 2003). In other words, by providing citizens with the resources to withstand shocks and build resilience, it can help cushion the adjustments that rapid growth and structural economic change bring and sustain the human resources needed for new growth. In China's case, the development of an equitable and reliable social

welfare system can also be seen as a small but important part of the effort to rebalance the economy away from its high investment and high savings rates towards greater consumption and greater income equity.

This brief study will first review a number of reasons why the development of a new social security system is a critical part of rebalancing and sustaining growth in China over the next phase of economic development. It then focuses on the issue of old-age retirement incomes and discusses the choice of model, the evolution of policy and the current operation of the system. It will conclude with a few comments on the lessons to be drawn and the challenges for further development.

The Underlying Challenges

In market economies, social security is a form of risk sharing and of managing market failures. It creates social equity and stability by ensuring basic incomes and services for citizens in need. It redistributes income across sectors and generations. In China's case, the planned economy model sought to achieve that within the unit of employment, with the result that the levels of service obtained by individuals depended on the resources available to their unit. A commune in a poor area had little to offer its farmers; one in a rich area could ensure a better quality of life. A well-endowed state enterprise could provide quality housing and retirement incomes. An inefficient and low-income factory had much less to offer. The shift to a market system with a large private sector inevitably required China to make the transition from a unit-based system to a socialised and government-managed system. Since the mid-1980s, therefore, China's social security system has gradually evolved towards local pooling of social security funds at county and urban levels and then towards higher levels of regional and national integration (Saunders and Shang 2001; Wang 2001:3–12). In that process, a number of key issues have emerged as drivers of the need to build an integrated national system.

First, there is the contradiction between labour market integration and the operation of a social security system based on place of employment and locality. The latter was originally designed for a sedentary population, with resources allocated through the bureaucratic distribution system. Economic reforms liberated the labour force and required labour flexibility and mobility in order to respond to changing market and production conditions. The most obvious sign of this has been the emergence since the 1980s of the huge flow of rural-to-urban migration. Though their mobility makes it difficult to produce accurate and reliable statistics, it was reported that in 2011 there were about 252 million such 'farmer-workers' in China, consisting of 94 million who were working

in off-farm enterprises in their locality and 158 million who had migrated elsewhere (SSB 2012). Their contribution to economic growth and structural change has been huge, but because of their rural household registration they are excluded from the urban social security system (Watson 2009). The fact that they can slip between the two categories adds to the complexity of designing social security systems for them. This problem of mobility, however, is not exclusive to migrants. The creation of urban social security pools helped share obligations and create mobility at the local level, but residents seeking to move between cities and provinces still face the challenge of transferring their social security registration and entitlements between different pool areas. In effect, by forming an obstacle to the flexible movement of labour, the social security system has risked becoming a barrier to further structural change.

A second issue requiring urgent change to the social security system is the ageing of the population. The need to provide retirement pensions, health care for the old and other support services for the ageing has long been a major challenge for public policy and social security systems in most developed economies. China's rapid social and economic changes combined with its family planning policies have meant that it has entered the phase of demographic transition to an ageing society much more rapidly than most countries (Wang 2011). According to estimates by the United Nations (UN 2011a:103), the Chinese population aged over sixty was nearly 12.8 per cent in 2010 and will grow to 33.9 per cent in 2050, and remain at more than 34 per cent by 2100. The same study (UN 2011b:327) estimates a rising dependency ratio from 12.7 per cent in 2010 to 18.4 per cent in 2020 and 40.1 per cent in 2040. Whatever the reliability of such estimates—and work by others has suggested that previous UN calculations might be underestimates (Zhao and Guo 2007)—even if population policies were to change today, the demographic momentum implies that the era of a plentiful, young workforce is coming to an end, the ratio of old to young will increase and the proportion of working-age people able to support the old will decline. This reality means that the design and implementation of an effective social security system and especially a set of policies to provide for old-age retirement incomes have become urgent priorities. Failure to prepare now would create a huge fiscal burden for the government in the future.

The issue of funding social security is thus another urgent challenge facing China's social security reform. Furthermore, while many aspects of social security such as unemployment, work injury, maternity and health are needed for only specific periods for each individual and can be managed through forms of insurance, the provision of old-age retirement incomes is something that lasts over many years and requires both a period of accumulation before retirement in order to prepare for the post-retirement obligation and a period of payout until death. In an ageing society, where the declining numbers of young are no

longer able to pay for the growing numbers of the old while at the same time saving for their own ageing, the need to make financial preparations is obvious. If the government decides to rely on paying pensions from fiscal revenue, the fiscal burdens become substantial. Furthermore, if accumulation through contributory insurance or superannuation schemes is adopted, the design has to be reliable and transparent, and the accumulated contributions have to be able to preserve and grow value. What is more, the total amount of funds in such schemes for a large population will be very large. They can provide a significant growth of capital resources and can play an important role in capital markets. They also require strong regulatory mechanisms to ensure the safety of the accumulation.

Finally, a further important dimension for the development of social security systems in China is their role in helping economic rebalancing. The need to rebalance China's economic growth model has long been recognised (Dollar 2007; Kuijs and Wang 2006; Pettis 2011). Growing income and regional inequalities, heavy reliance on investment in export manufacturing, a declining share of consumption and wages, high savings rates with low financial returns to savers and poor social security systems have all been identified as indicators of a need to change. A shift towards higher levels of wages and domestic consumption, increased growth of the service sector and small enterprises, and better social welfare are all seen as part of this process. Within that context, the introduction of a more equitable and accessible social security system would not only generate better social welfare outcomes, but would also reduce the need for individual saving, help increase the consumption of the disadvantaged and contribute to the redistribution of income.

Given these factors, it is not surprising that the development of social security has emerged as a key policy goal for the Chinese Government. Opinion surveys show that it has also become a major issue of concern for the average citizen (*China Daily*, 22 February 2011). While, as discussed below, the political economy is complex and implementation has faced many challenges, the issue has received a lot of attention in leaders' speeches over the past 10 years, and was given considerable prominence in the Twelfth Five-Year Plan (Xinhua 2011). The *Government Work Report* delivered by Wen Jiabao at the National People's Congress (NPC) on 5 March 2012 claimed that significant expansion of the system was taking place.

The administration of China's social security is entrusted to the Social Insurance Administration (SIA), a public service unit under the Ministry of Human Resources and Social Security (MOHRSS). The SIA has a hierarchy of bureaus at central, provincial, urban and county levels, each of which manages their local social insurance pools. It is responsible for drafting and

implementing legislation and for the management and regulation of the system. In October 2010, the NPC approved the Social Insurance Law, which had been in preparation for a number of years, and it was implemented on 1 July 2011 (NPC 2010). The overall model is based on contributory insurance and covers health, unemployment, work injury, maternity and old-age insurance. Against this overall background, this study now turns to examine the old-age insurance system, which because of its complexity provides clear insights into the challenges faced.

The Choice of Model for Old-Age Retirement Incomes

For many years, international economic institutions such as the World Bank, the Asian Development Bank (ADB) and the Organisation for Economic Cooperation and Development (OECD) have devoted considerable resources to studying the policy choices facing governments in providing for the old (World Bank 1994; World Bank and OECD 2008). They have supported policy-related research in many countries. These studies suggest that the key policy choices for old-age retirement incomes are

- the extent to which the state should provide for the old
- the extent to which individuals should provide for themselves
- the target levels of retirement income to be achieved
- the merits of ‘pay-as-you-go’ schemes, in which pensions are paid from current income, compared with ‘fully funded’ schemes, in which funds are accumulated from current income to pay for retirement incomes in future
- the mechanisms used to accrue funds for pension payments
- the mechanisms for the distribution of benefits.

In most countries, models of ‘pay-as-you-go’ schemes that provide the old with a defined benefit from current revenue are giving way to defined contribution schemes, in which contributions from employers and individuals are accumulated during their working life in order to provide the retirement incomes. In other words, what a person will get in retirement will depend on what is saved and will not be a defined proportion of final salary paid from current revenue after retirement. This trend has driven retirement income reform in Australia and many European countries.

Associated challenges include pressures to increase the retirement age so that people work longer and the number of retirement years is reduced, equalising retirement ages for men and women, and closing existing defined benefit

schemes whereby retirees are entitled to a defined benefit as a proportion of their final salary. These last schemes are common for public service workers and government employees and tend to be pay-as-you-go schemes funded from fiscal revenue.

Overall, the consensus in market economies focuses on building a three-pillar model.

1. *A state pension.* This generally gives a low level of income paid from fiscal revenue. It provides a basic safety net for those who do not have enough accumulation or income from other sources.
2. *A compulsory contributory scheme.* Such schemes are funded by contributions from employers and/or employees. The contributions are paid into an accumulation account held in each member's name and are eventually paid out after retirement in the form of annuity insurance or superannuation.
3. *A voluntary contributory scheme.* Individuals are encouraged to supplement the compulsory scheme by contributing more of their own funds to their retirement savings. Such schemes may also attract tax concessions or incentives from the state.

The aim of this model is to increase individual accumulation for old age and to reduce the burden on state revenue, especially in a context in which an ageing society means that there are declining numbers of people of working age paying taxes to support the old.

As discussed above, China's planned economy model was essentially a defined benefit scheme that operated at the unit of employment level. People's benefits thus varied by location and employment, with a major difference between the urban and the rural systems. During the reform period, the need for change was shaped by the key drivers listed above, and it has resulted in a move towards defined contribution schemes that embody the principles of the three-pillar model. This has been reflected in the transition from the unit-based system to local and regional pools and a gradual raising of the level of the pool from county and town to province, with the eventual goal of creating an integrated national scheme.

As yet, there is no *first pillar* in the form of a state pension, and a basic social safety net is provided by the guaranteed minimum income scheme launched in 1993 and operated through the Ministry of Civil Affairs. The extent of coverage is, however, patchy, especially in rural areas, there is considerable regional variation, and studies suggest it is not yet very effective (Chen et al. 2006; Tang 2012). The *second pillar* is provided by a combination of the basic urban old-age insurance for enterprise employees, the new rural pension plan that was

introduced in 2010 and is gradually spreading across the countryside, and the other emerging schemes for unemployed and self-employed urban residents. Public servants for the moment continue to receive defined benefit pensions paid from government revenue that are generous and indexed for wage increases (Chen 2008), but mooted reforms to public service units indicate that these might also eventually be changed into defined contribution schemes as well. The *third pillar* is left to the individual and to enterprise annuity schemes voluntarily established by employers.

The Evolution of Policy

As noted above, during the early phase of economic reform in the 1980s, China's unit-based system of social security gave way to a social pooling system based on county or urban administrations that brought the obligations of the local state-owned enterprises within an administrative area together. By the mid-1990s, as the urban reforms intensified, state-owned enterprises were reformed, merged or closed and the market and private economy grew, any remnants of the old model became unsustainable. There was no accumulated provision to fund pension obligations, and the ratio of pensions to wages was increasing (Zhao et al. 2006). In loss-making state enterprises, it was no longer possible to guarantee a fixed percentage of an individual's final wage as a pension, and the government had to look for alternative ways to smooth income over time in order to provide for peoples' old age. Given the growing number of people dependent on pensions, the ageing of the population underlined the urgent need for change. After 1990, therefore, China began to develop a new set of policies.

Between 1991 and 1998, the government progressively elaborated a system of basic old-age insurance for enterprise employees (Wang 2001, 2002:4–9; Zhao et al. 2006). Employers were required to pay the equivalent of a percentage of the wage into the old-age insurance fund and the individual worker also contributed a percentage. These two elements created the common social pool and the individual account. These developments were extended in August 1998 in the decision to work towards raising social pooling to provincial level and to merge 11 existing industry-based pension funds into the social insurance pools (SC 1998). Subsequently, regulations and decisions sought to clarify the management of the system and its requirements and entitlements, to increase the level of contributions to 20 per cent from the employer and 8 per cent from the employee, and to enable self-employed people to join (SC 2005). Ultimately, the basic principles of the scheme were incorporated into the Social Insurance Law of the People's Republic of China (NPC 2010) and further refinements were introduced to bring in migrant workers and to make transfers between pool areas by people with urban household registration easier (Watson 2009).

An important aspect of this process, however, was that existing retirees or those close to retirement were brought in as members, even though they did not bring any accumulated contributions with them. The funds thus had to cover old members (with 'empty accounts' and no accumulation), middle members (with partial accumulation) and new members (those making full contributions from the time of joining) (Wang 2005). There was thus an unfunded obligation that threatened funds with deficits and created pressures on local governments to defend their pools.

Because this scheme was designed for enterprise employees, unemployed urban residents did not have access to it. The State Council recognised this in its 2000 policy document on improving the urban welfare system, when it called for special provisions for such people (SC 2000). Given the difficulty that residents would have in paying both the pool levy and the individual payment, it was necessary to develop a different scheme for this category of people. Consequently, experiments began with establishing pensions through an insurance scheme based on individual contributions and government subsidies. These schemes paralleled the emerging new rural pension plan discussed below, and a number of cities introduced combined provisions for unemployed urban residents and for local landless farmers who had been displaced by urban expansion (Chen and Li 2012; State Council 2011; Yang 2012).

The rural system was much slower to replace the old collective structures. Until the recent innovations, rural social welfare continued to rely primarily on what the village or individual could provide. Initially there were a number of local experiments that attempted to provide insurance cover for farmers and, after central guidelines were issued in 1992, some provinces and localities introduced contributory old-age insurance schemes run by the Ministry of Civil Affairs (Luo and Lü 2006; Song 2008:436–8; Su 2009:53–61; Zhao et al. 2002:120–33). Collectively known as the 'old rural pension plan', these experiments suffered from reliance on individual contributions, low rates of return, poor administration and combined government and commercial operation with the associated high risks. It was estimated that by the end of 1997 they covered only about 80 million farmers, and the schemes subsequently tended to languish.

Given the increasing urban–rural inequalities, the lack of welfare provisions for farmers and the decline of rural family support systems with the growth of rural-to-urban migration, the need to improve the scheme was becoming increasingly urgent. In 2007 the Central Government re-emphasised the need to develop a rural pension system (Institute of Economics, Chinese Academy of Social Sciences 2010:353). At its Seventeenth Congress in 2007, the Chinese Communist Party (CCP) called for 'exploring the establishment of a rural

old-age insurance system', and in October 2008 proposed building 'a new rural pension system requiring a combination of individual contributions, collective subsidies and government subsidies'. This statement established the principle of direct government fiscal support for the rural scheme. The new national system was formally announced in August 2009, with trial implementation to begin in 10 per cent of counties in 2010 and national coverage to be achieved by 2020 (SC 2009). In practice, however, the scheme expanded rapidly and, by March 2012, Premier, Wen Jiabao, stated in the *Government Work Report* to the National People's Congress that trials of the system operated in 60 per cent of counties and embraced some 358 million people, of whom nearly 99 million received pensions. While, as discussed below, the level of benefit is not high and there are many challenges of implementation, this new rural pension plan marks a substantial development in rural welfare policy.

The other major group that had to be addressed in the development of old-age insurance policy was the rural-to-urban migrant workers (for a full discussion of the issues below, see Watson 2009). Since the basic urban system was built around one's place of household registration, migrant workers were excluded because of their rural registration; however, including those in township and village enterprises, there are now about 252 million of them, and they make up the major proportion of the total manufacturing workforce. They are characterised by relative youth (average age about twenty-nine), high mobility, low incomes and a high proportion of informal employment. Apart from the basic obstacle created by their household registration, there are a number of systemic and political economy challenges to bringing them within the basic urban system. Their mobility conflicts with the fragmented structure of the social pooling system and with regulations that require 15 years' contributions with the final five years to be in the same location. There are many technical and administrative difficulties of managing interregional transfers of registration. There is resistance from employers who are unwilling to increase their labour costs by paying social insurance. And local governments are happy to use any social contributions made on the migrants' behalf to bolster their pool funds and counteract implied deficits but reluctant to allow these contributions to be transferred out when the migrants move on. As a result, a major segment of the young workforce has been excluded from basic insurance at a time when they are most able to contribute.

Initially, some areas experimented with allowing migrants to join local schemes or established special programs of their own (Han 2009:480–2; Liu and Xu 2008:209–43). Eventually, however, the need to provide social security services for migrants and to combat discrimination against them was recognised at the national level. Document Five in 2006 called for a comprehensive review of migrant issues and for the establishment of an old-age insurance scheme to suit

their needs (SC 2006). Subsequently, the Ministry of Human Resources and Social Security issued a discussion draft of a separate scheme for migrants that allowed for lower levels of contribution and greater flexibility of transfers. Plans to develop this scheme, however, were rapidly overtaken by the introduction of the new rural pension plan. The proposed separate migrant worker scheme implied increased fragmentation of the social insurance system. It seemed that migrants might eventually have the choice of joining the basic urban scheme, the special migrants' scheme or the rural pension plan. The administrative complexity of managing transfers between several schemes also loomed large. In the face of these challenges, the decision was made in late 2009 to require the migrants to join the basic urban scheme, to have the right to transfer back to the rural pension plan if they wished and to improve the mechanisms for the transfer of social security registration between pool areas. Subsequently, the policy focus shifted to developing mechanisms for managing the migrants' transition to the integrated urban scheme, for making membership transfers between the rural and urban schemes and for the transfer of registration between pool areas.

This discussion of the process of policy development has illustrated the two interlinked features that have dominated the development of China's social welfare. The first is that the reforms have been profoundly shaped by the inheritance of the plan period. The second is that the new system is fragmented by location and by category. The division between urban and rural welfare based on household registration has continued to have a profound influence, and the practice of different categories of people in different localities obtaining different types of access and benefits remains embedded within the operation of local pools. The overall framework thus maintains separate systems for enterprise employees, migrants, non-employed residents, farmers and government employees. It is perhaps inevitable that a transitional system has to build on pre-existing practices and expectations. As in many other aspects of the gradual reform process, therefore, the political economy of the existing set of vested interests, understandings and obligations has made it difficult to sweep everything aside and start again. The result, however, is that the social security system remains fragmented by place and by employment status, and this is the core challenge facing its evolution.

The Operation of the System and its Challenges

Social insurance policies are implemented through the SIA. This has a hierarchy of offices from central to local levels at provincial, urban, county and district offices. As is common in the Chinese system, professional management comes through the ministerial hierarchy but local government handles the

administrative responsibilities. Each level has its Social Security Bureau, which manages the registration of members and the operation of the insurance. It has service centres that deal with both employers and members. Membership requires the employer to register the employee. After registration, the monthly contributions due from the employer and employee are calculated by the social security department and collected from the employer, who deducts the employee amount from the wage. The contributions are paid to the bureaus (in some localities the payments are made to the tax bureaus but the records are kept by the social security system). The funds are placed in a special account operated through the fiscal offices and subject to strict and conservative management rules in an effort to ensure their security. In this context, it is important to recognise that the definition of 'local' is complex. Enterprises register their employees at the level at which they operate. A provincial-level enterprise would register with the provincial bureau and an urban one at the urban level. The bureaus manage the collection of funds and the distribution of benefits.

During the 1990s, much of the record-keeping and administration was on paper, but the elaboration of the system required substantial improvement in management and information systems and in computerisation. This is an inevitable precondition for the introduction of an integrated national system. In 1999, the ministry began to introduce social security cards, and these now operate as smart cards in the more developed regions. In 2002, when the government announced a major drive to develop information systems for government, the Jinbao Project was launched to build up information technology (IT) for social security (State Council 2002). This project is operated by the MOHRSS. It aims to be a single, integrated platform with two sections: one for social security and one for employment. It operates at three levels: central, provincial and urban. The system includes the development of computerised systems for providing services, internal management, fund management and access for individuals to consult their own records through the Internet. Since computer systems are not yet nationally standardised and links between regional databases are still developing, there is some distance to go before a truly integrated system can be built. These technical challenges are also magnified by disparities in the capacity of local administrations; however, considerable investment is taking place and the infrastructure to enable an integrated national system is emerging.

The operation of the *basic urban old-age insurance scheme* is straightforward, though there can be much local variation in the details. Employers and employees contribute at a rate of 20 per cent and 8 per cent of the wage respectively. The employer contribution goes to the local social pool and the employee contribution goes to the individual account. Individuals are able to apply for a monthly pension after reaching the retirement age (currently fifty-five for women and sixty for men). The pension has two parts: the social pool

payment and the individual account payment. The social pool payment is set at 60 per cent of the local social average wage, provided there has been a minimum of 15 years' contributions, with the last five being continuous in the pool area. This payment is therefore based on the local average and not on the actual wage of the individual. It is adjusted over time to take account of wage changes. The individual account payment depends on the amount of accumulation in the individual account. It is paid at a monthly rate of 1/139 of the total accumulation (that is, it assumes an actuarial life of 139 months after retirement). Overall, the scheme has a number of characteristics that add to its complexity and underline its fragmented structure at the current stage of development.

1. While national integration is the long-term goal, it is not yet operated as a unified system but as a set of parallel local pools. These are managed as separate funds and can have their own specific features, such as variations to the national standards, depending on local average wages, and extra subsidies depending on the strength of local finances. As a result, the levels of contributions and benefits will vary by location. Although a growing number of provinces are developing provincial-level pooling, in practice many pools remain at city or county level. Transfers of contributions and benefits between cities and regions thus present problems.
2. The coexistence of the common social pool and the individual account means that the two elements are managed separately. Local authorities see the social pool as a local resource and rely on it to ensure that they can meet their obligations to their members. They therefore have an incentive to retain as much of it as they can when an individual moves to employment in a different pool area. This pressure was recognised in the 2009 transfer regulations, which allow local pools to retain some 40 per cent of the employer's contribution when an employee moves elsewhere, and only 60 per cent is transferred to the destination pool.
3. This strong sense of local interest is linked to the fact that when the system was introduced in 1996, no provision was made for existing retirees or for those approaching the end of their working life. The social pools thereby inherited unfunded liabilities from the pre-existing system. Areas with lots of failing state-owned enterprises faced large deficits, whereas new-economy areas with a smaller legacy and growing new industries had a much healthier financial position.

4. The system differentiates among different categories of people. As discussed above, employees in government agencies, public welfare units and similar institutions still receive the old planned economy defined benefits pensions and do not participate in these schemes. Self-employed people may join, provided they contribute to both the pool and the individual account. Unemployed urban residents have access to a different scheme.

The above characteristics highlight the barriers the design of the scheme presents to *migrant workers*. The high individual costs relative to low incomes, the operation of local pools and barriers to portability, the lack of formal employment contracts for most migrants and the retention of enterprise contributions in the local pool all combine to mean that migrants lack incentives to join the urban scheme. Their mobility, their frequent changes of job and their employment in the informal sector add to the obstacles. Migrants cannot guarantee that they will be able to make 15 years' worth of contributions to the fund (including the required five consecutive years of contributions in the final years of employment), and it is therefore difficult for them to qualify for a retirement benefit in a particular pool area. Until 2009, these barriers to transfers between pool areas were a major challenge. As a result, when migrants were allowed to join, they could withdraw their contributions to their individual account only when they moved elsewhere. The employer's social contribution made on their behalf was retained in the local pool. In effect, these contributions helped maintain the fund balance and reduced any funding deficits for the payment of pensions to the local population. The migrants' individual account contributions represented an enforced saving of a proportion of their wages until they changed jobs, when they were allowed to withdraw it. The 2009 procedures for transfers are intended to resolve this problem by guaranteeing transfers of pool contributions, but many technical issues of implementation remain to be resolved. For employers, registering migrant workers means increasing their labour costs. For the social security system, constant movement adds to the complexity of maintaining records and managing funds. These issues are magnified for female migrants who have greater job mobility, higher levels of informal employment and more inconsistent employment records because of childrearing and family responsibilities. Not surprisingly, therefore, migrants lack incentives to join and have little faith in the system.

The 2009 regulations requiring migrants to join the urban scheme were intended to address some of these issues. The new policy required: 1) compulsory participation with no withdrawals; 2) reducing the entry threshold for migrants by allowing lower contributions; 3) maintaining sealed accounts in local pools when migrants moved; 4) establishing a national database for migrant records; 5) developing a mechanism for pooling lifetime contributions at the place of final residence; and 6) designing procedures for linking the urban scheme

to the rural pension plan should the individual decide to retire back to the countryside. Designing mechanisms to implement these goals requires flexible, accurate and integrated information management systems, and good record-keeping to ensure that fund contributions are preserved in the various pools, combined and transferred to the place of final residence when the individual retires.

The *rural pension plan* mandates a minimum monthly cash pension of RMB55 to all rural residents, male and female, over the age of sixty. This payment is guaranteed by the government and funded by a combination of central, provincial and collective-level contributions. Individual farmers may join voluntarily while they are still working and make an annual payment into the scheme. If they do so, when they reach the pensionable age they become eligible to receive both the government pension and an additional monthly amount calculated at the actuarial rate of 1/139 of the total funds in their individual contribution account (that is, the same actuarial assumption as the urban scheme). As the scheme matures, it would therefore have two components like the basic urban insurance: the pension and the individual account. The difference is that in this case the basic pension is a guaranteed payment from government finances. All farmers aged sixteen and over who are not migrant workers and therefore do not belong to urban schemes are eligible to join in their home villages.

The basic design of this scheme is simple, and the payment of the government subsidy from the budget marks an important innovation in old-age income payments. This innovation has also been extended to unemployed urban residents who have a similar subsidy. There is also gender equity, since both males and females get the same pension. While the total amount of RMB55 per month per person is not large, it is in cash, which can be important in poor rural areas. There are also expectations that the pension level will rise over time.

Trial implementation of the new scheme during 2010 allowed a number of local policy variations.¹ The government subsidy was provided 100 per cent from the Central Government in the poor western provinces and 50 per cent from the centre and 50 per cent from provincial governments in the richer east. Further variations were then developed within provinces. For example, in Fujian, several ways of providing the 50 per cent local component of the subsidy were used. In poor counties, the province provided 30 per cent and required the counties to supply the remaining 20 per cent. In intermediate-level counties, the ratio became 10 per cent provincial and 40 per cent county. Rich counties had to provide the full 50 per cent themselves. In addition, if they wished, rich counties could add an amount so that the monthly pension

1 The following discussion draws on interviews with the Fujian Social Insurance Centre, 29 March 2010.

might be RMB10 higher than the national guideline. A further variation was in the contributory individual account amount to be paid by working farmers. The national guidelines proposed five levels from RMB100 to RMB500 per person per year. Recognising the capacity of its richer areas to accumulate more, Fujian introduced 12 levels ranging from RMB100 to RMB1200. Furthermore, to encourage farmers to join, it experimented with paying a RMB30 state subsidy to the individual account of farmers who started at the basic level. Administrative villages were also allowed to contribute an additional amount to the basic pension if they had the resources. It was therefore possible for the guaranteed pension in rich areas to be higher than the norm and for richer farmers to accumulate more in their account.

The implementation of the trial program also highlighted some of the difficulties and teething problems. Issues included

- identifying all the people who were eligible (some old farmers do not have ID cards or reliable records of their age)
- maintaining up-to-date records so that new entrants and exits through death can be accurately recorded each month
- having staff available at the basic level to manage the scheme
- enabling old people to have bank accounts through which the pension can be paid, in a context in which many old people are barely literate and many villages do not have a local financial institution
- persuading young farmers to join and ensuring that families will also pay contributions for female members
- experiments with a system of 'binding' that requires young family members to join the scheme and make contributions before their old parents can qualify for a pension, thereby changing a voluntary scheme into a compulsory one.

Practical issues of this kind can be expected as the new scheme is developed; however, it represents a major innovation for rural welfare and the rural elderly. Furthermore, the introduction of the new rural pension plan also created a challenge for migrant workers and for the operation of their old-age insurance schemes. They now face a range of choices. They may opt to join the local rural pension in their home village, to enrol in local insurance schemes for township and village employees, to enrol in any remaining special schemes for migrants in some cities or to join the basic urban scheme. They might also need to shift between these as their employment changes. The fragmentation of the schemes and the uncertainty about the differences in final outcomes for each of them makes a clear choice difficult. From the administrative point of view, maintaining reliable and accurate records of highly mobile migrants and calculating the

ratios for the transfer of entitlements and benefits between schemes that operate with different standards are both very difficult. These challenges for migrant workers underline the fact that, in the long term, the need is to move towards a standard, integrated national scheme for all citizens, regardless of where they live and work.

A further key issue facing the old-age insurance system is the management of the accumulated funds. Contributory old-age insurance schemes have a lifetime of up to 60 or more years for each member in order to cover both the period of accumulation and the period of payment of benefits. Commitment to long-term participation requires trust in the security of the fund and a belief that value will be preserved and will grow. If the system is not transparent and accountable or there is a fear of corruption and misuse then support for it is low. Members also need to have access to information on the performance of the fund and their individual accounts. Given that China's transitional structure means that there are still many retirees with unfunded 'empty accounts', the security of the fund remains an issue. According to Zhao et al. (2006:55), in 1999, 26 provinces operated with a deficit and in 2001 a number of provincial fund outgoings exceeded income by close to 30 per cent. One estimate put the national shortfall between accumulation and liabilities at RMB2.5 trillion (Wang 2005:8). Another recent estimate by expert commentator Zheng Bingwen (*Dongfang Zaobao*, 16 March 2012:A30) suggested a total of RMB1.7 trillion of such empty accounts. Some studies also suggest that these figures will blow out over the next 50 years. While the reliability of such claims can be questioned, the size indicates the scale of the challenge. It is not surprising therefore that Article 56 of the Social Insurance Law states that 'the balance between income and expenditure of the social insurance funds will be realized through the budget' and that governments at the county level and above will subsidise any deficits. Furthermore, the China Social Insurance web site takes pains to underline that the empty accounts may be managed through government subsidies (CNSS 2012). In effect, the system as a whole is not yet fully funded and in many ways operates as a pay-as-you-go fund.

The amount of capital involved is substantial. In 2010, the *Renmin Ribao* reported that the current size of the social security fund was about US\$130 billion and by 2015 it would grow to US\$300 billion (*Renmin Ribao*, 11 April 2010). The MOHRSS reported that in 2010, total income in the old-age insurance fund was some RMB1.35 trillion (including RMB1.95 billion of fiscal subsidies) (MOHRSS 2011). These funds represent a large and growing source of capital. At present, however, fund management is very conservative and is regulated to rely only on bank deposits and government bonds. There is no investment in stocks, property or other assets. Given the many risks of corruption and misuse, these

restrictions are understandable. This does, however, mean that the potential to preserve value against inflation and to grow value to match rising incomes and expectations is very limited. Not surprisingly, the ministry is now considering some experiments to improve investment performance, though the security of the funds remains a paramount concern (*China Daily*, 26 October 2011).

The above discussion has highlighted the many challenges facing the development of China's old-age insurance system. These include

- the legacies of the old system and its expectations
- the complexities of overcoming the fragmented structure
- the burdens of the transition to a fully funded scheme
- the significant improvements in the management and information systems that are needed
- the political economy of the conflicts of interests involved—the local governments, the employers, the local residents, the migrants and the different levels of government all have competing stakes in the way the system operates.

Nevertheless, the system as a whole continues to develop. Table 12.1 lists some recent statistics on the growth in membership of old-age insurance schemes, drawn from a number of sources. While the figures must, inevitably, be treated with caution, the reports indicate that the extent of coverage is growing and the system is becoming more elaborated. They also show that many people in each category are yet to become members and also that migrant workers continue to be excluded. Nevertheless, the issues are a major public concern. A web search of Chinese sources with such questions as: 'how do I claim my old-age benefits', 'can I still get medical benefits when I am drawing unemployment insurance', and so forth will yield a lot of discussion of the rules and their implementation.

While the distance between policy and implementation remains large and coverage still has many gaps, the significance of the issues facing an ageing society appears to have been recognised. As a result, the Twelfth Five-Year Plan adopted in March 2011 calls for

- all-round implementation of the rural pension plan
- further improvement of the basic urban insurance and unemployed resident insurance schemes
- realisation of provincial-level pooling
- national integration of the age funds
- realisation of better transfer and portability mechanisms
- gradual extension of the linkages between urban and rural schemes

- reform of government and public welfare enterprise pension systems.

This agenda is extensive, but failure to realise it would have major implications for China's sustainable development.

Table 12.1 Membership of Old-age Insurance Schemes (millions)

Item	2009	2010	2011
Total population	1334.7	1341	1347.4
Urban employment	311	347	359
Total number of migrant workers	230	242	253
Members of basic urban old-age insurance	235.5	257	284
Of which:			
pensioners	58	63	68.2
migrants	26.5	32.8	
Members of rural pension plan	86.9	102.8	326
Of which:			
pensioners	15.6	28.6	98.8
Members of non-employed urban residents scheme			13.34
Of which:			
pensioners			6.4

Source: Ministry of Human Resources and Social Security 2009 and 2010 Statistical Reports, Wen Jiabao's 2011 Government Work Report, March 2012 State Statistical Bureau, Annual Communiques on Economic and Social Development 2009/2010/2011.

Lessons and Conclusions

This study has outlined the main features of the development of China's social security system, and especially its old-age insurance schemes. It has emphasised the importance of these reforms for social justice and equity on the one hand and for sustaining growth and rebalancing the economy on the other. It suggests that there are a number of features that are now needed for successful and sustainable policy development in China. First, an integrated national system with equal access to all citizens is most likely to provide both social equity and efficiency of management. It would reduce barriers to labour mobility and simplify the complexities of service provision. Second, it will be important for the state to continue to provide system guarantees and to sustain a social safety net to cover retirement incomes for those who are disadvantaged or fall outside the system. Third, portability and flexibility of design and operation are essential. The system needs to be able to respond to the many adjustments that will take place in an individual's circumstances as structural economic change continues and the economic and demographic changes in an

ageing society. This challenge is thrown into stark relief by the needs of migrant workers. They represent the bulk of China's young labour force and preparations for their retirement are urgently required while they are still working. Fourth, it is necessary to design ways in which accumulated funds can preserve and grow value, while at the same time reducing or offsetting the risks created by exposure to market changes. Fifth, given the different life expectations and experiences of women and men, a gender perspective is needed when policy is being designed. Otherwise, there is the prospect of a growing cohort of old but poor women. Finally, the most successful public policy development and management require open, transparent and consultative processes. Citizens need to understand and trust the system. The ways competing interests are balanced against each other need to be debated and articulated. In this way, public confidence can be built and policy can be broadly supported and implemented.

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